Conifer Holdings, Inc.
Form 10-K
March 13, 2019

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

FORM 10-K

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

For the Fiscal Year Ended December 31, 2018
OR
TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from to
Commission file number 001-37536

Conifer Holdings, Inc.
(Exact name of registrant as specified in its charter)

Michigan	27-1298795
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

550 West Merrill Street, Suite 200	
Birmingham, Michigan	48009
(Address of principal executive offices)	(Zip code)

(248) 559-0840
(Registrant's telephone number, including area code)
Not Applicable
(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No þ
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 þ
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 þ No
Indicate by check mark whether the registrant has submitted electronically 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 during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes þ No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated

filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer	Accelerated filer	Non-accelerated filer	Smaller reporting company þ	Emerging growth company þ

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

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

The number of outstanding shares of the registrant's common stock, no par value, as of March 13, 2019, was 8,478,202.

CONIFER HOLDINGS, INC. AND SUBSIDIARIES

Form 10-K

INDEX

		Page No.
Part I		
Item 1.	Business	1
Item 1A.	Risk Factors	13
Item 1B.	Unresolved Staff Comments	29
Item 2.	Properties	29
Item 3.	Legal Proceedings	29
Item 4.	Mine Safety Disclosures	29
Part II		
Item 5.	Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities	30
Item 6.	Selected Consolidated Financial Data	32
Item 7.	Management's Discussion and Analysis of Financial Condition and Results of Operations	34
Item 7A.	Quantitative and Qualitative Disclosures About Market Risk	56
Item 8.	Financial Statements and Supplementary Data	57
Item 9.	Changes in and Disagreements with Accountants on Accounting and Financial Disclosure	57
Item 9A.	Controls and Procedures	57
Item 9B.	Other Information	57
Part III		
Item 10-14.		58
Part IV		
Item 15.	Exhibits and Financial Statement Schedules	59
Signatures		108

CONIFER HOLDINGS, INC. AND SUBSIDIARIES

PART I

ITEM 1. BUSINESS

Legal Organization

Conifer Holdings, Inc. (Nasdaq: CNFR) is a Michigan domiciled insurance holding company formed in 2009. Our principal executive offices are located at 550 W. Merrill, Suite 200, Birmingham, MI 48009 (telephone number: (248) 559-0840). Our corporate website address is www.cnfrh.com.

As used in this Form 10-K, references to “Conifer,” “Conifer Holdings,” “the Company,” “our Company,” “we,” “us,” and “ou refer to Conifer Holdings, Inc., a Michigan corporation, and its wholly owned subsidiaries Conifer Insurance Company (“CIC”), Red Cedar Insurance Company (“RCIC”), White Pine Insurance Company (“WPIC”), American Colonial Insurance Services and Sycamore Insurance Agency, Inc. (“SIA”). CIC, RCIC and WPIC are collectively referred to as the "Insurance Company Subsidiaries." On a stand-alone basis Conifer Holdings, Inc. is referred to as the "Parent Company." On December 30, 2016, the Company's wholly owned subsidiary, American Colonial Insurance Company ("ACIC") was merged into WPIC.

Business Overview

Through our Insurance Company Subsidiaries, we offer insurance coverage in both specialty commercial and specialty personal product lines. Currently, we are authorized to write insurance as an excess and surplus lines (“E&S”) carrier in 45 states including the District of Columbia. We are also licensed to write insurance in 42 states, including the District of Columbia, as an admitted carrier and we offer our insurance products in all 50 states.

Our revenues are primarily derived from premiums earned from our insurance operations. We also generate other revenues through investment income and other income which mainly consists of: installment fees and policy issuance fees generally related to the policies we write.

Many of our products are targeted to traditionally profitable classes of policyholders that we believe are underserved by other insurers. We market and sell these insurance products through a growing network of over 7,000 independent agents that distribute our policies through approximately 2,100 sales offices. We are focused on growing our business in non commoditized property and casualty insurance markets, while maintaining underwriting discipline and a conservative investment strategy.

We have substantial expertise in serving the unique commercial insurance needs of owner operated businesses in the following markets:

- Hospitality, such as restaurants, bars, taverns, and bowling centers (that require, among other lines, liquor liability insurance), as well as small grocery and convenience stores;
- Artisan contractors, such as plumbers, painters, carpenters, electricians and other independent contractors; and
- Security service providers, such as companies that provide security guard services, security alarm products and services, and private investigative services.

In our commercial lines business, we seek to differentiate ourselves and provide value to small business owner operators by bundling different insurance products that meet a significant portion of their insurance needs. For example, in the hospitality market we offer property, casualty, and liquor liability, as well as, in some jurisdictions, workers’ compensation coverage. The breadth of our specialty commercial insurance products enables our agents and their small business clients to avoid the administrative costs and time required to seek coverage for each of these items from separate insurers. As such, we compete for commercial lines business based on our flexible product offerings and customer service, rather than on pricing alone. Our target commercial lines customer has an average account size of $5,500 in premium.

We also have substantial expertise in providing specialty homeowners insurance products to targeted customers that are often underserved by other homeowners' insurance carriers. Our personal lines products primarily include the following:

- Low-value dwelling insurance tailored for owners of lower valued homes, which we currently offer in Illinois, Indiana, Louisiana and Texas; and

1

- Wind-exposed catastrophe coverage, including hurricane and wind coverage, to under-served homeowners in Texas and Florida.

In our personal lines business, we target homeowners in need of specific catastrophe coverage or dwelling insurance that are currently underserved by the insurance market, due to the modest value of their homes or the exposure to natural catastrophes in their geographic area. Because these homeowners are underserved, this portion of the market is typically subject to less pricing pressure from larger nationwide insurers that offer a more commoditized product. We believe our underwriting expertise enables us to compete effectively in these markets by evaluating and appropriately pricing risk. In addition, we believe our willingness to meet these underserved segments of the personal lines insurance market fosters deeper relationships with, and increased loyalty from, the agents who distribute our products. Our target personal lines customer has an average account size of $1,100 in premium.

Overall, we structure the multi-line distribution of our premium between commercial and personal lines to better diversify our business and mitigate the potential cyclical nature of either market. In serving these markets, we write business on both an “admitted” and “E&S” basis. As of December 31, 2018, approximately 49% of our gross written premiums were admitted, and approximately 51% were E&S. Insurance companies writing on an admitted basis are licensed by the states in which they sell policies and are required to offer policies using premium rates and forms that are typically filed with state insurance regulators. Non admitted carriers writing in the E&S market are not bound by most of the rate and form regulations imposed on standard market companies, allowing them the flexibility to change the coverage offered and the rate charged without the time constraints and financial costs associated with the filing process. Our corporate structure allows us to offer both admitted and E&S products in select markets through either CIC or WPIC. Our experience with specialty insurance products enables us to react to new market opportunities and underwrite multiple specialty lines.

Geographic Diversity and Mix of Business

Over the past several years, we have increased our focus on specific core commercial lines of business. As part of this business strategy, we have deemphasized our Florida homeowners' business and other wind-exposed business in Texas and Hawaii. We plan to continue to shift focus to low-value dwelling lines of business in order to bring personal lines premium levels back up and to maintain a strategic balance of commercial and personal lines of business.

While we pursue top line premium growth, we do not do so at the expense of losing underwriting discipline. Our underwriters have the experience and institutional flexibility to recognize when to exit certain products in favor of more profitable opportunities as insurance market conditions dictate. The following tables summarize our gross written premiums by segment and state for the years indicated therein (dollars in thousands):

	Gross Written Premium by Segment					
	2018	%	2017	%	2016	%
Commercial	$97,694	94 %	$92,112	81 %	$88,242	77 %
Personal	6,674	6 %	22,172	19 %	26,681	23 %
Total	$104,368	100%	$114,284	100%	$114,923	100%

2

Gross Written Premiums by State

	2018	%		2017	%		2016	%	
Florida	$23,389	22.4	%	$26,562	23.1	%	$23,910	20.7	%
Michigan	19,822	19.0	%	21,099	18.5	%	17,572	15.4	%
Texas	6,509	6.2	%	12,910	11.3	%	12,993	11.3	%
Pennsylvania	6,503	6.2	%	8,859	7.8	%	10,718	9.3	%
California	5,691	5.5	%	2,218	1.9	%	—	—	%
New Jersey	4,884	4.7	%	3,960	3.5	%	978	0.9	%
Ohio	4,025	3.9	%	3,850	3.4	%	3,556	3.1	%
Indiana	3,914	3.8	%	4,356	3.8	%	4,582	4.0	%
New York	3,845	3.7	%	3,095	2.7	%	—	—	%
Colorado	2,835	2.7	%	2,998	2.6	%	2,544	2.2	%
Montana	2,433	2.3	%	2,409	2.1	%	3,041	2.6	%
All Other States	20,518	19.6	%	21,968	19.3	%	35,029	30.5	%
Total	$104,368	100.0	%	$114,284	100.0	%	$114,923	100.0	%

The Conifer Approach

We have built our business in a manner that is designed to adapt to changing market conditions and deliver predictable results over time. The following highlights key aspects of our model that contribute to our balanced approach:

- Focus on under-served markets. We focus on providing specialty insurance products to targeted policyholders in under-served markets. We believe that most of our small business customers, many of which are owner operated, value the efficiency of dealing with a single insurer for multiple products. By targeting small- to medium-sized accounts, we add value to the business owner directly without competing solely on price.
- Strong relationships with our agents. We develop strong relationships with our independent agents providing them with responsive service, attractive commissions and competitive products to offer policyholders. We believe our agents understand that we view them as key partners in risk selection that help us serve our ultimate client-the insured.
- Deep understanding of the business and regulatory landscapes of our markets. The competition for insurance business and the regulatory operating environment vary significantly from state to state. We focus on tailoring our business to concentrate on the geographic markets and regulatory environments with the greatest opportunities for growth and profitability. Our business plan centers on identification of market opportunities in jurisdictions where our insurance products can profitably suit the needs of our potential customers.
- Emphasis on flexibility. We offer coverage to our insureds both on an E&S and admitted basis. We believe this flexibility enables us to pivot effectively between E&S and admitted policies as customer needs and regulatory conditions dictate.
- Conservative risk management with an emphasis on lowering volatility. We focus on the risk/reward of insurance underwriting, while maintaining a prudent investment policy. We employ conservative risk management practices and opportunistically purchase reinsurance to minimize our exposure to liability for individual risks. In addition, we seek to maintain a diversified liquid investment portfolio to reduce overall balance sheet volatility. As of December 31, 2018, our investments primarily consisted of fixed income investments with an average credit rating of “AA” and a duration-to-worst average of 3.1 years.

Our Competitive Strengths

We believe the following competitive strengths have allowed us to grow our business and will continue to support our strategic growth initiatives:

- Talented underwriters with broad expertise. Our underwriters have significant experience managing account profitability across market cycles. With an average of over 27 years of experience, our senior underwriters possess the required expertise to respond appropriately to market forces.

- Controlled and disciplined underwriting. We underwrite substantially all policies to our specific guidelines with our experienced, in-house underwriting team. We customize the coverages we offer, and continually monitor our markets and respond to changes in our markets by adjusting our pricing, product structures and underwriting guidelines. By tailoring the terms and conditions of our policies, we align our actual underwriting risk with the profit of each insurance account that we write.
- Proactive claims handling. We employ a proactive claims handling philosophy that utilizes an internal team of experienced in-house attorneys to manage and supervise our claims from inception until resolution. We pay what we owe, contest what we don't, and make sound judgment for those claims that fall in between. Our proactive handling of claims reinforces our relationships with our customers and agents by demonstrating our willingness to defend our insureds aggressively and help them mitigate losses.
- Proven management team. Our senior management team has an average of over 25 years of experience in the insurance industry. Our senior management team has successfully created, managed and grown numerous insurance companies and books of business, and has longstanding relationships with many independent agents and policyholders in our targeted markets.
- Ability to leverage technology to drive efficiency. We utilize a web based information technology system that creates greater organizational efficiency in our company. Leveraging the infrastructure of programmers and support staff of third party vendors allows our in house business analysts to focus on new product development and roll out. We believe this capability reduces our time to market for new products, enhances services for insureds, increases our ability to capture data, and reduces cost.

Marketing and Distribution

Independent agents are our main distribution source. The selection of an insurance company by a business or individual is strongly influenced by the business or individual's agent. We seek to maintain favorable relationships with our select group of agents. Our distribution philosophy is to treat our agents as partners, and we provide them with competitive products, personal service and attractive commissions. We believe these factors contribute to our positive agency retention.

In 2018, our top six independent agencies accounted for approximately 32% of our gross written premiums in our commercial lines, and our top four independent agencies, accounted for approximately 40% of our gross written premiums in our personal lines. We have long term relationships with each of these agencies. We anticipate our concentration in these agencies will decrease in future periods as we establish relationships with additional agencies, as part of our strategic growth plan. Our Insurance Company Subsidiaries market and distribute their products mainly through an independent agency network, however we utilize managing general agents and certain key wholesalers when appropriate.

We recruit our producers through referrals from our existing network of agents, word of mouth, advertisement, as well as direct contacts initiated by potential agents. Our marketing efforts are directed through our offices in Michigan, Florida, Pennsylvania and Tennessee.

We view our agents as key partners in risk selection. We actively solicit their input regarding potential improvements to our business methods and consult with them in developing new products and entering new customer markets. At the same time, we take careful measure to appropriately control and monitor our agents' operations. Controls include frequent review of the quality of business, loss experience and other mechanisms. We retain sole binding authority on the majority of our business. Binding authority is only granted to select long-term agents. When binding authority is granted, we restrict this authority to a specific set of guidelines that are provided to each agent. Moreover, our experienced underwriters review each risk to ensure the guidelines are followed.

In addition to marketing to individual agents, we formed Sycamore Insurance Agency to review specific opportunities to write select business on a direct basis. SIA also owns 50% of a small insurance agency that places small commercial risks, mainly for alarm and security guard markets.

Underwriting

We are focused on underwriting profitability and effective enterprise risk management. With an average of over 27 years of experience, our senior underwriters have the experience to properly manage account profitability across market cycles.

Our underwriting philosophy for our specialty commercial risks in the hospitality industry is to look at each risk individually and selectively before writing any policies. We remain focused on the small to medium-sized, well-operated business, where the owner is often on site and in a better position to efficiently and safely run the overall operations. We understand the risks associated with the smaller enterprises and, due to lighter competition, believe we can receive a fair premium to compensate for the risk taken.

With respect to commercial property coverages, we believe it is important to focus on the profitability of the insureds' business, as well as the traditional risk factors. Therefore, in addition to obtaining inspections on commercial risks, we strive to understand the insureds' business operations and bottom line to verify the underlying business is an acceptable risk.

All commercial and personal policy applications are underwritten according to established guidelines that have been provided to our independent agency force. These guidelines have been integrated into our information technology system framework and only policies that meet our guidelines are accepted by our system. Our underwriting staff has substantial industry experience in matching policy terms, conditions, and pricing to the risk profiles of our policyholders and therefore strengthens our ability to achieve profitability in the product lines we write.

Commercial Lines. In writing commercial lines policies, we frequently employ tailored limiting endorsements, rating surcharges and customized limits to align our product offerings to the risk profile of the class and the specific policyholder being underwritten. Furthermore, we consistently monitor our markets so that we are able to quickly implement changes in pricing, underwriting guidelines and product offerings as necessary to remain competitive. We do not pursue commercial product lines where competition is based primarily on price. We augment our own internally developed pricing models with benchmark rates and policy terms set forth by the Insurance Services Office, or ISO. The ISO system is a widely recognized industry resource for common and centralized rates and forms. It provides advisory ratings, statistical and actuarial services, sample policy provisions and other services to its members.

Personal Lines. We employ internal product managers to review our position relative to our competition, create better segmentation of pricing and originate premium rate changes as appropriate. Consistent with industry practice, we grant our personal lines agents limited binding authority within our specific guidelines. Once a completed application and premium payment are submitted to us, the application is placed in a bound status, and reviewed for final approval. If the agent has underwritten and submitted the account according to our guidelines, we process the application as complete. If our guidelines have not been followed, the application may be cancelled or updated and re submitted for further underwriting review.

