

FINANCIAL STATEMENTS – STATUTORY BASIS
AND SUPPLEMENTARY INFORMATION

State National Insurance Company, Inc.
Years Ended December 31, 2014 and 2013
With Report of Independent Auditors

State National Insurance Company, Inc.

Financial Statements – Statutory Basis
and Supplementary Information

Years Ended December 31, 2014 and 2013

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Report of Independent Auditors

The Board of Directors
State National Insurance Company, Inc.

We have audited the accompanying statutory-basis financial statements of State National Insurance Company, Inc., which comprise the balance sheets as of December 31, 2014 and 2013, and the related statements of income, changes in capital and surplus and cash flow for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in conformity with accounting practices prescribed or permitted by the Texas Department of Insurance. Management also is responsible for the design, implementation and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free of material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinions.



Basis for Adverse Opinion on U.S. Generally Accepted Accounting Principles

As described in Note 1, to meet the requirements of Texas the financial statements have been prepared in conformity with accounting practices prescribed or permitted by the Texas Department of Insurance, which practices differ from U.S. generally accepted accounting principles. The variances between such practices and U.S. generally accepted accounting principles and the effects on the accompanying financial statements are described in Note 7.

Adverse Opinion on U.S. Generally Accepted Accounting Principles

In our opinion, because of the effects of the matter described in the preceding paragraph, the statutory-basis financial statements referred to above do not present fairly, in conformity with U.S. generally accepted accounting principles, the financial position of State National Insurance Company at December 31, 2014 and 2013, or the results of its operations or its cash flows for the years then ended.

Opinion on Statutory-Basis of Accounting

However, in our opinion, the statutory-basis financial statements referred to above present fairly, in all material respects, the financial position of State National Insurance Company, Inc. at December 31, 2014 and 2013, and the results of its operations and its cash flows for the years then ended in conformity with accounting practices prescribed or permitted by the Texas Department of Insurance.

Ernst + Young LLP

Dallas, Texas

May 1, 2015

State National Insurance Company, Inc.

Balance Sheets – Statutory Basis

	December 31	
	2014	2013
Admitted assets		
Bonds	\$ 105,703,893	\$ 66,757,104
Preferred stocks	1,913,900	1,789,378
Common stocks	4,738	148,058
Common stocks of affiliates	118,237,995	85,248,604
Real estate, net	15,247,028	16,026,386
Cash, cash equivalents, and short-term investments	13,256,354	14,304,814
Total cash and invested assets	<u>254,363,908</u>	184,274,344
Agents' balances receivable	22,069,334	22,429,312
Reinsurance receivables	7,670,699	5,647,609
Equipment, net	422	1,845
Income taxes recoverable	512,095	197,496
Deferred taxes recoverable, net	4,819,996	4,421,838
Other assets	1,282,413	1,818,404
Total admitted assets	<u>\$ 290,718,867</u>	<u>\$ 218,790,848</u>
Liabilities and capital and surplus		
Liabilities:		
Unpaid losses and loss adjustment expenses	\$ 4,556,337	\$ 4,386,971
Unearned premiums	24,613,486	19,104,049
Ceded reinsurance premiums payable	17,782,657	15,518,664
Reinsurance payables	5,652,568	5,285,455
Agents' balances payable	763,164	1,148,601
Commissions payable	1,017,905	1,046,257
Taxes, licenses, and fees payable	2,620,893	2,297,593
Payable to affiliates	2,469,810	827,834
Deferred ceding fees	10,625,337	8,430,831
Other liabilities	4,774,865	5,178,415
Total liabilities	<u>74,877,022</u>	63,224,670
Capital and surplus:		
Common stock, \$1 par value, 6,500,000 shares authorized; 3,500,000 shares issued and outstanding	3,500,000	3,500,000
Paid-in surplus	85,998,230	32,998,230
Unassigned surplus	126,343,615	119,067,948
Total capital and surplus	<u>215,841,845</u>	155,566,178
Total liabilities and capital and surplus	<u>\$ 290,718,867</u>	<u>\$ 218,790,848</u>

See accompanying notes.

State National Insurance Company, Inc.

Statements of Income – Statutory Basis

	Year Ended December 31	
	2014	2013
Underwriting income:		
Premiums written	\$ 52,163,949	\$ 41,978,070
Change in unearned premiums	(5,509,437)	(2,860,002)
Premiums earned	46,654,512	39,118,068
Losses and loss adjustment expenses	19,846,326	15,762,454
Commissions	3,333,947	8,040,688
Taxes, licenses, and fees	6,528,471	6,084,484
Management fees, affiliate	4,626,077	4,942,721
Contract modification expense	8,010,000	–
Other underwriting expenses	2,767,666	2,640,148
Net underwriting income	1,542,025	1,647,573
Investment income:		
Net investment income	2,910,042	2,304,608
Net realized investment gains, net of tax	599,967	1,069,048
Net investment income	3,510,009	3,373,656
Other income (expense)	(273)	7,529
Income before federal income taxes	5,051,761	5,028,758
Federal income tax expense	1,827,465	2,525,281
Net income	\$ 3,224,296	\$ 2,503,477

See accompanying notes.

State National Insurance Company, Inc.

Statements of Changes in Capital and Surplus – Statutory Basis

	Common Stock	Paid-In Surplus	Unassigned Surplus	Total
Balance at December 31, 2012	\$ 3,500,000	\$ 32,998,230	\$ 111,310,752	\$ 147,808,982
Net income	–	–	2,503,477	2,503,477
Change in net unrealized capital gains	–	–	4,051,765	4,051,765
Change in net deferred taxes	–	–	1,201,886	1,201,886
Change in nonadmitted assets	–	–	68	68
Balance at December 31, 2013	3,500,000	32,998,230	119,067,948	155,566,178
Net income	–	–	3,224,296	3,224,296
Change in net unrealized capital gains	–	–	3,715,836	3,715,836
Change in net deferred taxes	–	–	333,752	333,752
Change in nonadmitted assets	–	–	1,783	1,783
Surplus paid-in	–	53,000,000	–	53,000,000
Balance at December 31, 2014	\$ 3,500,000	\$ 85,998,230	\$ 126,343,615	\$ 215,841,845

See accompanying notes.

State National Insurance Company, Inc.

Statements of Cash Flow – Statutory Basis

	Year Ended December 31	
	2014	2013
Operating activities		
Premiums collected, net of reinsurance	\$ 53,838,879	\$ 38,579,998
Net investment income received	5,434,190	3,823,491
Losses and loss adjustment expenses paid	(19,676,960)	(15,759,817)
(Paid to) received from affiliates for reinsurance settlements	(1,438,329)	(413,121)
Commissions and expenses paid	(21,807,356)	(27,190,241)
Federal income taxes paid	(2,473,628)	(3,182,223)
Miscellaneous income	–	7,529
Net cash (used in) provided by operating activities	13,876,796	(4,134,384)
Investing activities		
Proceeds from sales and maturities of investments	14,972,105	15,801,088
Cost of investment securities acquired	(82,897,361)	(20,795,014)
Net cash used in investing activities	(67,925,256)	(4,993,926)
Financing activities		
Proceeds from capital contribution	53,000,000	–
Net cash provided by financing activities	53,000,000	–
Net change in cash, cash equivalents, and short-term investments	(1,048,460)	(9,128,310)
Cash, cash equivalents, and short-term investments:		
Cash, cash equivalents, and short-term investments at beginning of year	14,304,814	23,433,124
Cash, cash equivalents, and short-term investments at end of year	\$ 13,256,354	\$ 14,304,814

See accompanying notes.

State National Insurance Company, Inc.

Notes to Financial Statements – Statutory Basis

December 31, 2014

1. Summary of Significant Accounting Policies

Business

State National Insurance Company, Inc. (SNIC or the Company), a Texas corporation, is a wholly owned subsidiary of State National Intermediate Holdings, Inc. (SNIH). SNIH's ultimate parent is State National Companies, Inc. (SNC). The Company owns 100% of National Specialty Insurance Company (NSIC) and 100% of United Specialty Insurance Company (USIC), which are reflected in the balance sheets as common stocks of affiliates.

The Company writes Collateral Protection Insurance (CPI) and Guaranteed Auto Protection (GAP) through TBA Insurance Group, Ltd. (TBA), an affiliate. The Company also writes program business, which includes distinct books of personal and commercial lines of business produced by program managers. A majority of the risk associated with program business is ceded to unaffiliated, highly rated reinsurance companies.

SNIC entered into a pooling arrangement with NSIC in 2002 and with USIC in 2006, whereby NSIC and USIC ceded 100% of their net business to SNIC, and SNIC retroceded 10% and 25% of the companies' combined net business to NSIC and USIC, respectively. On January 1, 2012, the pooling percentages changed to 20% and 35% for NSIC and USIC, respectively. The cessions to unaffiliated reinsurers are prior to the cession of the pooled business.

Basis of Presentation

The accompanying financial statements have been prepared in conformity with statutory accounting practices prescribed or permitted by the Texas Department of Insurance (the Department). Such practices vary from U.S. generally accepted accounting principles (GAAP). The National Association of Insurance Commissioners' (NAIC) *Accounting Practices and Procedures Manual* has been adopted as a component of prescribed practices by the state of Texas (NAIC SAP), subject to certain deviations permitted by the state of Texas Commissioner of Insurance. For the Company, there are no significant differences between Texas prescribed practices and the NAIC's *Accounting Practices and Procedures Manual*. The Company's permitted statutory accounting practices encompass all accounting practices prescribed by the Department. Such practices differ from state to state, may differ from company to company within a state, and may change in the future. A reconciliation of SNIC's shareholder's equity and net income from NAIC SAP to GAAP is presented in Note 7.

State National Insurance Company, Inc.

