

**FINANCIAL STATEMENTS – STATUTORY BASIS  
& SUPPLEMENTARY INFORMATION**

STATE NATIONAL INSURANCE COMPANY, INC.  
YEARS ENDED DECEMBER 31, 2015 AND 2014  
WITH REPORT OF INDEPENDENT AUDITORS

State National Insurance Company, Inc.  
Financial Statements – Statutory Basis  
and Supplementary Information

Years Ended December 31, 2015 and 2014

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## **Report of Independent Auditors**

The Audit Committee of 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, 2015 and 2014, 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, Inc. at December 31, 2015 and 2014, 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, 2015 and 2014, 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 13, 2016

State National Insurance Company, Inc.

Balance Sheets – Statutory Basis

	<u>December 31, 2015</u>	<u>December 31, 2014</u>
<b>Admitted assets</b>		
Bonds	\$ 117,289,908	\$ 105,703,893
Preferred stocks	2,874,958	1,913,900
Common stocks	334,603	4,738
Common stocks of affiliates	125,854,422	118,237,995
Real estate, net	14,571,562	15,247,028
Cash, cash equivalents, and short-term investments	<u>15,698,301</u>	<u>13,256,354</u>
Total cash and invested assets	276,623,754	254,363,908
Interest receivable	858,672	919,798
Agents' balances receivable	26,426,312	22,069,334
Reinsurance recoverables	9,353,217	7,670,699
Federal income taxes receivable	277,448	512,095
Deferred taxes recoverable, net	5,709,154	4,819,996
Other assets	<u>62,564</u>	<u>363,037</u>
Total assets	<u>\$ 319,311,121</u>	<u>\$ 290,718,867</u>
<b>Liabilities and capital and surplus</b>		
Liabilities:		
Unpaid losses and loss adjustment expenses	\$ 5,738,364	\$ 4,556,337
Unearned premiums	26,607,407	24,613,486
Ceded reinsurance premiums payable	20,860,447	17,782,657
Reinsurance payables	6,426,258	5,652,568
Agents' balances payable	756,298	763,164
Commissions payable	21,718	1,017,905
Taxes, licenses, and fees payable	3,634,911	2,620,893
Payable to affiliates	4,920,256	2,469,810
Deferred ceding fees	13,103,519	10,625,337
Other liabilities	<u>7,412,412</u>	<u>4,774,865</u>
Total liabilities	89,481,590	74,877,022
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	85,998,230
Unassigned surplus	<u>140,331,301</u>	<u>126,343,615</u>
Total capital and surplus	<u>229,829,531</u>	<u>215,841,845</u>
Total liabilities and capital and surplus	<u>\$ 319,311,121</u>	<u>\$ 290,718,867</u>

See accompanying notes.

State National Insurance Company, Inc.  
Statements of Income – Statutory Basis

	<b>Year Ended</b>	
	<b>December 31, 2015</b>	<b>December 31, 2014</b>
Underwriting income:		
Premiums written	\$ 56,176,420	\$ 52,163,949
Change in unearned premiums	(1,993,921)	(5,509,437)
Premiums earned	<u>54,182,499</u>	<u>46,654,512</u>
Losses and loss adjustment expenses	26,617,302	19,846,326
Commissions expense (income)	(8,567,644)	3,333,947
Taxes, licenses, and fees	7,748,283	6,528,471
Management fees, affiliate	19,175,338	4,626,077
Contract modification expense	—	8,010,000
Other underwriting expenses	2,817,441	2,767,666
Net underwriting income	<u>6,391,779</u>	<u>1,542,025</u>
Investment income:		
Net investment income	1,738,297	2,910,042
Net realized investment gains, net of tax	1,011,469	599,967
Net investment income	<u>2,749,766</u>	<u>3,510,009</u>
Other income (expense)	<u>45</u>	<u>(273)</u>
Income before federal income taxes	9,141,590	5,051,761
Federal income tax expense	3,586,380	1,827,465
Net income	<u>\$ 5,555,210</u>	<u>\$ 3,224,296</u>

*See accompanying notes.*

State National Insurance Company, Inc.