Claims

We believe that effective claims management is vitally important to our success, allowing us to cost effectively pay valid claims, while vigorously defending those claims that lack merit. Our claims department consists of experienced claims professionals located in Michigan, Florida, Pennsylvania and Tennessee. We utilize a proactive claims handling philosophy to internally manage or supervise all of our claims from inception through final disposition. By handling our claims internally, we can quickly assess claims, improve communication with our policyholders and claimants and better control our claims management costs.

We have several in house attorneys with considerable legal experience in trying cases in the lines of business we write. Included among these attorneys is our head in house litigator, who consults on all trials and has 25 years of litigation experience. We also have numerous seasoned property and liability adjusters which allow us to manage our claims exposures more carefully, across all markets. In addition, our claims professionals utilize a network of independent local adjusters and appraisers to assist with specific aspects of claims investigations, such as securing witness statements and conducting initial appraisals in states where it is practical to do so. These outside vendors are mainly compensated based on pre negotiated fee schedules to control overall costs.

Claims personnel are organized by line of business, with specific managers assigned as supervisors for each line of business. Reserving and payment authority levels of claims personnel are set by our Senior Vice President of claims and our Executive Vice President. Those limits of authority are integrated into our claims information technology systems to ensure strict compliance.

Initial claim reserves are determined and set using our statistical averages of paid indemnity and loss adjustment expenses by line of business. After reviewing statistical data and consulting with our internal actuary, our senior vice president of claims, together with other members of management, set initial reserves by line of business. Once initial reserves have been set, reserves are evaluated periodically as specific claim information changes to generate management's overall best estimate of reserves. In addition, claim reviews with in house adjusters and attorneys provide a regular opportunity to review the adequacy of reserves. Changes to claims reserves are made by senior management based on claim developments and input from these attorneys and adjusters. We utilize an in house,

experienced and fully credentialed actuary to support our financial efforts.

Reinsurance

We routinely purchase reinsurance for our commercial and personal lines to reduce volatility by limiting our exposure to large losses and to provide capacity for growth. In a reinsurance transaction, an insurance company transfers, or cedes, all or part of its exposure in return for a portion of the premium. We remain legally responsible for the entire obligation to policyholders, irrespective of any reinsurance coverage we may purchase.

Information relating to our reinsurance structure and treaty information is included within Note 6 ~ Reinsurance.

Loss Reserve Development

The following table presents the development of our loss and loss adjustment expenses ("LAE") reserves from 2009 through 2018, net of reinsurance recoverables (dollars in thousands).

	Year Ended December 31,									
	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Net liability for losses and loss expenses	$911	$18,795	$17,164	$17,547	$24,956	$28,307	$30,017	$47,993	$67,830	$63,122
Liability re estimated as of:										
One year later	764	16,565	12,807	13,508	23,763	29,321	40,239	57,452	71,186	
Two years later	593	13,071	9,870	13,601	25,521	33,274	52,321	60,453		
Three years later	495	10,300	10,038	13,821	26,560	38,569	58,251			
Four years later	452	10,698	10,064	13,860	27,784	40,822				
Five years later	434	10,926	10,227	13,980	27,920					
Six years later	434	11,215	10,414	14,048						
Seven years later	434	11,402	10,471							
Eight years later	434	11,463								
Nine years later	434									
Ten years later										
Net cumulative redundancy (deficiency)	477	7,332	6,693	3,499	(2,964)	(12,515)	(28,234)	(12,460)	(3,356)	
Deferred gain on ADC	—	—	—	—	—	—	—	(5,677)	(5,677)	
Net cumulative redundancy (deficiency)	$477	$7,332	$6,693	$3,499	$(2,964)	$(12,515)	$(28,234)	$(18,137)	$(9,033)	
Cumulative amount of net liability paid as of:										
One year later	$253	$4,112	$3,383	$5,186	$13,245	$16,091	$20,020	$29,533	44,521	
Two years later	315	6,277	6,092	9,106	19,711	24,060	35,972	56,962		
Three years later	426	8,302	7,917	11,444	23,241	32,699	50,676			
Four years later	434	9,372	8,788	13,015	26,056	37,474				
Five years later	434	9,971	9,730	13,522	27,217					
Six years later	434	10,799	10,167	13,903						
Seven years later	434	11,219	10,398							
Eight years later	434	11,416								
Nine years later	434									
Ten years later										
Gross liability end of year	911	32,047	29,574	24,843	28,909	31,532	35,423	54,651	87,896	92,807
Reinsurance recoverable on unpaid losses	—	13,252	12,410	7,296	3,952	3,225	5,405	6,658	20,066	29,685
Net liability end of year	911	18,795	17,164	17,547	24,957	28,307	30,018	47,993	67,830	63,122
Gross liability re estimated latest	434	22,167	18,690	20,293	34,273	48,387	70,706	88,271	113,304	
Reinsurance recoverable on unpaid losses re estimated latest	—	10,704	8,219	6,244	6,353	7,565	12,455	27,818	42,118	
Net liability re estimated latest	434	11,463	10,471	14,049	27,920	40,822	58,251	60,453	71,186	

Gross cumulative redundancy (deficiency)	$477	$9,880	$10,884	$4,550	$(5,364)	$(16,855)	$(35,283)	$(33,620)	$(25,408)

7

Data from 2009 relates only to American Equable, Inc., which is now known as CIC and the 2010 through 2018 columns include CIC and WPIC.

The first line of the table presents the unpaid loss and LAE reserves at December 31 for each year, including the incurred but not reported ("IBNR") reserve. The next section of the table sets forth the re estimates of incurred losses from later years, including payments, for the years indicated. The increase/decrease from the original estimate would generally be a combination of factors, including, but not limited to:

- Claims being settled for amounts different from the original estimates;
- Reserves being increased or decreased for individual claims that remain open as more information becomes known about those individual claims; and
- More or fewer claims being reported after the related year end, than had been expected to be reported before that date.

As our historical data for a particular line of business increases, both in terms of the number of years of loss experience and the size of our data pool, we will increasingly rely upon our own loss experience rather than industry loss experience in establishing our loss and LAE reserves. We plan to continue to apply reserving practices consistent with historical methodologies.

Additional information relating to our reserves is included within the Losses and Loss Adjustment Expenses section of Note 1 ~ Summary of Significant Accounting Policies and Note 5 ~ Unpaid Losses and Loss Adjustment Expenses of the Notes to the Consolidated Financial Statements, as well as in the Critical Accounting Policies ~ Unpaid Losses and Loss Adjustment Expenses section of Item 7, Management's Discussion and Analysis.

Regulation

Insurance Company Regulation

Our Insurance Company Subsidiaries are subject to regulation in the states where they conduct business. State insurance regulations generally are designed to protect the interests of policyholders, consumers or claimants rather than shareholders or other investors. The nature and extent of such state regulation varies by jurisdiction, but generally involves:

- Prior approval of the acquisition of control of an insurance company or of any company controlling an insurance company;
- Regulation of certain transactions entered into by such insurance company subsidiary with any of its affiliates;
- Approval of premium rates, forms and policies used for many lines of admitted insurance;
- Standards of solvency and minimum amounts of capital and surplus that must be maintained;
- Limitations on types and concentration of investments;
- Licensing of insurers and agents;
- Deposits of securities for the benefit of policyholders; and
- The filing of periodic reports with state insurance regulators with respect to financial condition and other matters.

In addition, state regulatory examiners perform periodic examinations of our Insurance Company Subsidiaries. The results of these examinations can give rise to regulatory orders requiring remedial, injunctive or other corrective action.

Insurance Holding Company Regulation

We operate as an insurance holding company and are subject to regulation in the jurisdictions in which we conduct business. These regulations require that each of our Insurance Company Subsidiaries register with the insurance department of its state of domicile and furnish information concerning the operations of companies within the holding company system that may materially affect the operations, management or financial condition of the insurers within the system. The insurance laws similarly provide that all transactions among members of a holding company system must be fair and reasonable. Certain types of transactions between our Insurance Company Subsidiaries and the Company and our other affiliates generally must be disclosed to the state regulators, and prior approval of the state insurance regulator generally is required for any material or extraordinary transaction. In addition, a change of control of a domestic insurer or of any controlling person requires the prior approval of the state of domicile insurance regulator.

Various State and Federal Regulation

Insurance companies are also affected by a variety of state and federal legislative and regulatory measures and judicial decisions that define and extend the risks and benefits for which insurance is sought and provided. In addition, for some classes of insureds individual state insurance departments may prevent premium rates for some classes of insureds from reflecting the level of risk assumed by the insurer for those classes. Such developments may adversely affect the profitability of various lines of insurance. In some cases, if permitted by applicable regulations, these adverse effects on profitability can be minimized through repricing of coverages or limitations or cessation of the affected business.

Reinsurance Intermediary

Our reinsurance intermediaries are also subject to regulation. Under applicable regulations, an intermediary is responsible, as a fiduciary, for funds received on account of the parties to the reinsurance transaction. The intermediaries are required to hold such funds in appropriate bank accounts subject to restrictions on withdrawals and prohibitions on commingling.

Licensing and Agency Contracts

We, or certain of our designated employees, must be licensed to act as agents by regulatory authorities in the states in which we conduct business. Regulations and licensing laws vary in each state and are often complex.

Insurance licenses are issued by state insurance regulators upon application and may be of perpetual duration or may require periodic renewal. There are often requirements to obtain appropriate new licenses before we can begin writing or offer new coverages in a new state. The requirements are more stringent when writing on an admitted basis, as opposed to on an E&S basis where there is greater form and rate flexibility.

Insurers operating on an admitted basis must file premium rate schedules and policy or coverage forms for review and approval by the insurance regulators. In many states, rates and policy forms must be approved prior to use, and insurance regulators have broad discretion in judging whether or not an insurer’s rates are adequate, excessive and unfairly discriminatory.

The applicable licensing laws and regulations in all states are subject to amendment or reinterpretation by state regulatory authorities, and such authorities are vested in most cases with relatively broad discretion as to the granting, revocation, suspension and renewal of licenses. We, or our employees, could be excluded, or temporarily suspended, from continuing with some or all of our activities in, or otherwise subjected to penalties by, a particular state.

Membership in Insolvency Funds and Associations, Mandatory Pools and Insurance Facilities

Most states require admitted property and casualty insurers to become members of insolvency funds or associations, which generally protect policyholders against the insolvency of insurers. Members of the fund or association must contribute to the payment of certain claims made against insolvent insurers. The Company's assessments from insolvency funds were minimal for the years ended December 31, 2018, 2017, and 2016.

Our Insurance Company Subsidiaries are also required to participate in various mandatory insurance facilities or in funding mandatory pools, which are generally designed to provide insurance coverage for consumers who are unable to obtain insurance in the voluntary insurance market. Among the pools participated in are those established in certain states to provide windstorm and other similar types of property coverage. These pools typically require all companies writing applicable lines of insurance in the state for which the pool has been established to fund deficiencies experienced by the pool based upon each company’s relative premium writings in that state, with any excess funding typically distributed to the participating companies on the same basis. To the extent that reinsurance treaties do not cover these assessments, they may have an adverse effect on the Company. For the years ended December 31, 2018, 2017, and 2016, total assessments paid to all such facilities were minimal.

Restrictions on Dividends and Risk-Based Capital

For information on Restrictions on Dividends and Risk-based Capital that affect us please refer to Note 9 ~ Statutory Financial Data, Risk-Based Capital and Dividend Restrictions of the Notes to the Consolidated Financial Statements and the Regulatory and Rating Issues section within Item 7, Management’s Discussion and Analysis.

NAIC-IRIS Ratios

The National Association of Insurance Commissioners' ("NAIC") Insurance Regulatory Information System ("IRIS") was developed by a committee of state insurance regulators and is primarily intended to assist state insurance departments in executing their statutory mandates to oversee the financial condition of insurance companies operating in their respective states. IRIS identifies thirteen industry ratios and specifies "usual values" for each ratio. Departure from the usual values on four or more ratios generally leads to inquiries or possible further review from individual state insurance commissioners. However, the generation of ratios outside of the usual values does not necessarily indicate a financial problem. For example, premium growth, alone, can trigger one or more unusual values. Refer to the Regulatory and Rating Issues section within Item 7, Management's Discussion and Analysis.

Effect of Federal Legislation

The Terrorism Risk Insurance Act, ("TRIA"), was enacted in November 2002. After several extensions, Congress enacted the Terrorism Risk Insurance Program Reauthorization of 2015 ("Act"). The Act extends the Federal Terrorism Insurance Program until December 31, 2020. The Act continues to require insurance companies to offer terrorism coverage. There is minimal exposure to this coverage as most of our policyholders decline this coverage option.

Employees

At December 31, 2018, we had 148 employees. Substantially all of our employees are full-time. Our employees are not subject to any collective bargaining agreement, and we are not aware of any current efforts to implement such an agreement. We believe we have good working relations with our employees.

Available Information

We maintain an internet website at http://www.cnfrh.com, where we make available, free of charge, our Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, Statements of Beneficial Ownership (Forms 3, 4, and 5), and any amendments to those reports, as soon as reasonably practicable after we electronically file such material with, or furnish to, the SEC. In addition, the SEC maintains an Internet site that contains reports, proxy statements, and other information that we file at www.sec.gov. The public may read and copy any materials we file with the Commission at the SEC's Public Reference Room at 100 F Street, NE., Washington, DC 20549, on official business days during the hours of 10 a.m. to 3 p.m. The public may obtain information on the operation of the Public Reference Room by calling the Commission at 1-800-SEC-0330. Information found on our website or any other website is not part of this annual report on Form 10-K or any other report we file with, or furnish to the SEC.

Glossary

Accident year	The annual calendar accounting period in which loss events occurred, regardless of when the losses are actually reported, booked or paid.
Accident year combined ratio	The accident year combined ratio is an insurance industry measure that excludes changes in net ultimate loss estimates from prior accident year loss reserves. The accident year combined ratio provides management with an assessment of the specific policy year's profitability (which matches policy pricing with related losses) and assists management in their evaluation of product pricing levels and quality of business written. Management uses accident year combined ratio as one component to assess the Company's current year performance and as a measure to evaluate, and if necessary, adjust current year pricing and underwriting.
Adjusted operating income (loss)	Net income (loss) excluding net realized investment and other gains (losses), net of tax, the effects of tax reform, the tax effect of changes in unrealized gains to the extent included in net income, the change in the fair value of equity securities, net of tax, and the capitalization and amortization of deferred gains from the ADC.
Adjusted operating income (loss), per share	Adjusted operating income (loss) on a per share basis.
Assignment of Benefits	A legal tool that allows a third party to assert a claim and be paid for services performed for an insured who would normally be reimbursed directly by the insurance company after making a claim themselves.
Book value per share	Total common shareholders' equity divided by the number of common shares outstanding.
Case reserves	Estimates of anticipated future payments to be made on each specific reported claim.
Combined Ratio based on accounting principles generally accepted in the United States of America ("GAAP")	The Combined Ratio is the sum of the Loss Ratio and the Expense Ratio. These ratios differ from statutory ratios to reflect GAAP accounting, as management evaluates the performance of our underwriting operations using the GAAP combined ratio.
Combined Ratio based on statutory accounting practices ("SAP")	The combined ratio based on SAP, expressed as a percentage, is the key measure of underwriting profitability traditionally used in the property and casualty insurance business. The combined ratio is a statutory accounting measurement, which represents the sum of (i) the ratio of losses and loss expenses to net earned premiums (loss ratio), plus (ii) the ratio of underwriting expenses to net written premiums (expense ratio).
Combined Ratio (Overall)	When the combined ratio is under 100%, underwriting results are generally considered profitable; when the combined ratio is over 100%, underwriting results are generally considered unprofitable.
Deferred policy acquisition costs	Primarily commissions and premium-related taxes that vary with, and are primarily related to, the production of new contracts and are deferred and amortized to achieve a matching of revenues and expenses when reported in financial statements prepared in accordance with GAAP.