Notes to Financial Statements – Statutory Basis (continued)

1. Summary of Significant Accounting Policies (continued)

The significant differences between statutory accounting practices prescribed by the Department and GAAP are as follows:

Investments: Investments in bonds are reported at amortized cost or fair value based on their NAIC rating; for GAAP, such bonds would be designated at purchase as held to maturity, trading, or available for sale. Held-to-maturity bonds would be reported at amortized cost. Those investments designated as trading would be reported at fair value with unrealized holding gains and losses reported in operations. For those investments designated as available for sale, unrealized gains and losses are reported as a separate component of other comprehensive income, net of the related deferred taxes.

Policy Acquisition Costs: The costs of acquiring and renewing business are charged to current operations as incurred. Under GAAP, those costs that are directly related to the successful acquisition of new and renewal insurance contracts, to the extent recoverable, would be deferred and amortized over the effective period of the related insurance policies.

Nonadmitted Assets: Certain assets designated as “nonadmitted” are excluded from the accompanying statutory-basis balance sheets and are charged directly to unassigned surplus. Under GAAP, such assets are included in the balance sheet to the extent that those assets are not impaired.

Premiums and Unearned Premiums: Return premiums, corresponding unearned premiums, and commissions for certain lines of business of the pooled group are charged to current operations as incurred. Under GAAP, an allowance for policy cancellations is provided for the estimated amount of return premiums and policy fees, net of commission expense and premium taxes that will be incurred on expected future policy cancellations associated with the Company’s business. This allowance is based on the Company’s historical cancellation experience. Under NAIC SAP, unearned premiums are calculated on a pro rata basis over the policy terms for all policies in force. Under GAAP, unearned premiums are calculated on a pro rata basis after consideration of these expected future policy cancellations.

Reinsurance: Reserves for losses and loss adjustment expenses (LAE) and unearned premiums ceded to reinsurers have been reported as reductions of the related reserves rather than as assets as would be required under GAAP.

State National Insurance Company, Inc.

Notes to Financial Statements – Statutory Basis (continued)

1. Summary of Significant Accounting Policies (continued)

Deferred Income Taxes: Deferred income tax assets are limited to: 1) the amount of federal income taxes paid in prior years that can be recovered through loss carrybacks for existing temporary differences that reverse during a time frame corresponding with the Internal Revenue Service tax loss carryback provisions, not to exceed three years, plus 2) the lesser of the remaining gross deferred income tax assets expected to be realized within three years of the balance sheet date or 15% of capital and surplus excluding any net deferred income tax assets, electronic data processing equipment, and operating software and any net positive goodwill, plus 3) the amount of remaining gross deferred income tax assets that can be offset against existing gross deferred income tax liabilities after considering the character (i.e., ordinary versus capital) of the deferred tax assets and liabilities. The remaining deferred income tax assets are nonadmitted. Only gross deferred tax assets that are more likely than not to generate a tax benefit are potentially admissible.

Deferred income taxes do not include amounts for state taxes. Under GAAP, state taxes are included in the computation of deferred income taxes.

Statements of Cash Flow: Cash, cash equivalents, and short-term investments represent cash balances and investments with initial maturities of one year or less. Under GAAP, the corresponding caption of cash and cash equivalents includes cash balances and investments with initial maturities of three months or less.

Permitted Practices

The Company has received permission from the Department for recording fees receivable from general agents or program managers in a manner that differs from NAIC SAP. According to the permitted practice, fees not associated with premiums that are due from general agents and program managers are recorded as an aggregate write-in for other-than-invested assets. There is no monetary effect on 2014 or 2013 net income or statutory surplus from the use of this practice.

The Company received permission from the Department to report its 2014 and 2013 creditor-placed auto coverage under the lines of business as set forth in the 2012 Annual Statement instructions. There was no monetary effect on net income or statutory surplus from using this practice.

State National Insurance Company, Inc.

Notes to Financial Statements – Statutory Basis (continued)

1. Summary of Significant Accounting Policies (continued)

Investments

Bonds are stated at amortized cost using the interest method or fair value, based on their NAIC rating. Preferred stocks are carried at cost or fair value, based on their NAIC rating. Common stocks are carried at fair value. Single-class and multi-class mortgage-backed/asset-backed securities are valued at amortized cost using the interest method, including anticipated prepayments. Prepayment assumptions are obtained from broker-dealer surveys and are based on the current interest rate and economic environment. The prospective adjustment method is used to value all such securities. Realized gains and losses on sales of investments are determined on a specific identification basis. Unrealized gains and losses on preferred and common stocks, also determined on a specific identification basis, are recorded as changes in surplus.

Common stocks of affiliates reflect SNIC's investments in NSIC and USIC, which are carried at the underlying statutory equity of the subsidiaries.

Investments are evaluated quarterly to determine whether any declines in fair value, below the cost basis, are other than temporary. If a decline in fair value is deemed to be other than temporary, the cost basis of the individual investment is written down to fair value, which becomes the new cost basis. The amount of the write-down is included in the statement of income as a realized loss.

In 2014 and 2013, all investment income due and accrued was less than 90 days past due. Accordingly, no such due and accrued investment income has been non-admitted.

Cash, cash equivalents, and short-term investments include securities with remaining maturities of one year or less at the time of acquisition and are stated at amortized cost. The carrying amount approximates fair value.

Real Estate, Equipment, and Depreciation

Land held for use is recorded at cost. Land held for sale is recorded at net realizable value. Building, building improvements, and equipment are recorded at depreciated cost. The Company changed its capitalization threshold as of January 1, 2014 from \$1,000 to \$5,000 per item. Depreciation on the building, building improvements, and equipment is computed using the straight-line method over estimated useful lives of 3 to 20 years.

State National Insurance Company, Inc.

Notes to Financial Statements – Statutory Basis (continued)

1. Summary of Significant Accounting Policies (continued)

Unpaid Losses and Loss Adjustment Expenses

The liability for unpaid losses and LAE includes an estimate for claims reported and an additional liability for claims incurred but not reported, based on the Company's historical loss experience. Ceded unpaid losses and LAE are reflected as reductions of direct loss and LAE reserves. While the Company's management (Management) believes the amounts included in the financial statements are adequate, such estimates may be more or less than the amounts ultimately paid when the claims are settled. These estimates are continually reviewed and adjusted as experience develops or new information becomes known and any necessary adjustments are included in current operations. The Company does not discount unpaid losses and LAE.

Program Business

In connection with writing program business, the Company enters into contractual agreements with both the producing program managers and reinsurers, whereby the program managers and reinsurers are obligated to each other for payment of insurance amounts, including premiums, commissions, and losses. These funds do not flow through the Company but are settled directly between the program manager and the reinsurer; accordingly, no receivables or payables are recorded for these amounts. All obligations of SNIC owed to or on behalf of its policyholders are recorded by the Company, and, to the extent appropriate, offsetting reinsurance recoverables are recorded. Reinsurance receivables and payables and agents' balances receivable and payable recorded in the balance sheets are carried at cost, which approximates fair value.

Deferred Ceding Fees

Ceding fees are deferred and recognized on a pro rata basis over the terms of the underlying policies and are included as a contra-expense in commissions in the accompanying statutory-basis statements of income.

Premiums

Premium revenue is recognized on a pro rata basis over the terms of the policies, with the exception of GAP premium revenue, which is recognized using the Rule of 78 method. Ceded premiums earned and unearned are reflected as reductions of direct and assumed premiums earned and unearned, respectively. Anticipated investment income is not utilized as a factor in the premium deficiency calculation.

State National Insurance Company, Inc.

Notes to Financial Statements – Statutory Basis (continued)

1. Summary of Significant Accounting Policies (continued) Reinsurance

Reinsurance premiums and unpaid losses and LAE are accounted for on bases consistent with those used in accounting for the original policies issued and the terms of the reinsurance contracts.

Commissions

The Company incurs a provisional commission on direct, assumed, and ceded premiums upon policy issuance. This commission expense is subject to retroactive adjustment based upon the claims experience of the policies produced and is recorded when incurred.

Other Liabilities

Other liabilities consist mainly of prepaid assessments collected from program managers and payables to service organizations.

Estimates

The preparation of financial statements in conformity with NAIC SAP requires Management to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the dates of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from these estimates.

State National Insurance Company, Inc.

Notes to Financial Statements – Statutory Basis (continued)

2. Investments

The book/adjusted carrying value, unrealized gains and losses, and the fair value of the Company's investment in bonds are summarized as follows:

	Book/Adjusted Carrying Value	Unrealized Gains	Unrealized Losses	Fair Value
December 31, 2014				
Bonds:				
Government	\$ 6,408,358	\$ 90,881	\$ (44,580)	\$ 6,454,659
Government agency	209,188	5,316	(1,933)	212,571
State and municipality	20,964,513	462,787	(7,868)	21,419,432
Industrial and miscellaneous	43,915,765	1,792,130	(183,731)	45,524,164
Residential mortgage backed	26,118,299	804,527	(251,977)	26,670,849
Commercial mortgage backed	8,087,770	150,631	(6,907)	8,231,494
Total bonds	<u>\$ 105,703,893</u>	<u>\$ 3,306,272</u>	<u>\$ (496,996)</u>	<u>\$ 108,513,169</u>
December 31, 2013				
Bonds:				
Government	\$ 5,780,091	\$ 123,315	\$ (118,302)	\$ 5,785,104
Government agency	635,434	13,058	(5,172)	643,320
State and municipality	15,491,622	299,141	(181,879)	15,608,884
Industrial and miscellaneous	23,083,849	1,370,140	(170,624)	24,283,365
Residential mortgage backed	19,870,094	479,193	(533,681)	19,815,606
Commercial mortgage backed	1,896,014	60,088	(25,151)	1,930,951
Total bonds	<u>\$ 66,757,104</u>	<u>\$ 2,344,935</u>	<u>\$ (1,034,809)</u>	<u>\$ 68,067,230</u>

Bonds that carry NAIC designations of 3 to 6 are reflected in the accompanying statutory-basis balance sheets at the lower of amortized cost or fair value. As a result, the amortized cost of bonds at December 31, 2014 and 2013, has been reduced by \$101,814 and \$11,379, respectively.