Statements of Changes in Capital and Surplus – Statutory Basis

	<u>Common Stock</u>	<u>Paid-In Surplus</u>	<u>Unassigned Surplus</u>	<u>Total</u>
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
Paid-in Surplus	—	53,000,000	—	53,000,000
Balance at December 31, 2014	<u>3,500,000</u>	<u>85,998,230</u>	<u>126,343,615</u>	<u>215,841,845</u>
Net income	—	—	5,555,210	5,555,210
Change in net unrealized capital gains	—	—	7,560,240	7,560,240
Change in net deferred taxes	—	—	858,903	858,903
Change in nonadmitted assets	—	—	13,333	13,333
Paid-in Surplus	—	—	—	—
Balance at December 31, 2015	<u>\$ 3,500,000</u>	<u>\$ 85,998,230</u>	<u>\$ 140,331,301</u>	<u>\$ 229,829,531</u>

*See accompanying notes.*

State National Insurance Company, Inc.  
Statements of Cash Flow – Statutory Basis

	<b>Year Ended</b>	
	<b>December 31, 2015</b>	<b>December 31, 2014</b>
<b>Operating activities</b>		
Premiums collected, net of reinsurance	\$ 56,463,521	\$ 53,838,879
Net investment income received	3,478,160	5,434,190
Losses and loss adjustment expenses paid	(25,435,275)	(19,676,960)
Paid to affiliates for reinsurance settlements	(1,097,010)	(1,438,329)
Commissions and expenses paid	(14,217,963)	(21,807,356)
Federal income taxes paid	(3,834,202)	(2,473,628)
Net cash provided by operating activities	<u>15,357,231</u>	<u>13,876,796</u>
<b>Investing activities</b>		
Proceeds from sales and maturities of investments	26,273,703	14,972,105
Cost of investment securities acquired	(39,188,987)	(82,897,361)
Net cash used in investing activities	<u>(12,915,284)</u>	<u>(67,925,256)</u>
<b>Financing activities</b>		
Proceeds from capital contribution	—	53,000,000
Net cash provided by financing activities	<u>—</u>	<u>53,000,000</u>
Net change in cash, cash equivalents, and short-term investments	2,441,947	(1,048,460)
Cash, cash equivalents, and short-term investments:		
Cash, cash equivalents, and short-term investments at beginning of year	<u>13,256,354</u>	<u>14,304,814</u>
Cash, cash equivalents, and short-term investments at end of year	<u>\$ 15,698,301</u>	<u>\$ 13,256,354</u>

*See accompanying notes.*

State National Insurance Company, Inc.  
Notes to Financial Statements – Statutory Basis

December 31, 2015

**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.

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. The Company invests in convertible securities that have embedded derivatives. Derivatives embedded within non-derivative instruments, such as options embedded in convertible fixed maturity securities, are not bifurcated from the host instrument; for GAAP, embedded derivatives that meet the criteria for bifurcation are bifurcated from the host instrument. Under GAAP, changes in the estimated fair value of the embedded derivatives are reflected in "Realized net investment gains" in the consolidated statements of income.

State National Insurance Company, Inc.  
Notes to Financial Statements – Statutory Basis (continued)

*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.

*Commissions:* Ceding fees for our program business are included as a contra-expense in commissions in the accompanying statutory-basis statements of income rather than as income as reported under GAAP.

*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 2015 or 2014 net income or statutory surplus from the use of this practice.

State National Insurance Company, Inc.  
Notes to Financial Statements – Statutory Basis (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 2015 and 2014, 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. Depreciation on the building, building improvements, and equipment is computed using the straight-line method over estimated useful lives of 3 to 20 years.

**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.

State National Insurance Company, Inc.  
Notes to Financial Statements – Statutory Basis (continued)

**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 recoverables and payables and agents' balances receivable and payable recorded in the balance sheets are carried at cost, which approximates fair value.

**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.

**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 (including ceding fees)**

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.

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. Ceding fees associated with a program not meeting contractual annual minimum premiums are amortized over the contract year.