11

Deficiency	With regard to reserves for a given liability, a deficiency exists when it is estimated or determined that the reserves are insufficient to pay the ultimate settlement value of the related liabilities. Where the deficiency is the result of an estimate, the estimated amount of deficiency (or even the finding of whether or not a deficiency exists) may change as new information becomes available.
Expense Ratio	For GAAP, it is the ratio of GAAP underwriting expenses incurred to net earned premiums plus other income. For SAP, it is the ratio of Statutory underwriting expenses incurred to net written premiums.
Incurred but not reported (IBNR) reserves	Reserves for estimated losses and LAE that have been incurred but not yet reported to the insurer. This includes amounts for unreported claims, development on known cases, and re-opened claims.
Loss	An occurrence that is the basis for submission and/or payment of a claim. Losses may be covered, limited or excluded from coverage, depending on the terms of the policy.
Loss adjustment expenses (LAE)	The expenses of settling claims, including legal and other fees and the portion of general expenses allocated to claim settlement costs.
Loss ratio	The ratio of incurred losses and loss adjustment expenses to net earned premiums plus other income.
Loss reserves	Liabilities established by insurers and reinsurers to reflect the estimated cost of claims incurred that the insurer or reinsurer will ultimately be required to pay in respect of insurance or reinsurance it has written. Reserves are established for losses and for LAE, and consist of case reserves and IBNR reserves. As the term is used in this document, “loss reserves” is meant to include reserves for both losses and LAE, unless stated otherwise.
Loss reserve development	The increase or decrease in Loss or LAE as a result of the re-estimation of claims and claim adjustment expense reserves at successive valuation dates for a given group of claims. Loss reserve development may be related to prior year or current year development.
Losses incurred	The total losses sustained by an insurance company under a policy or policies, whether paid or unpaid. Incurred losses include a provision for IBNR.
NAIC-IRIS ratios	Financial ratios calculated by the NAIC to assist state insurance departments in monitoring the financial condition of insurance companies.
Policyholders' surplus	As determined under SAP, the amount remaining after all liabilities, including loss reserves, are subtracted from all admitted assets. Admitted assets are assets of an insurer prescribed or permitted by a state to be recognized on the statutory balance sheet. Policyholders' surplus is also referred to as “surplus” or “statutory surplus” for statutory accounting purposes.
Premium leverage ratio	The ratio of written premium (gross or net) to consolidated statutory surplus.
Redundancy	With regard to reserves for a given liability, a redundancy exists when it is estimated or determined that the reserves are greater than what will be needed to pay the ultimate settlement value of the related liabilities. Where the redundancy is the result of an estimate, the estimated amount of redundancy (or even the finding of whether or not a redundancy exists) may change as new information becomes available.
Risk-Based Capital (RBC)	A measure adopted by the NAIC and enacted by states for determining the minimum statutory policyholders' surplus requirements of insurers. Insurers having total adjusted capital less than that required by the RBC calculation will be subject to varying degrees of regulatory action.
Statutory accounting practices (SAP)	The practices and procedures prescribed or permitted by domiciliary state insurance regulatory authorities in the United States for recording transactions and preparing financial statements.
Underwriting gain or loss	Net earned premiums plus other income, less losses, LAE, commissions, and operating expenses.

ITEM 1A. RISK FACTORS

Summary Risk Factors

You should read the following risk factors carefully in connection with evaluating our business and the forward-looking information contained in this Annual Report on Form 10-K. Any of the following risks could materially and adversely affect our business, operating results, financial condition and the actual outcome of matters as to which forward-looking statements are made in this Annual Report on Form 10-K. While we believe we have identified and discussed below the key risk factors affecting our business, there may be additional risks and uncertainties that are not presently known or that are not currently believed to be significant that may adversely affect our business, operating results or financial condition in the future.

Our actual incurred losses may be greater than our loss and loss adjustment expense reserves, which could have a material adverse effect on our financial condition and results of operations.

Insurance companies' financial condition and results of operations depend upon their ability to accurately assess the potential losses and loss adjustment expenses under the terms of the insurance policies they underwrite. Reserves do not represent an exact calculation of liability. Rather, reserves represent an estimate of what the expected ultimate settlement and administration of claims will cost, and the ultimate liability may be greater or less than the current estimate. In the insurance industry, there is always the risk that reserves may prove inadequate as it is possible for insurance companies to underestimate the cost of claims.

We base our estimates on our assessment of known facts and circumstances, as well as estimates of future trends in claim severity, claim frequency, judicial theories of liability and other factors. These variables are affected by both internal and external events that could increase our exposure to losses, including changes in actuarial projections, claims handling procedures, inflation, severe weather, climate change, economic and judicial trends, and legislative changes. We continually monitor reserves using new information on reported claims and a variety of statistical techniques to update our current estimate. Our estimates could prove to be inadequate, and this underestimation could have a material adverse effect on our financial strength.

Among the uncertainties we encounter in establishing our reserves for losses and related expenses in connection with our insurance businesses are as follows:

- When we write "occurrence" policies, we are obligated to pay covered claims, up to the contractually agreed amount, for any covered loss that occurs while the policy is in force. Accordingly, claims may be reported and develop many years after a policy has lapsed;
- Even when a claim is received (irrespective of whether the policy is a "claims-made", which requires claims to be reported during the policy period, or an "occurrence" based form), it may take considerable time to fully appreciate the extent of the covered loss suffered by the insured and, consequently, estimates of loss associated with specific claims can increase over time;
- New theories of liability are enforced retroactively from time to time by courts;
- Volatility in the financial markets, economic events, weather events and other external factors may result in an increase in the number of claims and the severity of the claims reported. In addition, elevated inflationary conditions would, among other things, drive loss costs to increase;
- If claims became more frequent, even if we had no liability for those claims, the cost of evaluating these potential claims could escalate beyond the amount of the reserves we have established. If we enter new lines of business, or encounter new theories of claims liability, we may encounter an increase in claims frequency and greater claims handling costs than we had anticipated; and
- Estimation of "IBNR" losses is a complex and inherently uncertain process which involves a considerable degree of judgment and expertise, which adds to the overall difficulty of estimating loss reserves.

If any of our insurance reserves should prove to be inadequate for the reasons discussed above, or for any other reason, we will be required to increase reserves, resulting in a reduction in our net income and shareholders' equity in the period in which the deficiency is identified. Future loss experience substantially in excess of established reserves could also have a material adverse effect on future earnings and liquidity and financial rating, which would affect our ability to attract business and could affect our ability to retain or hire qualified personnel.

Severe weather conditions and other catastrophes are inherently unpredictable and may have a material adverse effect on our financial results and financial condition.

Our property insurance business is exposed to the risk of severe weather conditions and other catastrophes. Catastrophes can be caused by various events, including natural events such as hurricanes, winter weather, tornadoes, windstorms, earthquakes, hailstorms, severe thunderstorms, fires and other non-natural events such as explosions or riots.

The incidence and severity of catastrophes and severe weather conditions are inherently unpredictable. The extent of losses from a catastrophe is a function of both the total amount of insured exposure in the area affected by the event and the severity of the event. Severe weather conditions and catastrophes can cause greater losses in our property lines and cause our liquidity and financial condition to deteriorate. In addition, our inability to obtain reinsurance coverage at reasonable rates and in amounts adequate to mitigate the risks associated with severe weather conditions and other catastrophes could have a material adverse effect on our business and results of operation.

If we are unable to underwrite risks accurately and charge competitive yet profitable rates to our policyholders, our business, financial condition and results of operations will be adversely affected.

In general, the premiums for our insurance policies are established at the time a policy is issued and, therefore, before all of our underlying costs are known. Like other insurance companies, we rely on estimates and assumptions in setting our premium rates. Establishing adequate premium rates is necessary, together with investment income, to generate sufficient revenue to offset losses, LAE and other underwriting costs and to earn a profit. If we do not accurately assess the risks that we underwrite, we may not charge adequate premiums to cover our losses and expenses, which would adversely affect our results of operations and our profitability. Alternatively, we could set our premiums too high, which could reduce our competitiveness and lead to lower revenues.

Pricing involves the acquisition and analysis of historical loss data and the projection of future trends, loss costs and expenses, and inflation trends, among other factors, for each of our products in multiple risk tiers and many different markets. In order to accurately price our policies, we:

- Collect and properly analyze a substantial volume of data from our insureds;
- Develop, test and apply appropriate actuarial projections and rating formulas;
- Closely monitor and timely recognize changes in trends; and
- Project both frequency and severity of our insureds' losses with reasonable accuracy.

We seek to implement our pricing accurately in accordance with our assumptions. Our ability to undertake these efforts successfully and, as a result, accurately price our policies, is subject to a number of risks and uncertainties, including:

- Insufficient or unreliable data;
- Incorrect or incomplete analysis of available data;
- Uncertainties generally inherent in estimates and assumptions;
- Our failure to implement appropriate actuarial projections and rating formulas or other pricing methodologies;
- Regulatory constraints on rate increases; and
- Our failure to accurately estimate investment yields and the duration of our liability for loss and loss adjustment expenses, as well as unanticipated court decisions, legislation or regulatory action.

In addition, as a result of current industry non-weather factors, such as the increase in litigation surrounding the Assignment of Benefits claims and lawsuits in Florida, in particular, we may experience additional losses that could adversely affect our financial position or results of operations.

We operate in a highly competitive environment and we may not continue to be able to compete effectively against larger or more well established business rivals.

We compete with a large number of other companies in our selected lines of business. Many of our competitors are substantially larger and may enjoy better name recognition, substantially greater financial resources, higher financial strength ratings by rating agencies, broader and more diversified product lines and more widespread agency relationships than us. Insurers in our markets generally compete on the basis of price, consumer recognition, coverages offered, claims handling, financial stability, customer service and geographic coverage. Although pricing is influenced to some degree by that of our competitors, it is not in our best interests to compete solely on price, and we may from time-to-time experience a loss of

14

market share during periods of intense price competition. A number of new, proposed or potential legislative or industry developments could further increase competition in our industry including, but not limited to:

- An increase in capital raising by companies in our lines of business, which could result in new entrants to our markets and an excess of capital in the industry;
- The deregulation of commercial insurance lines in certain states and the possibility of federal regulatory reform of the insurance industry, which could increase competition from standard carriers for our E&S lines of insurance business; and
- Changing practices caused by the Internet may lead to greater competition in the insurance business. Among the possible changes are shifts in the way insurance is purchased. If our distribution model was to be significantly altered by changes in the way products were marketed, including, without limitation, through use of the Internet, it could have a material adverse effect on our premiums, underwriting results and profits.

There is no assurance that we will be able to continue to compete successfully in the insurance market. Increased competition in our market could result in a change in the supply and/or demand for insurance, affect our ability to price our products at risk adequate rates and retain existing business, or underwrite new business on favorable terms. If this increased competition so limits our ability to transact business, our operating results could be adversely affected.

The price of our common stock may be volatile and limited public float and low trading volume for our shares may have an adverse impact on the share price or make it difficult to liquidate.

The trading price of our common stock is likely to be highly volatile and could be subject to wide fluctuations in response to various factors, some of which are beyond our control and may not be related to our operating performance. These fluctuations could be significant and could cause a loss in the amount invested in our shares of common stock.

In addition, the stock market in general, and the market for insurance companies in particular, has experienced extreme price and volume fluctuations that have often been unrelated or disproportionate to the operating performance of those companies. Securities class action litigation has often been instituted against companies following periods of volatility in the overall market and in the market price of a company’s securities. This litigation, if instituted against us, could result in substantial costs, divert our management’s attention and resources, and harm our business, operating results, and financial condition.

As a result of these factors, investors in our common stock may not be able to resell their shares at or above their purchase price or may not be able to resell them at all. These market and industry factors may materially reduce the market price of our common stock, regardless of our operating performance. In addition, price volatility may be greater if the public float and the trading volume of our common stock remain low.

Our investment portfolio is subject to significant market and credit risks, which could result in an adverse impact on our financial conditions or results of operations.

Our results of operations depend, in part, on the performance of our investment portfolio. We seek to hold a diversified portfolio of investments that is managed by professional investment advisory management firms in accordance with our investment policy and routinely reviewed by our Investment Committee. However, our investments are subject to general economic conditions and market risks as well as risks inherent to particular securities.

The value of our investment portfolio is subject to the risk that certain investments may default or become impaired due to deterioration in the financial condition of one or more issuers of the securities held, or due to deterioration in the financial condition of an insurer that guarantees an issuer’s payments of such investments. Such defaults and impairments could reduce our net investment income and result in realized investment losses.

Risks for all types of securities are managed through application of our investment policy, which establishes investment parameters that include but are not limited to maximum percentages of investment in certain types of securities and minimum levels of credit quality, which we believe are within guidelines established by the NAIC and various state insurance departments, as applicable.

A severe economic downturn could cause us to incur substantial realized and unrealized investment losses in future periods, which would have an adverse impact on our financial condition, results of operations, debt and financial strength ratings, Insurance Company Subsidiaries’ capital liquidity and ability to access capital markets.

Although we seek to preserve our capital, we cannot be certain that our investment objectives will be achieved, and results may vary substantially over time. In addition, although we seek to employ investment strategies that are not

15

correlated with our insurance exposures, losses in our investment portfolio may occur at the same time as underwriting losses and, therefore, exacerbate the adverse effect of the losses on us.
Our ability to meet ongoing cash requirements, service debt and pay dividends may be limited by our holding company structure and regulatory constraints restricting dividends or other distributions by our Insurance Company Subsidiaries.
We are a holding company that transacts the majority of our business through our Insurance Company Subsidiaries. Our ability to meet our obligations on our outstanding debt, and to pay our expenses and shareholder dividends, depends upon the dividend paying capacity of our Insurance Company Subsidiaries. We will be limited by the earnings of our Insurance Company Subsidiaries, and the distribution or other payment of such earnings to it in the form of dividends, loans, advances or the reimbursement of expenses. Payments of dividends to us by our Insurance Company Subsidiaries are subject to various business considerations and restricted by state insurance laws, including laws establishing minimum solvency and liquidity thresholds, and could be subject to revised restrictions in the future. The ability to pay ordinary and extraordinary dividends must be reviewed in relation to the impact on key financial measurement ratios, including RBC ratios. The Insurance Company Subsidiaries' ability to pay future dividends without advance regulatory approval is dependent upon maintaining a positive level of unassigned surplus. As a result, at times, we may not be able to receive dividends from our Insurance Company Subsidiaries in amounts necessary to meet our debt obligations, to pay shareholder dividends on our capital stock or to pay corporate expenses. Therefore, the inability of our Insurance Company Subsidiaries to pay dividends or make other distributions could have a material adverse effect on our business and financial condition.
We may be adversely affected by interest rate changes.
Our investment portfolio is predominantly comprised of fixed income securities. These securities are sensitive to changes in interest rates. An increase in interest rates typically reduces the fair market value of fixed income securities. In addition, if interest rates decline, investment income earned from future investments in fixed income securities will be lower. We generally hold our fixed income securities to maturity, so our interest rate exposure does not usually result in realized losses. However, as noted above, rising interest rates could result in a significant reduction of our book value. A low investment yield environment could adversely impact our net earnings, as a result of fixed income securities maturing and being replaced with lower yielding securities which impact investing results. Interest rates are highly sensitive to many factors beyond our control including general economic conditions, governmental monetary policy, and political conditions. As discussed above, fluctuations in interest rates may adversely impact our business. See "Item 7A. Qualitative and Quantitative Disclosures About Market Risk" for further discussion on interest rate risk.
A decline in our financial strength rating may result in a reduction of new or renewal business.
Participants in the insurance industry use ratings from independent ratings agencies, such as A.M. Best Company, Inc. ("A.M. Best") and Kroll Bond Rating Agency ("Kroll") as an important means of assessing the financial strength and quality of insurers. In setting their ratings, A.M. Best and Kroll utilize a quantitative and qualitative analysis of a company's balance sheet strength, operating performance and business profile. These analyses include comparisons to peers and industry standards as well as assessments of operating plans, philosophy and management. For A.M. Best, the ratings range from A++, or superior, to F for in liquidation. Kroll's ratings range from AAA (extremely strong) to R (under regulatory supervision). As of the date of this Form 10-K, A.M. Best has assigned financial strength ratings of B++ (Good) and B+ (Good) for WPIC. A rating of B++ for CIC and a rating of B+ for WPIC means A.M. Best considers both companies to have a "good" ability to meet ongoing financial obligations. Kroll has given CIC and WPIC an insurance financial strength rating of BBB+ with a stable outlook (fourth highest rating level out of eleven) as of the date of this Form 10-K. A BBB+ rating indicates that the insurer's financial condition is adequate.
A.M. Best and Kroll assign ratings that are intended to provide an independent opinion of an insurance company's ability to meet its financial obligations to policyholders and such ratings are not evaluations directed to investors. A.M. Best and Kroll periodically review our ratings and may revise ratings downward or revoke them at their sole discretion based primarily on their analyses of our balance sheet strength (including capital adequacy and loss and loss adjustment expense reserve adequacy), operating performance and business profile. Factors that could affect such analyses include but are not limited to:

•

If we change our business practices from our organizational business plan in a manner that no longer supports A.M. Best's or Kroll's rating;

- If unfavorable financial, regulatory or market trends affect us, including excess market capacity;
- If we incur operating losses;
- If we have unresolved issues with government regulators;

- If we are unable to retain our senior management or other key personnel;
- If our investment portfolio incurs significant losses; or
- If A.M. Best or Kroll alters its capital adequacy assessment methodology in a manner that would adversely affect our rating.