State National Insurance Company, Inc.

Notes to Financial Statements – Statutory Basis (continued)

2. Investments (continued)

The book/adjusted carrying value, unrealized gains and losses, and fair value on investments in preferred and common stocks are summarized as follows:

	Book/Adjusted Carrying Value	Unrealized Gains	Unrealized Losses	Fair Value
December 31, 2014				
Common stocks	\$ 4,738	\$ –	\$ –	\$ 4,738
Preferred stocks	1,913,900	730,033	–	2,643,933
Total stocks	<u>\$ 1,918,638</u>	<u>\$ 730,033</u>	<u>\$ –</u>	<u>\$ 2,648,671</u>
December 31, 2013				
Common stocks	\$ 148,058	\$ –	\$ –	\$ 148,058
Preferred stocks	1,789,378	424,072	–	2,213,450
Total stocks	<u>\$ 1,937,436</u>	<u>\$ 424,072</u>	<u>\$ –</u>	<u>\$ 2,361,508</u>

Investment securities are exposed to various risks such as interest rate, market, and credit risk. Fair values of securities fluctuate based on the magnitude of changing market conditions; significant changes in market conditions could materially affect portfolio value in the near term.

The following tables show unrealized losses and fair values of bonds, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, at December 31, 2014 and 2013:

	Less Than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
December 31, 2014						
Government	\$ 522,150	\$ (1,658)	\$ 2,376,452	\$ (42,922)	\$ 2,898,602	\$ (44,580)
Government agency	–	–	107,969	(1,933)	107,969	(1,933)
State and municipality	548,105	(2,609)	661,998	(5,259)	1,210,103	(7,868)
Industrial and miscellaneous	13,931,641	(173,365)	587,064	(10,366)	14,518,706	(183,731)
Residential mortgage backed	3,884,281	(25,139)	5,964,929	(226,838)	9,849,210	(251,977)
Commercial mortgage backed	806,406	(2,180)	251,558	(4,727)	1,057,964	(6,907)
	<u>\$ 19,692,583</u>	<u>\$ (204,951)</u>	<u>\$ 9,949,970</u>	<u>\$ (292,045)</u>	<u>\$ 29,642,554</u>	<u>\$ (496,996)</u>

State National Insurance Company, Inc.

Notes to Financial Statements – Statutory Basis (continued)

2. Investments (continued)

	Less Than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
December 31, 2013						
Government	\$ 3,607,005	\$ (118,302)	\$ –	\$ –	\$ 3,607,005	\$ (118,302)
Government agency	104,709	(5,172)	–	–	104,709	(5,172)
State and municipality	6,428,037	(181,879)	–	–	6,428,037	(181,879)
Industrial and miscellaneous	5,701,745	(136,895)	1,336,647	(33,729)	7,038,392	(170,624)
Residential mortgage backed	8,537,235	(317,922)	3,196,080	(215,759)	11,733,315	(533,681)
Commercial mortgage backed	612,501	(25,151)	–	–	612,501	(25,151)
	<u>\$ 24,991,232</u>	<u>\$ (785,321)</u>	<u>\$ 4,532,727</u>	<u>\$ (249,488)</u>	<u>\$ 29,523,959</u>	<u>\$ (1,034,809)</u>

Management believes that the temporary impairments for bonds are primarily the result of interest rate fluctuations, current conditions in capital markets, and the impact of those conditions on market liquidity and prices. In reviewing for other-than-temporary impairment, the Company evaluated information regarding creditworthiness, future outlook, and the extent to which each security was impaired.

There are 86 securities in an unrealized loss position at December 31, 2014. These securities are all considered investment grade based on their NAIC rating. The Company does not have the intent to sell these bonds before recovery of the amortized cost and has the ability to hold these investments until maturity or until fair value recovers above amortized cost. Therefore, the Company does not consider these investments to be other-than-temporarily impaired at December 31, 2014.

There were no preferred stocks or common stocks of affiliates in an unrealized loss position at December 31, 2014 or 2013.

State National Insurance Company, Inc.

Notes to Financial Statements – Statutory Basis (continued)

2. Investments (continued)

The following table presents the Company’s gross realized gains (losses) on bonds and equity securities for the years ended December 31:

	2014	2013
Realized gains:		
Bonds	\$ 992,635	\$ 1,532,876
Equity securities	33,779	170,711
Gross realized gains	1,026,414	1,703,587
Realized losses:		
Bonds	(75,468)	(77,554)
Equity securities	(19,415)	–
Other-than-temporary impairment losses on bonds	–	(41,878)
Other-than-temporary impairment losses on common stock	–	(7,353)
Gross realized losses	(94,883)	(126,785)
Net realized investment gains	931,531	1,576,802
Capital gains tax	(331,564)	(507,754)
Net realized investment gains, net of tax	\$ 599,967	\$ 1,069,048

Proceeds from sales of investment securities during 2014 and 2013 were \$10,378,912 and \$10,303,764, respectively.

In 2014, the Company had nine noncash exchanges of investment securities. Noncash consideration received for these exchanges is \$2,322,568. A gain of \$308,805 was recognized from these exchanges and is reflected in the “net realized investment gains, net of tax” balance shown on the accompanying statutory-basis statements of income.

In 2013, the Company had seven noncash exchanges of investment securities. Noncash consideration received for these exchanges is \$1,380,705. A gain of \$143,898 was recognized from these exchanges and is reflected in the “net realized investment gains, net of tax” balance shown on the accompanying statutory-basis statements of income.

State National Insurance Company, Inc.

Notes to Financial Statements – Statutory Basis (continued)

2. Investments (continued)

The following table shows the Company's current investment holdings, including loan-backed investments, for which an other-than-temporary impairment (OTTI) has been recognized, with the present value of the cash flows expected to be collected less than the amortized cost of the securities at impairment.

CUSIP	Description	Amortized Cost Basis Before OTTI	Recognized OTTI	Amortized Cost Basis After OTTI	Fair Value at Impairment	Period Impairment Reported
23242M-AD-3	CWL 2006-S3	\$ 749,997	\$ 352,497	\$ 397,500	\$ 397,500	2008
02149V-AG-4	CWALT INC 2007-3T1	209,245	24,052	185,193	185,193	2009
12544L-AA-9	CWHL 2007-11	249,033	20,245	228,788	228,788	2009
12493V-AC-4	CBO HOLDGS VII LTD	99,984	6,065	93,919	93,919	2009
126673-JE-3	CWL 2004-10	395,994	217,589	178,405	178,405	2009
12493V-AC-4	CBO HOLDGS VII LTD	94,940	12,968	81,972	81,972	2010
126673-JE-3	CWL 2004-10	181,063	51,883	129,180	129,180	2010
02149V-AG-4	CWALT INC 2007-3T1	114,593	28,023	86,570	86,570	2011
12544L-AA-9	CWHL 2007-11	155,578	15,613	139,965	139,965	2011
126673-JE-3	CWL 2004-10	132,142	22,216	109,926	109,926	2011
829ESC-9D-6	SINGAPORE TELECOM	29,507	29,507	–	–	2013
			<u>\$ 780,658</u>			

The following table shows the Company's structured securities at December 31, 2014:

CUSIP	Description	Actual Cost	Fair Value	Book/Adjusted Carrying Value	Mortgage- Referenced Security
00170F-20-9	AMG CAP TR II	\$ 265,192	\$ 666,900	\$ 265,192	No
94973V-BG-1	WELLPOINT INC	562,213	705,713	557,262	No
458140-AF-7	INTEL CORP	486,001	704,194	480,127	No
50540R-AG-7	LABORATORY CORP AMER HLDGS	676,882	736,634	574,604	No
530610-AB-0	LIBERTY INTERACTIVE LLC	361,355	386,313	359,111	No
81170Y-AB-5	SEACOR HOLDINGS INC	102,850	100,238	102,897	No
811904-AM-3	SEACOR HOLDINGS INC	137,981	126,900	126,900	No
928298-AJ-7	VISHAY INTERTECHNOLOGY INC	38,475	40,556	38,482	No
		<u>\$ 2,630,949</u>	<u>\$ 3,467,448</u>	<u>\$ 2,504,575</u>	

State National Insurance Company, Inc.

Notes to Financial Statements – Statutory Basis (continued)

2. Investments (continued)

The following schedule details the maturities of the Company’s bonds as of December 31, 2014. Actual maturities may differ from contractual maturities because certain borrowers have the right to call or prepay obligations, with or without call or prepayment penalties.

	Book/Adjusted Carrying Value	Fair Value
Due in one year or less	\$ 4,114,204	\$ 4,286,194
Due after one through five years	29,213,192	29,771,450
Due after five through ten years	33,723,245	34,473,556
Due after ten years	4,447,183	5,079,626
Residential mortgage-backed securities	26,118,299	26,670,849
Commercial mortgage-backed securities	8,087,770	8,231,494
	<u>\$ 105,703,893</u>	<u>\$ 108,513,169</u>

The Company is required by various states and regulatory agencies in which it is licensed to maintain deposits for the benefit of policyholders.

The Company entered into an agreement with one of its CPI clients whereby the Company agreed to secure certain unearned premium liabilities arising from CPI business. These liabilities were secured by loan-backed securities and money market funds. The client had the right to withdraw the deposit only upon a determination of the Company’s insolvency by the Department. The Company receives all benefits of the interest, dividends, or benefits generated by the deposited funds. This agreement terminated in 2014.

