

UNITED FIRE GROUP INC  
Form 10-Q  
August 02, 2017  
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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549  
FORM 10-Q

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

For the quarterly period ended June 30, 2017

or

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

Commission File Number 001-34257

UNITED FIRE GROUP, INC.  
(Exact name of registrant as specified in its charter)

Iowa 45-2302834  
(State of Incorporation) (IRS Employer Identification No.)

118 Second Avenue, S.E., Cedar Rapids, Iowa 52401  
(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code: (319) 399-5700

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 R NO o

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 (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

YES R NO o

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

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting Emerging growth  
R o o company o company o

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

YES  NO

As of July 31, 2017, 25,028,746 shares of common stock were outstanding.

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**FORWARD-LOOKING INFORMATION**

This report may contain forward-looking statements about our operations, anticipated performance and other similar matters. The Private Securities Litigation Reform Act of 1995 provides a safe harbor under the Securities Act of 1933 (the "Securities Act") and the Securities Exchange Act of 1934, as amended (the "Exchange Act"), for forward-looking statements. The forward-looking statements are not historical facts and involve risks and uncertainties that could cause actual results to differ from those expected and/or projected. Such forward-looking statements are based on current expectations, estimates, forecasts and projections about United Fire Group, Inc. ("UFG," the "Registrant," the "Company," "we," "us," or "our"), the industry in which we operate, and beliefs and assumptions made by management. Words such as "expect(s)," "anticipate(s)," "intend(s)," "plan(s)," "believe(s)," "continue(s)," "seek(s)," "estimate(s)," "goal(s)," "target(s)," "forecast(s)," "project(s)," "predict(s)," "should," "could," "may," "will continue," "might," "hope," "can" and other words and terms of similar meaning or expression in connection with a discussion of future operations, financial performance or financial condition, are intended to identify forward-looking statements. See Part I, Item 1A "Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2016 and Part II, Item 1A "Risk Factors" of this report for more information concerning factors that could cause actual results to differ materially from those in the forward-looking statements.

Risks and uncertainties that may affect the actual financial condition and results of the Company include, but are not limited to, the following:

The frequency and severity of claims, including those related to catastrophe losses and the impact those claims have on our loss reserve adequacy; the occurrence of catastrophic events, including international events, significant severe weather conditions, climate change, acts of terrorism, acts of war and pandemics;

The adequacy of our reserves for property and casualty insurance losses and loss settlement expenses and our life insurance reserve for future policy benefits;

Geographic concentration risk in both property and casualty insurance and life insurance segments;

The potential disruption of our operations and reputation due to unauthorized data access, cyber-attacks or cyber-terrorism and other security breaches;

Developments in general economic conditions, domestic and global financial markets, interest rates and other-than-temporary impairment losses that could affect the performance of our investment portfolio;

Our ability to effectively underwrite and adequately price insured risks;

Changes in industry trends, an increase in competition and significant industry developments;

Litigation or regulatory actions that could require us to pay significant damages, fines or penalties or change the way we do business;

Lowering of one or more of the financial strength ratings of our operating subsidiaries or our issuer credit ratings and the adverse impact such action may have on our premium writings, policy retention, profitability and liquidity;

- Governmental actions, policies and regulations, including, but not limited to, domestic health care reform, financial services regulatory reform, corporate governance, new laws or regulations or court decisions interpreting existing laws and regulations or policy provisions; changes in laws, regulations and stock exchange requirements relating to corporate governance and the cost of compliance;

Our relationship with and the financial strength of our reinsurers; and

Competitive, legal, regulatory or tax changes that affect the distribution cost or demand for our products through our independent agent/agency distribution network.

These are representative of the risks, uncertainties, and assumptions that could cause actual outcomes and results to differ materially from what is expressed in forward-looking statements. Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date of this report or as of the date they are made. Except as required under the federal securities laws and the rules and regulations of the Securities and Exchange Commission ("SEC"), we do not have any intention or obligation to update publicly any forward-looking statements, whether as a result of new information, future events, or otherwise.



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## PART I — FINANCIAL INFORMATION

## ITEM 1. FINANCIAL STATEMENTS

United Fire Group, Inc.

Consolidated Balance Sheets

(In Thousands, Except Share Data)

	June 30, 2017 (unaudited)	December 31, 2016
<b>ASSETS</b>		
Investments		
Fixed maturities		
Held-to-maturity, at amortized cost (fair value \$192 in 2017 and \$199 in 2016)	\$ 192	\$ 198
Available-for-sale, at fair value (amortized cost \$2,912,326 in 2017 and \$2,887,505 in 2016)	2,955,079	2,898,126
Trading securities, at fair value (amortized cost \$13,945 in 2017 and \$13,054 in 2016)	15,828	14,390
Equity securities		
Available-for-sale, at fair value (cost \$62,533 in 2017 and \$68,504 in 2016)	276,306	270,416
Trading securities, at fair value (cost \$6,046 in 2017 and \$5,434 in 2016)	6,612	5,644
Mortgage loans	3,573	3,706
Policy loans	5,499	5,366
Other long-term investments	65,664	67,639
Short-term investments	175	175
	3,328,928	3,265,660
Cash and cash equivalents	130,421	110,853
Accrued investment income	25,530	25,056
Premiums receivable (net of allowance for doubtful accounts of \$1,178 in 2017 and \$1,255 in 2016)	361,866	306,202
Deferred policy acquisition costs	167,512	164,112
Property and equipment (primarily land and buildings, at cost, less accumulated depreciation of \$51,144 in 2017 and \$50,925 in 2016)	57,726	55,524
Reinsurance receivables and recoverables	73,967	69,413
Prepaid reinsurance premiums	3,966	3,782
Income taxes receivable	8,288	15,061
Goodwill and intangible assets	24,355	24,740
Other assets	14,853	14,355
<b>TOTAL ASSETS</b>	<b>\$4,197,412</b>	<b>\$ 4,054,758</b>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Liabilities		
Future policy benefits and losses, claims and loss settlement expenses		
Property and casualty insurance	\$1,180,478	\$ 1,123,896
Life insurance	1,329,855	1,350,503
Unearned premiums	502,415	443,873
Accrued expenses and other liabilities	173,610	159,014
Deferred income taxes	48,466	35,588
<b>TOTAL LIABILITIES</b>	<b>\$3,234,824</b>	<b>\$ 3,112,874</b>
Stockholders' Equity		
Common stock, \$0.001 par value; authorized 75,000,000 shares; 25,028,037 and 25,429,769 shares issued and outstanding in 2017 and 2016, respectively	\$25	\$ 25

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Additional paid-in capital	199,759	216,482
Retained earnings	625,836	616,322
Accumulated other comprehensive income, net of tax	136,968	109,055
<b>TOTAL STOCKHOLDERS' EQUITY</b>	<b>\$962,588</b>	<b>\$ 941,884</b>
<b>TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY</b>	<b>\$4,197,412</b>	<b>\$ 4,054,758</b>

The Notes to unaudited Consolidated Financial Statements are an integral part of these statements.

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United Fire Group, Inc.

Consolidated Statements of Income and Comprehensive Income (Unaudited)

(In Thousands, Except Share Data)	Three Months Ended		Six Months Ended	
	June 30, 2017	2016	June 30, 2017	2016
Revenues				
Net premiums earned	\$259,563	\$253,487	\$513,435	\$494,785
Investment income, net of investment expenses	24,610	24,507	49,645	46,731
Net realized investment gains (includes reclassifications for net unrealized investment gains on available-for-sale securities of \$1,975 and \$5,380 in 2017 and \$700 and \$2,346 in 2016; previously included in accumulated other comprehensive income)	2,680	1,596	6,634	3,651
Other income	126	183	324	291
Total revenues	\$286,979	\$279,773	\$570,038	\$545,458
Benefits, Losses and Expenses				
Losses and loss settlement expenses	\$197,698	\$180,412	\$365,321	\$322,540
Increase in liability for future policy benefits	5,281	16,002	13,860	28,554
Amortization of deferred policy acquisition costs	53,093	52,585	105,227	102,816
Other underwriting expenses (includes reclassifications for employee benefit costs of \$1,352 and \$2,704 in 2017 and \$1,371 and \$2,742 in 2016; previously included in accumulated other comprehensive income)	26,201	24,772	51,091	51,525
Interest on policyholders' accounts	4,651	5,138	9,395	10,385
Total benefits, losses and expenses	\$286,924	\$278,909	\$544,894	\$515,820
Income before income taxes	\$55	\$864	\$25,144	\$29,638
Federal income tax expense (benefit) (includes reclassifications of \$219 and \$937 in 2017 and (\$234) and (\$138) in 2016; previously included in accumulated other comprehensive income)	(2,903 )	(2,250 )	2,250	4,097
Net income	\$2,958	\$3,114	\$22,894	\$25,541
Other comprehensive income				
Change in net unrealized appreciation on investments	\$30,653	\$49,332	\$45,619	\$93,208
Change in liability for underfunded employee benefit plans	—	—	—	—
Other comprehensive income, before tax and reclassification adjustments	\$30,653	\$49,332	\$45,619	\$93,208
Income tax effect	(10,729 )	(17,267 )	(15,967 )	(32,624 )
Other comprehensive income, after tax, before reclassification adjustments	\$19,924	\$32,065	\$29,652	\$60,584
Reclassification adjustment for net realized investment gains included in income	\$(1,975 )	\$(700 )	\$(5,380 )	\$(2,346 )
Reclassification adjustment for employee benefit costs included in expense	1,352	1,371	2,704	2,742
Total reclassification adjustments, before tax	\$(623 )	\$671	\$(2,676 )	\$396
Income tax effect	219	(234 )	937	(138 )
Total reclassification adjustments, after tax	\$(404 )	\$437	\$(1,739 )	\$258
Comprehensive income	\$22,478	\$35,616	\$50,807	\$86,383
Weighted average common shares outstanding	25,133,035	25,366,283	25,288,068	25,288,086
Basic earnings per common share	\$0.12	\$0.12	\$0.91	\$1.01
Diluted earnings per common share	0.12	0.12	0.89	1.00



The Notes to unaudited Consolidated Financial Statements are an integral part of these statements.

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Consolidated Statement of Stockholders' Equity (Unaudited)

(In Thousands, Except Share Data)	Six Months Ended June 30, 2017
<b>Common stock</b>	
Balance, beginning of year	\$25
Shares repurchased (496,608 shares)	—
Shares issued for stock-based awards (104,634 shares)	—
Balance, end of period	\$25
<b>Additional paid-in capital</b>	
Balance, beginning of year	\$216,482
Compensation expense and related tax benefit for stock-based award grants	2,254
Shares repurchased	(21,184 )
Shares issued for stock-based awards	2,207
Balance, end of period	\$199,759
<b>Retained earnings</b>	
Balance, beginning of year	\$616,322
Net income	22,894
Dividends on common stock (\$0.53 per share)	(13,380 )
Balance, end of period	\$625,836
<b>Accumulated other comprehensive income, net of tax</b>	
Balance, beginning of year	\$109,055
Change in net unrealized investment appreciation <sup>(1)</sup>	26,156
Change in liability for underfunded employee benefit plans <sup>(2)</sup>	1,757
Balance, end of period	\$136,968
<b>Summary of changes</b>	
Balance, beginning of year	\$941,884
Net income	22,894
All other changes in stockholders' equity accounts	(2,190 )
Balance, end of period	\$962,588

(1) The change in net unrealized appreciation is net of reclassification adjustments and income taxes.

(2) The change in liability for underfunded employee benefit plans is net of reclassification adjustments and income taxes.

The Notes to unaudited Consolidated Financial Statements are an integral part of these statements.

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United Fire Group, Inc.

Consolidated Statements of Cash Flows (Unaudited)

(In Thousands)	Six Months Ended	
	June 30, 2017	2016
Cash Flows From Operating Activities		
Net income	\$22,894	\$25,541
Adjustments to reconcile net income to net cash provided by operating activities		
Net accretion of bond premium	7,857	7,076
Depreciation and amortization	2,333	3,179
Stock-based compensation expense	2,254	1,865
Net realized investment gains	(6,634 )	(3,651 )
Net cash flows from trading investments	(1,524 )	256
Deferred income tax benefit	(1,040 )	(1,761 )
Changes in:		
Accrued investment income	(474 )	235
Premiums receivable	(55,664 )	(63,334 )
Deferred policy acquisition costs	(7,153 )	(11,007 )
Reinsurance receivables	(4,554 )	(7,413 )
Prepaid reinsurance premiums	(184 )	(363 )
Income taxes receivable	6,773	(12,341 )
Other assets	(498 )	47
Future policy benefits and losses, claims and loss settlement expenses	71,378	78,807
Unearned premiums	58,542	60,851
Accrued expenses and other liabilities	17,300	7,083
Income taxes payable	—	(4,917 )
Deferred income taxes	(1,112 )	(550 )
Other, net	1,640	1,474
Total adjustments	\$89,240	\$55,536
Net cash provided by operating activities	\$112,134	\$81,077
Cash Flows From Investing Activities		
Proceeds from sale of available-for-sale investments	\$5,059	\$3,042
Proceeds from call and maturity of held-to-maturity investments	7	14
Proceeds from call and maturity of available-for-sale investments	147,717	311,478
Proceeds from short-term and other investments	3,320	1,412
Purchase of available-for-sale investments	(174,022 )	(338,213 )
Purchase of short-term and other investments	(2,985 )	(415 )
Net purchases and sales of property and equipment	(3,861 )	(2,825 )
Net cash used in investing activities	\$(24,765 )	\$(25,507 )
Cash Flows From Financing Activities		
Policyholders' account balances		
Deposits to investment and universal life contracts	\$38,382	\$45,467
Withdrawals from investment and universal life contracts	(73,826 )	(81,672 )
Payment of cash dividends	(13,380 )	(11,898 )
Repurchase of common stock	(21,184 )	—
Issuance of common stock	2,207	6,138
Tax impact from issuance of common stock	—	(354 )
Net cash used in financing activities	\$(67,801 )	\$(42,319 )
Net Change in Cash and Cash Equivalents	\$19,568	\$13,251

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Cash and Cash Equivalents at Beginning of Period	110,853	106,449
Cash and Cash Equivalents at End of Period	\$130,421	\$119,700

The Notes to unaudited Consolidated Financial Statements are an integral part of these statements.