These and other factors could result in a downgrade of our rating. A downgrade of our rating could cause our current and future agents, retail brokers and insureds to choose other, more highly rated competitors. A downgrade of this rating could also increase the cost or reduce the availability of reinsurance to us.

In addition, in view of the earnings and capital pressures recently experienced by many financial institutions, including insurance companies, it is possible that rating organizations will heighten the level of scrutiny that they apply to such institutions and may increase the capital and other requirements employed in the rating organizations' models for maintenance of certain ratings levels. It is possible that such reviews of us may result in adverse ratings consequences, which could have a material adverse effect on our financial condition and results of operations. A downgrade or withdrawal of any rating could severely limit or prevent us from writing new and renewal insurance contracts.

We distribute our insurance products through a select group of agents, several of which account for a significant portion of our business, and there can be no assurance that such relationships will continue, or if they do continue, that the relationship will be on favorable terms to us. In addition, reliance on agents subjects us to their credit risk.

Our distribution model depends almost entirely on the agencies that distribute our products. In 2018, our top six independent agencies accounted for approximately 32% of our gross written premiums in our commercial lines, and our top four independent agencies, accounted for approximately 40% of our gross written premiums in our personal lines. We cannot assure you that these relationships, or our relationships with any of our agencies will continue. Even if the relationships do continue, they may not be on terms that are profitable for us. The termination of a relationship with one or more significant agents could result in lower direct written premiums and could have a material adverse effect on our results of operations or business prospects.

Certain premiums from policyholders, where the business is produced by agents, are collected directly by the agents and forwarded to our Insurance Company Subsidiaries. In certain jurisdictions, when the insured pays its policy premium to these agents for payment on behalf of our Insurance Company Subsidiaries, the premiums might be considered to have been paid under applicable insurance laws and regulations. Accordingly, the insured would no longer be liable to us for those amounts, whether or not we have actually received the premiums from that agent. Consequently, we assume a degree of credit risk associated with agents. There may be instances where agents collect premiums but do not remit them to us and we may be required under applicable law to provide the coverage set forth in the policy despite the absence of premiums. If we are unable to collect premiums from agents in the future, underwriting profits may decline and our financial condition and results of operations could be materially and adversely affected.

The property and casualty insurance business is historically cyclical in nature, and we may experience periods with excess underwriting capacity and unfavorable premium rates, which could adversely affect our business.

Historically, insurers have experienced significant fluctuations in operating results due to competition, frequency and severity of catastrophic events, levels of capacity, adverse litigation trends, regulatory constraints, general economic conditions and other factors. The supply of insurance is related to prevailing prices, the level of insured losses and the level of capital available to the industry that, in turn, may fluctuate in response to changes in rates of return on investments being earned in the insurance industry. As a result, the insurance business historically has been a cyclical industry characterized by periods of intense price competition due to excessive underwriting capacity as well as periods when shortages of capacity increased premium levels. Demand for insurance depends on numerous factors, including the frequency and severity of catastrophic events, levels of capacity, the introduction of new capital providers, and general economic conditions. All of these factors fluctuate and may contribute to price declines generally in the insurance industry.

We cannot predict with certainty whether market conditions will improve, remain constant or deteriorate. Negative market conditions may impair our ability to underwrite insurance at rates we consider appropriate and commensurate relative to the risk assumed. If we cannot underwrite insurance at appropriate rates, our ability to transact business will be materially and adversely affected. Any of these factors could lead to an adverse effect on our business, financial

condition and results of operations.

Adverse economic factors, including recession, inflation, periods of high unemployment or lower economic activity could result in the sale of fewer policies than expected or an increase infrequency or severity of claims and premium defaults or both, which, in turn, could affect our growth and profitability.

Factors, such as business revenue, economic conditions, the volatility and strength of the capital markets and inflation can all affect the business and economic environment in which we operate. These same factors affect our ability to generate revenue and profits. In an economic downturn that is characterized by higher unemployment, declining spending and reduced corporate revenues, the demand for insurance products is adversely affected, which directly affects our premium levels and profitability. Negative economic factors may also affect our ability to receive the appropriate rate for the risk we insure with our policyholders and may adversely affect the number of policies we can write, including with respect to our opportunities to underwrite profitable business. In an economic downturn, our customers may have less need for insurance coverage, cancel existing insurance policies, modify their coverage or not renew with us. Existing policyholders may exaggerate or even falsify claims to obtain higher claims payments. These outcomes would reduce our underwriting profit to the extent these factors are not reflected in the rates we charge.

We are subject to extensive regulation, which may adversely affect our ability to achieve our business objectives. In addition, if we fail to comply with these regulations, we may be subject to penalties, including fines and suspensions, which may adversely affect our financial condition and results of operations.

As a holding company which owns insurance companies domiciled in the United States, we and our admitted Insurance Company Subsidiaries are subject to extensive regulation, primarily by Michigan (the domiciliary state for CIC and WPIC) and to a lesser degree, the other jurisdictions in which we operate. Most insurance regulations are designed to protect the interests of insurance policyholders, as opposed to the interests of shareholders. These regulations generally are administered by a department of insurance in each state and relate to, among other things, authorizations to write certain lines of business, capital and surplus requirements, reserve requirements, rate and form approvals, investment and underwriting limitations, affiliate transactions, dividend limitations, cancellation and non renewal of policies, changes in control, solvency and a variety of other financial and non financial aspects of our business. These laws and regulations are regularly re examined and any changes in these laws and regulations or new laws may be more restrictive, could make it more expensive to conduct business or otherwise adversely affect our operations. State insurance departments also conduct periodic examinations of the affairs of insurance companies and require the filing of annual and other reports relating to financial condition, holding company issues and other matters. These regulatory requirements may impose timing and expense or other constraints that could adversely affect our ability to achieve some or all of our business objectives.

In addition, regulatory authorities have broad discretion to deny or revoke licenses for various reasons, including the violation of regulations. In some instances, where there is uncertainty as to applicability, we follow practices based on our interpretations of regulations or practices that we believe are generally followed by the industry. These practices may turn out to be different from the interpretations of regulatory authorities. If we do not have the requisite licenses and approvals or do not comply with applicable regulatory requirements, insurance regulatory authorities could preclude or temporarily suspend us from carrying on some or all of our activities or otherwise penalize us. This could adversely affect our ability to operate our business.

The admitted market is subject to more state regulation than the E&S market, particularly with regard to rate and form filing requirements, restrictions on the ability to exit lines of business, premium tax payments and membership in various state associations, such as guaranty associations. Some states have deregulated their commercial insurance markets. We cannot predict the effect that further deregulation would have on our business, financial condition or results of operations.

The NAIC has developed a system to test the adequacy of statutory capital of U.S. based insurers, known as Risk-Based Capital ("RBC"), that many states have adopted. This system establishes the minimum amount of RBC necessary for a company to support its overall business operations. It identifies property casualty insurers that may be inadequately capitalized by looking at certain inherent risks of each insurer’s assets and liabilities and its mix of premiums. Insurers falling below a calculated threshold may be subject to varying degrees of regulatory action, including supervision, rehabilitation or liquidation. Failure to maintain adequate risk based capital at the required levels could adversely affect the ability of our Insurance Company Subsidiaries to maintain regulatory authority to conduct their business.

In addition, the various state insurance regulators have increased their focus on risks within an insurer’s holding company system that may pose enterprise risk to the insurer. In 2012, the NAIC adopted significant changes to the insurance holding company act and regulations (the “NAIC Amendments”). The NAIC Amendments, when adopted by the various states, are designed to respond to perceived gaps in the regulation of insurance holding company systems in the United States. One of the major changes is a requirement that an insurance holding company system’s ultimate controlling person submit annually to its lead state insurance regulator an “enterprise risk report” that identifies activities, circumstances or

events involving one or more affiliates of an insurer that, if not remedied properly, are likely to have a material adverse effect upon the financial condition or liquidity of the insurer or its insurance holding company system as a whole. Other changes include requiring a controlling person to submit prior notice to its domiciliary insurance regulator of a divestiture of control, having detailed minimum requirements for cost sharing and management agreements between an insurer and its affiliates and expanding of the agreements between an insurer and its affiliates to be filed with its domiciliary insurance regulator. The NAIC Amendments must be adopted by the individual state legislatures and insurance regulators in order to be effective. Michigan (i.e., our main domiciliary state for both our CIC and WPIC subsidiaries), requires a form of the enterprise risk report.

In 2012, the NAIC also adopted the Risk Management and Own Risk and Solvency Assessment Model Act (the “ORSA Model Act”). The ORSA Model Act, when adopted by the various states, will require an insurance holding company system’s Chief Risk Officer to submit annually to its lead state insurance regulator an Own Risk and Solvency Assessment Summary Report (“ORSA”). The ORSA is a confidential internal assessment appropriate to the nature, scale and complexity of an insurer, conducted by that insurer of the material and relevant risks identified by the insurer associated with an insurer’s current business plan and the sufficiency of capital resources to support those risks. The ORSA Model Act must be adopted by the individual state legislature and insurance regulators in order to be effective. Michigan has adopted the ORSA Model Act. ORSA filings were required in Michigan starting in 2018. The Company is currently exempt from providing an ORSA summary report as it does not meet the minimum premium requirements.

We cannot predict the impact, if any, that the NAIC Amendments, compliance with the ORSA Model Act or any other regulatory requirements may have on our business, financial condition or results of operations.

We may become subject to additional government or market regulation which may have a material adverse impact on our business.

Market disruptions like those experienced during the credit driven financial market collapse in 2008, as well as the dramatic increase in the capital allocated to alternative asset management during recent years, have led to increased governmental as well as self regulatory scrutiny of the insurance industry in general. In addition, certain legislation proposing greater regulation of the industry is periodically considered by governing bodies of some jurisdictions, and the credit driven equity market collapse may increase the likelihood that some increased regulation of the industry is mandated.

Our business could be adversely affected by changes in state laws, including those relating to asset and reserve valuation requirements, surplus requirements, limitations on investments and dividends, enterprise risk and risk based capital requirements and, at the federal level, by laws and regulations that may affect certain aspects of the insurance industry, including proposals for preemptive federal regulation. The U.S. federal government generally has not directly regulated the insurance industry except for certain areas of the market, such as insurance for flood, nuclear and terrorism risks. However, the federal government has undertaken initiatives or considered legislation in several areas that may affect the insurance industry, including tort reform and corporate governance. The Dodd Frank Wall Street Reform and Consumer Protection Act (the “Dodd Frank Act”) also established the Federal Insurance Office, which is authorized to study, monitor and report to Congress on the insurance industry and to recommend that the Financial Stability Oversight Council (the “FSOC”) designate an insurer as an entity posing risks to U.S. financial stability in the event of the insurer’s material financial distress or failure. In December 2013, the Federal Insurance Office issued a report on alternatives to modernize and improve the system of insurance regulation in the United States, including increasing national uniformity through either a federal charter or effective action by the states. Any additional regulations established as a result of the Dodd Frank Act or actions in response to the Federal Insurance Office Report could increase our costs of compliance or lead to disciplinary action. In addition, legislation has been introduced from time to time that, if enacted, could result in the federal government assuming a more direct role in the regulation of the insurance industry, including federal licensing in addition to or in lieu of state licensing and reinsurance for natural catastrophes. We are unable to predict whether any legislation will be enacted or any regulations will be adopted, or the effect any such developments could have on our business, financial condition or results of operations.

It is impossible to predict what, if any, changes in the regulations applicable to us, the markets in which we operate, trade and invest or the counterparties with which we do business may be instituted in the future. Any such regulation

could have a material adverse impact on our business.

The effect of emerging claim and coverage issues on our business is uncertain.

As industry practices and legal, judicial, social and other environmental conditions change, unexpected and unintended issues related to claims and coverage may emerge. These issues may adversely affect our business by either broadening 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.

We may not be able to manage our growth effectively.
We intend to continue to grow our business, which could require additional capital, systems development and skilled personnel. We cannot assure you that we will be able to locate profitable business opportunities, meet our capital needs, expand our systems and our internal controls effectively, allocate our human resources optimally, identify qualified employees or agents or incorporate effectively the components of any businesses we may acquire in our effort to achieve growth. The failure to manage our growth effectively and maintain underwriting discipline could have a material adverse effect on our business, financial condition and results of operations.
We may be unable to obtain reinsurance coverage at reasonable prices or on terms that provide us adequate protection.
We purchase reinsurance in many of our lines of business to help manage our exposure to insurance risks that we underwrite and to reduce volatility in our results.
The availability and cost of reinsurance are subject to prevailing market conditions, both in terms of price and available capacity, each of which can affect our business volume and profitability. The availability of reasonably affordable reinsurance is a critical element of our business plan. One important way we utilize reinsurance is to reduce volatility in claims payments by limiting our exposure to losses from large risks. Another way we use reinsurance is to purchase substantial protection against concentrated losses when we enter new markets. As a result, our ability to manage volatility and avoid significant losses, expand into new markets or grow by offering insurance to new kinds of enterprises may be limited by the unavailability of reasonably priced reinsurance. We may not be able to obtain reinsurance on acceptable terms or from entities with satisfactory creditworthiness. In such event, if we are unwilling to accept the terms or credit risk of potential reinsurers, we would have to reduce the level of our underwriting commitments, which would reduce our revenues.
Many reinsurance companies have begun to exclude certain coverages from, or alter terms in, the reinsurance contracts we enter into with them. Some exclusions relate to risks that we cannot in turn exclude from the policies we write due to business or regulatory constraints. In addition, reinsurers are imposing terms, such as lower per occurrence and aggregate limits, on direct insurers that do not wholly cover the risks written by these direct insurers. As a result, we, like other direct insurance companies, write insurance policies which to some extent do not have the benefit of reinsurance protection. These gaps in reinsurance protection expose us to greater risk and greater potential losses. For example, certain reinsurers have excluded coverage for terrorist acts or priced such coverage at unreasonably high rates.
If we are unable to retain key management and employees or recruit other qualified personnel, we may be adversely affected.
We believe that our future success depends, in large part, on our ability to retain our experienced management team and key employees, particularly our chairman and chief executive officer, James G. Petcoff. There can be no assurance that we can attract and retain the necessary employees to conduct our business activities on a timely basis or at all. Our competitors may offer more favorable compensation arrangements to our key management or employees to incentivize them to leave our Company. Furthermore, our competitors may make it more difficult for us to hire their personnel by offering excessive compensation arrangements to certain employees to induce them not to leave their current employment and bringing litigation against employees who do leave (and possibly us as well) to join us. The loss of any of our executive officers or other key personnel, or our inability to recruit and retain additional qualified personnel as we grow, could materially and adversely affect our business and results of operations, and could prevent us from fully implementing our growth strategies.
We may require additional capital in the future, which may not be available or available only on unfavorable terms.
Our future capital requirements depend on many factors, including our ability to write new and renewal business successfully and to establish premium rates and reserves at levels sufficient to cover losses. Our ability to underwrite depends largely upon the expected quality of our claims paying process and our perceived financial strength as estimated by potential insureds, agents, brokers, other intermediaries and independent rating agencies. To the extent that our existing capital is insufficient to fund our future operating requirements, cover claim losses, or satisfy ratings agencies in order to maintain a satisfactory rating, we may need to raise additional capital in the future through offerings of debt or equity securities or otherwise to:

- Fund liquidity needs caused by underwriting or investment losses;
- Replace capital lost in the event of significant reinsurance losses or adverse reserve developments;

- Satisfy letters of credit or guarantee bond requirements that may be imposed by our clients or by regulators;
- Meet rating agency or regulatory capital requirements; or

- Respond to competitive pressures.