The following table shows the segregation of the Company’s asset restrictions:

Asset Restriction	2014 Book/Adjusted Carrying Value	2014 Percentage to Total Admitted Assets	2013 Book/Adjusted Carrying Value	2013 Percentage to Total Admitted Assets
State deposits	\$ 23,335,105	8.03%	\$ 10,831,573	4.95%
Regulatory agency deposits	618,377	0.21	624,776	0.29
CPI collateral	–	–	5,116,258	2.34
Other restricted assets	1,730,103	0.60	1,729,398	0.79
Total restricted assets	<u>\$ 25,683,585</u>	<u>8.84%</u>	<u>\$ 18,302,005</u>	<u>8.37%</u>

State National Insurance Company, Inc.

Notes to Financial Statements – Statutory Basis (continued)

2. Investments (continued)

Net investment income for the years ended December 31 consists of the following:

	2014	2013
Interest on investments	\$ 5,722,092	\$ 5,035,545
Dividends	98,810	97,861
Gross investment income	5,820,902	5,133,406
Investment expenses	(2,910,860)	(2,828,798)
Net investment income	\$ 2,910,042	\$ 2,304,608

Summarized Financial Information of Affiliates

The summarized financial information of NSIC and USIC is presented below:

	December 31, 2014		December 31, 2013	
	NSIC	USIC	NSIC	USIC
Total cash and invested assets	\$ 57,310,128	\$ 99,434,443	\$ 41,226,879	\$ 72,865,407
Other assets	13,808,697	21,872,201	11,447,791	17,669,375
Total admitted assets	\$ 71,117,825	\$ 121,306,644	\$ 52,674,670	\$ 90,534,782
Total liabilities	\$ 27,861,044	\$ 46,326,430	\$ 21,268,752	\$ 36,692,096
Capital and surplus	43,257,781	74,980,214	31,405,918	53,842,686
Total liabilities and capital and surplus	\$ 71,118,825	\$ 121,306,644	\$ 52,674,670	\$ 90,534,782
Net underwriting income	\$ 685,345	\$ 1,199,353	\$ 732,254	\$ 1,281,445
Net investment income	1,106,735	2,436,132	997,667	2,413,934
Other income	(122)	(213)	3,346	5,856
Net income	1,147,338	2,407,872	651,274	1,891,881

State National Insurance Company, Inc.

Notes to Financial Statements – Statutory Basis (continued)

2. Investments (continued)

Statutory carrying value and cost of the Company's subsidiaries, as reported in common stocks of affiliates, are as follows:

	Statutory Carrying Value	Cost	Unrealized Gains
December 31, 2014			
National Specialty Insurance Company	\$ 43,257,781	\$ 32,350,000	\$ 10,907,781
United Specialty Insurance Company	74,980,214	53,550,000	21,430,214
	<u>\$ 118,237,995</u>	<u>\$ 85,900,000</u>	<u>\$ 32,337,995</u>
December 31, 2013			
National Specialty Insurance Company	\$ 31,405,918	\$ 21,750,000	\$ 9,655,918
United Specialty Insurance Company	53,842,686	35,000,000	18,842,686
	<u>\$ 85,248,604</u>	<u>\$ 56,750,000</u>	<u>\$ 28,498,604</u>

3. Real Estate, Equipment, and Depreciation

The following is a summary of real estate, equipment, and depreciation balances:

	December 31	
	2014	2013
Land held for use	\$ 3,443,119	\$ 3,443,119
Land held for sale	1,034,000	1,034,000
Building	15,126,799	15,126,799
Computer equipment and software	74,839	74,839
	<u>19,678,757</u>	<u>19,678,757</u>
Accumulated depreciation	(4,431,307)	(3,650,526)
Real estate and equipment, net	<u>\$ 15,247,450</u>	<u>\$ 16,028,231</u>
Disclosed as:		
Real estate, net	\$ 15,247,028	\$ 16,026,386
Equipment, net	422	1,845
Real estate and equipment, net	<u>\$ 15,247,450</u>	<u>\$ 16,028,231</u>
Depreciation Expense	<u>\$ 779,999</u>	<u>\$ 781,430</u>

State National Insurance Company, Inc.

Notes to Financial Statements – Statutory Basis (continued)

3. Real Estate, Equipment, and Depreciation (continued)

On November 28, 2007, the Company purchased a tract of land with a plan to build a new home office building for its own use. During 2009, the Company classified this land as held for sale, since it had abandoned its plan to build a new home office and purchased an existing building for its own use. No losses were recognized on real estate and equipment in 2014 or 2013.

4. Unpaid Losses and Loss Adjustment Expenses

Activity in the liability for unpaid losses and LAE is as follows:

	Year Ended December 31	
	2014	2013
Unpaid losses and LAE, net of reinsurance receivables, at January 1	\$ 4,386,971	\$ 4,384,334
Incurred related to:		
Current year	20,068,000	16,246,000
Prior years	(221,674)	(483,546)
Total incurred	19,846,326	15,762,454
Paid related to:		
Current year	16,889,641	13,646,471
Prior years	2,787,319	2,113,346
Total paid	19,676,960	15,759,817
Unpaid losses and LAE, net of reinsurance receivables, at December 31	\$ 4,556,337	\$ 4,386,971

The estimate for ultimate losses incurred related to prior years decreased by \$221,674 in 2014 and decreased by \$483,546 in 2013. The favorable development in 2014 is primarily the result of unpaid losses and loss adjustment expenses on credit, commercial multi-peril, and other liability lines of insurance. The favorable development in 2013 is primarily the result of unpaid losses and loss adjustment expenses on workers' compensation, commercial multi-peril, and credit lines of insurance. The net changes in 2014 and 2013 are the result of ongoing analysis of recent loss development trends. Original estimates are adjusted as additional information becomes known regarding individual claims.

At the end of the current year, the amount of reserve credit recorded for high deductibles on unpaid losses was \$9,043,213 and there were no outstanding billings recoverable.

State National Insurance Company, Inc.

Notes to Financial Statements – Statutory Basis (continued)

5. Income Taxes

The Company files its federal income taxes on a consolidated basis with its parent company, SNIH, and its subsidiaries, NSIC and USIC. The parent of SNIH, TBA, and TBA's parent, SNC, filed as Subchapter S corporations under the Internal Revenue Code until this status terminated on June 25, 2014. As a result, SNC and TBA will be included in the consolidated tax return for the period June 26, 2014 through December 31, 2014. The method of allocation among companies is subject to a written agreement, approved by the Company's directors, whereby allocation is made primarily on a separate return basis, with a current credit for losses. Tax years ended December 31, 2011 through December 31, 2013, are open for examination by the Internal Revenue Service (IRS).

The components of the net deferred tax balances at December 31 are as follows:

	2014			2013		
	Ordinary	Capital	Total	Ordinary	Capital	Total
Gross deferred tax asset	\$ 5,604,503	\$ 252,468	\$ 5,856,971	\$ 4,373,079	\$ 189,603	\$ 4,562,682
Statutory valuation allowance	–	–	–	–	–	–
Adjusted gross deferred tax asset	5,604,503	252,468	5,856,971	4,373,079	189,603	4,562,682
Gross deferred tax liabilities	(1,035,400)	(1,575)	(1,036,975)	(136,888)	(3,956)	(140,844)
Net deferred tax asset	4,569,103	250,893	4,819,996	4,236,191	185,647	4,421,838
Nonadmitted deferred tax asset	–	–	–	–	–	–
Net deferred tax asset admitted	\$ 4,569,103	\$ 250,893	\$ 4,819,996	\$ 4,236,191	\$ 185,647	\$ 4,421,838
Change in deferred tax asset nonadmitted	\$ –	\$ –	\$ –	\$ –	\$ –	\$ –

Deferred taxes are recorded by the Company to reflect the tax consequences on future years of differences between the tax bases of assets and liabilities and their financial reporting amounts. The Company admits deferred taxes pursuant to SSAP No. 101 for the years ended December 31, 2014 and 2013.

State National Insurance Company, Inc.

Notes to Financial Statements – Statutory Basis (continued)

5. Income Taxes (continued)

The Company's admitted deferred tax asset is computed as follows, pursuant to SSAP No. 101:

	2014			2013		
	Ordinary	Capital	Total	Ordinary	Capital	Total
Federal tax paid in carryback years 11a	\$ 4,965,191	\$ 252,468	\$ 5,217,659	\$ 3,042,487	\$ 189,603	\$ 3,232,090
Lesser of:						
Deferred taxes expected to be realized following the balance sheet due date 11b(i)	620,261	–	620,261	1,323,594	–	1,323,594
Or						
Adjusted gross deferred tax assets allowed per limitation threshold 11b(ii)	N/A	N/A	31,653,277	N/A	N/A	22,671,651
Lesser of 11b(i) and 11b(ii)	620,261	–	620,261	1,323,594	–	1,323,594
Amount of gross deferred tax assets that can be offset against deferred tax liabilities 11c	19,051	–	19,051	6,998	–	6,998
Total of 11a, 11b, 11c	<u>\$ 5,604,503</u>	<u>\$ 252,468</u>	<u>\$ 5,856,971</u>	<u>\$ 4,373,079</u>	<u>\$ 189,603</u>	<u>\$ 4,562,682</u>
Gross admitted deferred tax assets	\$ 5,604,503	\$ 252,468	\$ 5,856,971	\$ 4,373,079	\$ 189,603	\$ 4,562,682
Gross deferred tax liabilities	(1,035,400)	(1,575)	(1,036,975)	(136,888)	(3,956)	(140,844)
Net admitted deferred tax assets	<u>\$ 4,569,103</u>	<u>\$ 250,893</u>	<u>\$ 4,819,996</u>	<u>\$ 4,236,191</u>	<u>\$ 185,647</u>	<u>\$ 4,421,838</u>

There are no deferred tax liabilities not recognized as of December 31, 2014 and 2013.