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UNITED FIRE GROUP, INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

(Amounts in thousands, except share amounts or as otherwise noted)

NOTE 1. NATURE OF OPERATIONS AND BASIS OF PRESENTATION

Nature of Business

United Fire Group, Inc. ("UFG," the "Registrant," the "Company," "we," "us," or "our") and its consolidated subsidiaries and affiliates are engaged in the business of writing property and casualty insurance and life insurance and selling annuities through a network of independent agencies. We report our operations in two business segments: property and casualty insurance and life insurance. Our insurance company subsidiaries are licensed as a property and casualty insurer in 46 states and the District of Columbia, and as a life insurer in 37 states.

Basis of Presentation

The unaudited consolidated interim financial statements have been prepared in accordance with U.S. generally accepted accounting principles ("GAAP") for interim financial reporting and with the instructions to Form 10-Q and Regulation S-X promulgated by the SEC. Certain financial information that is included in our Annual Report on Form 10-K, including certain financial statement footnote disclosures, are not required by the rules and regulations of the SEC for interim financial reporting and have been condensed or omitted.

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. The financial statement categories that are most dependent on management estimates and assumptions include: investments; deferred policy acquisition costs; reinsurance receivables and recoverables; future policy benefits and losses, claims and loss settlement expenses; and pension and postretirement benefit obligations.

Certain prior year amounts have been reclassified to conform to the current year presentation.

Management of UFG believes the accompanying unaudited Consolidated Financial Statements contain all adjustments (consisting of normal recurring adjustments) necessary to present fairly the financial position, results of operations and cash flows for the periods presented. All significant intercompany transactions have been eliminated in consolidation. The results reported for the interim periods are not necessarily indicative of the results of operations that may be expected for the year. The unaudited Consolidated Financial Statements should be read in conjunction with our Annual Report on Form 10-K for the year ended December 31, 2016. The review report of Ernst & Young LLP as of June 30, 2017 and for the three- and six-month periods ended June 30, 2017 and 2016 accompanies the unaudited Consolidated Financial Statements included in Part I, Item 1 "Financial Statements."

Cash and Cash Equivalents

For purposes of reporting cash flows, cash and cash equivalents include cash, money market accounts, and non-negotiable certificates of deposit with original maturities of three months or less.

For the six-month periods ended June 30, 2017 and 2016, we made payments for income taxes totaling \$7,628 and \$24,017, respectively. We received a tax refund of \$10,000 during the six-month period ended June 30, 2017. We did not receive a tax refund during the six-month period ended June 30, 2016.

For the six-month periods ended June 30, 2017 and 2016, we made no interest payments (excluding interest credited to policyholders' accounts).

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## Deferred Policy Acquisition Costs ("DAC")

Certain costs associated with underwriting new business (primarily commissions, premium taxes and variable underwriting and policy issue expenses associated with successful acquisition efforts) are deferred. The following table is a summary of the components of DAC, including the related amortization recognized for the six-month period ended June 30, 2017.

	Property & Casualty Insurance	Life Insurance	Total
Recorded asset at beginning of period	\$93,362	\$70,750	\$164,112
Underwriting costs deferred	109,900	2,480	112,380
Amortization of deferred policy acquisition costs	(101,859 )	(3,368 )	(105,227 )
Ending unamortized deferred policy acquisition costs	\$101,403	\$69,862	\$171,265
Impact of unrealized gains and losses on available-for-sale securities	—	(3,753 )	(3,753 )
Recorded asset at June 30, 2017	\$101,403	\$66,109	\$167,512

Property and casualty insurance policy acquisition costs deferred are amortized as premium revenue is recognized. The method followed in computing DAC limits the amount of such deferred costs to their estimated realizable value. This takes into account the premium to be earned, losses and loss settlement expenses expected to be incurred and certain other costs expected to be incurred as the premium is earned.

For traditional life insurance policies, DAC is amortized to income over the premium-paying period in proportion to the ratio of the expected annual premium revenue to the expected total premium revenue. Expected premium revenue and gross profits are based on the same mortality and withdrawal assumptions used in determining future policy benefits. These assumptions are not revised after policy issuance unless the recorded DAC asset is deemed to be unrecoverable from future expected profits.

For non-traditional life insurance policies, DAC is amortized over the anticipated terms in proportion to the ratio of the expected annual gross profits to the total expected gross profits. Changes in the amount or timing of expected gross profits result in adjustments to the cumulative amortization of these costs. The effect on amortization of DAC for revisions to estimated gross profits is reported in earnings in the period the estimated gross profits are revised.

The effect on DAC that results from the assumed realization of unrealized gains (losses) on investments allocated to non-traditional life insurance business is recognized with an offset to net unrealized investment appreciation as of the balance sheet date. The impact of unrealized gains and losses on available-for-sale securities decreased the DAC asset by \$10,166 and \$6,413 at June 30, 2017 and December 31, 2016, respectively.

## Income Taxes

Deferred tax assets and liabilities are established based on differences between the financial statement bases of assets and liabilities and the tax bases of those same assets and liabilities, using the currently enacted statutory tax rates. Deferred income tax expense is measured by the year-to-year change in the net deferred tax asset or liability, except for certain changes in deferred tax amounts that affect stockholders' equity and do not impact federal income tax expense.

We reported a federal income tax expense of \$2,250 and \$4,097 for the six-month periods ended June 30, 2017 and 2016, respectively. Our effective tax rate is different than the federal statutory rate of 35.0 percent due principally to the effect of tax-exempt municipal bond interest income and non-taxable dividend income.

The Company performs a quarterly review of its tax positions and makes a determination of whether it is more likely than not that the tax position will be sustained upon examination. If based on review, it appears not more likely than



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not that the positions will be sustained, the Company will calculate any unrecognized tax benefits and, if necessary, calculate and accrue any related interest and penalties. We did not recognize any liability for unrecognized tax benefits at June 30, 2017 or December 31, 2016. In addition, we have not accrued for interest and penalties related to unrecognized tax benefits. However, if interest and penalties would need to be accrued related to unrecognized tax benefits, such amounts would be recognized as a component of federal income tax expense.

We file a consolidated federal income tax return. We also file income tax returns in various state jurisdictions. We are no longer subject to federal or state income tax examination for years before 2009 or for the year 2012. The Internal Revenue Service is conducting routine examinations of our income tax return for the 2011 and 2015 tax years.

## Subsequent Events

In the preparation of the accompanying financial statements, the Company has evaluated all material subsequent events or transactions that occurred after the balance sheet date through the date on which the financial statements were issued for potential recognition or disclosure in the Company's financial statements. The Company concluded there are no material subsequent events or transactions that have occurred after the balance sheet date through the date on which the financial statements were issued.

### Recently Issued Accounting Standards

#### Accounting Standards Adopted in 2017

##### Share-Based Payments

In March 2016, the Financial Accounting Standards Board ("FASB") issued new guidance on the accounting for share-based payments. The new guidance was issued to simplify the accounting of share-based payments, specifically in the areas of income taxes, classification on the balance sheets as liabilities or equity and classification in the cash flow statement. The new guidance is effective for annual periods beginning after December 15, 2016 and interim periods within those years. The Company adopted the new guidance prospectively as of January 1, 2017. The new guidance resulted in classification changes between the financing and operating section of the Statement of Cash Flow for stock based compensation expense. The adoption also resulted in a tax benefit of \$354 and \$484 during the three- and six-months ended June 30, 2017.

##### Income Taxes

In December 2015, the FASB issued guidance on the balance sheet classification of deferred taxes. The new guidance eliminates the requirement to split deferred tax liabilities and assets between current and non-current in a classified balance sheet. The new guidance allows deferred tax liabilities and assets to be included in non-current accounts. The Company adopted the new guidance as of January 1, 2017. The adoption had no impact on the Company's financial position and results of operations since we do not currently report deferred taxes in classified balance sheets.

##### Pending Adoption of Accounting Standards

##### Revenue Recognition

In May 2014, the FASB issued comprehensive new guidance on revenue recognition which supersedes nearly all existing revenue recognition guidance under GAAP. The new guidance requires a company to recognize revenue when it transfers promised goods or services to customers in an amount that reflects the consideration to which the company expects to be entitled in exchange for those goods or services. The standard creates a five-step model that requires companies to exercise judgment when considering the terms of the contract(s) and all relevant facts and circumstances. Insurance contracts are not within the scope of this new guidance. The new guidance is effective for annual and interim periods beginning after December 15, 2017. The Company will adopt the guidance as of January 1, 2018. The adoption of the new guidance will have no impact on the Company's reporting and disclosure of net



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premiums earned, net investment income or net realized gains and losses, as these items are not within the scope of this new guidance. The Company is currently evaluating the impact on the Company's financial position and results of operations with other revenue streams under this new guidance. These other revenue streams, currently reported in other income in the Consolidated Statements of Income and Comprehensive Income, are not a material amount of the Company's total revenue.

### Financial Instruments

In January 2016, the FASB issued guidance updating certain aspects of recognition, measurement, presentation, and disclosure of financial instruments. The amendments in this update supersede the guidance to classify equity securities with readily determinable fair values into different categories (for example, trading or available-for-sale) and require equity securities to be measured at fair value with changes in the fair value recognized through net income. The new guidance also simplifies the impairment process for equity investments without readily determinable fair values. The new guidance is effective for annual periods beginning after December 15, 2017 and interim periods within those years. The Company will adopt the new guidance as of January 1, 2018 and is currently evaluating the impact on the Company's financial position, results of operations and key processes. If the new guidance were adopted as of March 31, 2017, there would be a reclassification from accumulated other comprehensive income to retained earnings equal to the amount of net unrealized gains and losses on available-for-sale equity securities at December 31, 2016 disclosed in Note 2 "Summary of Investments," of this section. The impact to net realized gains (losses) would equal the change in net unrealized gains and losses on available-for-sale equity securities between June 30, 2017 and December 31, 2016, in the same tables.

### Statement of Cash Flows - Classification of Certain Cash Receipts and Payments

In August 2016, the FASB issued an update that clarifies the classification of certain cash receipts and payments in the Statement of Cash Flows. The update addresses eight existing cash flow issues by clarifying the correct classification to establish uniformity in practice. The updated guidance is effective for annual periods beginning after December 15, 2017 and interim periods within those years. The Company will adopt the new guidance as of January 1, 2018 and is currently reviewing the updates to the eight existing cash flow issues. Currently, management believes that one existing cash flow issue will be impacted by these updates. Management believes the update will have no impact on the Company's financial position and results of operations but may effect the current classification of the cash flow in the Statement of Cash Flows.

### Defined Benefit Retirement Plan Cost

In March 2017, the FASB issued guidance on the presentation of net periodic benefit costs of defined benefit retirement benefit plans in the Statements of Income. The new guidance requires the service cost component of net periodic benefit cost of defined benefit plans to be presented in the same line in the Statements of Income as other employee compensation expenses. Also, under the new guidance, the service cost component of the net periodic benefit costs will be the only portion of costs subject to be capitalized in assets. The new guidance is effective for annual periods beginning after December 15, 2017 and interim periods within those years. The Company will adopt the new guidance as of January 1, 2018 and is currently evaluating the presentation of net periodic benefit costs in its financial statements and the impact on the Company's financial position and results of operations.

### Leases

In February 2016, the FASB issued guidance on the accounting for leases. The new guidance requires lessees to place most leases on their balance sheets with expenses recognized on the income statement in a similar manner as previous methods. The new guidance is effective for annual periods beginning after December 15, 2018 and interim periods within those years. The Company will adopt the new guidance as of January 1, 2019. The Company has created an inventory of its leases and has calculated the current minimum future lease payment, which is disclosed in Note 13 "Lease Commitments" of our Annual Report on Form 10-K for the year ended December 31, 2016.

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Financial Instruments - Credit Losses

In June 2016, the FASB issued new guidance on the measurement of credit losses for most financial instruments. The new guidance replaces the current incurred loss model for recognizing credit losses with an expected loss model for instruments measured at amortized cost and requires allowances to be recorded for available-for-sale debt securities rather than reduce the carrying amount. These allowances will be remeasured each reporting period. The new guidance is effective for annual periods beginning after December 15, 2020 and interim periods within those years. The Company will adopt the new guidance as of January 1, 2021 and is currently evaluating the impact on the Company's financial position, results of operations and key processes.