Any equity or debt financing, if available at all, may be on terms that are unfavorable to us. Further, any additional capital raised through the sale of equity could dilute your ownership interest in the Company and may cause the value of our shares to decline. Additional capital raised through the issuance of debt may result in creditors having rights, preferences and privileges senior or otherwise superior to those of the holders of our shares and may limit our flexibility in operating our business and make it more difficult to obtain capital in the future. Disruptions, uncertainty, or volatility in the capital and credit markets may also limit our access to capital required to operate our business. If we are not able to obtain adequate capital, our business, financial condition and results of operations could be materially adversely affected.

We are subject to credit risk with regard to our reinsurance counterparties.

Although reinsurance makes the assuming reinsurer liable to us to the extent of the risk ceded, we are not relieved of our primary liability to our insureds as the direct insurer. We cannot be sure that our reinsurers will pay all reinsurance claims on a timely basis or at all. For example, reinsurers may default in their financial obligations to us as the result of insolvency, lack of liquidity, operational failure, fraud, asserted defenses based on agreement wordings or the principle of utmost good faith, asserted deficiencies in the documentation of agreements or other reasons. The failure of a reinsurer to pay us does not lessen our contractual obligations to insureds. If a reinsurer fails to pay the expected portion of a claim or claims, our net losses might increase substantially and adversely affect our financial condition. Any disputes with reinsurers regarding coverage under reinsurance contracts could be time consuming, costly and uncertain of success.

Downgrades to the credit ratings of our reinsurance counterparties may result in the reduction of rating agency capital credit provided by those reinsurance contracts and could, therefore, result in a downgrade of our own credit ratings. We evaluate each reinsurance claim based on the facts of the case, historical experience with the reinsurer on similar claims and existing case law and include any amounts deemed uncollectible from the reinsurer in our reserve for uncollectible reinsurance.

Our Insurance Company Subsidiaries are subject to minimum capital and surplus requirements. Failure to meet these requirements could subject us to regulatory action.

Our Insurance Company Subsidiaries are subject to minimum capital and surplus requirements imposed under the laws of their respective states of domicile and each state in which they issue policies. As of December 31, 2018, our Insurance Company Subsidiaries were in compliance with all such reserves. Any failure by one of our Insurance Company Subsidiaries to meet minimum capital and surplus requirements imposed by applicable state law will subject it to corrective action. This may include requiring adoption of a comprehensive financial plan, revocation of its license to sell insurance products or placing the subsidiary under state regulatory control. A decline in the risk based capital ratios of our Insurance Company Subsidiaries could limit their ability to make a dividend to us and could be a factor in causing rating agencies to downgrade our ratings. Any new minimum capital and surplus requirements adopted in the future may require us to increase the capital and surplus of our Insurance Company Subsidiaries, which we may not be able to do.

Any debt service obligations will reduce the funds available for other business purposes, and the terms and covenants relating to our current and future indebtedness could adversely impact our financial performance and liquidity.

As of December 31, 2018, we had $25.3 million of senior unsecured notes (the “Notes”) outstanding, and $10.5 million of subordinated notes (the "Subordinated Notes") outstanding. We are subject to risks typically associated with debt financing, such as insufficient cash flow to meet required debt service payment obligations and the inability to refinance existing indebtedness.

The Subordinated Notes contain various restrictive covenants that relate to the Company’s tangible net worth, fixed-charge coverage ratios, dividend paying capacity, reinsurance retentions, and risk-based capital ratios. If we are unable to meet debt covenant requirements or to obtain future waivers regarding such failures, we could be in breach of our credit agreement. Any such breach could cause significant disruption to our operations, including a requirement to immediately repay our indebtedness, and would have severe adverse effects on our liquidity and financial flexibility.

The failure of any of the loss limitations or exclusions we employ, or changes in other claims or coverage issues, could have a material adverse effect on our financial condition or results of operations.

Although we seek to mitigate our loss exposure through a variety of methods, the future is inherently unpredictable. It is difficult to predict the timing, frequency and severity of losses with statistical certainty. It is not possible to completely eliminate our exposure to un forecasted or unpredictable events and, to the extent that losses from such risks occur, our financial condition and results of operations could be materially adversely affected.

For instance, various provisions of our policies, such as limitations or exclusions from coverage or choice of forum, 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 endorsements to our policies that limit exposure to known risks. 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 the underwriting intent or by increasing the size or number of claims.

In addition, we design our policy terms to manage our exposure to expanding theories of legal liability like those which have given rise to claims for lead paint, asbestos, mold, construction defects and environmental matters. Many of the policies we issue also include conditions requiring the prompt reporting of claims to us and entitle us to decline coverage in the event of a violation of that condition. Also, many of our policies limit the period during which a policyholder may bring a claim under the policy, which in many cases is shorter than the statutory period under which such claims can be brought against our policyholders. While these exclusions and limitations help us assess and reduce our loss exposure and help eliminate known exposures to certain risks, it is possible that a court or regulatory authority could nullify or void an exclusion or legislation could be enacted modifying or barring the use of such endorsements and limitations. These types of governmental actions could result in higher than anticipated losses and loss adjustment expenses, which could have a material adverse effect on our financial condition or results of operations. In some instances, these changes may not become apparent until sometime after we have issued insurance policies that are affected by the changes. As a result, the full extent of liability under our insurance contracts may not be known for many years after a contract is issued.

Increased information technology security threats and more sophisticated computer crimes pose a risk to our systems, networks, products and services.

Our business is dependent upon the uninterrupted functioning of our information technology and telecommunication systems. We rely upon our systems, as well as the systems of our vendors, to underwrite and process our business; make claim payments; provide customer service; provide policy administration services, such as endorsements, cancellations and premium collections; comply with insurance regulatory requirements; and perform actuarial and other analytical functions necessary for pricing and product development. We have established security policies, processes and layers of defense designed to help identify and protect against intentional and unintentional misappropriation or corruption of our systems and information and disruption of our operations. Our security measures are focused on the prevention, detection and remediation of damage from computer viruses, natural disasters, unauthorized access, cyber attack and other similar disruptions.

Despite these efforts, our systems may be damaged, disrupted, or shut down due to attacks by unauthorized access, malicious software, undetected intrusion, hardware failures, or other events, and in these circumstances our disaster recovery planning may be ineffective or inadequate. Information technology security threats from user error to cybersecurity attacks are increasing in frequency and sophistication. Cybersecurity attacks may range from random attempts to coordinated and targeted attacks, including sophisticated computer crime and advanced threats. These threats pose a risk to the security of our systems and networks and the confidentiality, availability and integrity of our data. The potential consequences of a material cybersecurity attack include reputational damage, litigation with third parties, and increased cybersecurity protection and remediation costs. A sustained business interruption or system failure could adversely impact our ability to process our business, provide customer service, pay claims in a timely manner or perform other necessary business functions. We could also be subject to fines and penalties from a security breach. The cost to remedy a severe breach could be substantial.

We rely on our systems and employees, and those of certain third party vendors and service providers in conducting our operations, and certain failures, including internal or external fraud, operational errors, or systems malfunctions, could materially adversely affect our operations.

We are exposed to many types of operational risk, including the risk of fraud by employees and outsiders, clerical and recordkeeping errors and computer or telecommunications systems malfunctions. Our business depends on our ability to process a large number of increasingly complex transactions. If any of our operational, accounting, or other data processing systems fail or have other significant shortcomings, we could be materially adversely affected. Similarly, we depend on our employees. We could be materially adversely affected if one or more of our employees cause a significant operational breakdown or failure, either as a result of human error or intentional sabotage or fraudulent

manipulation of our operations or systems.

Third parties with whom we do business, including vendors that provide services or security solutions for our operations, could also be sources of operational and information security risk to us, including from breakdowns, failures, or capacity constraints of their own systems or employees. Any of these occurrences could diminish our ability to operate our business, or cause financial loss, potential liability to insureds, inability to secure insurance, reputational damage or regulatory intervention, which could materially adversely affect us.

Our geographic concentration ties our performance to the business, economic, natural perils, man-made perils, and regulatory conditions within our most concentrated region.
Our revenues and profitability are subject to the prevailing regulatory, legal, economic, political, demographic, competitive, weather and other conditions in the principal states in which we do business. Changes in any of these conditions could make it less attractive for us to do business in such states and would have a more pronounced effect on us compared to companies that are more geographically diversified. In addition, our exposure to severe losses from localized perils, such as earthquakes, hurricanes, tropical storms, tornadoes, wind, ice storms, hail, fires, terrorism, riots and explosions, is increased in those areas where we have written significant numbers of insurance policies.
Litigation and legal proceedings against our subsidiaries could have a material adverse effect on our business, financial condition and/or results of operations.
As an insurance holding company, our subsidiaries are named as defendants in various legal actions in the ordinary course of business. We believe that the outcome of presently pending matters, individually and in the aggregate, will not have a material adverse effect on our consolidated financial position, operating results or liquidity. However, the outcomes of lawsuits cannot be predicted and, if determined adversely, could require us to pay significant damage amounts or to change aspects of our operations, which could have a material adverse effect on our financial results.
We are subject to assessments and other surcharges from state guaranty funds, and mandatory state insurance facilities, which may reduce our profitability.
Our Insurance Company Subsidiaries are subject to assessments in most states where we are licensed for the provision of funds necessary for the settlement of covered claims under certain policies provided by impaired, insolvent or failed insurance companies. These assessments, which are levied by guaranty associations within the state in proportion to premiums written by member insures in the lines of business in which the impaired, insolvent or failed insurer was engaged. Maximum contributions required by law in any one year vary by state, and have historically been less than one percent of annual premiums written. We cannot predict with certainty the amount of future assessments because they depend on factors outside our control, such as insolvencies of other insurance companies. Significant assessments could have a material adverse effect on our financial condition and results of operations.
Risks Related to Ownership of Our Common Stock
Our principal shareholders and management own a significant percentage of our stock and will be able to exert significant control over matters subject to shareholder approval.
As of December 31, 2018, our executive officers, directors, 5% shareholders and their affiliates owned approximately 50.7% of our voting stock. Therefore, these shareholders will have the ability to influence us through their ownership position. These shareholders may be able to significantly influence all matters requiring shareholder approval. For example, these shareholders may be able to significantly influence elections of directors, amendments of our organizational documents, or approval of any merger, sale of assets, or other major corporate transaction. This may prevent or discourage unsolicited acquisition proposals or offers for our common stock that you may feel are in your best interest as one of our shareholders.
We cannot assure you that we will declare or pay dividends on our common shares in the future so any returns may be limited to the value of our stock.
We currently anticipate that we will retain future earnings for the development, operation and expansion of our business and do not anticipate declaring or paying any cash dividends for the foreseeable future. Any return to shareholders will therefore be limited to appreciation in value of their stock, if any.
In addition, any determination to declare or pay future dividends to our shareholders will be at the discretion of our board of directors and will depend on a variety of factors, including (1) our financial condition, liquidity, results of operations (including our ability to generate cash flow in excess of expenses and our expected or actual net income), retained earnings and collateral and capital requirements, (2) general business conditions, (3) legal, tax and regulatory limitations, (4) contractual prohibitions and other restrictions, (5) the effect of a dividend or dividends upon our financial strength ratings and (6) any other factors that our board of directors deems relevant.
We incur significant increased costs as a result of operating as a public company, and our management will be required to devote substantial time to new compliance initiatives.
As a public company, we incur significant legal, accounting and other expenses that we did not incur as a private company. In addition, we are subject to the reporting requirements of the Exchange Act, which require, among other

things, that we file with the SEC, annual, quarterly and current reports with respect to our business and financial condition. We are

---

also subject to other reporting and corporate governance requirements, including certain requirements of Nasdaq and certain provisions of the Sarbanes Oxley Act and the regulations promulgated thereunder, which will impose significant compliance obligations upon us.

The Sarbanes Oxley Act and the Dodd Frank Act, as well as new rules subsequently implemented by the SEC and Nasdaq, have increased regulation of, and imposed enhanced disclosure and corporate governance requirements on, public companies. Our efforts to comply with these evolving laws, regulations and standards have increased our operating costs and may divert management's time and attention from revenue generating activities.

Other expenses associated with being a public company include increases in auditing, accounting and legal fees and expenses, investor relations expenses, increased directors' fees and director and officer liability insurance costs, registrar and transfer agent fees and listing fees, as well as other expenses.

Certain provisions of our corporate governance documents and Michigan law could discourage, delay or prevent a merger or acquisition at a premium price.

Our amended and restated articles of incorporation and bylaws will contain provisions that may make the acquisition of our Company more difficult without the approval of our board of directors (our "Board"). These include provisions that, among other things:

- Permit the Board to issue up to 10 million shares of preferred stock, with any rights, preferences and privileges as they may determine (including the right to approve an acquisition or other change in control);
- Provide that the authorized number of directors may be fixed only by the Board in accordance with our amended and restated bylaws;
- Do not provide for cumulative voting rights (therefore allowing the holders of a majority of the shares entitled to vote in any election of directors to elect all of the directors standing for election);
- Provide that all vacancies and newly created directorships may be filled by the affirmative vote of a majority of directors then in office, even if less than a quorum;
- Prohibit removal of directors without cause;
- Prohibit shareholders from calling special meetings of shareholders;
- Requires unanimous consent for shareholders to take action by written consent without approval of the action by our Board;
- Provide that shareholders seeking to present proposals before a meeting of shareholders or to nominate candidates for election as directors at a meeting of shareholders must provide advance notice in writing and also comply with specified requirements related to the form and content of a shareholder's notice;
- Require at least 80% supermajority shareholder approval to alter, amend or repeal certain provisions of our amended and restated articles of incorporation; and
- Require at least 80% supermajority shareholder approval in order for shareholders to adopt, amend or repeal our amended and restated bylaws.

These provisions may frustrate or prevent any attempts by our shareholders to replace or remove our current management by making it more difficult for shareholders to replace members of the Board of Directors, which is responsible for appointing members of our management.

In addition, the 2015 Omnibus Incentive Plan permits the Board or a committee thereof to accelerate, vest or cause the restrictions to lapse with respect to outstanding equity awards, in the event of, or immediately prior to, a change in control. Such vesting or acceleration could discourage the acquisition of our Company.

We could also become subject to certain anti takeover provisions under Michigan law which may discourage, delay or prevent someone from acquiring us or merging with us, whether or not an acquisition or merger is desired by or beneficial to our shareholders. If a corporation's board of directors chooses to "opt in" to certain provisions of Michigan Law, such corporation may not, in general, engage in a business combination with any beneficial owner, directly or indirectly, of 10% of the corporation's outstanding voting shares unless the holder has held the shares for five years or more or, among other things, the board of directors has approved the business combination. Our Board of Directors has not elected to be subject to this provision, but could do so in the future. Any provision of our amended and restated articles of incorporation or bylaws or Michigan law that has the effect of delaying or deterring a change in control could limit the opportunity for our shareholders

24

to receive a premium for their shares, and could also affect the price that some investors are willing to pay for our common stock otherwise.

Risks Related to Ownership of Our Publicly Traded Debt

There are limited covenants in the Indenture.

In addition to our currently outstanding indebtedness and other liabilities, the Indenture does not restrict us or our subsidiaries from incurring additional debt or other liabilities, including additional senior debt or secured debt under our secured credit facilities. If we incur additional debt or liabilities, our ability to pay the obligations on the Notes could be adversely affected.

Our indebtedness, including the indebtedness we or our subsidiaries may incur in the future, could have important consequences for the holders of the Notes, including:

- limiting our ability to satisfy our obligations with respect to the Notes;
- increasing our vulnerability to general adverse economic and industry conditions;
- limiting our ability to obtain additional financing to fund future working capital, capital expenditures, and other general corporate requirements;
- requiring a substantial portion of our cash flow from operations for the payment of principal of, and interest on, our indebtedness and thereby reducing our ability to use our cash flow to fund working capital, capital expenditures and general corporate requirements; and
- limiting our flexibility in planning for, or reacting to, changes in our business and the industry; and putting us at a disadvantage compared to competitors with less indebtedness.

In addition, we have limited restrictions under the Indenture from granting security interests in our assets, paying dividends or issuing or repurchasing securities.

Moreover, the Indenture does not require us to maintain any financial ratios or specific levels of net worth, revenues, income, cash flow or liquidity and, accordingly, does not protect holders of the Notes in the event that we experience material adverse changes in our financial condition or results of operations. Holders of the Notes have limited protection under the Indenture in the event of a highly leveraged transaction, reorganization, default under our existing indebtedness, restructuring, merger or similar transaction.