The risk-based capital level to determine the applicable realization period and percentage from the Realization Threshold Limitation Table for RBC Reporting Entities is:

	2014	2013
Admitted deferred tax assets	\$ 4,819,996	\$ 4,421,838
Admitted assets	290,718,867	218,790,848
Statutory surplus	215,841,845	155,566,178
Total adjusted capital and surplus	211,021,849	151,144,340
Authorized control level of risk-based capital	46,445,253	32,000,626
Ratio percentage used to determine recovery period and threshold limitation	454%	472%

State National Insurance Company, Inc.

Notes to Financial Statements – Statutory Basis (continued)

5. Income Taxes (continued)

The tax effects of temporary differences that give rise to the deferred tax assets and deferred tax liabilities as of December 31 are summarized as follows:

	2014	2013
Deferred tax assets:		
Capital:		
Bonds	\$ 211,167	\$ 180,168
Stocks	41,301	9,435
Total gross capital deferred tax asset	252,468	189,603
Nonadmitted capital deferred tax asset	–	–
Admitted capital deferred tax asset	252,468	189,603
Ordinary:		
Compensation and benefits	62,470	62,424
Unearned premiums	1,722,944	1,310,538
Unpaid losses and LAE	76,792	99,974
Uncollected premiums	3,552	3,184
Deferred ceding fees	3,718,868	2,891,775
Real estate and equipment	15,211	–
Other	4,666	5,184
Total gross ordinary deferred tax asset	5,604,503	4,373,079
Nonadmitted ordinary deferred tax asset	–	–
Admitted ordinary deferred tax asset	5,604,503	4,373,079
Deferred tax liabilities:		
Capital:		
Stocks	(1,575)	(3,956)
Total gross capital deferred tax liabilities	(1,575)	(3,956)
Ordinary:		
Bonds discount amortization	(53,436)	(45,126)
Management Fee	(981,964)	–
Real estate and equipment	–	(88,982)
Other	–	(2,780)
Total ordinary deferred tax liabilities	(1,035,400)	(136,888)
Total deferred tax liabilities	(1,036,975)	(140,844)
Net admitted deferred tax assets	\$ 4,819,996	\$ 4,421,838

State National Insurance Company, Inc.

Notes to Financial Statements – Statutory Basis (continued)

5. Income Taxes (continued)

The change in net deferred taxes, exclusive of nonadmitted assets, comprises the following:

	December 31		Change
	2014	2013	
Gross deferred tax assets	\$ 5,856,971	\$ 4,562,682	\$ 1,294,289
Gross deferred tax liabilities	(1,036,975)	(140,844)	(896,131)
Net deferred tax asset	\$ 4,819,996	\$ 4,421,838	398,158
Tax effect of change in unrealized gains/losses			(64,406)
Change in net deferred taxes			\$ 333,752

The Company computed its income tax provision using a 35% tax rate for the year ending December 31, 2014. During 2013, the Company computed its income tax provision using a 34.3% tax rate as its taxable income was within the graduated rates of 34% to 35%. The provision for federal income taxes incurred is different from that which would be obtained by applying the statutory federal income tax rate utilized to income before income taxes. The significant items causing this difference as of December 31 are as follows:

	2014		2013	
	Amount	Effective Tax Rate	Amount	Effective Tax Rate
Provisions computed at statutory rate	\$ 1,884,164	35.0%	\$ 1,899,024	34.3%
Tax-exempt interest income, net of proration	(115,958)	(2.1%)	(98,746)	(1.8%)
Accrual adjustment – prior year	108,384	2.0%	(5,870)	(0.1%)
Change in federal statutory rate	(91,040)	(1.7%)	–	–
Other	39,727	0.7%	36,741	0.7%
Total	\$ 1,825,277	33.9%	\$ 1,831,149	33.1%
Federal income taxes incurred	\$ 2,159,029		\$ 3,033,035	
Change in net deferred taxes	(333,752)		(1,201,886)	
Total statutory income taxes	\$ 1,825,277		\$ 1,831,149	

State National Insurance Company, Inc.

Notes to Financial Statements – Statutory Basis (continued)

5. Income Taxes (continued)

The impact of tax planning strategies on the determination of adjusted gross deferred tax assets and the determination of net admitted deferred tax assets is as follows:

	2014		2013		Change	
	Ordinary	Capital	Ordinary	Capital	Ordinary	Capital
Adjusted gross DTAs	5,604,503	252,468	4,373,079	189,603	1,231,424	62,865
Percentage of adjusted gross DTAs	0.0%	100.0%	0.0%	100.0%	0.0%	0.0%
Net admitted adjusted gross DTAs	5,604,503	252,468	4,373,079	189,603	1,231,424	62,865
Percentage of net admitted adjusted gross DTAs	0.0%	100.0%	0.0%	100.0%	0.0%	0.0%

Current income taxes consist of the following major components for the years ended December 31:

	2014	2013
Current income tax expense (benefit)	\$ 1,747,562	\$ 2,596,490
Tax on capital gains	331,564	507,754
Prior-year (over) under accrual	79,903	(71,209)
Federal income taxes incurred	\$ 2,159,029	\$ 3,033,035

At December 31, 2014 and 2013, the Company did not have any unused operating loss carryforwards or capital loss carryforwards available to offset future taxable income.

Federal income taxes incurred in current and prior years that are available for recoupment in the event of future net losses are as follows:

	Ordinary	Capital	Total
2014	\$ 1,747,562	\$ 331,564	\$ 2,079,126
2013	2,620,394	518,139	3,138,533
	\$ 4,367,956	\$ 849,703	\$ 5,217,659

State National Insurance Company, Inc.

Notes to Financial Statements – Statutory Basis (continued)

5. Income Taxes (continued)

No deposits were admitted under Section 6603 of the Internal Revenue Code. The Company recognizes interest and penalties related to uncertain tax positions in general and administrative expenses. There were no penalties or interest recognized during 2014 and 2013.

6. Capital and Surplus

The payment of dividends by the Company is limited and can only be made from earned profits without the prior approval from the Department. The maximum dividend that may be paid without prior approval of the Commissioner of Insurance is limited to the greater of 10% of statutory surplus at the end of the preceding calendar year or the statutory net income of the preceding calendar year. Accordingly, SNIC has unrestricted net assets available for dividends to SNIH in 2015 of \$21,584,185. The minimum required statutory capital and surplus was \$5,000,000 at December 31, 2014. Unassigned surplus at December 31, 2014, contains net unrealized gains of \$32,347,253 and nonadmitted assets of \$13,333.

The Company is subject to certain Risk-Based Capital (RBC) requirements, as specified by the NAIC. Under the RBC standards, risks specific to the Company in such areas as asset risk, insurance risk, interest rate risk, and business risk are calculated and compared to the Company's capital and surplus. In its calculation of risk-based capital, the Company has deducted amounts for which it holds collateral (either trust funds in the name of the Company or irrevocable letters of credit) for amounts recoverable from reinsurance companies. The Company believes this practice to be appropriate because the credit risk for the related reinsurance balances is virtually eliminated due to the protection provided by the collateral. This practice differs from NAIC statutory annual statement instructions. There is no monetary effect on 2014 or 2013 net income or statutory surplus from the use of this practice. If the Company would have used the practice outlined in the NAIC's annual statement instructions, its RBC calculation would not have resulted in a regulatory event in 2014 or 2013.

State National Insurance Company, Inc.

Notes to Financial Statements – Statutory Basis (continued)

7. NAIC SAP to GAAP Reconciliation

A reconciliation of SNIC’s shareholder’s equity and net income from NAIC SAP to GAAP is as follows:

	Year Ended December 31	
	2014	2013
Shareholder’s equity:		
Statutory-basis capital and surplus	\$ 215,841,845	\$ 155,566,178
Adjustments for:		
Commissions payable	12,882,778	9,648,407
Allowance for return commissions	26,210,155	19,543,801
Allowance for policy cancellations	(21,874,311)	(15,561,491)
Deferred acquisition costs	11,809,555	12,085,663
GAAP adjustment effects of pooling agreement	(6,174,316)	(4,647,901)
Management fees	(10,449,713)	(9,110,678)
Deferred income taxes	(5,959,477)	(5,118,982)
Unrealized gains on investments	3,568,548	1,749,747
Investment in subsidiaries	5,704,266	4,517,912
Nonadmitted assets	13,333	15,116
Other	16,158	144,412
Shareholder’s equity in accordance with GAAP	<u>\$ 231,588,821</u>	<u>\$ 168,832,184</u>
Net income:		
Statutory-basis net income	\$ 3,224,296	\$ 2,503,477
Adjustments for:		
Contingent commissions	3,234,371	1,581,413
Allowance for return commissions	6,666,354	3,369,256
Allowance for policy cancellations	(6,312,820)	(2,208,358)
Deferred acquisition costs	(276,108)	1,618,571
GAAP adjustment effects of pooling agreement	(1,526,415)	(1,993,036)
Management fees	(1,339,035)	(1,775,885)
Deferred income taxes	128,457	1,011,788
Equity in earnings of subsidiaries	4,167,135	4,312,698
Other	(128,254)	(37,670)
Net income in accordance with GAAP	<u>\$ 7,837,981</u>	<u>\$ 8,382,254</u>

State National Insurance Company, Inc.

Notes to Financial Statements – Statutory Basis (continued)

8. Program Managers

Through unaffiliated program managers, SNIC primarily writes commercial lines of business. This business is written pursuant to quota share and excess of loss reinsurance contracts and general agency agreements that are tripartite agreements executed by SNIC, the reinsurer, and the general agent. Substantially all of the risk associated with this business is retained by the reinsurer.

As compensation for writing this business, SNIC receives ceding commissions from the program managers and, accordingly, the related ceding commissions receivable are reflected as agents' balances receivable. If the program manager defaults on its obligation to pay these commissions (or any other amount due under the contract), the reinsurer is obligated to make the payment under the guarantee contained in the contracts.