**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:

<u>December 31, 2015</u>	<u>Book/Adjusted Carrying Value</u>	<u>Unrealized Gains</u>	<u>Unrealized Losses</u>	<u>Fair Value</u>
Bonds:				
Government	\$ 9,556,792	\$ 43,220	\$ (32,945)	\$ 9,567,067
Government agency	209,888	222	(1,146)	208,964
State and municipality	30,559,693	848,215	(1,261)	31,406,647
Industrial and miscellaneous	48,062,721	1,640,030	(734,026)	48,968,725
Residential mortgage-backed	21,691,287	652,281	(206,443)	22,137,125
Commercial mortgage-backed	7,209,527	22,371	(58,941)	7,172,957
Total bonds	<u>\$ 117,289,908</u>	<u>\$ 3,206,339</u>	<u>\$ (1,034,762)</u>	<u>\$ 119,461,485</u>

<u>December 31, 2014</u>	<u>Book/Adjusted Carrying Value</u>	<u>Unrealized Gains</u>	<u>Unrealized Losses</u>	<u>Fair Value</u>
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>

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, 2015 and 2014, has been reduced by \$393,935 and \$101,814, respectively.

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

<u>December 31, 2015</u>	<u>Book/Adjusted Carrying Value</u>	<u>Unrealized Gains</u>	<u>Unrealized Losses</u>	<u>Fair Value</u>
Common stocks	\$ 334,603	\$ —	\$ —	\$ 334,603
Preferred stocks	2,874,958	19,211	—	2,894,169
Total stocks	<u>\$ 3,209,561</u>	<u>\$ 19,211</u>	<u>\$ —</u>	<u>\$ 3,228,772</u>

State National Insurance Company, Inc.  
Notes to Financial Statements – Statutory Basis (continued)

<u>December 31, 2014</u>	<u>Book/Adjusted Carrying Value</u>	<u>Unrealized Gains</u>	<u>Unrealized Losses</u>	<u>Fair Value</u>
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>

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, 2015 and 2014:

<u>December 31, 2015</u>	<u>Less than 12 Months</u>		<u>12 Months or More</u>		<u>Total</u>	
	<u>Fair Value</u>	<u>Unrealized Losses</u>	<u>Fair Value</u>	<u>Unrealized Losses</u>	<u>Fair Value</u>	<u>Unrealized Losses</u>
Government	\$ 2,664,476	\$ (17,013)	\$ 728,048	\$ (15,932)	\$ 3,392,524	\$ (32,945)
Government agency	108,777	(1,146)	—	—	108,777	(1,146)
State and municipality	294,231	(1,261)	—	—	294,231	(1,261)
Industrial and miscellaneous	21,683,739	(507,489)	973,474	(226,537)	22,657,213	(734,026)
Residential mortgage-backed	7,009,349	(47,561)	4,336,988	(158,882)	11,346,337	(206,443)
Commercial mortgage-backed	4,297,212	(55,973)	203,586	(2,968)	4,500,798	(58,941)
	<u>\$ 36,057,784</u>	<u>\$ (630,443)</u>	<u>\$ 6,242,096</u>	<u>\$ (404,319)</u>	<u>\$ 42,299,880</u>	<u>\$ (1,034,762)</u>

<u>December 31, 2014</u>	<u>Less than 12 Months</u>		<u>12 Months or More</u>		<u>Total</u>	
	<u>Fair Value</u>	<u>Unrealized Losses</u>	<u>Fair Value</u>	<u>Unrealized Losses</u>	<u>Fair Value</u>	<u>Unrealized Losses</u>
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>

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 108 securities in an unrealized loss position at December 31, 2015. 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

State National Insurance Company, Inc.  
Notes to Financial Statements – Statutory Basis (continued)

above amortized cost. Therefore, the Company does not consider these investments to be other-than-temporarily impaired at December 31, 2015.