For these reasons, you should not consider the covenants in the Indenture a significant factor in evaluating whether to invest in the Notes.

The Notes will be structurally subordinated to the indebtedness and other liabilities of our subsidiaries.

The Notes are obligations exclusively of Conifer Holdings, Inc. and not of any of our subsidiaries. None of our subsidiaries is a guarantor of the Notes and the Notes are not required to be guaranteed by any subsidiary we may acquire or create in the future. Any assets of our subsidiaries will not be directly available to satisfy the claims of our creditors, including holders of the Notes. Except to the extent we are a creditor with recognized claims against our subsidiaries, all claims of creditors of our subsidiaries will have priority over our equity interests in such subsidiaries (and therefore the claims of our creditors, including holders of the Notes) with respect to the assets of such subsidiaries. Even if we are recognized as a creditor of one or more of our subsidiaries, our claims would still be effectively subordinated to any security interests in the assets of any such subsidiary and to any indebtedness or other liabilities of any such subsidiary senior to our claims. Consequently, the Notes will be structurally subordinated to all indebtedness and other liabilities of any of our subsidiaries and any subsidiaries that we may in the future acquire or establish. Our subsidiaries may incur substantial indebtedness in the future, all of which would be structurally senior to the Notes.

Servicing our indebtedness will require a significant amount of cash. Our ability to generate sufficient cash depends on many factors, some of which are not within our control.

Our ability to make payments on our indebtedness (including the Notes) will depend on our ability to generate cash in the future. To a certain extent, this is subject to general economic, financial, competitive, legislative, regulatory and other factors that are beyond our control. If we are unable to generate sufficient cash flow to service our debt and meet our other commitments, we may need to restructure or refinance all or a portion of our debt, sell material assets or operations or raise additional debt or equity capital. We may not be able to effect any of these actions on a timely basis, on commercially reasonable terms or at all, and these actions may not be sufficient to meet our capital requirements. In addition, the terms of our existing or future debt arrangements may restrict us from effecting any of

these alternatives.

Our ability to meet our obligations on our outstanding debt, including making principal and interest payments on the Notes and the Subordinated Notes, may be limited by our holding company structure and regulatory constraints restricting dividends or other distributions by our Insurance Company Subsidiaries.
We are a holding company that transacts the majority of our business through our Insurance Company Subsidiaries and, as a result, our principal sources of funds are dividends and other payments from our Insurance Company Subsidiaries, including intercompany service fees. Our ability to meet our obligations on our outstanding debt obligations, including making principal and interest payments on the Notes, depends on continuing to receive sufficient funds from our Insurance Company Subsidiaries. We have met, and expect to continue to meet our outstanding debt obligations, including making principal and interest payments on the Notes, primarily through intercompany service fees we receive. We also may use dividends paid to us by our Insurance Company Subsidiaries to meet part or all of our debt obligations, including making principal and interest payments on the Notes. State insurance laws, however, limit the ability of our Insurance Company Subsidiaries to pay dividends and require them to maintain specified minimum levels of statutory capital and surplus. The aggregate maximum amount of dividends permitted by law to be paid by an insurance company does not necessarily define an insurance company's actual ability to pay dividends. The actual ability to pay dividends may be further constrained by business and regulatory considerations, such as the impact of dividends on surplus, by our competitive position and by the amount of premiums that we can write. As a result, our ability to use dividends as a source of funds to meet part or all of our debt obligations, including making principal and interest payments on the Notes, may be significantly limited. Any significant reduction in the intercompany service fees we receive, and any regulatory and other limitations on the payment of dividends to us by our Insurance Company Subsidiaries, may adversely affect our ability to pay interest on the Notes as it comes due and the principal of the Notes at their maturity.
We may be able to incur substantially more debt.
Conifer may be able to incur substantial indebtedness in the future and such debt may be secured debt or debt of its subsidiaries. The terms of the Indenture governing the notes will not prohibit Conifer or its subsidiaries from incurring unsecured debt and the limitation on incurring secured debt is subject to important limitations, qualifications and exceptions. If Conifer incurs any secured debt (including secured revolving loans under our Senior Credit Facility) or any of its subsidiaries incur any debt, all such debt will be effectively senior to the Notes either to the extent of the value of the collateral securing such debt or structurally, and if Conifer incurs any additional indebtedness that ranks equally with the Notes, the holders of that debt will be entitled to share ratably with the holders of the Notes in any proceeds distributed in connection with any insolvency, liquidation, reorganization, dissolution or other winding up of Conifer. If new debt is added to Conifer's current debt levels, or Conifer's subsidiaries incur additional debt, the related risks Conifer faces will increase.
Although the Notes may be listed on the NASDAQ, an active trading market for the Notes may not develop, which could limit the market price of the Notes or your ability to sell them.
Although the Notes may be listed on the NASDAQ, we cannot provide any assurances that an active trading market will develop for the Notes or that you will be able to sell your Notes. If the Notes are traded after their initial issuance, they may trade at a discount from their initial offering price depending on prevailing interest rates, the market for similar securities, our credit ratings, general economic conditions, our financial condition, performance and prospects and other factors. The underwriters have advised us that they intend to make a market in the Notes, but they are not obligated to do so. The underwriters may discontinue any market-making in the Notes at any time at their sole discretion. Accordingly, we cannot assure you that a liquid trading market will develop for the Notes, that you will be able to sell your Notes at a particular time or that the price you receive when you sell will be favorable. To the extent an active trading market does not develop, the liquidity and trading price for the Notes may be harmed. Accordingly, you may be required to bear the financial risk of an investment in the Notes for an indefinite period of time.
No market currently exists for the Notes and an active trading market may not develop.
The Notes are a new issue of securities with no established trading market. We have applied for listing of the Notes on the Nasdaq Global Market, but no assurance can be given as to the approval of the Notes for listing or, if listed, the continued listing for the term of the Notes, or the liquidity or trading market for the Notes. There can be no assurance that a secondary market for the Notes will develop. We are not required to maintain a listing on the Nasdaq Global Market or any other exchange. Even if the listing of the Notes on the Nasdaq Global Market is approved, we cannot

assure you that a market will develop, or continue, or that you will be able to sell your Notes easily.
The liquidity of any market for the Notes will depend upon various factors, including:

- the number of holders of the Notes;
- the interest of securities dealers in making a market for the Notes;

- the overall market for debt securities;
- our financial performance and prospects; and
- the prospects for companies in our industry generally.

Accordingly, we cannot assure you that an active trading market will develop, or continue, for the Notes. If the Notes are traded after their initial issuance, they may trade at a discount from their initial offering price, depending upon prevailing interest rates and other factors, including those listed above.

Volatility in the market price and trading volume of our common stock could adversely impact the trading price of the Notes.

The stock market in recent years has experienced significant price and volume fluctuations that have often been unrelated to the operating performance of companies. In addition, the market price of our common stock historically has been volatile. The market price of our common stock could fluctuate significantly for many reasons, including in response to the risks described in this section or in our Annual Report on Form 10-K/A for the fiscal year ended December 31, 2017, or our subsequently filed quarterly reports on Form 10-Q or elsewhere in this prospectus for reasons unrelated to our operations, such as reports by industry analysts, investor perceptions or negative announcements by our customers, competitors or suppliers regarding their own performance, as well as industry conditions and general financial, economic and political instability. A decrease in the market price of our common stock would likely adversely impact the trading price of the Notes. The market price of our common stock could also be affected by possible sales of our common stock by investors who view the Notes as a more attractive means of equity participation in us and by hedging or arbitrage trading activity that may develop involving our common stock. This trading activity could, in turn, affect the trading price of the Notes. This volatility in the market price of our common stock may affect the price at which you could sell the shares of our common stock you receive upon conversion of your Notes, if any, and the sale of substantial amounts of our common stock could adversely affect the price of our common stock and the value of your Notes.

If we default on our obligations to pay our other indebtedness, we may not be able to make payments on the Notes.

Any default under the agreements governing our indebtedness, including other indebtedness to which we may be a party that is not waived by the required lenders, and the remedies sought by the holders of such indebtedness could make us unable to pay principal, premium, if any, and interest on the Notes and substantially decrease the market value of the Notes. If we are unable to generate sufficient cash flow and are otherwise unable to obtain funds necessary to meet required payments of principal, premium, if any, and interest on our indebtedness, or if we otherwise fail to comply with the various covenants, including financial and operating covenants, in the instruments governing our indebtedness, we could be in default under the terms of the agreements governing such indebtedness. In the event of such default, the holders of such indebtedness could elect to declare all the funds borrowed thereunder to be due and payable, together with accrued and unpaid interest, the lenders under any other debt we may incur in the future could elect to terminate their commitments, cease making further loans and institute foreclosure proceedings against our assets, and we could be forced into bankruptcy or liquidation. If our operating performance declines, we may in the future need to seek to obtain waivers from the required lenders under other debt that we may incur in the future to avoid being in default. If we breach our covenants under other debt and seek a waiver, we may not be able to obtain a waiver from the required lenders. If this occurs, we would be in default under other debt, the lenders could exercise their rights as described above, and we could be forced into bankruptcy or liquidation. If we are unable to repay debt, lenders having secured obligations could proceed against the collateral securing the debt.

The price at which holders will be able to sell their Notes prior to maturity will depend on a number of factors and may be substantially less than the amount originally invested.

We believe that the value of the Notes in any secondary market will be affected by the supply and demand of the Notes, the interest rate, their ranking and a number of other factors. The following factors, among others, may have an impact on the market value of the Notes:

- United States interest rates. We expect that the market value of the Notes will be affected by actual or anticipated changes in interest rates in the United States. In general, if U.S. interest rates increase, the market value of the Notes may decrease.
- Our credit ratings, financial condition and results. Actual or anticipated changes in our A.M. Best ratings, other credit ratings, financial condition or results of operations may affect the market value of the Notes.

- Our other existing and future liabilities. Existing and any future indebtedness and other obligations of our, or of our subsidiaries, may affect the market value of the Notes.
- General economic conditions. General economic conditions may affect the market value of the Notes.
- Market for similar securities. The market for similar securities may affect the market value of the Notes.

Some of these factors are interrelated in complex ways. As a result, the effect of any one factor, such as an increase in United States interest rates, may be offset or magnified by the effect of one or more other factors.

We may redeem the Notes before maturity, and holders of the redeemed Notes may be unable to reinvest the proceeds at the same or a higher rate of return.

We may redeem all or a portion of the Notes. If redemption does occur, holders of the redeemed Notes may be unable to reinvest the money received in the redemption at a rate that is equal to or higher than the rate of return on the Notes.

ITEM 1B. UNRESOLVED STAFF COMMENTS
None.

ITEM 2. PROPERTIES
We lease office space in Birmingham, Michigan, where our principal executive office is located. We also lease offices in Southfield, Michigan; Jacksonville, Orlando and Miami, Florida; Somerset, Pennsylvania; and Brentwood, Tennessee. We believe that our facilities are adequate for our current needs and that suitable additional or substitute space will be available as needed.

ITEM 3. LEGAL PROCEEDINGS
We are party to legal proceedings which arise in the ordinary course of business. We believe that the outcome of such matters, individually and in the aggregate, will not have a material adverse effect on our consolidated financial position, operating results or liquidity.

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.

Shareholder Information

Corporate Headquarters	Transfer Agent & Registrar
550 W. Merrill Street	American Stock Transfer & Trust Co, LLC
Birmingham, MI 48009	6201 15th Avenue
Phone: (248) 559-0840	Brooklyn, NY 11219

Corporate Counsel
Honigman Miller Schwartz and Cohn, LLP
600 Woodward Avenue
2290 First National Building
Detroit, MI 48226-3506

Shareholder Relations and Form 10-K

A copy of our 2018 Annual Report and Form 10-K, as filed with the Securities and Exchange Commission, may be obtained upon written request to our Financial Reporting Department at our corporate headquarters at ir@cnfrh.com.

Share Price and Dividend Information

Our common stock is traded on the Nasdaq under the symbol “CNFR.” The following table sets forth the high and low sale prices of our common shares as reported by the Nasdaq for each period shown:

	High	Low
2018		
First Quarter	6.85	5.15
Second Quarter	6.40	5.60
Third Quarter	7.20	5.60
Fourth Quarter	5.90	3.06
2017		
First Quarter	7.75	6.55
Second Quarter	8.05	6.75
Third Quarter	7.30	6.05
Fourth Quarter	7.15	5.55

Neither Michigan law nor our amended and restated articles of incorporation requires our board of directors to declare dividends on our common stock. Conifer Holdings, Inc. is a holding company that has no substantial revenues of its own, and relies primarily on intercompany service fees, cash dividends or distributions from its subsidiaries to pay operating expenses, service debts, and pay dividends to shareholders. The payment of dividends by the Insurance Company Subsidiaries is limited under the laws and regulations of their respective state of domicile. These regulations stipulate the maximum amount of annual dividends or other distributions available to shareholders without prior approval of the relevant regulatory authorities. Any future determination to declare cash dividends on our common stock will be made at the discretion of the board of directors and will depend on the financial condition, results of operations, capital requirements, general business conditions and other factors that the board of directors may deem relevant. The Parent Company has not historically paid dividends and does not anticipate paying cash dividends on its common stock for the foreseeable future.

For additional information regarding dividend restrictions, refer to the Liquidity and Capital Resources section of Management's Discussion and Analysis.

Shareholders of Record

As of March 13, 2019, there were 30 shareholders of record of our common stock. A substantially greater number of holders are beneficial owners whose shares are held of record by banks, brokers and other nominees.

Repurchases of Company's Stock

On December 5, 2018, the Company's Board of Directors authorized a stock repurchase program, under which the Company may repurchase up to one million shares of the Company's common stock. Shares may be purchased in the open market or through negotiated transactions. The program may be terminated or suspended at any time, at the discretion of the Company. The Company may in the future enter into a Rule 10b5-1 trading plan to effect a portion of the authorized purchases, if criteria set forth in the plan are met. Such a plan would enable the Company to repurchase its shares during periods outside of its normal trading windows, when the Company typically would not be active in the market. The timing of purchases, and the exact number of any shares to be purchased, will depend on market conditions. The repurchase program does not include specific price targets or timetables. For the year ended December 31, 2018, the Company had repurchased 129,175 shares of stock valued at approximately $584,000. Upon the repurchase of the Company's shares, the shares remain authorized, but not issued or outstanding.

On February 25, 2016, the Company's Board of Directors authorized a stock repurchase program, under which the Company may repurchase up to $2.1 million of its outstanding common stock. Under this program, management was authorized to repurchase shares at prevailing market prices through open market purchases, privately negotiated transactions, block purchases or otherwise in accordance with applicable federal securities laws, including Rule 10b5-1 and 10b-18 of the Securities Exchange Act of 1934, as amended. The actual timing, number and value of shares repurchased under the program was determined by management in its discretion and depended on a number of factors, including the market price of the Company's stock, general market conditions, and other factors. The Company did not repurchase any of its outstanding common stock during 2017.

Recent Sales of Unregistered Securities

In the past three years, we have sold and issued the following unregistered securities:

On September 27, 2017, the Company's Board of Directors authorized a private placement stock purchase offering wherein the Company was authorized to sell a maximum of $7.0 million of the Company's common stock, no par value per share, pursuant to Section 4(a)(2) of the Securities Act of 1933, as amended, and Rule 506(b) of Regulation D as promulgated under the Securities Act and in accordance with applicable federal securities laws, including Rule 10b5-1 and 10b-18 of the Securities Exchange Act of 1934 as amended. The participants in the private placement consisted mainly of members of the Company's management team and Board of Directors, including the Company's Chairman and CEO, James Petcoff.

Under this private placement offering, the Company issued $5.0 million of common equity consisting of 800,000 shares at the price of $6.25 per share on September 28, 2017. The Company's common stock closing market price on the Nasdaq Stock Market on September 28, 2017, was $6.05 per share. The offering was made to accredited investors only. No commissions or other remuneration were paid in connection with the issuance. The actual timing, number and value of shares to be issued under the private placement offering was determined by management in its discretion and depended on a number of factors, including the market price of the Company's stock, general marketing conditions, and other factors. The Company used the proceeds from the issuance to strengthen its balance sheet through contributions to the Insurance Company Subsidiaries to support future growth, as well as to cover the cost of the ADC and reserve strengthening.