For the years ended December 31, 2014 and 2013, direct premiums written by unaffiliated program managers or an affiliated agent are shown below:

	<u>2014</u>	<u>2013</u>
All Star Risk Managers, Inc.	\$ 45,386,152	\$ 32,245,786
Appalachian Underwriters, Inc.	341,821	12,696,019
Cal-Regent Insurance Services Corp.	1,173,860	12,781,423
Brit Insurance Services USA, Inc.	14,210,418	495,233
Direct General Insurance Company	20,463,322	19,204,675
Knight Management Insurance Services	48,429,621	33,308,466
Meadowbrook Insurance Group	102,998,692	74,721,536
Sure Products Insurance Agency	14,904,204	13,430,494
T.B.A. Insurance Group, Ltd., affiliate	125,566,083	116,556,071
Torus US Intermediaries	5,183,285	25,271,602
TST, Ltd.	11,607,750	10,262,835
ULICO Insurance Group, Inc.	666,696	14,591,554
Venture Underwriters, Inc.	29,277,707	22,299,130
Others	71,070,442	79,511,996
	<u>\$ 491,280,053</u>	<u>\$ 467,376,820</u>

All of the program managers in the preceding table have been granted underwriting, policy issuance, collections, and claim administration authority.

State National Insurance Company, Inc.

Notes to Financial Statements – Statutory Basis (continued)

9. Reinsurance

The Company entered into a reinsurance agreement in 2009 to cede 50% of certain CPI policies to CUMIS Insurance Society, Inc. (CUNA) and receives a ceding commission related to these policies. Effective July 1, 2014 CUNA's quota share was reduced from 50% to 30% for all policies written on or after July 1, 2014 (see Note 12).

The Company remains liable for unearned premiums and unpaid losses and LAE with respect to reinsurance ceded should the reinsurer be unable to meet its obligations. Management considers the possibility of a reinsurer becoming unable to meet its obligations as remote due to the reinsurers' financial stability, A.M. Best Company rating, size, security funds available, and other factors as appropriate. Following is a summary of these balances at December 31:

	2014	2013
Ceded unearned premiums	\$ 225,289,742	\$ 210,800,340
Ceded unpaid losses and LAE	663,075,822	640,621,271
Total reinsurance recoverables	888,365,564	851,421,611
Less secured reinsurance recoverables	(604,496,148)	(580,687,831)
Unsecured reinsurance recoverables	\$ 283,869,416	\$ 270,733,780

The fair value of the collateral is approximately 147% of the secured reinsurance recoverables as of December 31, 2014.

The effects of reinsurance on premiums written and earned are as follows:

	2014		2013	
	Written	Earned	Written	Earned
Direct premiums	\$ 491,280,053	\$ 473,610,770	\$ 467,376,820	\$ 425,277,181
Assumed premiums:				
Affiliates	10,694,957	8,617,903	6,798,495	5,872,768
Nonaffiliates	608,305	355,805	2,987,005	3,201,506
Ceded premiums:				
Affiliates	(63,755,938)	(57,022,183)	(51,306,531)	(47,810,973)
Nonaffiliates	(386,663,428)	(378,907,783)	(383,877,719)	(347,422,414)
Net premiums	\$ 52,163,949	\$ 46,654,512	\$ 41,978,070	\$ 39,118,068

State National Insurance Company, Inc.

Notes to Financial Statements – Statutory Basis (continued)

9. Reinsurance (continued)

At December 31, 2014, the Company has unsecured reinsurance recoverables that exceed 3% of surplus from the following reinsurers:

State Automobile Mutual Insurance Company	\$ 53,620,338
Torus National Insurance Company	45,557,710
Technology Insurance Company, Inc.	34,520,610
United Specialty Insurance Company, affiliate	22,687,640
Maiden Reinsurance North America, Inc.	17,698,502
North Carolina Reinsurance Facility	17,176,633
California Capital Insurance Company	15,259,118
Jubilee Syndicate No 5820	13,169,168
National Specialty Insurance Company, affiliate	12,964,366
CUMIS Insurance Society, Inc.	11,174,200
Brit Syndicate 2987	10,625,583
Harco National Insurance Company	9,508,156
United States Fire Insurance Company	6,831,423

The net amount of return commissions payable or recoverable at December 31, 2014, if all assumed and ceded reinsurance treaties were canceled, is summarized as follows:

	Assumed Reinsurance		Ceded Reinsurance		Net	
	Unearned Premium Reserve	Commission Payable	Unearned Premium Reserve	Commission Recoverable	Unearned Premium Reserve	Commission Recoverable
Affiliates	\$ 4,940,053	\$ 2,635,916	\$ 30,083,150	\$ 14,877,225	\$ (25,143,097)	\$ (12,241,309)
Nonaffiliates	311,000	–	195,206,592	49,347,180	(194,895,592)	(49,347,180)
Total	<u>\$ 5,251,053</u>	<u>\$ 2,635,916</u>	<u>\$ 225,289,742</u>	<u>\$ 64,224,405</u>	<u>\$ (220,038,689)</u>	<u>\$ (61,588,489)</u>

State National Insurance Company, Inc.

Notes to Financial Statements – Statutory Basis (continued)

9. Reinsurance (continued)

Additional or return commissions or other equivalent amounts pursuant to contractual agreements of a profit-sharing nature are accrued based on the experience of the underlying business using case and statistical methods. Contingent commission amounts payable at December 31 are summarized as follows:

	2014	2013
Direct	\$ 1,861,988	\$ 1,973,026
Assumed	400,023	351,989
Ceded	(1,244,106)	(1,278,758)
Net	<u>\$ 1,017,905</u>	<u>\$ 1,046,257</u>

10. Fair Value Measurements

Assets and liabilities reported in the financial statements at fair value are required to be classified according to a fair value hierarchy that prioritizes the use of inputs used in valuation methodologies into three levels. The hierarchy gives the highest ranking to fair values determined using unadjusted quoted prices in active markets for identical assets and liabilities (Level 1) and the lowest ranking to fair values determined using methodologies and models with unobservable inputs (Level 3). An asset's or liability's classification is based on the lowest level input that is significant to its measurement. For example, a Level 3 fair value measurement may include inputs that are both observable (Level 1 and 2) and unobservable (Level 3). The levels of the fair value hierarchy are as follows:

- Level 1: Inputs are quoted prices for identical assets or liabilities in active markets that are accessible at the measurement date.
- Level 2: Inputs include quoted prices for similar assets or liabilities in active markets, quoted prices from those willing to trade in markets that are not active, or other inputs that are observable or can be corroborated by market data for the term of the instrument. These inputs include market interest rates and volatilities, spreads, and yield curves.
- Level 3: Inputs are unobservable. Unobservable inputs reflect the Company's own assumptions about the assumptions market participants would use in pricing the asset or liability based on the best information available in the circumstances.

State National Insurance Company, Inc.

Notes to Financial Statements – Statutory Basis (continued)

10. Fair Value Measurements (continued)

A description of the Company’s valuation techniques used to measure its assets at fair value is as follows:

- Bonds: Level 2 inputs are used to determine fair value of all bonds. These inputs are obtained from either an independent pricing service using quoted prices or from its third-party investment managers and are valued utilizing observable data that may include dealer quotes, market spreads, cash flows, yield curves, live trading levels, trade execution data, market consensus prepayment speeds, credit information, and the security’s terms and conditions, among other information.
- Equity Securities: Level 2 inputs are used to determine fair value of equity securities. For these securities, the Company obtains fair value measurements from an independent pricing service using quoted prices.

Management has reviewed the process used by the pricing services and has determined that they result in fair values consistent with requirements of SSAP No. 100, *Fair Value Measurements*. The Company had no other assets or liabilities subject to fair value measurement at December 31, 2014 or 2013.

Based on an analysis of the inputs, the Company’s financial assets that are measured at fair value on a recurring basis due to their NAIC designation at December 31, 2014 and 2013, have been categorized as follows:

	Level 1	Level 2	Level 3	December 31, 2014
Investments:				
Bonds:				
Industrial and miscellaneous	\$ –	\$ 1,128,434	\$ –	\$ 1,128,434
Common stocks	–	4,738	–	4,738
Preferred stocks	–	665,612	–	665,612
	\$ –	\$ 1,798,784	\$ –	\$ 1,798,784

State National Insurance Company, Inc.

Notes to Financial Statements – Statutory Basis (continued)

10. Fair Value Measurements (continued)

	Level 1	Level 2	Level 3	December 31, 2013
Investments:				
Bonds:				
Industrial and miscellaneous	\$ –	\$ 509,352	\$ –	\$ 509,352
Residential mortgage backed	–	136,962	–	136,962
Common stocks	–	148,058	–	148,058
Preferred stocks	–	1,553,664	–	1,553,664
	<u>\$ –</u>	<u>\$ 2,348,036</u>	<u>\$ –</u>	<u>\$ 2,348,036</u>

The aggregate fair value and related hierarchy for the Company's marketable financial instruments at December 31, 2014 and 2013, is as follows:

	Level 1	Level 2	Level 3	December 31, 2014
Investments:				
Bonds:				
Government	\$ –	\$ 6,454,659	\$ –	\$ 6,454,659
Government agency	–	212,571	–	212,571
State and municipality	–	21,419,432	–	21,419,432
Industrial and miscellaneous	–	45,524,164	–	45,524,164
Residential mortgage backed	–	26,670,849	–	26,670,849
Commercial mortgage backed	–	8,231,494	–	8,231,494
Common stocks	–	4,738	–	4,738
Preferred stocks	–	2,643,933	–	2,643,933
	<u>\$ –</u>	<u>\$ 111,161,840</u>	<u>\$ –</u>	<u>\$ 111,161,840</u>

State National Insurance Company, Inc.