Income Taxes - Intra-entity Transfers

In October 2016, the FASB issued new guidance on the income tax treatment of intra-entity transfers. The new guidance replaces the current guidance which prohibits the recognition of current and deferred income taxes of intra-entity transfers until the asset is sold externally. Under the new guidance, the exemption is eliminated and income taxes will be recognized on transfers of intra-entity assets. The new guidance is effective for annual periods beginning after December 15, 2018 and interim periods beginning after December 15, 2019. The Company will adopt the new guidance as of January 1, 2019 and is currently evaluating the impact on the Company's financial position and results of operations.

Goodwill

In January 2017, the FASB issued new guidance which simplifies the test for goodwill impairment. The new guidance eliminates the implied fair value calculation when measuring a goodwill impairment charge. Under the new guidance, impairment charges will be based on the excess of the carrying value over fair value of goodwill. The new guidance is effective for annual and interim periods beginning after December 15, 2019. The Company will adopt the new guidance as of January 1, 2020 and is currently evaluating the impact on the Company's financial position and results of operations.

Share-Based Payments

In May 2017, the FASB issued new guidance which clarifies and addresses the diversity in practice when there is a change in the terms of a share-based payment award. The updated guidance clarifies when to use modification accounting when there is a change in the terms of a share-based payment and provides three conditions where modification accounting should not be applied. The new guidance is effective for annual and interim periods beginning after December 15, 2017. The Company will adopt the new guidance as of January 1, 2018 and is currently evaluating the impact on the Company's financial position and results of operations.

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## NOTE 2. SUMMARY OF INVESTMENTS

## Fair Value of Investments

A reconciliation of the amortized cost (cost for equity securities) to fair value of investments in held-to-maturity and available-for-sale fixed maturity and equity securities as of June 30, 2017 and December 31, 2016 is as follows:  
June 30, 2017

Type of Investment	Cost or Amortized Cost	Gross Unrealized Appreciation	Gross Unrealized Depreciation	Fair Value
<b>HELD-TO-MATURITY</b>				
Fixed maturities:				
Bonds				
Corporate bonds - financial services	\$ 150	\$ —	\$ —	\$ 150
Mortgage-backed securities	42	—	—	42
Total Held-to-Maturity Fixed Maturities	\$ 192	\$ —	\$ —	\$ 192
<b>AVAILABLE-FOR-SALE</b>				
Fixed maturities:				
Bonds				
U.S. Treasury	\$22,068	\$ 56	\$ 80	\$22,044
U.S. government agency	79,643	1,574	424	80,793
States, municipalities and political subdivisions				
General obligations:				
Midwest	128,921	2,588	555	130,954
Northeast	54,322	1,348	91	55,579
South	141,845	2,496	1,350	142,991
West	120,651	2,468	1,165	121,954
Special revenue:				
Midwest	163,411	3,579	678	166,312
Northeast	80,282	926	1,229	79,979
South	258,666	3,871	3,547	258,990
West	152,224	2,614	2,377	152,461
Foreign bonds	55,503	1,987	—	57,490
Public utilities	207,437	4,474	240	211,671
Corporate bonds				
Energy	99,416	2,249	200	101,465
Industrials	214,919	5,726	219	220,426
Consumer goods and services	179,992	4,927	157	184,762
Health care	75,863	2,469	—	78,332
Technology, media and telecommunications	143,209	3,224	175	146,258
Financial services	261,314	6,763	526	267,551
Mortgage-backed securities	15,515	178	195	15,498
Collateralized mortgage obligations				
Government national mortgage association	155,129	2,228	1,490	155,867
Federal home loan mortgage corporation	194,556	2,566	2,894	194,228

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Federal national mortgage association	103,061	2,367	752	104,676
Asset-backed securities	4,379	419	—	4,798
Total Available-for-Sale Fixed Maturities	\$2,912,326	\$61,097	\$18,344	\$2,955,079
Equity securities:				
Common stocks				
Public utilities	\$6,394	\$15,062	\$140	\$21,316
Energy	6,514	7,133	121	13,526
Industrials	13,116	44,356	181	57,291
Consumer goods and services	10,070	15,379	118	25,331
Health care	7,763	24,958	—	32,721
Technology, media and telecommunications	6,009	8,837	107	14,739
Financial services	11,630	98,733	51	110,312
Nonredeemable preferred stocks	1,037	33	—	1,070
Total Available-for-Sale Equity Securities	\$62,533	\$214,491	\$718	\$276,306
Total Available-for-Sale Securities	\$2,974,859	\$275,588	\$19,062	\$3,231,385



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December 31, 2016

Type of Investment	Cost or Amortized Cost	Gross Unrealized Appreciation	Gross Unrealized Depreciation	Fair Value
<b>HELD-TO-MATURITY</b>				
Fixed maturities:				
Bonds				
Corporate bonds - financial services	\$ 150	\$ —	\$ —	\$ 150
Mortgage-backed securities	48	1	—	49
Total Held-to-Maturity Fixed Maturities	\$ 198	\$ 1	\$ —	\$ 199
<b>AVAILABLE-FOR-SALE</b>				
Fixed maturities:				
Bonds				
U.S. Treasury	\$23,216	\$ 87	\$ 108	\$23,195
U.S. government agency	76,692	1,445	540	77,597
States, municipalities and political subdivisions				
General obligations:				
Midwest	143,747	1,808	1,412	144,143
Northeast	57,731	909	231	58,409
South	129,475	1,249	2,355	128,369
West	114,524	1,380	2,173	113,731
Special revenue:				
Midwest	167,430	2,313	1,433	168,310
Northeast	70,202	487	2,624	68,065
South	244,225	1,753	6,791	239,187
West	134,287	1,509	4,052	131,744
Foreign bonds	62,995	2,239	—	65,234
Public utilities	212,360	3,761	447	215,674
Corporate bonds				
Energy	107,084	2,195	419	108,860
Industrials	225,526	5,359	982	229,903
Consumer goods and services	178,135	3,847	295	181,687
Health care	81,211	2,063	151	83,123
Technology, media and telecommunications	143,402	2,029	819	144,612
Financial services	269,981	5,328	1,358	273,951
Mortgage-backed securities	17,288	201	241	17,248
Collateralized mortgage obligations				
Government national mortgage association	145,947	1,279	2,766	144,460
Federal home loan mortgage corporation	176,226	1,638	3,406	174,458
Federal national mortgage association	101,414	1,816	1,334	101,896
Asset-backed securities	4,407	145	282	4,270
Total Available-for-Sale Fixed Maturities	\$2,887,505	\$ 44,840	\$ 34,219	\$2,898,126
Equity securities:				
Common stocks				

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Public utilities	\$6,394	\$13,465	\$188	\$19,671
Energy	6,514	8,555	22	15,047
Industrials	13,252	38,715	173	51,794
Consumer goods and services	10,324	13,851	58	24,117
Health care	7,763	19,657	—	27,420
Technology, media and telecommunications	5,931	9,476	38	15,369
Financial services	17,289	98,728	67	115,950
Nonredeemable preferred stocks	1,037	11	—	1,048
Total Available-for-Sale Equity Securities	\$68,504	\$202,458	\$546	\$270,416
Total Available-for-Sale Securities	\$2,956,009	\$247,298	\$34,765	\$3,168,542

Maturities

The amortized cost and fair value of held-to-maturity, available-for-sale and trading fixed maturity securities at June 30, 2017, by contractual maturity, are shown in the following table. Actual maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties. Asset-backed securities, mortgage-backed securities and collateralized mortgage obligations may be subject to prepayment risk and are therefore not categorized by contractual maturity.

June 30, 2017	Held-To-Maturity		Available-For-Sale		Trading	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Due in one year or less	\$ 150	\$ 150	\$141,196	\$142,309	\$2,958	\$3,300
Due after one year through five years	—	—	787,370	808,996	7,532	8,733
Due after five years through 10 years	—	—	769,568	788,131	1,302	1,379
Due after 10 years	—	—	741,552	740,576	2,153	2,416
Asset-backed securities	—	—	4,379	4,798	—	—
Mortgage-backed securities	42	42	15,515	15,498	—	—
Collateralized mortgage obligations	—	—	452,746	454,771	—	—
	\$ 192	\$ 192	\$2,912,326	\$2,955,079	\$13,945	\$15,828

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## Net Realized Investment Gains and Losses

Net realized gains on disposition of investments are computed using the specific identification method and are included in the computation of net income. A summary of the components of net realized investment gains (losses) is as follows:

	Three Months Ended June 30, 2017		Six Months Ended June 30, 2016	
Net realized investment gains (losses)				
Fixed maturities:				
Available-for-sale	\$676	\$846	\$2,671	\$1,362
Trading securities				
Change in fair value	176	98	547	371
Sales	(11 )	461	46	461
Equity securities:				
Available-for-sale	1,299	—	2,709	984
Trading securities				
Change in fair value	245	237	356	330
Sales	6	(26 )	16	(26 )
Short-term investments	—	(43 )	—	—
Cash equivalents	—	23	—	169
Real estate	289	—	289	—
Total net realized investment gains	\$2,680	\$1,596	\$6,634	\$3,651

The proceeds and gross realized gains on the sale of available-for-sale fixed maturity securities are as follows:

	Three Months Ended June 30, 2017	Six Months Ended June 30, 2016	2016
Proceeds from sales	\$—	\$1,074	\$5,059
Gross realized gains	—	54	2,300
Gross realized losses	—	(78 )	975

There were no sales of held-to-maturity securities during the three- and six-month periods ended June 30, 2017 and 2016.

Our investment portfolio includes trading securities with embedded derivatives. These securities are primarily convertible securities which are recorded at fair value. Income or loss, including the change in the fair value of these trading securities, is recognized currently in earnings as a component of net realized investment gains. Our portfolio of trading securities had a fair value of \$22,440 and \$20,034 at June 30, 2017 and December 31, 2016, respectively.

## Funding Commitment

Pursuant to an agreement with one of our limited liability partnership investments, we are contractually committed through December 31, 2023 to make capital contributions upon request of the partnership. Our remaining potential contractual obligation was \$5,576 at June 30, 2017.





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## Unrealized Appreciation

A summary of the changes in net unrealized investment appreciation during the reporting period is as follows:

	Six Months Ended	
	June 30,	
	2017	2016
Change in net unrealized investment appreciation		
Available-for-sale fixed maturities	\$32,132	\$98,381
Available-for-sale equity securities	11,861	12,700
Deferred policy acquisition costs	(3,753 )	(20,220 )
Income tax effect	(14,084 )	(31,802 )
Total change in net unrealized investment appreciation, net of tax	\$26,156	\$59,059

We continually monitor the difference between our cost basis and the estimated fair value of our investments. Our accounting policy for impairment recognition requires other-than-temporary impairment ("OTTI") charges to be recorded when we determine that it is more likely than not that we will be unable to collect all amounts due according to the contractual terms of the fixed maturity security or that the anticipated recovery in fair value of the equity security will not occur in a reasonable amount of time. Impairment charges on investments are recorded based on the fair value of the investments at the measurement date or based on the value calculated using a discounted cash flow model. Credit-related impairments on fixed maturity securities that we do not plan to sell, and for which we are not more likely than not to be required to sell, are recognized in net income. Any non-credit related impairment is recognized as a component of other comprehensive income. Factors considered in evaluating whether a decline in value is other-than-temporary include: the length of time and the extent to which fair value has been less than cost; the financial condition and near-term prospects of the issuer; our intention to hold the investment; and the likelihood that we will be required to sell the investment.

The tables on the following pages summarize our fixed maturity and equity securities that were in an unrealized loss position at June 30, 2017 and December 31, 2016. The securities are presented by the length of time they have been continuously in an unrealized loss position. It is possible that we could recognize OTTI charges in future periods on securities held at June 30, 2017, if future events or information cause us to determine that a decline in fair value is other-than-temporary.

We have evaluated the near-term prospects of the issuers of our fixed maturity securities in relation to the severity and duration of the unrealized loss and determined that these losses did not warrant the recognition of an OTTI charge at June 30, 2017 or at June 30, 2016. We have no intent to sell, and it is more likely than not that we will not be required to sell, these securities until the fair value recovers to at least equal our cost basis or the securities mature.

We have evaluated the near-term prospects of the issuers of our equity securities in relation to the severity and duration of the unrealized loss and determined that these losses did not warrant the recognition of an OTTI charge at June 30, 2017 or at June 30, 2016. Our largest unrealized loss greater than 12 months on an individual equity security at June 30, 2017 was \$173. We have no intention to sell any of these securities prior to a recovery in value, but will continue to monitor the fair value reported for these securities as part of our overall process to evaluate investments for OTTI recognition.