No underwriters were involved in the foregoing sales of securities. The issuances of the securities described above were deemed to be exempt from registration under the Securities Act in reliance on Section 4(2) of the Securities Act as transactions by an issuer not involving a public offering.

ITEM 6. SELECTED CONSOLIDATED FINANCIAL DATA

The following tables set forth selected consolidated historical financial information of Conifer Holdings, Inc. and Subsidiaries as of the dates and for the periods indicated. The selected financial data for the years ended December 31, 2018, 2017, 2016, 2015 and 2014 were derived from our audited consolidated financial statements and related notes thereto.

These historical results are not necessarily indicative of results to be expected for any future period. The following financial information should be read in conjunction with "Management's Discussion and Analysis of Financial Condition and Results of Operations" and our consolidated financial statements and the related notes thereto included elsewhere in this report (dollars in thousands, except for per share data).

	Year Ended December 31,				
	2018	2017	2016	2015	2014
Operating Results:					
Gross written premiums	$104,368	$114,284	$114,923	$93,750	$83,847
Ceded written premiums	(15,282)	(23,044)	(14,994)	(14,076)	(17,548)
Net written premiums	$89,086	$91,240	$99,929	$79,674	$66,299
Net earned premiums	$93,811	$91,729	$89,627	$66,765	$57,528
Net investment income	3,336	2,728	2,173	1,902	1,175
Net realized investment gains	61	70	1,365	285	417
Change in fair value of equity securities	121	—	—	—	—
Other gains (losses) (1)	—	750	(400)	104	—
Other income	1,582	1,560	1,118	1,667	1,809
Total revenue	98,911	96,837	93,883	70,723	60,929
Losses and loss adjustment expenses, net	62,515	73,917	59,003	38,882	40,730
Policy acquisition costs	25,534	26,245	25,280	16,183	14,696
Operating expenses	17,683	17,367	17,596	14,806	12,139
Interest expense	2,644	1,362	647	769	584
Total expenses	108,376	118,891	102,526	70,640	68,149
Income (loss) before income taxes	(9,465)	(22,054)	(8,643)	83	(7,220)
Income tax expense (benefit)	52	(447)	(77)	48	(281)
Equity earnings (losses) in affiliates, net of tax	290	65	129	(52)	—
Net income (loss)	(9,227)	(21,542)	(8,437)	(17)	(6,939)
Less net income (loss) attributable to non-controlling interest	—	—	—	(81)	(4)
Net income (loss) attributable to Conifer	$(9,227)	$(21,542)	$(8,437)	$64	$(6,935)
Net income (loss) allocable to common shareholders	$(9,227)	$(21,542)	$(8,437)	$(476)	$(7,200)
Net income (loss) per share allocable to common shareholders, basic and diluted	$(1.08)	$(2.74)	$(1.11)	$(0.09)	$(2.69)
Weighted average common shares outstanding, basic and diluted	8,543,876	7,867,344	7,618,588	5,369,960	2,672,440

32

	Year Ended December 31,				
	2018	2017	2016	2015	2014
Balance Sheet Data:					
Cash and invested assets	$150,894	$169,518	$141,023	$130,427	$123,726
Reinsurance recoverables	34,745	24,539	7,498	7,044	5,139
Total assets	232,752	239,032	203,701	177,927	163,738
Unpaid losses and loss adjustment expenses	92,807	87,896	54,651	35,422	31,531
Unearned premiums	52,852	57,672	58,126	47,916	43,381
Debt	33,502	29,027	17,750	12,750	27,562
Total liabilities	190,589	186,206	135,907	100,665	113,460
Preferred stock (2)	—	—	—	—	6,119
Total shareholders' equity attributable to Conifer	42,163	52,826	67,794	77,262	44,182
Other Data:					
Shareholders' equity per common share outstanding	$4.97	$6.20	$8.88	$10.11	$11.06
Regulatory capital and surplus (3)	63,993	62,451	62,189	71,153	65,974

	Year Ended December 31,				
	2018	2017	2016	2015	2014
Underwriting Ratios:					
Loss ratio	65.5 %	79.2 %	65.0 %	56.8 %	68.6 %
Expense ratio	45.3 %	46.8 %	47.2 %	45.3 %	45.2 %
Combined ratio	110.8%	126.0%	112.2%	102.1%	113.8%

(1) In 2017, the Company recognized a $750,000 gain on the sale of the renewal rights of a portion of the low value dwelling book of business to another insurer. In 2016, as a result of the merger of ACIC into WPIC, the value of intangible assets recorded for insurance licenses on ACIC were written off resulting in a loss. In 2015, the Company recognized a gain as a result of the deconsolidation of an affiliate.

(2) In March 2015, the Company reclassified the then carrying amount of its preferred stock of $6,180 from temporary equity to permanent equity as the redemption of the preferred stock became within the Company's control as a result of the amendments to the preferred stock designations.

(3) For our Insurance Company Subsidiaries, the excess of assets over liabilities are determined in accordance with statutory accounting principles as determined by the domiciliary state for each Insurance Company Subsidiary. In 2018, CIC issued a surplus note to WPIC for $10.0 million. The regulatory capital and surplus balance as of year ended December 31, 2018 eliminates the $10.0 million surplus note from the consolidated balance.

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

The following Management’s Discussion and Analysis of financial condition and results of operations should be read in conjunction with the Consolidated Financial Statements, related notes and other financial information appearing elsewhere in this Annual Report on Form 10-K, filed with the U. S. Securities and Exchange Commission (“SEC”).

Forward-Looking Statements

Certain statements contained in this Annual Report on Form 10-K, which are not statements of historical fact, are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, as Section 21E of the Securities Exchange Act of 1934, as amended. Forward-looking statements give current expectations or forecasts of future events or our future financial or operating performance. Words such as “anticipate,” “believe,” “estimate,” “expect,” "will," “intend,” “may,” “plan,” “seek” and similar terms and phrases, or the negative thereof, may be used to identify forward-looking statements.

The forward-looking statements contained in this report are based on management’s good-faith belief and reasonable judgment based on current information. The forward-looking statements are qualified by important factors, risks and uncertainties, many of which are beyond our control, which could cause our actual results to differ materially from those in the forward-looking statements, including those described above in Item 1A Risk Factors and subsequent reports filed with or furnished to the SEC. Any forward-looking statement made by us in this report speaks only as of the date hereof or as of the date specified herein. We undertake no obligation to publicly update any forward-looking statement, whether as a result of new information, future developments or otherwise, except as may be required by any applicable laws or regulations.

Business Overview

We are an insurance holding company that markets and services our product offerings through specialty commercial and specialty personal insurance business lines. Our growth has been significant since our founding in 2009. Currently, we are authorized to write insurance as an excess and surplus lines carrier in 45 states, including the District of Columbia. We are licensed to write insurance in 42 states, including the District of Columbia, as an admitted carrier and we offer our insurance products in all 50 states.

Our revenues are primarily derived from premiums earned from our insurance operations. We also generate other revenues through investment income and other income which mainly consists of: installment fees and policy issuance fees generally related to the policies we write and commission income from SIA's 50% owned agency (the "Affiliate"). The Affiliate places small commercial risks mainly for alarm and security guard markets.

Our expenses consist primarily of losses and loss adjustment expenses, agents’ commissions, and other underwriting and administrative expenses. We organize our operations in two insurance businesses: commercial insurance lines and personal insurance lines.

Through our commercial insurance lines, we offer coverage for both commercial property and commercial liability. We also offer coverage for commercial automobiles and workers’ compensation. Our insurance policies are sold to targeted small and mid-sized businesses on a single or multiple-coverage basis.

Through our personal insurance lines, we offer homeowners insurance and dwelling fire insurance products to individuals in several states. Our specialty homeowners insurance line is primarily comprised of either wind-exposed homeowners insurance providing hurricane and wind coverage to underserved homeowners in Texas, Hawaii and Florida or low-value dwelling insurance tailored for owners of lower valued homes, which we offer in Illinois, Indiana, Louisiana and Texas. Due to certain Florida-based industry events, we have deemphasized our Florida homeowners business and other wind-exposed business in Texas and Hawaii. We plan to continue to shift focus to low-value dwelling lines of business in order to bring personal lines premium levels back up and to maintain a strategic balance of commercial and personal lines of business.

Critical Accounting Policies and Estimates

General

We identified the accounting estimates below as critical to the understanding of our financial position and results of operations. Critical accounting estimates are defined as those estimates that are both important to the portrayal of our financial condition and results of operations and which require us to exercise significant judgment. We use significant judgment concerning future results and developments in applying these critical accounting estimates and in preparing our consolidated financial statements. These judgments and estimates affect the reported amounts of assets, liabilities, revenues and expenses and the disclosure of material contingent assets and liabilities. Actual results may differ materially from the estimates and assumptions used in preparing the consolidated financial statements. We evaluate our estimates regularly using information that we believe to be relevant. See the Consolidated Financial Statements Note 1 – Summary of Significant Accounting Policies, for further details.

Loss and Loss Adjustment Expense Reserves

Our recorded loss and loss adjustment expenses ("LAE") reserves represent management's best estimate of unpaid loss and LAE at each balance sheet date, based on information, facts and circumstances known at such time. Our loss and LAE reserves reflect our estimates at the balance sheet date of:

- Case reserves, which are unpaid loss and LAE amounts that have been reported; and
- Incurred but not reported ("IBNR") reserves, which are (1) unpaid loss and LAE amounts that have been incurred but not yet reported; and (2) the expected development on case reserves.

We do not discount the loss and LAE reserves for the time value of money.

Case reserves are initially set by our claims personnel. When a claim is reported to us, our claims department completes a case basis valuation and establishes a case reserve for the estimated amount of the probable ultimate losses and LAE associated with that claim. Our claims department updates their case basis valuations upon receipt of additional information and reduces case reserves as claims are paid. The case reserve is based primarily upon an evaluation of the following factors:

- The type of loss;
- The severity of injury or damage;
- Our knowledge of the circumstances surrounding the claim;
- The jurisdiction of the occurrence;
- Policy provisions related to the claim;
- Expenses intended to cover the ultimate cost of settling claims, including investigation and defense of lawsuits resulting from such claims, costs of outside adjusters and experts, and all other expenses which are identified to the case; and
- Any other information considered pertinent to estimating the indemnity and expense exposure presented by the claim.

IBNR reserves are determined by subtracting case reserves and paid loss and LAE from the estimated ultimate loss and LAE. Our actuarial department develops estimated ultimate loss and LAE on a quarterly basis. Our Reserve Review Committee (which includes our Chief Executive Officer, President, Chief Financial Officer, other members of executive management, and key actuarial, underwriting and claims personnel) meets each quarter to review our actuaries' estimated ultimate expected loss and LAE.

We use several generally accepted actuarial methods to develop estimated ultimate loss and LAE estimates by line of business and accident year. This process relies on the basic assumption that past experience, adjusted for the effects of current developments and likely trends, is a reasonable basis for predicting future outcomes. These methods utilize various inputs, including:

- Written and earned premiums;
- Paid and reported losses and LAE;
- Expected initial loss and LAE ratio, which is the ratio of incurred losses and LAE to earned premiums; and

- Expected claim reporting and payout patterns based on our own loss experience and supplemented with insurance industry data where applicable.

The principal standard actuarial methods used by our actuaries for their comprehensive reviews include:

- Loss ratio method—This method uses loss and LAE ratios for prior accident years, adjusted for current trends, to determine an appropriate expected loss and LAE ratio for a given accident year;
- Loss development methods—Loss development methods assume that the losses and LAE yet to emerge for an accident year are proportional to the paid or reported loss and LAE amounts observed to date. The paid loss development method uses losses and LAE paid to date, while the reported loss development method uses losses and LAE reported to date;
- Bornheutter Ferguson method—This method is a combination of the loss ratio and loss development methods, where the loss development factor is given more weight as an accident year matures; and
- Frequency/severity method—This method projects claim counts and average cost per claim on a paid or reported basis for high frequency, low severity products.

Our actuaries give different weights to each of these methods based upon the amount of historical experience data by line of business and by accident year, and based on judgment as to what method is believed to result in the most accurate estimate. The application of each method by line of business and by accident year may change in the future if it is determined that a different emphasis for each method would result in more accurate estimates.

Our actuaries also analyze several diagnostic measures by line of business and accident year, including but not limited to: reported and closed frequency and severity, claim reporting and claim closing patterns, paid and incurred loss ratio development, and ratios of paid loss and LAE to incurred loss and LAE. After the actuarial methods and diagnostic measures have been performed and analyzed, our actuaries use their judgment and expertise to select an estimated ultimate loss and LAE by line of business and by accident year.

Our actuaries estimate an IBNR reserve for our unallocated LAE not specifically identified to a particular claim, namely our internal claims department salaries and associated general overhead and administrative expenses associated with the adjustment and processing of claims. These estimates, which are referred to as unallocated loss adjustment expense ("ULAE") reserves, are based on internal cost studies and analyses reflecting the relationship of ULAE paid to actual paid and incurred losses. We select factors that are applied to case reserves and IBNR reserve estimates in order to estimate the amount of ULAE reserves applicable to estimated loss reserves at the balance sheet date.

We allocate the applicable portion of our estimated loss and LAE reserves to amounts recoverable from reinsurers under reinsurance contracts and report those amounts separately from our loss and LAE reserves as an asset on our balance sheet.

The estimation of ultimate liability for losses and LAE is a complex, imprecise and inherently uncertain process, and therefore involves a considerable degree of judgment and expertise. Our loss and LAE reserves do not represent an exact measurement of liability, but are estimates based upon various factors, including but not limited to:

- Actuarial projections of what we, at a given time, expect to be the cost of the ultimate settlement and administration of claims reflecting facts and circumstances then known;
- Estimates of future trends in claims severity and frequency;
- Assessment of asserted theories of liability; and
- Analysis of other factors, such as variables in claims handling procedures, economic factors, and judicial and legislative trends and actions.

Most or all of these factors are not directly or precisely quantifiable, particularly on a prospective basis, and are subject to a significant degree of variability over time. In addition, the establishment of loss and LAE reserves makes no provision for the broadening of coverage by legislative action or judicial interpretation or for the extraordinary future emergence of new types of losses not sufficiently represented in our historical experience or which cannot yet be quantified. As a result, an integral component of our loss and LAE reserving process is the use of informed subjective estimates and judgments about our ultimate exposure to losses and LAE. Accordingly, the ultimate liability may vary significantly from the current estimate. The effects of change in the estimated loss and LAE reserves are included in the results of operations in the period in which the estimate is revised.

Our reserves consist entirely of reserves for property and liability losses, consistent with the coverages provided for in the insurance policies directly written or assumed by us under reinsurance contracts. Occasionally, several years may elapse

---

between the occurrence of an insured loss, the reporting of the loss to us and our payment of the loss. The level of IBNR reserves in relation to total reserves depends upon the characteristics of the specific line of business, particularly related to the speed with which claims are reported and outstanding claims are paid. Lines of business for which claims are reported slowly will have a higher percentage of IBNR reserves than lines of business that report and settle claims more quickly.

The following table shows the ratio of IBNR reserves to total reserves net of reinsurance recoverables as of December 31, 2018 (dollars in thousands):

Line of Business	Case Reserves	IBNR Reserves	Total Reserves	Ratio of IBNR to Total Reserves
Commercial Lines	$25,513	$35,211	$60,724	58.0 %
Personal Lines	1,615	783	2,398	32.7 %
Total Lines	$27,128	$35,994	$63,122	57.0 %

Although we believe that our reserve estimates are reasonable, it is possible that our actual loss and LAE experience may not conform to our assumptions and may, in fact, vary significantly from our assumptions. Accordingly, the ultimate settlement of losses and the related LAE may vary significantly from the estimates included in our financial statements. We continually review our estimates and adjust them as we believe appropriate as our experience develops or new information becomes known to us. Such adjustments are included in current operations.

Our loss and LAE reserves do not represent an exact measurement of liability, but are estimates. The most significant assumptions affecting our IBNR reserve estimates are the loss development factors applied to paid losses and case reserves to develop IBNR by line of business and accident year. Although historical loss development provides us with an indication of future loss development, it typically varies from year to year. Thus, for each accident year within each line of business we select one loss development factor out of a range of historical factors.