Notes to Financial Statements – Statutory Basis (continued)

10. Fair Value Measurements (continued)

	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>December 31, 2013</u>
Investments:				
Bonds:				
Government	\$ –	\$ 5,785,104	\$ –	\$ 5,785,104
Government agency	–	643,320	–	643,320
State and municipality	–	15,608,884	–	15,608,884
Industrial and miscellaneous	–	24,283,365	–	24,283,365
Residential mortgage backed	–	19,815,606	–	19,815,606
Commercial mortgage backed	–	1,930,951	–	1,930,951
Common stocks	–	148,058	–	148,058
Preferred stocks	–	2,213,450	–	2,213,450
	<u>\$ –</u>	<u>\$ 70,428,738</u>	<u>\$ –</u>	<u>\$ 70,428,738</u>

There was no Level 3 activity including gains or losses recognized, purchases, or sales transactions during the periods ending December 31, 2014 and December 31, 2013.

Transfers between levels are recognized at the end of the reporting period. The Company had no transfers between Level 1, Level 2, and Level 3 during 2014 or 2013.

State National Insurance Company, Inc.

Notes to Financial Statements – Statutory Basis (continued)

11. Related-Party Transactions

On June 27, 2014, the Company's ultimate parent, SNC, made a surplus contribution to TBA of \$87,000,000. TBA then made a surplus contribution of \$53,000,000 to SNIH and SNIH made a surplus contribution of \$53,000,000 to SNIC. Subsequently, on July 30, 2014, the Company made surplus contributions to its two subsidiaries, NSIC and USIC, of \$10,600,000 and \$18,550,000, respectively.

TBA produces CPI and GAP business under an agency agreement with the Company. Following is a summary of the Company's affiliated agency balances, direct and assumed, as of and for the years ended December 31:

	<u>2014</u>	<u>2013</u>
Earned premiums	\$ 119,198,524	\$ 107,755,572
Commission expense incurred	62,492,350	61,870,242
Net receivable	4,673,096	5,496,405

Under the terms of a management agreement between TBA and the Company, TBA provides management services to the Company for the oversight of the Company's business development and underwriting operations. Fees incurred by the Company for such services were \$4,626,077 and \$4,942,721 during 2014 and 2013, respectively. Payable to affiliates related to the management agreement is \$2,443,710 and \$793,737 at December 31, 2014 and 2013, respectively. In addition, the company paid claims processing fees to TBA of \$2,749,050 and \$2,505,900 in 2014 and 2013, respectively.

The Company leases office space in its current home office building to TBA, an affiliate (see Note 13).

At December 31, 2014 and 2013, the net amount payable to NSIC related to intercompany pooling is \$566,005 and \$1,019,260, respectively. At December 31, 2014 and 2013, the net amount due to/(from) USIC related to intercompany pooling is \$447,442 and (\$827,811), respectively.

State National Insurance Company, Inc.

Notes to Financial Statements – Statutory Basis (continued)

12. Commitments and Contingencies

The Company is party to various legal proceedings that have arisen in the normal course of business. Those proceedings are considered by the Company in estimating the liability for unpaid losses and LAE. Management does not anticipate that the outcome of such legal actions will have a material effect on the Company's financial position or its results of operations.

The Company is subject to assessments from various insurance regulatory agencies related to insurance company insolvencies. Management is not aware of any material assessments for which notice has not yet been received. However, to the extent that such assessments are made, the Company has the contractual right to recover these amounts from the underlying reinsurer(s).

In July 2009, the Company formed a Collateral Protection Alliance (the Alliance) with CUMIS Insurance Society, Inc., a subsidiary of CUNA, to administer and write CPI business for their customers. The Alliance includes an agency agreement and a reinsurance agreement whereby the Company ceded 50% of the business back to CUNA. The Company did not account for the Alliance as a business combination because it did not result in a change of control. In connection with the Alliance, the Company has a purchase option and CUNA has a put option, whereby the Company is obligated to purchase CUNA's right to participate in future program business in the event of termination of the Alliance at a specified price.

On May 19, 2014, the Company signed an amendment to alter certain provisions of the July 24, 2009 Alliance with CUNA. The amendment, effective July 1, 2014, reduced CUNA's quota share percentage under the reinsurance agreement from 50% to 30% for all policies written on or after July 1, 2014. In addition, the term of the Alliance was extended through July 31, 2018, with an automatic three-year renewal (subject to the right of either party to give notice of nonrenewal); the termination rights for each party were modified, and the purchase price calculation was modified.

State National Insurance Company, Inc.

Notes to Financial Statements – Statutory Basis (continued)

12. Commitments and Contingencies (continued)

In consideration of these changes, the Company made two payments to CUNA on July 8, 2014. The first payment of \$14.8 million is not subject to any future adjustments. The second payment of \$3.0 million is subject to potential future adjustment based upon the net premium and loss ratio for the 12-month period ending June 30, 2015, with any payment adjustment due on August 7, 2015. Due to the nature of the Company's management agreement, which is based on underwriting income, the net financial impact to SNIC, after pooling, management fee and tax, was approximately \$1.3 million. The following table shows the effect of the contract modification expense:

Contract modification expense	\$ 17,800,000
Pooled to subsidiaries	<u>(9,790,000)</u>
Contract modification expense after pooling	8,010,000
Management fee adjustment	<u>(6,007,500)</u>
Federal income tax at effective rate	<u>(678,848)</u>
Net impact	<u>\$ 1,323,652</u>

13. Leases

SNIC owns its current home office building, which it leases in part to TBA, an affiliate. Rental income earned from this operating lease was \$2,077,578 and \$2,083,917 for the years ended December 31, 2014 and 2013, respectively. Future minimum lease payments associated with the TBA lease are \$2,008,958 for each of the succeeding five years.

Additionally, the Company leased the remaining portion of its home office building to an unaffiliated third party under the terms of an operating lease. Rental income was \$2,130,312 and \$1,396,819 for the years ended December 31, 2014 and 2013, respectively. In November 2013, the Company received an early termination notice from the unaffiliated third party relating to the operating lease between the parties. The early termination notice was in compliance with the terms of the lease. The lease continued to be considered an operating lease through the early termination date of November 30, 2014. Per the lease agreement an early termination fee of \$1,543,752 was received at the early termination date, recognized on a monthly basis subsequent to receiving notice.

State National Insurance Company, Inc.

Notes to Financial Statements – Statutory Basis (continued)

14. Concentration of Risk

The Company maintains cash and short-term investments in accounts with various financial institutions in excess of the amounts insured by the Federal Deposit Insurance Corporation. The Company monitors the financial stability of these depository institutions, and Management does not believe there is significant risk associated with deposits in excess of federally insured amounts.

A significant portion of the Company's premium writings occurs in New York, California, Florida, Texas, and North Carolina. During 2014, five program managers comprised approximately 67% of the Company's program writings and four reinsurers represented 55% of the Company's unsecured ceded balances.

15. Regulatory Examination

At periodic intervals, the Department routinely examines the Company's statutory-basis financial statements as part of its legally prescribed oversight of the insurance industry. Based on these examinations, the regulators can direct that the Company's statutory-basis financial statements be adjusted in accordance with their findings. The Texas Department of Insurance completed its examination of the December 31, 2006 through December 31, 2010, statutory-basis financial statements in 2012, with no significant findings reported.

16. Transferable State Tax Credits

The Company did not purchase any tax credits in 2014. In 2014 and 2013, the Company fully utilized \$165,000 of transferrable Louisiana CAPCO credits purchased at a discount in 2012 and 2013, respectively.

17. 401(k) Profit-Sharing Plan and Trust

The Company participates in a 401(k) profit-sharing plan, sponsored by TBA, for employees that covers substantially all officers and employees who are at least 18 years of age. The Company is required to make a matching contribution of 50% of employees' contributions, limited to 6% of eligible employees' compensation. Also, the Company may make additional matching and profit-sharing contributions that are discretionary and are determined at the end of each plan year. The employer contribution expense included in other underwriting expenses is \$198,396 and \$198,373 for the years ended December 31, 2014 and 2013, respectively.

State National Insurance Company, Inc.

Notes to Financial Statements – Statutory Basis (continued)

18. Subsequent Events

The Company has evaluated subsequent events from the balance sheet date through May 1, 2015, which is the date the accompanying statutory-basis financial statements were available to be issued.

Supplementary Information



Report of Independent Auditors on Supplementary Information

Board of Directors
State National Insurance Company, Inc.

Our audits were conducted for the purpose of forming an opinion on the statutory-basis financial statements as a whole. The accompanying supplemental schedule of reinsurance disclosures and supplemental investment disclosures are presented to comply with the National Association of Insurance Commissioners' Annual Statement Instructions and the National Association of Insurance Commissioners' Accounting Practices and Procedures Manual and for purposes of additional analysis and are not a required part of the financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the statutory-basis financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States. In our opinion, the information is fairly stated, in all material respects, in relation to the financial statements as a whole.

This report is intended solely for the information and use of the Company and state insurance departments to whose jurisdiction the Company is subject and is not intended to be and should not be used by anyone other than these specified parties.

Ernst + Young LLP

Dallas, Texas

May 1, 2015

State National Insurance Company, Inc.