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June 30, 2017	Less than 12 months		12 months or longer		Total			
Type of Investment	Number of Issues	Fair Value	Gross Unrealized Depreciation	Number of Issues	Fair Value	Gross Unrealized Depreciation	Fair Value	Gross Unrealized Depreciation
<b>AVAILABLE-FOR-SALE</b>								
Fixed maturities:								
Bonds								
U.S. Treasury	4	\$10,159	\$ 78	2	\$1,604	\$ 2	\$11,763	\$ 80
U.S. government agency States, municipalities and political subdivisions	8	33,669	424	—	—	—	33,669	424
General obligations								
Midwest	5	17,233	381	1	5,254	174	22,487	555
Northeast	1	3,574	91	—	—	—	3,574	91
South	15	36,447	839	2	9,271	511	45,718	1,350
West	9	29,069	1,061	1	2,029	104	31,098	1,165
Special revenue								
Midwest	12	28,702	678	—	—	—	28,702	678
Northeast	16	48,096	1,229	—	—	—	48,096	1,229
South	33	82,121	2,461	4	15,640	1,086	97,761	3,547
West	27	69,324	2,377	—	—	—	69,324	2,377
Public utilities								
Corporate bonds	8	16,557	235	1	92	5	16,649	240
Energy	5	12,755	200	—	—	—	12,755	200
Industrials	5	9,004	75	2	4,803	144	13,807	219
Consumer goods and services	8	13,832	157	—	—	—	13,832	157
Technology, media and telecommunications	7	20,121	62	2	10,584	113	30,705	175
Financial services	15	36,947	526	—	—	—	36,947	526
Mortgage-backed securities	14	8,927	152	2	996	43	9,923	195
Collateralized mortgage obligations								
Government national mortgage association	18	56,024	945	8	18,631	545	74,655	1,490
Federal home loan mortgage corporation	26	107,586	2,693	3	4,814	201	112,400	2,894
Federal national mortgage association	12	33,550	480	5	8,327	272	41,877	752
<b>Total Available-for-Sale Fixed Maturities</b>	<b>248</b>	<b>\$673,697</b>	<b>\$ 15,144</b>	<b>33</b>	<b>\$82,045</b>	<b>\$ 3,200</b>	<b>\$755,742</b>	<b>\$ 18,344</b>
Equity securities:								
Common stocks								
Public utilities	—	\$—	\$ —	1	\$168	\$ 140	\$168	\$ 140
Energy	2	553	95	1	160	26	713	121
Industrials	—	—	—	6	231	181	231	181
Consumer goods and services	1	22	1	4	215	117	237	118
Technology, media and telecommunications	3	544	55	1	14	52	558	107
Financial services	1	52	3	2	166	48	218	51
<b>Total Available-for-Sale Equity Securities</b>	<b>7</b>	<b>\$1,171</b>	<b>\$ 154</b>	<b>15</b>	<b>\$954</b>	<b>\$ 564</b>	<b>\$2,125</b>	<b>\$ 718</b>
<b>Total Available-for-Sale Securities</b>	<b>255</b>	<b>\$674,868</b>	<b>\$ 15,298</b>	<b>48</b>	<b>\$82,999</b>	<b>\$ 3,764</b>	<b>\$757,867</b>	<b>\$ 19,062</b>



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December 31, 2016	Less than 12 months		12 months or longer			Total	Gross	
Type of Investment	Number of Issues	Fair Value	Gross Unrealized Depreciation	Number of Issues	Fair Value	Gross Unrealized Depreciation	Fair Value	Unrealized Depreciation
<b>AVAILABLE-FOR-SALE</b>								
Fixed maturities:								
Bonds								
U.S. Treasury	9	\$10,800	\$ 108	—	\$—	\$ —	\$10,800	\$ 108
U.S. government agency States, municipalities and political subdivisions	10	36,593	540	—	—	—	36,593	540
General obligations								
Midwest	27	40,545	1,412	—	—	—	40,545	1,412
Northeast	9	9,874	231	—	—	—	9,874	231
South	37	53,699	2,355	—	—	—	53,699	2,355
West	30	55,265	2,173	—	—	—	55,265	2,173
Special revenue								
Midwest	41	62,937	1,433	—	—	—	62,937	1,433
Northeast	22	54,993	2,624	—	—	—	54,993	2,624
South	79	152,979	6,791	—	—	—	152,979	6,791
West	44	81,676	4,052	—	—	—	81,676	4,052
Public utilities	20	38,511	423	2	2,122	24	40,633	447
Corporate bonds								
Energy	8	15,938	313	3	8,232	106	24,170	419
Industrials	24	42,854	596	3	5,641	386	48,495	982
Consumer goods and services	11	21,059	295	—	—	—	21,059	295
Health care	9	20,918	151	—	—	—	20,918	151
Technology, media and telecommunications	16	41,230	516	3	10,241	303	51,471	819
Financial services	37	75,286	1,358	—	—	—	75,286	1,358
Mortgage-backed securities	16	9,611	187	5	1,198	54	10,809	241
Collateralized mortgage obligations								
Government national mortgage association	36	82,430	2,261	9	13,603	505	96,033	2,766
Federal home loan mortgage corporation	41	105,775	3,165	3	5,141	241	110,916	3,406
Federal national mortgage association	27	46,633	1,091	4	4,341	243	50,974	1,334
Asset-backed securities	1	971	29	1	2,559	253	3,530	282
Total Available-for-Sale Fixed Maturities	554	\$1,060,577	\$ 32,104	33	\$53,078	\$ 2,115	\$1,113,655	\$ 34,219
Equity securities:								
Common stocks								
Public utilities	—	\$—	\$ —	3	\$120	\$ 188	\$120	\$ 188
Energy	—	—	—	1	163	22	163	22
Industrials	—	—	—	6	239	173	239	173
Consumer goods and services	3	282	55	2	15	3	297	58
Technology, media and telecommunications	7	26	5	8	33	33	59	38

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Financial services	3	53	3	2	150	64	203	67
Total Available-for-Sale Equity	13	\$361	\$ 63	22	\$720	\$ 483	\$1,081	\$ 546
Securities								
Total Available-for-Sale Securities	567	\$1,060,938	\$ 32,167	55	\$53,798	\$ 2,598	\$1,114,736	\$ 34,765

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NOTE 3. FAIR VALUE OF FINANCIAL INSTRUMENTS

Current accounting guidance on fair value measurements includes the application of a fair value hierarchy that requires us to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. Our financial instruments that are recorded at fair value are categorized into a three-level hierarchy, which is based upon the priority of the inputs to the valuation technique. The fair value hierarchy gives the highest priority to quoted prices in active markets for identical assets (i.e., Level 1) and the lowest priority to unobservable inputs (i.e., Level 3). If the inputs used to measure fair value fall within different levels of the hierarchy, the category level is based on the lowest priority level input that is significant to the fair value measurement of the financial instrument. Financial instruments recorded at fair value are categorized in the fair value hierarchy as follows:

• Level 1: Valuations are based on unadjusted quoted prices in active markets for identical financial instruments that we have the ability to access.

• Level 2: Valuations are based on quoted prices for similar financial instruments, other than quoted prices included in Level 1, in markets that are not active or on inputs that are observable either directly or indirectly for the full term of the financial instrument.

• Level 3: Valuations are based on pricing or valuation techniques that require inputs that are both unobservable and significant to the overall fair value measurement of the financial instrument. Such inputs may reflect management's own assumptions about the assumptions a market participant would use in pricing the financial instrument.

We review our fair value hierarchy categorizations on a quarterly basis at which time the classification of certain financial instruments may change if the input observations have changed. Transfers between levels, if any, are recorded as of the beginning of the reporting period.

To determine the fair value of the majority of our investments, we utilize prices obtained from independent, nationally recognized pricing services. We obtain one price for each security. When the pricing services cannot provide a determination of fair value for a specific security, we obtain non-binding price quotes from broker-dealers with whom we have had several years experience and who have demonstrated knowledge of the subject security. We request and utilize one broker quote per security.

In order to determine the proper classification in the fair value hierarchy for each security where the price is obtained from an independent pricing service, we obtain and evaluate the vendors' pricing procedures and inputs used to price the security, which include unadjusted quoted market prices for identical securities, such as a New York Stock Exchange closing price, and quoted prices for identical securities in markets that are not active. For fixed maturity securities, an evaluation of interest rates and yield curves observable at commonly quoted intervals, volatility, prepayment speeds, credit risks and default rates may also be performed. We have determined that these processes and inputs result in fair values and classifications consistent with the applicable accounting guidance on fair value measurements.

When possible, we use quoted market prices to determine the fair value of fixed maturities, equity securities, trading securities and short-term investments. When quoted market prices do not exist, we base estimates of fair value on market information obtained from independent pricing services and brokers or on valuation techniques that are both unobservable and significant to the overall fair value measurement of the financial instrument. Such inputs may reflect management's own assumptions about the assumptions a market participant would use in pricing the financial instrument. Our valuation techniques are discussed in more detail throughout this section.

The fair value of our mortgage loans is determined by modeling performed by us based on the stated principal and coupon payments provided for in the loan agreements. These cash flows are then discounted using an appropriate risk-adjusted discount rate to determine the security's fair value, which is a Level 3 fair value measurement.

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The fair value of our policy loans is equivalent to carrying value, which is a reasonable estimate of fair value and is classified as Level 2. We do not make policy loans for amounts in excess of the cash surrender value of the related policy. In all instances, the policy loans are fully collateralized by the related liability for future policy benefits for traditional insurance policies or by the policyholders' account balance for non-traditional policies.

Our other long-term investments consist primarily of our interests in limited liability partnerships that are recorded on the equity method of accounting. The fair value of the partnerships is obtained from the fund managers, which is based on the fair value of the underlying investments held in the partnerships. In management's opinion, these values represent a reasonable estimate of fair value. We have not adjusted the net asset value provided by the fund managers. For cash and cash equivalents and accrued investment income, carrying value is a reasonable estimate of fair value due to the short-term nature of these financial instruments.

The Company formed a rabbi trust in 2014 to fund obligations under the United Fire & Casualty Company Non-qualified Deferred Compensation Plan and United Fire Group Supplemental Executive Retirement and Deferral Plan (collectively, the "Executive Retirement Plans"). Within the rabbi trust, corporate-owned life insurance ("COLI") policies are utilized as an investment vehicle and source of funding for the Company's Executive Retirement Plans. The COLI policies invest in mutual funds, which are priced daily by independent sources. As of June 30, 2017, the cash surrender value of the COLI policies was \$3,244, which is equal to the fair value measured using Level 2 inputs, based on the underlying assets of the COLI policies, and is included in other assets in the Consolidated Balance Sheets.

Policy reserves are developed and recorded for deferred annuities, which is an interest-sensitive product, and income annuities. The fair value of the reserve liability for these annuity products is based upon an estimate of the discounted pretax cash flows that are forecast for the underlying business, which is a Level 3 fair value measurement. We base the discount rate on the current U.S. Treasury spot yield curve, which is then risk-adjusted for nonperformance risk and, for interest-sensitive business and market risk factors. The risk-adjusted discount rate is developed using interest rates that are available in the market and representative of the risks applicable to the underlying business.





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A summary of the carrying value and estimated fair value of our financial instruments at June 30, 2017 and December 31, 2016 is as follows:

	June 30, 2017		December 31, 2016	
	Fair Value	Carrying Value	Fair Value	Carrying Value
<b>Assets</b>				
<b>Investments</b>				
<b>Fixed maturities:</b>				
Held-to-maturity securities	\$ 192	\$ 192	\$ 199	\$ 198
Available-for-sale securities	2,955,079	2,955,079	2,898,126	2,898,126
Trading securities	15,828	15,828	14,390	14,390
<b>Equity securities:</b>				
Available-for-sale securities	276,306	276,306	270,416	270,416
Trading securities	6,612	6,612	5,644	5,644
Mortgage loans	3,765	3,573	3,895	3,706
Policy loans	5,499	5,499	5,366	5,366
Other long-term investments	65,664	65,664	67,639	67,639
Short-term investments	175	175	175	175
Cash and cash equivalents	130,421	130,421	110,853	110,853
Corporate-owned life insurance	3,244	3,244	2,592	2,592
<b>Liabilities</b>				
<b>Policy reserves</b>				
Annuity (accumulations) <sup>(1)</sup>	\$ 629,169	\$ 631,070	\$ 646,764	\$ 666,711
Annuity (benefit payments)	143,925	94,323	144,283	95,129

(1) Annuity accumulations represent deferred annuity contracts that are currently earning interest.