We generated a sensitivity analysis of our net reserves which represents reasonably likely levels of variability in our selected loss development factors. We believe the most meaningful approach to the sensitivity analysis is to vary the loss development factors that drive the ultimate loss and LAE estimates. We applied this approach on an accident year basis, reflecting the reasonably likely differences in variability by level of maturity of the underlying loss experience for each accident year. Generally, the most recent accident years are characterized by more unreported losses and less information available for settling claims, and have more inherent uncertainty than the reserve estimates for more mature accident years. Therefore, we used variability factors of plus or minus 10% for the most recent accident year, 5% for the preceding accident year, and 2.5% for the second preceding accident year. There is minimal expected variability for accident years at four or more years' maturity.

The following table displays ultimate net loss and LAE and net loss and LAE reserves by accident year for the year ended December 31, 2018. We applied the sensitivity factors to each accident year amount and have calculated the amount of potential net loss and LAE reserve change and the impact on 2018 reported pre-tax income and on net income and shareholders' equity at December 31, 2018. We believe it is not appropriate to sum the illustrated amounts as it is not reasonably likely that each accident year's reserve estimate assumptions will vary simultaneously in the same direction to the full extent of the sensitivity factor. We also believe that such changes to our reserve balance would not have a material impact on our operating results, financial position, or liquidity. The net income and shareholders' equity amounts include an income tax rate assumption of 21%. The dollar amounts in the table are in thousands.

	Ultimate Loss and LAE Sensitivity Factor	December 31, 2018 Ultimate Loss and LAE	December 31, 2018 Loss and LAE Reserves, Net	Potential Impact on 2018 Pre-Tax Income	Potential Impact on 2018 Net Income and December 31, 2018 Shareholders' Equity
Increased Ultimate Losses & LAE					
Accident Year 2018	10.0 %	$ 53,249	$ 36,457	$ 5,325	$ 4,207
Accident Year 2017	5.0 %	63,433	23,175	3,172	2,506
Accident Year 2016	2.5 %	48,715	2,127	1,218	962
Prior to 2016 Accident Years	— %	—	1,363	—	—
Decreased Ultimate Losses & LAE					
Accident Year 2018	(10.0)%	53,249	36,457	(5,325)	(4,207)
Accident Year 2017	(5.0)%	63,433	23,175	(3,172)	(1,801)
Accident Year 2016	(2.5)%	48,715	2,127	(1,218)	(982)
Prior to 2016 Accident Years	— %	—	1,363	—	—

Investment Valuation and Impairment

We carry debt securities classified as available for sale at fair value, and unrealized gains and losses on such securities, net of any deferred taxes, are reported as a separate component of accumulated other comprehensive income. Our equity securities that do not result in consolidation and are not accounted for under the equity method are measured at fair value and any changes in fair value are recognized in net income. We carry other equity investments that do not have a readily determinable fair value. These equity investments are recorded at cost, less impairment and adjusted for observable price changes under the measurement alternative provided under GAAP. We review these investments for impairment during each reporting period. We do not have any securities classified as trading or held to maturity.

We evaluate our available for sale investments regularly to determine whether there have been declines in value that are other than temporary. Our outside investment managers assist us in this evaluation. When we determine that a security has experienced an other than temporary impairment, the impairment loss is recognized as a realized investment loss. We consider a number of factors in assessing whether an impairment is other than temporary, including (1) the amount and percentage that current fair value is below cost or amortized cost, (2) the length of time that the fair value has been below cost or amortized cost and (3) recent corporate developments or other factors that may impact an issuer's near term prospects. In addition, for debt securities, we consider the credit quality ratings for the securities, with a special emphasis on securities downgraded to below investment grade. We also consider our intent to sell available for sale debt securities in an unrealized loss position, and if it is more likely than not that we will be required to sell these securities before a recovery in fair value to their cost or amortized cost basis.

Fair values are measured in accordance with ASC 820, Fair Value Measurements. The guidance establishes a framework for measuring fair value and a three level hierarchy based upon the quality of inputs used to measure fair

value. The three levels of the fair value hierarchy are: (1) Level 1: inputs are based on quoted prices (unadjusted) in active markets for

38

---

identical assets or liabilities, (2) Level 2: inputs are other than quoted prices that are observable for the asset or liabilities, either directly or indirectly, for substantially the full term of the asset or liability and (3) Level 3: unobservable inputs that are supported by little or no market activity. The unobservable inputs represent the Company’s best assumption of how market participants would price the assets or liabilities.

The fair values of debt and equity securities have been determined using fair value prices provided by our investment managers, who utilize internationally recognized independent pricing services. The prices provided by the independent pricing services are generally based on observable market data in active markets (e.g., broker quotes and prices observed for comparable securities).

The values for publicly traded equity securities are generally based on Level 1 inputs which use the market approach valuation technique. The values for debt securities generally incorporate significant Level 2 inputs. The carrying value of cash and short term investments approximate their fair values due to their short term maturity.

We review fair value prices provided by our outside investment managers for reasonableness by comparing the fair values provided by the managers to those provided by our investment custodian. We also review and monitor changes in unrealized gains and losses. We obtain an understanding of the methods, models and inputs used by our investment managers and independent pricing services, and controls are in place to validate that prices provided represent fair values. Our control process includes initial and ongoing evaluation of the methodologies used, a review of specific securities and an assessment for proper classification within the fair value hierarchy.

Income Taxes

Our income tax expense, deferred tax assets and liabilities, and liabilities for unrecognized tax benefits reflect management’s best assessment of estimated current and future taxes to be paid. We are subject to income taxes in the United States and numerous state jurisdictions. Significant judgment is required in determining the consolidated income tax expense.

On December 22, 2017, the U.S. federal government enacted H.R. 1, “An Act to Provide for Reconciliation Pursuant to Titles II and V of the Concurrent Resolution on the Budget for Fiscal Year 2018” (the “Act”). The Act provided for significant changes to corporate taxation including the decrease of the corporate tax rate from 34% to 21%. In 2017, the Company completed an analysis of the impact of the Act and followed the additional guidance provided by the Security and Exchange Commission’s Staff Accounting Bulletin No. 118 (“SAB 118”). There were no material provisional balances as of December 31, 2017.

In 2018, the Company recognized a measurement period adjustment of $42,735 related to loss reserve discounting, which reduced deferred tax expense. The Company also recognized a measurement period adjustment of $42,735 related to the loss reserve discounting transitional adjustment, which increased deferred tax expense. The measurement period adjustments were based upon obtaining additional information about facts and circumstances that existed as of the enactment date that, if known, would have affected the income tax effects initially reported as provisional amounts under the Act. The measurement period adjustments had no effect on the effective tax rate for the year ending December 31, 2018. The accounting for the income tax effects of the Act pursuant to SAB 118 has been completed as of the end of the December 22, 2018, measurement period and for the year ending December 31, 2018.

Deferred income taxes arise from temporary differences between the tax basis of assets and liabilities and their reported amounts in the financial statements, which will result in taxable or deductible amounts in the future. In evaluating our ability to recover our deferred tax assets within the jurisdiction from which they arise, we consider all available positive and negative evidence, including scheduled reversals of deferred tax liabilities, projected future taxable income, tax planning strategies, and results of recent operations. In projecting future taxable income, we begin with historical results and incorporate assumptions about the amount of future state and federal pretax operating income adjusted for items that do not have tax consequences. The assumptions about future taxable income require significant judgment and are consistent with the plans and estimates we are using to manage the underlying businesses. In evaluating the objective evidence that historical results provide, we consider three years of cumulative operating income or loss.

As of December 31, 2018, we have federal and state income tax net operating loss (“NOL”) carryforwards of $48.3 million and $11.9 million, respectively, which will expire at various dates from 2019 through 2038. Of the federal NOL amount, $14.1 million are subject to limitations under Section 382 of the Internal Revenue Code. These net NOL carryforwards are limited in the amount that can be utilized in any one year and may expire before they are realized.

At this time we do not expect that any of the remaining NOL carryforwards will expire before utilized.
The carrying value of our gross deferred tax asset for the NOL carryforwards is equal to the total NOL carryforward amount times the applicable federal and state tax rates, and was $10.7 million and $9.5 million as of December 31, 2018 and 2017, respectively. Total gross deferred tax assets were $15.4 million and $13.3 million as of December 31, 2018 and 2017. A

valuation allowance of $12.6 million and $9.9 million has been recorded against the gross deferred tax assets as of December 31, 2018 and 2017, respectively, as the Company has recognized a three-year cumulative loss as of December 31, 2018 which is significant negative evidence to support the lack of recoverability of those deferred tax assets in accordance with ASC 740, Income Taxes. If the $12.6 million valuation allowance as of December 31, 2018 was reversed in the future, it would increase book value by $1.49. The net deferred tax liability was $115,000 as of December 31, 2018 and 2017.

If, in the future, we determine we can support the recoverability of a portion or all of the deferred tax assets under the guidance, the tax benefits relating to any reversal of the valuation allowance on deferred tax assets will be accounted for as a reduction of income tax expense and result in an increase in equity. Changes in tax laws and rates may affect recorded deferred tax assets and liabilities and our effective tax rate in the future.

Non-GAAP Financial Measures

Adjusted Operating Income (Loss) and Adjusted Operating Income (Loss) Per Share

Adjusted operating income (loss) and adjusted operating income (loss) per share are non-GAAP measures that represent net income allocable to common shareholders excluding net realized investment and other gains (losses), net of tax, the effects of tax reform, the tax effect of changes in unrealized gains to the extent included in net income, the change in the fair value of equity securities, net of tax, and the capitalization and amortization of deferred gains from the ADC. The most directly comparable financial GAAP measures to adjusted operating income and adjusted operating income per share are net income and net income per share, respectively. Adjusted operating income and adjusted operating income per share are intended as supplemental information and are not meant to replace net income or net income per share. Adjusted operating income and adjusted operating income per share should be read in conjunction with the GAAP financial results. Our definition of adjusted operating income may be different from that used by other companies. The following is a reconciliation of net income to adjusted operating income (dollars in thousands), as well as net income per share to adjusted operating income per share:

	For the Years Ended December 31,		
	2018	2017	2016
Net income (loss)	$(9,227)	$(21,542)	$(8,437)
Less:			
Net realized investment gains and other gains, net of tax	61	820	965
Effect of tax law change	—	63	—
Tax effect of unrealized gains and losses on investments	—	356	147
Change in fair value of equity securities, net of tax	121	—	—
Net (increase) in deferred gain on losses ceded to ADC, net of tax	(5,677)	—	—
Adjusted operating income (loss)	$(3,732)	$(22,781)	$(9,549)
Weighted average common shares, diluted	8,543,876	7,867,344	7,618,588
Diluted (loss) per common share:			
Net income (loss)	$(1.08)	$(2.74)	$(1.11)
Net realized investment gains and other gains, net of tax	0.01	0.10	0.13
Effect of tax law change	—	0.01	—
Tax effect of unrealized gains and losses on investments	—	0.05	0.02
Change in fair value of equity securities, net of tax	0.01	—	—
Net (increase) in deferred gain on losses ceded to ADC, net of tax	(0.66)	—	—
Adjusted operating (loss) per share	$(0.44)	$(2.90)	$(1.26)

We use adjusted operating income and adjusted operating income per share, in conjunction with other financial measures, to assess our performance and to evaluate the results of our business. We believe these measures provide investors with valuable information relating to our ongoing performance that may be obscured by the effect of

investment gains and

losses as a result of our market risk sensitive instruments, which primarily relate to fixed income securities that are available-for-sale and not held for trading purposes. Realized investment gains and losses may vary significantly between periods and are generally driven by external economic developments, such as capital market conditions. Accordingly, adjusted operating income excludes the effect of items that tend to be highly variable from period to period and highlights the results from our ongoing business operations and the underlying loss or profitability of our business. We believe that it is useful for investors to evaluate adjusted operating income and adjusted operating income per share, along with net income and net income per share, when reviewing and evaluating our performance.

Executive Overview

For the year ended December 31, 2018, we continued to expand our commercial lines and reposition our personal lines of business. Our commercial lines gross written premiums grew by $5.6 million, or 6.1%, to $97.7 million in 2018, compared to $92.1 million in 2017. Personal lines gross written premiums decreased by $15.5 million, or 69.9%, to $6.7 million in 2018, compared to $22.2 million in 2017.

The Company reported a net loss of $9.2 million, or $1.08 per share, in 2018, compared to a net loss of $21.5 million, or $2.74 per share, in 2017.

Adjusted operating loss, a non-GAAP measure, was $3.7 million, or $0.44 per share, for the year ended December 31, 2018, compared to an adjusted operating loss of $22.8 million, or $2.90 per share, for the year ended December 31, 2017.

The 2018 results were mainly driven by $9.0 million of adverse development. The largest difference between net loss and adjusted operating loss is related to the ADC (described below) in which $5.7 million of benefit from the ADC was included in the adjusted operating loss, but is deferred under retrospective accounting and will be recognized as a benefit over the next two years.

In 2018, there was $583,000 of loss development on Hurricane Harvey and $1.0 million of catastrophe reinsurance reinstatement costs relating to Hurricane Irma. The reinstatement costs, plus a short-term reduction in net earned premiums as we repositioned our business profile, contributed to a slightly higher expense ratio.

In an effort to reduce interest costs, we restructured our debt during 2018 by issuing $25.3 million of public senior unsecured notes (the "Notes") and paid down $19.5 million of our subordinated notes to $10.5 million.

In 2017, we entered into the ADC to protect against loss development of up to $17.5 million in excess of stated reserves as of June 30, 2017. The agreement provides up to $17.5 million of reinsurance for adverse net loss reserve development for accident years 2005 through 2016. The agreement attaches when net losses exceed $1.4 million of the $36.6 million carried reserves at June 30, 2017, and extends to $19.5 million in coverage up to $57.5 million (inclusive of a 10% co-participation).

The 2017 results were mainly driven by adverse development on prior-year reserves, the cost of the ADC, and losses from Hurricanes Irma and Harvey.

Potential impact of ADC on future periods

We purchased the ADC to greatly reduce our exposure to prior-year adverse development. The benefits of the ADC can be seen during 2018 wherein we ceded $10.3 million of adverse development to the ADC. Of the $10.3 million of ceded losses, $4.6 million was amortized in 2018, and reduced losses and LAE expense. The remaining $5.7 million was recognized as a deferred gain under retroactive reinsurance accounting rules and will be amortized over the next two years as a reduction in losses and LAE expense using the interest method. In 2017, we recorded $7.2 million in ceded premiums under the ADC, and ceded $7.2 million in losses. As of December 31, 2018, the ADC has been fully utilized.

Results of Operations - 2018 Compared to 2017
The following table summarizes our operating results for the years indicated (dollars in thousands):
Summary Operating Results

	Years Ended December 31,			
	2018	2017	$ Change	% Change
Gross written premiums	$104,368	$114,284	$(9,916)	(8.7%)
Net written premiums	$89,086	$91,240	$(2,154)	(2.4%)
Net earned premiums	$93,811	$91,729	$2,082	2.3%
Other income	1,582	1,560	22	1.4%
Losses and loss adjustment expenses, net	62,515	73,917	(11,402)	(15.4%)
Policy acquisition costs	25,534	26,245	(711)	(2.7%)
Operating expenses	17,683	17,367	316	1.8%
Underwriting gain (loss)	(10,339)	(24,240)	13,901	*
Net investment income	3,336	2,728	608	22.3%
Net realized investment gains	61	70	(9)	(12.9%)
Change in fair value of equity securities	121	—	121	*
Other gains (losses)	—	750	(750)	*
Interest expense	2,644	1,362	1,282	94.1%
Income (loss) before income taxes	(9,465)	(22,054)	12,589	*
Income tax expense (benefit)	52	(447)	499	*
Equity earnings (losses) in affiliates, net of tax	290	65	225	*
Net income (loss)	$(9,227)	$(21,542)	$12,315	*
Underwriting Ratios:				
Loss ratio	65.5%	79.2%		
Expense ratio	45.3%	46.8%		
Combined ratio	110.8%	126.0%		

* Percentage change is not meaningful

Premiums

Earned premiums are earned ratably over the term of the policy, whereas written premiums are reflected on the effective date of the policy. All commercial lines and homeowners products have annual policies, under which premiums are earned evenly over one year. Almost all personal automobile policies are six month term policies under which premiums are earned evenly over a six-month period. The resulting net earned premiums are impacted by the gross and ceded written premiums, earned ratably over time.

Our premiums are presented below for the years ended December 31, 2018 and 2017 (dollars in thousands):
Summary of Premium Revenue