Investment Risk Interrogatories

December 31, 2014

1. The reporting entity's total admitted assets as reported on page 2 of the Annual Statement as of December 31, 2014, were \$290,718,867.
2. The ten largest exposures to a single issuer/borrower/investment, excluding: (i) U.S. Government, U.S. Government agency securities, and those U.S. Government money market funds listed in the Appendix to the *SVO Purposes and Procedures Manual* as exempt, (ii) property occupied by the Company, and (iii) policy loans, are as follows:

Investment Category	Amount	Percentage of Total Admitted Assets
a. Stocks – United Specialty Insurance Company (affiliate)	\$ 74,980,214	25.79%
b. Stocks – National Specialty Insurance Company (affiliate)	43,257,781	14.88
c. Bonds – Birmingham Alabama GO	1,504,602	0.52
d. Bonds – Wellpoint Inc.	1,062,640	0.37
e. Bonds – Washington St. Var	1,039,901	0.36
f. Bonds – Intel Corp	1,019,786	0.35
g. Bonds – Discover Card Exe Tr 2014-5	999,920	0.34
h. Bonds – TMSQ Mortgage Trust	977,971	0.34
i. Bonds – Anchorage Alaska	977,707	0.34
j. Bonds – Johnson County Kansas GO	875,343	0.30

3. The amounts and percentages of the Company's total admitted assets held in bonds, short-term investments, and preferred stocks, by NAIC rating, are as follows:

Bonds and Short-Term Investments			Preferred Stocks		
NAIC Rating	Amount	Percentage of Total Admitted Assets	NAIC Rating	Amount	Percentage of Total Admitted Assets
NAIC-1	\$ 92,842,387	31.94%	P/PSF-1	\$ –	0.00%
NAIC-2	14,441,808	4.97	P/PSF-2	998,243	0.34
NAIC-3	2,193,464	0.75	P/PSF-3	915,657	0.31
NAIC-4	601,631	0.21	P/PSF-4	–	0.00
NAIC-5	65,222	0.02	P/PSF-5	–	0.00
NAIC-6	–	0.00	P/PSF-6	–	0.00

State National Insurance Company, Inc.

Investment Risk Interrogatories (continued)

4. Assets held in foreign investments are less than 2.5% of the Company's total admitted assets.
5. Assets held in Canadian investments are less than 2.5% of the Company's total admitted assets.
6. Assets held in investments with contractual sales restrictions are less than 2.5% of the Company's total admitted assets.
7. The amounts and percentages of admitted assets held in equity interests (including investments in the shares of mutual funds, preferred stocks, publicly traded equity securities, and other equity securities, and excluding money market and bond mutual funds listed in the Appendix to the *SVO Practices and Procedures Manual* as exempt or Class 1) are as follows:

Investment Category	Amount	Percentage of Total Admitted Assets
a. Stocks – United Specialty Insurance Company (affiliate)	\$ 74,980,214	25.79%
b. Stocks – National Specialty Insurance Company (affiliate)	43,257,781	14.88
c. Stocks – Stanley Black & Decker PFD	598,813	0.21
d. Stocks – Bunge, Ltd	416,518	0.14
c. Stocks – Centerpoint Energy Inc Convertible	399,431	0.14
d. Stocks – AMG Cap Tr II	265,192	0.09
e. Stocks – New York Cmnty Cap TR V Pfd	233,946	0.08
g. Stocks – Emerald Plantation Holdings LTD	4,738	0.00

8. Assets held in nonaffiliated, privately placed equities are less than 2.5% of the Company's total admitted assets.
9. Assets held in general partnership interests are less than 2.5% of the Company's total admitted assets.
10. Mortgage loans reported in Schedule B are less than 2.5% of the Company's total admitted assets.

State National Insurance Company, Inc.

Investment Risk Interrogatories (continued)

11. The five largest investments in one parcel or group of contiguous parcels of real estate reported in Schedule A are less than 2.5% of the Company's total admitted assets.
12. The Company has no assets subject to securities lending, repurchase agreements, reserve repurchase agreements, dollar repurchase agreements, or dollar reserve repurchase agreements.
13. The Company has no warrants.
14. The Company has no potential for exposure for collars, swaps, and forwards.
15. The Company has no potential for exposure for futures contracts.

State National Insurance Company, Inc.

Summary Investment Schedule

December 31, 2014

Investment Categories	Gross Investment Holdings*		Admitted Assets as Reported in the Annual Statement	
Bonds:				
U.S. Treasury securities	\$ 6,408,358	2.5%	\$ 6,408,358	2.5%
U.S. Government agency and corporate obligations (excluding mortgage-backed securities):				
Issued by U.S. Government sponsored agencies	209,188	0.1	209,188	0.1
Securities issued by states, territories and possessions, and political subdivisions in the U.S.:				
States, territories, and possessions general obligations	3,071,990	1.2	3,071,990	1.2
Political subdivisions of states, territories and possessions, and political subdivisions general obligations	9,015,101	3.6	9,015,101	3.6
Revenue and assessment obligations	8,213,043	3.2	8,213,043	3.2
Industrial development and similar obligations	664,379	0.3	664,379	0.3
Mortgage-backed securities (includes residential and commercial MBS):				
Pass-through securities:				
Issued or guaranteed by GNMA	1,579,158	0.6	1,579,158	0.6
Issued or guaranteed by FNMA and FHLMC	10,466,259	4.1	10,466,259	4.1
CMOs and REMICs:				
Issued or guaranteed by GNMA, FNMA, FHLMC, or VA	11,695,754	4.6	11,695,754	4.6
All other	10,464,899	4.1	10,464,899	4.1
Other debt and other fixed-income securities (excluding short term):				
Unaffiliated domestic securities (includes credit tenant loans rated by the SVO)	38,987,756	15.3	38,987,756	15.3
Unaffiliated non-U.S. securities (including Canada)	4,928,008	1.9	4,928,008	1.9
Equity interests:				
Preferred stocks:				
Unaffiliated	1,913,900	0.8	1,913,900	0.8
Publicly traded equity securities:				
Unaffiliated	4,738	0.0	4,738	0.0
Other equity securities:				
Affiliated	118,237,995	46.5	118,237,995	46.5
Real estate investments:				
Property occupied by Company	14,213,028	5.6	14,213,028	5.6
Property held for sale	1,034,000	0.4	1,034,000	0.4
Cash, cash equivalents, and short-term investments	13,256,354	5.2	13,256,354	5.2
Total invested assets	\$ 254,363,908	100.0%	\$ 254,363,908	100.0%

*Gross investment holdings, as valued in compliance with the NAIC's *Accounting Practices and Procedures Manual*.

State National Insurance Company, Inc.

Schedule of Reinsurance Disclosures

December 31, 2014

State National Insurance Company, Inc. (the Company) has eleven reinsurance contracts containing provisions that have allowed the Company to reinsure risk with other entities under quota share reinsurance contracts that include provisions that would limit the reinsurer's losses below the stated quota share percentage (e.g., a deductible, a loss ratio corridor, a loss cap, an aggregate limit, or similar provisions). The amount of reinsurance credit taken reflects the reduction in quota share coverage caused by any applicable limiting provision.

For the year ended December 31, 2014, the Company has not ceded any risk under any reinsurance contract (or under multiple contracts with the same reinsurer or its affiliates) for which: (i) it recorded a positive or negative underwriting result greater than 5% of prior year-end surplus as regards policyholders or it reported calendar-year written premium ceded or year-end loss and loss expense reserves ceded greater than 5% of prior year-end surplus as regards policyholders; (ii) it accounted for that contract as reinsurance and not as a deposit; and (iii) the contract contains one or more of the following features that would have similar results:

- a. A contract term longer than two years and the contract is noncancelable by the reporting entity during the contract term;
- b. A limited or conditional cancellation provision under which cancellation triggers an obligation by the reporting entity, or an affiliate of the reporting entity, to enter into a new reinsurance contract with the reinsurer, or an affiliate of the reinsurer;
- c. Aggregate stop-loss reinsurance coverage;
- d. An unconditional or unilateral right by either party to commute the reinsurance contract, except for such provisions which are only triggered by a decline in the credit status of the other party;
- e. A provision permitting reporting of losses, or payment of losses, less frequently than on a quarterly basis (unless there is no activity during the period); or
- f. Payment schedules, accumulating retentions from multiple years, or any features inherently designed to delay timing of the reimbursement to the ceding entity.

State National Insurance Company, Inc.

Schedule of Reinsurance Disclosures (continued)

For the year ended December 31, 2014, the Company has not ceded any risk under any reinsurance contract (or under multiple contracts with the same reinsurer or its affiliates) for which, during the period covered by the statement, it recorded a positive or negative underwriting result greater than 5% of prior year-end surplus as regards policyholders or it reported calendar-year written premium ceded or year-end loss and loss expense reserves ceded greater than 5% of prior year-end surplus as regards policyholders; excluding cessions to approved pooling arrangements or to captive insurance companies that are directly or indirectly controlling, controlled by, or under common control with: (i) one or more unaffiliated policyholders of the reporting entity, or (ii) an association of which one or more unaffiliated policyholders of the reporting entity is a member, whereby:

- a. The written premium ceded to the reinsurer by the reporting entity or its affiliates represents fifty percent (50%) or more of the entire direct and assumed premium written by the reinsurer based on its most recently available financial statements; or
- b. Twenty-five percent (25%) or more of the written premium ceded to the reinsurer has been retroceded back to the reporting entity or its affiliates.

Except for transactions meeting the requirements of paragraph 31 of SSAP No. 62R, *Property and Casualty Reinsurance*, the Company has not ceded any risk under any reinsurance contract (or multiple contracts with the same reinsurer or its affiliates), during the year ended December 31, 2014, and either:

- a. Accounted for that contract as reinsurance (either prospective or retroactive) under statutory accounting principles (SAP) and as a deposit under generally accepted accounting principles (GAAP); or
- b. Accounted for that contract as reinsurance under GAAP and as a deposit under SAP.

State National Insurance Company, Inc.

Note to Supplementary Information

December 31, 2014

1. Basis of Presentation

The accompanying supplemental schedules present selected statutory-basis financial data as of December 31, 2014, and for the year then ended for purposes of complying with the National Association of Insurance Commissioners' *Accounting Practices and Procedures Manual* and agree to or are included in the amounts reported in the Company's 2014 Statutory Annual Statement as filed with the Texas Department of Insurance.