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The following tables present the categorization for our financial instruments measured at fair value on a recurring basis in our Consolidated Balance Sheets at June 30, 2017 and December 31, 2016:

Description	Total	Fair Value Measurements		
		Level 1	Level 2	Level 3
<b>AVAILABLE-FOR-SALE</b>				
Fixed maturities:				
Bonds				
U.S. Treasury	\$22,044	\$—	\$22,044	\$—
U.S. government agency	80,793	—	80,793	—
States, municipalities and political subdivisions				
General obligations				
Midwest	130,954	—	130,954	—
Northeast	55,579	—	55,579	—
South	142,991	—	142,991	—
West	121,954	—	121,954	—
Special revenue				
Midwest	166,312	—	166,235	77
Northeast	79,979	—	79,979	—
South	258,990	—	258,990	—
West	152,461	—	152,461	—
Foreign bonds	57,490	—	57,490	—
Public utilities	211,671	—	211,671	—
Corporate bonds				
Energy	101,465	—	101,465	—
Industrials	220,426	—	220,426	—
Consumer goods and services	184,762	—	184,034	728
Health care	78,332	—	78,332	—
Technology, media and telecommunications	146,258	—	146,258	—
Financial services	267,551	—	259,223	8,328
Mortgage-backed securities	15,498	—	15,498	—
Collateralized mortgage obligations				
Government national mortgage association	155,867	—	155,867	—
Federal home loan mortgage corporation	194,228	—	194,228	—
Federal national mortgage association	104,676	—	104,676	—
Asset-backed securities	4,798	—	4,176	622
Total Available-for-Sale Fixed Maturities	\$2,955,079	\$—	\$2,945,324	\$9,755
Equity securities:				
Common stocks				
Public utilities	\$21,316	\$21,316	\$—	\$—
Energy	13,526	13,526	—	—
Industrials	57,291	57,291	—	—
Consumer goods and services	25,331	25,331	—	—

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Health care	32,721	32,721	—	—
Technology, media and telecommunications	14,739	14,739	—	—
Financial services	110,312	110,312	—	—
Nonredeemable preferred stocks	1,070	475	—	595
Total Available-for-Sale Equity Securities	\$276,306	\$275,711	\$—	\$595
Total Available-for-Sale Securities	\$3,231,385	\$275,711	\$2,945,324	\$10,350
TRADING				
Fixed maturities:				
Corporate bonds				
Industrials	\$3,724	\$—	\$3,724	\$—
Consumer goods and services	293	—	293	—
Health care	3,708	—	3,708	—
Technology, media and telecommunications	1,200	—	1,200	—
Financial services	4,262	—	4,262	—
Redeemable preferred stocks	2,641	2,641	—	—
Equity securities:				
Public utilities	819	819	—	—
Energy	216	216	—	—
Industrials	947	947	—	—
Consumer goods and services	1,200	1,200	—	—
Health care	370	370	—	—
Financial services	232	232	—	—
Nonredeemable preferred stocks	2,828	2,828	—	—
Total Trading Securities	\$22,440	\$9,253	\$13,187	\$—
Short-Term Investments	\$175	\$175	\$—	\$—
Money Market Accounts	\$14,641	\$14,641	\$—	\$—
Corporate-Owned Life Insurance	\$3,244	\$—	\$3,244	\$—
Total Assets Measured at Fair Value	\$3,271,885	\$299,780	\$2,961,755	\$10,350

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December 31, 2016		Fair Value Measurements		
Description	Total	Level 1	Level 2	Level 3
AVAILABLE-FOR-SALE				
Fixed maturities:				
Bonds				
U.S. Treasury	\$23,195	\$—	\$23,195	\$—
U.S. government agency	77,597	—	77,597	—
States, municipalities and political subdivisions				
General obligations				
Midwest	144,143	—	144,143	—
Northeast	58,409	—	58,409	—
South	128,369	—	128,369	—
West	113,731	—	113,731	—
Special revenue				
Midwest	168,310	—	168,142	168
Northeast	68,065	—	68,065	—
South	239,187	—	239,187	—
West	131,744	—	131,744	—
Foreign bonds	65,234	—	65,234	—
Public utilities	215,674	—	215,674	—
Corporate bonds				
Energy	108,860	—	108,860	—
Industrials	229,903	—	229,903	—
Consumer goods and services	181,687	—	180,590	1,097
Health care	83,123	—	83,123	—
Technology, media and telecommunications	144,612	—	144,612	—
Financial services	273,951	—	265,154	8,797
Mortgage-backed securities	17,248	—	17,248	—
Collateralized mortgage obligations				
Government national mortgage association	144,460	—	144,460	—
Federal home loan mortgage corporation	174,458	—	174,458	—
Federal national mortgage association	101,896	—	101,896	—
Asset-backed securities	4,270	—	3,821	449
Total Available-for-Sale Fixed Maturities	\$2,898,126	\$—	\$2,887,615	\$10,511
Equity securities:				
Common stocks				
Public utilities	\$19,671	\$19,671	\$—	\$—
Energy	15,047	15,047	—	—
Industrials	51,794	51,794	—	—
Consumer goods and services	24,117	24,117	—	—
Health care	27,420	27,420	—	—
Technology, media and telecommunications	15,369	15,369	—	—
Financial services	115,950	111,958	—	3,992

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Nonredeemable preferred stocks	1,048	453	—	595
Total Available-for-Sale Equity Securities	\$270,416	\$265,829	\$—	\$4,587
Total Available-for-Sale Securities	\$3,168,542	\$265,829	\$2,887,615	\$15,098

## TRADING

## Fixed maturities:

## Bonds

## Corporate bonds

Industrials	\$3,919	\$—	\$3,919	\$—
Consumer goods and services	127	—	127	—
Health care	3,410	—	3,410	—
Technology, media and telecommunications	787	—	787	—
Financial services	4,842	—	4,842	—
Redeemable preferred stocks	1,305	1,305	—	—

## Equity securities:

Public utilities	613	613	—	—
Energy	286	286	—	—
Industrials	877	877	—	—
Consumer goods and services	1,202	1,202	—	—
Health care	339	339	—	—
Financial services	206	206	—	—
Nonredeemable preferred stocks	2,121	2,121	—	—
Total Trading Securities	\$20,034	\$6,949	\$13,085	\$—
Short-Term Investments	\$175	\$175	\$—	\$—
Money Market Accounts	\$16,802	\$16,802	\$—	\$—
Corporate-Owned Life Insurance	\$2,592	\$—	\$2,592	\$—
Total Assets Measured at Fair Value	\$3,208,145	\$289,755	\$2,903,292	\$15,098

The fair value of securities that are categorized as Level 1 is based on quoted market prices that are readily and regularly available.

We use a market-based approach for valuing all of our Level 2 securities and submit them primarily to a third-party valuation service provider. Any of these securities not valued by this service provider are submitted to another third-party valuation service provider. Both service providers use a market approach to find pricing of similar financial instruments. The market inputs our service providers normally seek to value our securities include the following, listed in approximate order of priority: benchmark yields, reported trades, broker/dealer quotes, issuer spreads, two-sided markets, benchmark securities, bids, offers, and reference data including market research publications. The method and inputs for these securities classified as Level 2 are the same regardless of industry category, credit quality, duration, geographical concentration or economic characteristics. For our mortgage-backed securities, collateralized mortgage obligations and asset-backed securities, our service providers use additional market inputs to value these securities, including the following: new issue data, periodic payment information, monthly payment information, collateral performance and real estate analysis from third parties. Our service providers prioritize inputs based on market conditions, and not all inputs listed are available for use in the valuation process for each security on any given day.

At least annually, we review the methodologies and assumptions used by our valuation service providers and verify that they are reasonable and representative of the fair value of the underlying securities held in the investment portfolio. We validate the prices obtained from independent pricing services and brokers prior to their use for

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reporting purposes by evaluating their reasonableness on a monthly basis. Our validation process includes a review for unusual fluctuations. Unusual fluctuations outside of our expectations are independently corroborated with additional third-party sources that use similar valuation techniques as discussed above. In addition, we also randomly select securities and independently corroborate the valuations obtained from our third-party valuation service providers. In our opinion, the pricing obtained at June 30, 2017 and December 31, 2016 was reasonable.

For the three- and six-month periods ended June 30, 2017, the change in our available-for-sale securities categorized as Level 1 and Level 2 is the result of investment purchases that were made using funds held in our money market accounts, disposals and the change in unrealized gains on both fixed maturities and equity securities. During the three- and six-month periods ended June 30, 2017, there were no securities transferred between Level 1 and Level 2. Securities categorized as Level 3 include holdings in certain private placement fixed maturity and equity securities for which an active market does not currently exist. The fair value of our Level 3 private placement securities is determined by management relying on pricing received from our independent pricing services and brokers consistent with the process to estimate fair value for Level 2 securities. However, securities are categorized as Level 3 if these quotes cannot be corroborated by other market observable data due to the unobservable nature of the brokers' valuation processes. If pricing cannot be obtained from these sources, which occurs on a limited basis, management will perform a discounted cash flow analysis, using an appropriate risk-adjusted discount rate, on the underlying security to estimate fair value. During the three- and six-month periods ended June 30, 2017, there were no securities transferred in or out of Level 3.

The following table provides a summary of the changes in fair value of our Level 3 securities for the three-month period ended June 30, 2017:

	States, municipalities and political subdivisions	Corporate bonds	Asset-backed securities	Equities	Total
Balance at March 31, 2017	\$ 168	\$ 9,494	\$ 456	\$ 4,718	\$ 14,836
Net unrealized gains (losses) <sup>(1)</sup>	(6 )	68	166	—	228
Disposals	(85 )	(506 )	—	(4,123 )	(4,714 )
Balance at June 30, 2017	\$ 77	\$ 9,056	\$ 622	\$ 595	\$ 10,350

(1) Net unrealized gains (losses) are recorded as a component of comprehensive income.

The following table provides a summary of the changes in fair value of our Level 3 securities for the six-month period ended June 30, 2017:

	States, municipalities and political subdivisions	Corporate bonds	Asset-backed securities	Equities	Total
Balance at January 1, 2017	\$ 168	\$ 9,894	\$ 449	\$ 4,587	\$ 15,098
Net unrealized gains (losses) <sup>(1)</sup>	(6 )	1	173	—	168
Purchases	—	—	—	145	145
Disposals	(85 )	(839 )	—	(4,137 )	(5,061 )
Balance at June 30, 2017	\$ 77	\$ 9,056	\$ 622	\$ 595	\$ 10,350

(1) Net unrealized gains (losses) are recorded as a component of comprehensive income.

The fixed maturities reported as disposals relate to the receipt of principal on calls or sinking fund bonds, in accordance with the indentures.

**NOTE 4. RESERVES FOR LOSSES AND LOSS SETTLEMENT EXPENSES**

Property insurance indemnifies an insured with an interest in physical property for loss of, or damage to, such property or the loss of its income-producing abilities. Casualty insurance primarily covers liability for damage to





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property of, or injury to, a person or entity other than the insured. In most cases, casualty insurance also obligates the insurance company to provide a defense for the insured in litigation, arising out of events covered by the policy.

Liabilities for losses and loss settlement expenses reflect management's best estimates at a given point in time of what we expect to pay for claims that have been reported and those that have been incurred but not reported ("IBNR"), based on known facts, circumstances, and historical trends. Because property and casualty insurance reserves are estimates of the unpaid portions of incurred losses that have been reported to us, as well as losses that have been incurred but not reported, the establishment of appropriate reserves, including reserves for catastrophes, is an inherently uncertain and complex process. The ultimate cost of losses and related loss settlement expenses may vary materially from recorded amounts. We regularly update our reserve estimates as new information becomes available and as events unfold that may affect the resolution of unsettled claims. Changes in prior year reserve estimates, which may be material, are reported as a component of losses and loss settlement expenses incurred in the period such changes are determined.

The determination of reserves (particularly those relating to liability lines of insurance that have relatively longer lag in claim reporting) requires significant work to reasonably project expected future claim reporting and payment patterns. If, during the course of our regular monitoring of reserves, we determine that coverages previously written are incurring higher than expected losses, we will take action that may include, among other things, increasing the related reserves. Any adjustments we make to reserves are reflected in operating results in the year in which we make those adjustments. We engage an independent actuary, Regnier Consulting Group, Inc. ("Regnier"), to render an opinion as to the reasonableness of our statutory reserves annually. The actuarial opinion is filed in those states where we are licensed.

On a quarterly basis, UFG's internal actuary performs a detailed actuarial review of IBNR reserves. This review includes a comparison of results from the most recent analysis of reserves completed by both our internal and external actuaries. Senior management meets with our internal actuary to review, on a regular and quarterly basis, the adequacy of carried reserves based on results from this actuarial analysis. There are two fundamental types or sources of IBNR reserves. We record IBNR reserves for "normal" types of claims and also specific IBNR reserves related to unique circumstances or events. A major hurricane is an example of an event that might necessitate establishing specific IBNR reserves because an analysis of existing historical data would not provide an appropriate estimate.

We do not discount loss reserves based on the time value of money.

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The following table provides an analysis of changes in our property and casualty losses and loss settlement expense reserves at June 30, 2017 and December 31, 2016 (net of reinsurance amounts):

	June 30, 2017	December 31, 2016
Gross liability for losses and loss settlement expenses at beginning of year	\$1,123,896	\$1,003,895
Ceded losses and loss settlement expenses	(59,794 )	(54,653 )
Net liability for losses and loss settlement expenses at beginning of year	\$1,064,102	\$949,242
Losses and loss settlement expenses incurred for claims occurring during		
Current year	\$386,352	\$683,662
Prior years	(41,202 )	(31,229 )
Total incurred	\$345,150	\$652,433
Losses and loss settlement expense payments for claims occurring during		
Current year	\$116,808	\$277,053
Prior years	175,126	260,520
Total paid	\$291,934	\$537,573
Net liability for losses and loss settlement expenses at end of year	\$1,117,318	\$1,064,102
Ceded loss and loss settlement expenses	63,160	59,794
Gross liability for losses and loss settlement expenses at end of period	\$1,180,478	\$1,123,896

There are a multitude of factors that can impact loss reserve development. Those factors include, but are not limited to: historical data, the potential impact of various loss reserve development factors and trends including historical loss experience, legislative enactments, judicial decisions, legal developments in imposition of damages, experience with alternative dispute resolution, results of our medical bill review process, the potential impact of salvage and subrogation and changes and trends in general economic conditions, including the effects of inflation. All of these factors influence our estimates of required reserves and for long tail lines these factors can change over the course of the settlement of the claim. However, there is no precise method for evaluating the specific dollar impact of any individual factor on the development of reserves.

The significant drivers of the favorable reserve development in 2017 was in our commercial liability or long-tail liability line of business and workers' compensation line of business. Much of the favorable long-tail liability development continues to come from loss adjustment expense and is attributed to our continued litigation management efforts. There was also a reduction in reserves for incurred but not reported claims because our long tail liability has experienced fewer late reported claims than what was initially anticipated. The majority of the favorable workers compensation development is due to reductions in reserves for reported claims which were greater than what was necessary to offset claim payments. Commercial fire and allied lines and assumed reinsurance exhibited adverse development, which provided a partial offset to the much larger favorable development previously noted. Assumed reinsurance was adversely affected by increases in reserves for reported claims while commercial fire adverse development is attributable to loss payments which were greater than reductions in reported loss reserves and reserves for claims incurred but not reported. The majority of adverse commercial fire development resulted from claim payments that exceeded reductions in reserves for reported claims.

The significant drivers of the favorable reserve development in 2016 were our commercial liability and workers compensation. Much of the favorable commercial liability development came from loss adjustment expense and is attributed to our continued litigation management efforts. Workers compensation favorable development was due to the combined effects of decreases in claim reserves along with favorable changes affecting loss adjustment expense. Loss adjustment expense, closely tied to loss, generally decreases when loss decreases. Commercial property, commercial automobile and assumed reinsurance exhibited adverse development which provided a partial offset to the favorable development previously noted. The adverse development for all three lines is due to paid loss which was greater than reductions in reported loss reserves and reserves for claims incurred but not reported. No other single line of business contributed a significant portion of the total development.

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Generally, we base reserves for each claim on the estimated ultimate exposure for that claim. We believe that it is appropriate and reasonable to establish a best estimate for reserves within a range of reasonable estimates, especially when we are reserving for claims for bodily injury, disabilities and similar claims, for which settlements and verdicts can vary widely. Our reserving philosophy may result in favorable reserve development in future years that will decrease losses and loss settlement expenses for prior year claims in the year of adjustment. We realize that this philosophy, coupled with what we believe to be aggressive and successful claims management and loss settlement practices, has resulted in year-to-year redundancies in reserves. We believe our approach produces recorded reserves that are reasonably consistent as to their relative position within a range of reasonable reserves from year-to-year. However, conditions and trends that have affected the reserve development for a given year do change. Therefore, such development cannot be used to project future reserve redundancies or deficiencies.

We are not aware of any significant contingent liabilities related to environmental issues. Because of the type of property coverage we write, we have potential exposure to environmental pollution, mold and asbestos claims. Our underwriters are aware of these exposures and use riders or endorsements to limit exposure.

## NOTE 5. EMPLOYEE BENEFITS

## Net Periodic Benefit Cost

The components of the net periodic benefit cost for our pension and postretirement benefit plans are as follows:

	Pension Plan		Postretirement Benefit Plan	
	2017	2016	2017	2016
Three Months Ended June 30,				
Net periodic benefit cost				
Service cost	\$1,714	\$1,623	\$505	\$932
Interest cost	1,765	1,663	482	754
Expected return on plan assets	(2,412 )	(1,988 )	—	—
Amortization of prior service credit	—	—	(1,352 )	—
Amortization of net loss	891	992	461	379
Net periodic benefit cost	\$1,958	\$2,290	\$96	\$2,065
Six Months Ended June 30,				
Net periodic benefit cost				
Service cost	\$3,427	\$3,246	\$1,010	\$1,864
Interest cost	3,530	3,326	964	1,508
Expected return on plan assets	(4,824 )	(3,976 )	—	—
Amortization of prior service credit	—	—	(2,704 )	—
Amortization of net loss	1,782	1,984	922	758
Net periodic benefit cost	\$3,915	\$4,580	\$192	\$4,130

## Employer Contributions

We previously disclosed in our Annual Report on Form 10-K for the year ended December 31, 2016 that we expected to contribute \$6,400 to the pension plan in 2017. For the six-month period ended June 30, 2017, we contributed \$3,196 to the pension plan.

NOTE 6. STOCK-BASED COMPENSATION

Non-qualified Employee Stock Award Plan

The United Fire Group, Inc. 2008 Stock Plan (the "2008 Stock Plan") authorized the issuance of restricted and unrestricted stock awards, restricted stock units, stock appreciation rights, incentive stock options, and non-qualified stock options for up to 1,900,000 shares of UFG common stock to employees. In May 2014, the Registrant's

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shareholders approved an additional 1,500,000 shares of UFG common stock issuable at any time and from time to time pursuant to the 2008 Stock Plan, among other amendments, and renamed such plan as the United Fire Group, Inc. Stock Plan (as amended, the "Stock Plan"). At June 30, 2017, there were 997,259 authorized shares remaining available for future issuance. The Stock Plan is administered by the Board of Directors, which determines those employees who will receive awards, when awards will be granted, and the terms and conditions of the awards. The Board of Directors may also take any action it deems necessary and appropriate for the administration of the Stock Plan. Pursuant to the Stock Plan, the Board of Directors may, at its sole discretion, grant awards to our employees who are in positions of substantial responsibility with UFG.

Options granted pursuant to the Stock Plan are granted to buy shares of UFG's common stock at the market value of the stock on the date of grant. All outstanding option awards have graded vesting over 3 years or 5 years from the grant date, unless the Board of Directors authorizes acceleration of vesting. Performance stock units cliff-vest after 3 years and the certification of performance results by UFG's Compensation Committee. To the extent not exercised, vested option awards accumulate and are exercisable by the awardee, in whole or in part, in any subsequent year included in the option period, but not later than 10 years from the grant date. Restricted and unrestricted stock awards granted pursuant to the Stock Plan are granted at the market value of UFG's common stock on the date of the grant. Restricted stock units fully vest after 3 years or 5 years from the date of issuance, unless accelerated upon the approval of the Board of Directors, at which time UFG common stock will be issued to the awardee.

The activity in the Stock Plan is displayed in the following table:

Authorized Shares Available for Future Award Grants	Six Months Ended June 30, 2017	From Inception to June 30, 2017
Beginning balance	1,248,651	1,900,000
Additional shares authorized	—	1,500,000
Number of awards granted	(254,620 )	(2,867,186)
Number of awards forfeited or expired	3,228	464,445
Ending balance	997,259	997,259
Number of option awards exercised	74,466	1,023,534
Number of unrestricted stock awards granted	725	8,050
Number of restricted stock awards vested	—	36,970

#### Non-qualified Non-employee Director Stock Option and Restricted Stock Plan

The United Fire Group, Inc. 2005 Non-qualified Non-employee Director Stock Option and Restricted Stock Plan (the "Director Plan") authorizes the issuance of restricted stock awards and non-qualified stock options to purchase shares of UFG's common stock to non-employee directors. At June 30, 2017, we had 61,813 authorized shares available for future issuance.

The Board of Directors has the authority to determine which non-employee directors receive awards, when options and restricted stock shall be granted, the option price, the option expiration date, the date of grant, the vesting schedule of options or whether the options shall be immediately vested, the terms and conditions of options and restricted stock (other than those terms and conditions set forth in the plan) and the number of shares of common stock to be issued pursuant to an option agreement or restricted stock agreement (subject to limits set forth in the plan). The Board of Directors may also take any action it deems necessary and appropriate for the administration of the Director Plan.





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The activity in the Director Plan is displayed in the following table:

Authorized Shares Available for Future Award Grants	Six Months Ended June 30, 2017	From Inception to June 30, 2017
Beginning balance	74,771	300,000
Number of awards granted	(12,958)	(262,190)
Number of awards forfeited or expired	—	24,003
Ending balance	61,813	61,813
Number of option awards exercised	6,727	59,200
Number of restricted stock awards vested	22,716	54,272

#### Stock-Based Compensation Expense

For the three-month periods ended June 30, 2017 and 2016, we recognized stock-based compensation expense of \$1,210 and \$889, respectively. For the six-month periods ended June 30, 2017 and 2016, we recognized stock-based compensation expense of \$2,254 and \$1,865, respectively. Stock-based compensation expense is recognized over the vesting period of the stock options.

As of June 30, 2017, we had \$10,614 in stock-based compensation expense that has yet to be recognized through our results of operations. We expect this compensation to be recognized over the remainder of 2017 and subsequent years according to the table below, except with respect to awards that are accelerated by the Board of Directors, in which case we will recognize any remaining compensation expense in the period in which the awards are accelerated.

2017	\$2,371
2018	3,981
2019	2,718
2020	1,111
2021	393
2022	40
Total	\$10,614

#### NOTE 7. SEGMENT INFORMATION

We have two reportable business segments in our operations: property and casualty insurance and life insurance. The property and casualty insurance segment has six domestic locations from which it conducts its business. The life insurance segment operates from our home office in Cedar Rapids, Iowa. Because all of our insurance is sold domestically, we have no revenues from foreign operations.

We evaluate the two segments on the basis of both statutory accounting principles prescribed or permitted by our states of domicile and GAAP. We analyze results based on profitability (i.e., loss ratios), expenses, and return on equity. The basis we use to determine and analyze segments and to measure segment profit or loss have not changed from that reported in our Annual Report on Form 10-K for the year ended December 31, 2016.

We have reconciled the amounts in the following table for the three-month periods ended June 30, 2017 and 2016 to the amounts reported in our unaudited Consolidated Financial Statements, adjusting for intersegment eliminations.



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	Property and Casualty Insurance	Life Insurance	Total
As of and for the Three Months Ended June 30, 2017			
Net premiums earned	\$245,222	\$14,341	\$259,563
Investment income, net of investment expenses	12,208	12,426	24,634
Net realized investment gains	1,081	1,599	2,680
Other income	—	126	126
Total reportable segment	\$258,511	\$28,492	\$287,003
Intersegment eliminations	(24 )	—	(24 )
Total revenues	\$258,487	\$28,492	\$286,979
Net income	\$109	\$2,849	\$2,958
Assets	\$2,595,147	\$1,602,265	\$4,197,412
Invested assets	\$1,836,736	\$1,492,192	\$3,328,928
As of and for the Three Months Ended June 30, 2016			
Net premiums earned	\$232,282	\$21,205	\$253,487
Investment income, net of investment expenses	11,655	12,889	24,544
Net realized investment gains	966	630	1,596
Other income	—	183	183
Total reportable segment	\$244,903	\$34,907	\$279,810
Intersegment eliminations	(37 )	—	(37 )
Total revenues	\$244,866	\$34,907	\$279,773
Net income (loss)	\$3,434	\$(320 )	\$3,114
Assets	\$2,459,526	\$1,646,312	\$4,105,838
Invested assets	\$1,723,641	\$1,547,765	\$3,271,406

We have reconciled the amounts in the following table for the six-month periods ended June 30, 2017 and 2016 to the amounts reported in our unaudited Consolidated Financial Statements, adjusting for intersegment eliminations.

	Property and Casualty Insurance	Life Insurance	Total
As of and for the Six Months Ended June 30, 2017			
Net premiums earned	\$481,666	\$31,769	\$513,435
Investment income, net of investment expenses	24,813	24,876	49,689
Net realized investment gains	3,330	3,304	6,634
Other income	—	324	324
Total reportable segment	\$509,809	\$60,273	\$570,082
Intersegment eliminations	(44 )	—	(44 )
Total revenues	\$509,765	\$60,273	\$570,038
Net income	\$18,693	\$4,201	\$22,894
Assets	\$2,595,147	\$1,602,265	\$4,197,412
Invested assets	\$1,836,736	\$1,492,192	\$3,328,928
As of and for the Six Months Ended June 30, 2016			
Net premiums earned	\$452,507	\$42,278	\$494,785
Investment income, net of investment expenses	21,064	25,741	46,805

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Net realized investment gains	2,703	948	3,651
Other income	—	291	291
Total reportable segment	\$476,274	\$69,258	\$545,532
Intersegment eliminations	(74 )	—	(74 )
Total revenues	\$476,200	\$69,258	\$545,458
Net income	\$25,454	\$87	\$25,541
Assets	\$2,459,526	\$1,646,312	\$4,105,838
Invested assets	\$1,723,641	\$1,547,765	\$3,271,406

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## NOTE 8. EARNINGS PER COMMON SHARE

Basic earnings per share is computed by dividing net income by the weighted-average number of common shares outstanding during the reporting period. Diluted earnings per share gives effect to all dilutive common shares outstanding during the reporting period. The dilutive shares we consider in our diluted earnings per share calculation relate to our outstanding stock options, restricted stock awards and restricted stock unit awards.

We determine the dilutive effect of our outstanding stock options using the "treasury stock" method. Under this method, we assume the exercise of all of the outstanding stock options whose exercise price is less than the weighted-average market value of our common stock during the reporting period. This method also assumes that the proceeds from the hypothetical stock option exercises are used to repurchase shares of our common stock at the weighted-average market value of the stock during the reporting period. The net of the assumed stock options exercised and assumed common shares repurchased represents the number of dilutive common shares, which we add to the denominator of the earnings per share calculation.

The components of basic and diluted earnings per share were as follows for the three-month periods ended June 30, 2017 and 2016:

(In Thousands, Except Share Data)	Three Months Ended June 30,			
	2017		2016	
	Basic	Diluted	Basic	Diluted
Net income	\$2,958	\$ 2,958	\$3,114	\$ 3,114
Weighted-average common shares outstanding	25,133,035	25,133,035	25,366,283	25,366,283
Add dilutive effect of restricted stock unit awards	—	248,717	—	155,270
Add dilutive effect of stock options	—	242,934	—	273,923
Weighted-average common shares	25,133,035	25,624,686	25,366,283	25,795,476
Earnings per common share	\$0.12	\$ 0.12	\$0.12	\$ 0.12
Awards excluded from diluted earnings per share calculation <sup>(1)</sup>	—	—	—	—

(1) Outstanding awards that are not "in-the-money" are excluded from the diluted earnings per share calculation because the effect of including them would have been anti-dilutive.

The components of basic and diluted earnings per share were as follows for the six-month periods ended June 30, 2017 and 2016:

(In Thousands, Except Share Data)	Six Months Ended June 30,			
	2017		2016	
	Basic	Diluted	Basic	Diluted
Net income	\$22,894	\$ 22,894	\$25,541	\$ 25,541
Weighted-average common shares outstanding	25,288,068	25,288,068	25,288,086	25,288,086
Add dilutive effect of restricted stock unit awards	—	248,717	—	155,270
Add dilutive effect of stock options	—	215,740	—	186,221
Weighted-average common shares	25,288,068	25,752,525	25,288,086	25,629,577
Earnings per common share	\$0.91	\$ 0.89	\$1.01	\$ 1.00
Awards excluded from diluted earnings per share calculation <sup>(1)</sup>	—	—	—	—

(1) Outstanding awards that are not "in-the-money" are excluded from the diluted earnings per share calculation because the effect of including them would have been anti-dilutive.

## NOTE 9. CREDIT FACILITY

On February 2, 2016, the Company, as borrower, entered into a Credit Agreement (the "Credit Agreement") by and among the Company, with the lenders from time to time party thereto and KeyBank National Association ("Key



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Bank"), as administrative agent, swingline lender and letter of credit issuer. The Credit Agreement provides for a \$50,000 four-year unsecured revolving credit facility that includes a \$20,000 letter of credit subfacility and a swingline subfacility in the amount up to \$5,000. The Credit Agreement allows the Company to increase the aggregate amount of the commitments thereunder by up to \$100,000, provided that no event of default has occurred and is continuing and certain other conditions are satisfied.

The Credit Agreement is available for the Company's general corporate purposes, including liquidity, acquisitions and working capital. All unpaid principal and accrued interest under the Credit Agreement is due and payable in full at maturity on February 2, 2020. Based on the type of loan, advances under the Credit Agreement would bear interest on either the London interbank offered rate ("LIBOR") or a base rate plus, in each case, a calculated margin amount. The unused commitments under the Credit Agreement will be subject to a commitment fee that will be calculated at a per annum rate. The applicable margins for borrowings under the Credit Agreement and the commitment fee thereunder will be determined by reference to a pricing grid based on the Company's issuer credit rating by A.M. Best Company, Inc.

The Credit Agreement contains customary representations, conditions to borrowing, covenants and events of default, including certain covenants that limit or restrict, subject to certain exceptions, the ability of the Company and its subsidiaries to sell or transfer assets, enter into a merger or consolidate with another company, create liens, impose restrictions on subsidiary dividends, enter into sale-leaseback transactions, make investments or acquisitions, enter into certain reinsurance agreements, pay dividends during any period of default, enter into transactions with affiliates, change the nature of its business, or incur indebtedness. The Credit Agreement also includes financial covenants that require the Company to (i) maintain a minimum consolidated net worth, (ii) maintain a minimum consolidated statutory surplus and (iii) not exceed a 0.35 to 1.0 debt to total capitalization ratio.

There was no outstanding balance on the Credit Agreement at June 30, 2017 and 2016, respectively. For the six-month periods ended June 30, 2017 and 2016, we did not incur any interest expense related to either credit facility. We were in compliance with all covenants of the Credit Agreement at June 30, 2017.

## NOTE 10. ACCUMULATED OTHER COMPREHENSIVE INCOME

The following table shows the changes in the components of our accumulated other comprehensive income (loss), net of tax, for the three-month period ended June 30, 2017:

	Net unrealized appreciation on investments	Liability for underfunded employee benefit costs <sup>(1)</sup>	Total
Balance as of March 31, 2017	\$ 141,407	\$ (23,959 )	\$ 117,448
Change in accumulated other comprehensive income before reclassifications	19,924	—	19,924
Reclassification adjustments from accumulated other comprehensive income (loss)	(1,283 )	879	(404 )
Balance as of June 30, 2017	\$ 160,048	\$ (23,080 )	\$ 136,968

(1) Estimates and Assumptions: The preparation of financial statements in conformity with GAAP requires us to make various estimates and assumptions that affect the reporting of net periodic benefit cost, plan assets and plan obligations for each plan at the date of the financial statements. Actual results could differ from these estimates. One significant estimate relates to the calculation of the benefit obligation for each plan. We annually establish the discount rate, which is an estimate of the interest rate at which these benefits could be effectively settled, that is used to determine the present value of the respective plan's benefit obligations as of December 31.





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The following table shows the changes in the components of our accumulated other comprehensive income (loss), net of tax, for the six-month period ended June 30, 2017:

	Net unrealized appreciation on investments	Liability for underfunded employee benefit costs <sup>(1)</sup>	Total
Balance as of January 1, 2017	\$ 133,892	\$ (24,837 )	\$ 109,055
Change in accumulated other comprehensive income before reclassifications	29,652	—	29,652
Reclassification adjustments from accumulated other comprehensive income (loss)	(3,496 )	1,757	(1,739 )
Balance as of June 30, 2017	\$ 160,048	\$ (23,080 )	\$ 136,968

(1) Estimates and Assumptions: The preparation of financial statements in conformity with GAAP requires us to make various estimates and assumptions that affect the reporting of net periodic benefit cost, plan assets and plan obligations for each plan at the date of the financial statements. Actual results could differ from these estimates. One significant estimate relates to the calculation of the benefit obligation for each plan. We annually establish the discount rate, which is an estimate of the interest rate at which these benefits could be effectively settled, that is used to determine the present value of the respective plan's benefit obligations as of December 31.

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Review Report of Independent Registered Public Accounting Firm

Board of Directors and Stockholders  
United Fire Group, Inc.

We have reviewed the consolidated balance sheet of United Fire Group, Inc. (the "Company") as of June 30, 2017, and the related consolidated statements of income and comprehensive income for the three- and six-month periods ended June 30, 2017 and 2016, the consolidated statements of cash flows for the six-month periods ended June 30, 2017 and 2016, and the consolidated statement of stockholders' equity for the six-month period ended June 30, 2017. These financial statements are the responsibility of the Company's management.

We conducted our review in accordance with the standards of the Public Company Accounting Oversight Board (United States). A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with the standards of the Public Company Accounting Oversight Board (United States), the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our review, we are not aware of any material modifications that should be made to the consolidated financial statements referred to above for them to be in conformity with U.S. generally accepted accounting principles.

We have previously audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheet of United Fire Group, Inc. as of December 31, 2016, and the related consolidated statements of income and comprehensive income, stockholders' equity, and cash flows for the year then ended (not presented herein) and we expressed an unqualified audit opinion on those consolidated financial statements in our report dated February 28, 2017. In our opinion, the accompanying consolidated balance sheet of United Fire Group, Inc. as of December 31, 2016 is fairly stated, in all material respects, in relation to the consolidated balance sheet from which it has been derived.

/s/  
Ernst  
&  
Young  
LLP  
Ernst  
&  
Young  
LLP

Des Moines, Iowa  
August 2, 2017

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### ITEM 2. 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 Part I, Item 1 "Financial Statements."

#### CRITICAL ACCOUNTING POLICIES

Critical accounting policies are defined as those that are representative of significant judgments and uncertainties and that potentially may result in materially different results under different assumptions and conditions. We base our discussion and analysis of our results of operations and financial condition on the amounts reported in our Consolidated Financial Statements, which we have prepared in accordance with GAAP. As we prepare these Consolidated Financial Statements, we must make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses for the reporting period. We evaluate our estimates on an ongoing basis. We base our estimates on historical experience and on other assumptions that we believe to be reasonable under the circumstances. Actual results could differ from those estimates. Our critical accounting policies are more fully described in our Management's Discussion and Analysis of Financial Condition and Results of Operations presented in our Annual Report on Form 10-K for the year ended December 31, 2016. There have been no changes in our critical accounting policies from December 31, 2016.

#### INTRODUCTION

The purpose of this Management's Discussion and Analysis is to provide an understanding of our results of operations and consolidated financial position. Our Management's Discussion and Analysis should be read in conjunction with our consolidated financial statements and related notes, including those in our Annual Report on Form 10-K for the year ended December 31, 2016. Our consolidated financial statements are prepared on the basis of GAAP. We also prepare financial statements for each of our insurance company subsidiaries based on statutory accounting principles and file them with insurance regulatory authorities in the states where they do business.

When we provide information on a statutory or other basis, we label it as such, otherwise all other data is presented in accordance with GAAP.

#### OUR BUSINESS

Founded in 1946 as United Fire & Casualty Company, United Fire Group, Inc. ("UFG," the "Registrant," the "Company," "we," "us," or "our") and its consolidated insurance subsidiaries provide insurance protection for individuals and businesses through several regional offices. Our property and casualty insurance company subsidiaries are licensed in 46 states plus the District of Columbia and are represented by approximately 1,200 independent agencies. Our life insurance subsidiary is licensed in 37 states and is represented by approximately 1,500 independent agencies.

#### Segments

We operate two business segments, each with a wide range of products:

• property and casualty insurance, which includes commercial lines insurance, personal lines insurance, surety bonds and assumed reinsurance; and

• life insurance, which includes deferred and immediate annuities, universal life products and traditional life (primarily single premium whole life) insurance products.

We manage these business segments separately, as they generally do not share the same customer base, and each has different products, pricing, and expense structures.

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For the six-month period ended June 30, 2017, property and casualty insurance business accounted for approximately 93.8 percent of our net premiums earned, of which 92.7 percent was generated from commercial lines. Life insurance business accounted for approximately 6.2 percent of our net premiums earned, of which 66.2 percent was generated from traditional life insurance products.

### Pooling Arrangement

All of our property and casualty insurance subsidiaries are members of an intercompany reinsurance pooling arrangement. The Company's pooling arrangement permits the participating companies to rely on the capacity of the entire pool's capital and surplus, rather than being limited to policy exposures of a size commensurate with each participant's own surplus level.

### Geographic Concentration

For the six-month period ended June 30, 2017, approximately 48.1 percent of our property and casualty premiums were written in Texas, California, Iowa, Missouri and Minnesota; approximately 65.4 percent of our life insurance premiums were written in Iowa, Wisconsin, Minnesota, Illinois and Nebraska.

### Segment Revenue and Expense

We evaluate segment profit or loss based upon operating and investment results. Segment profit or loss described in the following sections of this Management's Discussion and Analysis is reported on a pre-tax basis. Additional segment information is presented in Part I, Item 1, Note 7 "Segment Information" to the unaudited Consolidated Financial Statements.

Our primary sources of revenue are premiums and investment income. Major categories of expenses include losses and loss settlement expenses, future policy benefits, underwriting and other operating expenses and interest on policyholders' accounts.

#### Profit Factors

Our profitability is influenced by many factors, including price, competition, economic conditions, investment returns, interest rates, catastrophic events and other natural disasters, man-made disasters, state regulations, court decisions, and changes in the law. To manage these risks and uncertainties, we seek to achieve consistent profitability through strong agency relationships, exceptional customer service, fair and prompt claims handling, disciplined underwriting, superior loss control services, prudent management of our investments, appropriate matching of assets and liabilities, effective use of ceded reinsurance and effective and efficient use of technology.



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## CONSOLIDATED FINANCIAL HIGHLIGHTS

(In Thousands)	Three Months Ended June 30,			Six Months Ended June 30,		
	2017	2016	%	2017	2016	%
<b>Revenues</b>						
Net premiums earned	\$259,563	\$253,487	2.4 %	\$513,435	\$494,785	3.8 %
Investment income, net of investment expenses	24,610	24,507	0.4	49,645	46,731	6.2
Net realized investment gains	2,680	1,596	67.9	6,634	3,651	81.7
Other income	126	183	(31.1)	324	291	11.3
<b>Total revenues</b>	<b>\$286,979</b>	<b>\$279,773</b>	<b>2.6 %</b>	<b>\$570,038</b>	<b>\$545,458</b>	<b>4.5 %</b>
<b>Benefits, Losses and Expenses</b>						
Losses and loss settlement expenses	\$197,698	\$180,412	9.6 %	\$365,321	\$322,540	13.3 %
Increase in liability for future policy benefits	5,281	16,002	(67.0)	13,860	28,554	(51.5)
Amortization of deferred policy acquisition costs	53,093	52,585	1.0	105,227	102,816	2.3
Other underwriting expenses	26,201	24,772	5.8	51,091	51,525	(0.8 )
Interest on policyholders' accounts	4,651	5,138	(9.5 )	9,395	10,385	(9.5 )
<b>Total benefits, losses and expenses</b>	<b>\$286,924</b>	<b>\$278,909</b>	<b>2.9 %</b>	<b>\$544,894</b>	<b>\$515,820</b>	<b>5.6 %</b>
Income before income taxes	\$55	\$864	(93.6)%	\$25,144	\$29,638	(15.2)%
Federal income tax expense (benefit)	(2,903 )	(2,250 )	29.0	2,250	4,097	(45.1)
<b>Net income</b>	<b>\$2,958</b>	<b>\$3,114</b>	<b>(5.0 )%</b>	<b>\$22,894</b>	<b>\$25,541</b>	<b>(10.4)%</b>

The following is a summary of our financial performance for the three- and six-month periods ended June 30, 2017:

## Consolidated Results of Operations

For the three-month period ended June 30, 2017, net income was \$3.0 million compared to \$3.1 million for the same period of 2016. The decrease in net income was driven by an increase in losses and loss settlement expenses from a deterioration in our core loss ratio; partially offset by an increase in net premiums earned from organic growth and a smaller increase in liability for future policy benefits from a decrease in sales of single premium whole life products. Consolidated net premiums earned increased to \$259.6 million compared to \$253.5 million for the same period of 2016.

For the six-month period ended June 30, 2017, net income was \$22.9 million compared to \$25.5 million for the same period of 2016. The decrease in net income was driven by an increase in losses and loss settlement expenses from a deterioration in our core loss ratio; partially offset by an increase in net premiums earned from organic growth and a smaller increase in liability for future policy benefits from a decrease in sales of single premium whole life products. Consolidated net premiums earned increased to \$513.4 million compared to \$494.8 million for the same period of 2016.

Losses and loss settlement expenses increased by \$17.3 million during the three-month period ended June 30, 2017 compared to the same period of 2016, and the net loss ratio increased by 2.4 percentage points during the three-month period ended June 30, 2017 compared to the same period of 2016. The increase was primarily due to the deterioration in our core loss ratio. This deterioration was primarily due to an increase in frequency and severity of losses in our commercial automobile line of business offset slightly by a decrease in catastrophe losses. Pre-tax catastrophe losses for the three-month period ended June 30, 2017 were \$28.3 million compared to \$35.5 million in the same period of 2016.





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Losses and loss settlement expenses increased by \$42.8 million during the six-month period ended June 30, 2017 compared to the same period of 2016, and the net loss ratio increased by 4.0 percentage points during the six-month period ended June 30, 2017 compared to the same period of 2016. The increase was primarily due to the deterioration in our core loss ratio. This deterioration was primarily due to an increase in frequency and severity in losses in our commercial automobile line of business offset slightly by a decrease in catastrophe losses. Pre-tax catastrophe losses for the six-month period ended June 30, 2017 were \$38.1 million compared to \$39.9 million in the same period of 2016.

Investment income increased by \$0.1 million and \$2.9 million during the three- and six-month periods ended June 30, 2017, respectively, compared to the same periods of 2016. The increase in the six-month period ended June 30, 2017 was primarily due to the \$2.2 million increase in the change in value of our investments in limited liability partnerships as compared to the same period in 2016.

Consolidated Financial Condition

Our stockholders' equity increased to \$962.6 million at June 30, 2017, from \$941.9 million at December 31, 2016. The increase was attributable to net income of \$22.9 million and an increase in net unrealized investment gains of \$26.2 million, net of tax, partially offset by stockholder dividends of \$13.4 million and share repurchases of \$21.2 million.

Net unrealized investment gains totaled \$160.0 million as of June 30, 2017, an increase of \$26.2 million, net of tax, or 19.5 percent, since December 31, 2016. The increase in net unrealized investment gains is primarily the result of a decrease in interest rates, which positively impacted the valuation of our fixed maturity security portfolio during 2017 and, to a lesser extent, an increase in the fair value of our equity security portfolio.

At June 30, 2017, the book value per share of our common stock was \$38.46. During the six-month period ended June 30, 2017, 361,627 shares of common stock were repurchased under our share repurchase program at a total cost of \$21.2 million and an average share price of \$42.68. Under our share repurchase program, which is scheduled to expire on August 31, 2018, we were authorized to repurchase an additional 2,441,863 shares of our common stock as of June 30, 2017.



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## RESULTS OF OPERATIONS

## Property and Casualty Insurance Segment Results

(In Thousands, Except Ratios)	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
Net premiums earned	\$245,222	\$232,282	\$481,666	\$452,507
Losses and loss settlement expenses	(188,596 )	(173,128 )	(345,148 )	(306,265 )
Amortization of deferred policy acquisition costs	(51,398 )	(50,563 )	(101,859 )	(98,976 )
Other underwriting expenses	(22,824 )	(19,803 )	(44,083 )	(41,422 )
Underwriting gain (loss)	\$(17,596 )	\$(11,212 )	\$(9,424 )	\$5,844
Investment income, net of investment expenses	12,184	11,618	24,769	20,990
Net realized investment gains	1,081	966	3,330	2,703
Income (loss) before income taxes	\$(4,331 )	\$1,372	\$18,675	\$29,537

## GAAP Ratios:

Net loss ratio (without catastrophes)	65.3	% 59.2	% 63.8	% 58.9	%
Catastrophes - effect on net loss ratio	11.6	15.3	7.9	8.8	
Net loss ratio <sup>(1)</sup>	76.9	% 74.5	% 71.7	% 67.7	%
Expense ratio <sup>(2)</sup>	30.3	30.3	30.3	31.0	
Combined ratio <sup>(3)</sup>	107.2	% 104.8	% 102.0	% 98.7	%

(1) The net loss ratio is calculated by dividing the sum of losses and loss settlement expenses by net premiums earned. We use the net loss ratio as a measure of the overall underwriting profitability of the insurance business we write and to assess the adequacy of our pricing. Our net loss ratio is meaningful in evaluating our financial results as reported in our unaudited Consolidated Financial Statements.

(2) The expense ratio is calculated by dividing nondeferred underwriting expenses and amortization of deferred policy acquisition costs by net premiums earned. The expense ratio measures a company's operational efficiency in producing, underwriting and administering its insurance business.

(3) The combined ratio is a commonly used financial measure of property and casualty underwriting performance. A combined ratio below 100.0 percent generally indicates a profitable book of business. The combined ratio is the sum of the net loss ratio and the underwriting expense ratio.

For the three- and six-month periods ended June 30, 2017, our property and casualty segment reported a loss before income taxes of \$4.3 million and income before income taxes of \$18.7 million, a decrease of \$5.7 million and \$10.9 million, respectively, compared to the same periods of 2016. The decrease in the three- and six-month periods ended June 30, 2017 was driven by an increase in losses and loss settlement expenses from a deterioration in our core loss ratio; partially offset by an increase in net premiums earned from organic growth and an increase in investment income.

Net premiums earned increased 5.6 percent to \$245.2 million in the three-month period ended June 30, 2017, compared to \$232.3 million in the same period of 2016. Net premiums earned increased 6.4 percent to \$481.7 million in the six-month period ended June 30, 2017, compared to \$452.5 million in the same period of 2016. This increase is the result of organic growth.

The combined ratio increased 2.4 percentage points to 107.2 percent, for the three-month period ended June 30, 2017, compared to 104.8 percent for the same period of 2016. The combined ratio increased 3.3 percentage points to 102.0 percent, for the six-month period ended June 30, 2017, compared to 98.7 percent for the same period of 2016. The increase in the combined ratio in the three- and six-month periods ended June 30, 2017, as compared to the same

periods of 2016, was primarily attributable to an increase in the net loss ratio. The increase in net loss ratio was primarily driven by a deterioration in our core loss ratio, primarily in our commercial automobile line of business, which experienced an increase in frequency and severity of losses.

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The net loss ratio, a component of the combined ratio, increased by 2.4 percentage points to 76.9 percent and 4.0 percentage points to 71.7 in the three- and six-month periods ended June 30, 2017, respectively, as compared to the same periods of 2016, due to a deterioration in our core loss ratio offset slightly by a decrease in catastrophe losses. The deterioration in our core loss ratio was primarily due to an increase in frequency and severity of losses in our commercial automobile lines of business. Pre-tax catastrophe losses totaled \$28.3 million and \$38.1 million and for the three- and six-month periods ended June 30, 2017, as compared to \$35.5 million and \$39.9 million in the same periods of 2016.

The expense ratio, a component of the combined ratio, was 30.3 percent, respectively, for both the three- and six-month periods ended June 30, 2017, a 0.0 percentage point and 0.7 percentage point decrease as compared with the same periods of 2016. The decrease in the six-month period ended June 30, 2017 was primarily due to a decrease in post-retirement benefit expenses and contingent commission expenses; partially offset by a deterioration in the profitability of the commercial and personal auto lines of business that has limited the amount of underwriting expenses eligible for deferral in our deferred acquisition costs calculation.

For a detailed discussion of our consolidated investment results, refer to the "Investment Portfolio" section below.  
Reserve Development

For many liability claims, significant periods of time, ranging up to several years, and for certain construction defect claims, more than a decade, may elapse between the occurrence of the loss, the reporting of the loss to us and the settlement or other disposition of the claim. As a result, loss experience in the more recent accident years for the long-tail liability coverages has limited statistical credibility in our reserving process because a relatively small proportion of losses in these accident years are reported claims and an even smaller proportion are paid losses. In addition, long-tail liability claims are more susceptible to litigation and can be significantly affected by changing contract interpretations and the legal environment. Consequently, the estimation of loss reserves for long-tail coverages is more complex and subject to a higher degree of variability. Reserves for these long-tail coverages represent a significant portion of our overall carried reserves.

When establishing reserves and monitoring reserve adequacy, we analyze historical data and consider the potential impact of various loss development factors and trends including historical loss experience, legislative enactments, judicial decisions, legal developments in imposition of damages, experience with alternative dispute resolution, results of our medical bill review process, the potential impact of salvage and subrogation and changes and trends in general economic conditions, including the effects of inflation. All of these factors influence our estimates of required reserves and for long-tail lines these factors can change over the course of the settlement of the claim. However, there is no precise method for evaluating the specific dollar impact of any individual factor on the development of reserves.

Our reserving philosophy is to reserve claims to their ultimate expected loss amount as soon as practicable after information about a claim becomes available. This approach tends to produce, on average, prudently conservative case reserves, which we expect to result in some level of favorable development over the course of settlement.

### 2017 Development

The property and casualty insurance segment experienced \$16.3 million and \$41.2 million of favorable development in our net reserves for prior accident years for the three- and six-month periods ended June 30, 2017, respectively. For the three-month period ended June 30, 2017 the majority of favorable development came from two lines, commercial liability with \$15.8 million favorable development and workers compensation with \$6.0 million favorable development, which was partially offset by unfavorable development from two other lines, commercial fire and allied lines with \$3.8 million unfavorable development and commercial auto with \$2.1 million unfavorable development. During the three-month period ended June 30, 2017 all other lines combined contributed \$0.4 million favorable

development. For the six-month period ended June 30, 2017 the majority of favorable development came from two lines, commercial liability with \$41.5 million favorable development and workers compensation with \$10.0 million favorable development, which was partially offset

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by unfavorable development from two other lines, commercial fire and allied lines with \$6.3 million unfavorable development and assumed reinsurance with \$5.4 million unfavorable development. During the six-month period ended June 30, 2017 all other lines combined contributed \$1.4 million favorable development. Much of the favorable long-tail liability development continues to come from loss adjustment expense and is attributed to our continued litigation management efforts. There was also a reduction in reserves for incurred but not reported claims because our long tail liability has experienced fewer late reported claims than what was initially anticipated. The majority of the favorable workers compensation development is due to reductions in reserves for reported claims which were greater than what was necessary to offset claim payments.

2016 Development

The property and casualty insurance segment experienced \$2.5 million and \$26.4 million of favorable development in our net reserves for prior accident years for the three- and six-month periods ended June 30, 2016, respectively. For the three-month period ended June 30, 2016 the majority of favorable development was from commercial automobile with \$3.3 million favorable development, commercial fire and allied lines with \$2.5 million favorable development and workers compensation with \$1.7 million favorable development, all partially offset with unfavorable development of \$6.0 million in commercial liability; no other single line contributed a significant portion of the total development. For the six-month period ended June 30, 2016 the majority of favorable development was from commercial liability with \$13.8 million favorable development, workers compensation with \$7.2 million favorable development and commercial automobile with \$6.2 million favorable development, all partially offset by commercial fire and allied lines with \$4.4 million unfavorable development; no other single line contributed a significant portion of the total development. The favorable development is attributable to reductions in reserves for reported claims as well as reductions in required reserves for incurred but not reported claims combined with continued successful management of litigation expenses.

Development amounts can vary significantly from quarter-to-quarter and year-to-year depending on a number of factors, including the number of claims settled and the settlement terms, and are subject to reallocation between accident years and lines of business. At June 30, 2017, our total reserves were within our actuarial estimates.





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The following table displays our net premiums earned, net losses and loss settlement expenses and net loss ratio by line of business:

	Three Months Ended June 30, 2017			2016		
	Net Premiums Earned	Net Losses and Loss Settlement Expenses Incurred	Net Loss Ratio	Net Premiums Earned	Net Losses and Loss Settlement Expenses Incurred	Net Loss Ratio
(In Thousands, Except Ratios) Unaudited						
Commercial lines						
Other liability	\$76,215	\$10,711	14.1 %	\$71,454	\$35,303	49.4 %
Fire and allied lines	54,419	64,335	118.2	56,012	52,758	94.2
Automobile	61,497	72,778	118.3	52,544	44,848	85.4
Workers' compensation	27,222	15,583	57.2	25,660	19,690	76.7
Fidelity and surety	5,714	376	6.6	5,316	(423)	(8.0)
Miscellaneous	537	120	22.3	450	113	25.1
Total commercial lines	\$225,604	\$163,903	72.7 %	\$211,436	\$152,289	72.0 %
Personal lines						
Fire and allied lines	\$10,782	\$15,639	145.0%	\$11,090	\$12,531	113.0 %
Automobile	6,674	8,141	122.0	6,216	6,335	101.9
Miscellaneous	287	17	5.9	270	412	152.6
Total personal lines	\$17,743	\$23,797	134.1%	\$17,576	\$19,278	109.7 %
Reinsurance assumed	\$1,875	\$896	47.8 %	\$3,270	\$1,561	47.7 %
Total	\$245,222	\$188,596	76.9 %	\$232,282	\$173,128	74.5 %

	Six Months Ended June 30, 2017	2016
	Net Losses	Net Losses