There were no preferred stocks or common stocks of affiliates in an unrealized loss position at December 31, 2015 or 2014. The following table presents the Company's gross realized gains (losses) on bonds and equity securities for the years ended December 31:

	<b>Year Ended</b>	
	<b>December 31, 2015</b>	<b>December 31, 2014</b>
Realized gains:		
Bonds	\$ 1,337,919	\$ 992,635
Equity securities	355,099	33,779
Gross realized gains	<u>1,693,018</u>	<u>1,026,414</u>
Realized losses:		
Bonds	(198,564)	(75,468)
Equity securities	(516)	(19,415)
Gross realized losses	<u>(199,080)</u>	<u>(94,883)</u>
Net realized investment gains	1,493,938	931,531
Capital gains tax	(482,469)	(331,564)
Net realized investment gains	<u>\$ 1,011,469</u>	<u>\$ 599,967</u>

Proceeds from sales of investment securities during 2015 and 2014 were \$18,495,017 and \$10,378,912, respectively.

In 2015, the Company had seven noncash exchanges of investment securities. Noncash consideration received for these exchanges was \$1,881,578. A gain of \$333,396 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 2014, the Company had nine noncash exchanges of investment securities. Noncash consideration received for these exchanges was \$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.

State National Insurance Company, Inc.  
Notes to Financial Statements – Statutory Basis (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.

<b>CUSIP</b>	<b>Description</b>	<b>Amortized Cost Basis Before OTTI</b>	<b>Recognized OTTI</b>	<b>Amortized Cost Basis After OTTI</b>	<b>Fair Value at Impairment</b>	<b>Period Impairment Reported</b>
23242MAD3	CWL 2006-S3	\$ 749,997	\$ 352,497	\$ 397,500	\$ 397,500	2008
02149VAG4	CWALT Inc 2007-3T1	209,245	24,052	185,193	185,193	2009
12544LAA9	CWHL 2007-11	249,033	20,245	228,788	228,788	2009
12493VAC4	CBO Holdgs VII Ltd	99,984	6,065	93,919	93,919	2009
126673JE3	CWL 2004-10	395,994	217,589	178,405	178,405	2009
12493VAC4	CBO Holdgs VII Ltd	94,940	12,968	81,972	81,972	2010
126673JE3	CWL 2004-10	181,063	51,883	129,180	129,180	2010
02149VAG4	CWALT Inc 2007-3T1	114,593	28,023	86,570	86,570	2011
12544LAA9	CWHL 2007-11	155,578	15,613	139,965	139,965	2011
126673JE3	CWL 2004-10	132,142	22,216	109,926	109,926	2011
829ESC9D6	Singapore Telecom	29,507	29,507	—	—	2013
			<u>\$ 780,658</u>			

The following table shows the Company's structured securities at December 31, 2015:

<b>CUSIP</b>	<b>Description</b>	<b>Actual Cost</b>	<b>Fair Value</b>	<b>Book/Adjusted Carrying Value</b>	<b>Mortgage- Referenced Security</b>
00170F209	Amg Cap Tr II	\$ 358,837	\$ 692,021	\$ 692,021	No
15189T206	Centerpoint Energy Inc Conv	259,809	350,364	350,364	No
458140AD2	Intel Corp	43,523	44,778	43,474	No
458140AF7	Intel Corp	486,001	673,568	477,786	No
50540RAG7	Laboratory Corp Amer Hldgs	676,882	844,688	447,255	No
530610AB0	Liberty Interactive Llc	360,169	346,489	346,489	No
60855RAD2	Molina Healthcare Inc	29,650	30,016	29,543	No
81170YAB5	Seacor Holdings Inc	102,850	87,175	87,175	No
811904AM3	Seacor Holdings Inc	137,981	113,100	113,100	No
896522AF6	Trinity Inds Inc	384,466	371,033	370,782	No
928298AJ7	Vishay Intertechnology Inc	38,475	34,397	34,397	No
		<u>\$ 2,878,643</u>	<u>\$ 3,587,629</u>	<u>\$ 2,992,386</u>	

State National Insurance Company, Inc.  
Notes to Financial Statements – Statutory Basis (continued)

The following schedule details the maturities of the Company's bonds as of December 31, 2015. 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.

	<u>Book/Adjusted Carrying Value</u>	<u>Fair Value</u>
Due in one year or less	\$ 3,101,985	\$ 3,147,507
Due after one year through five years	37,814,321	38,319,798
Due after five years through ten years	44,084,579	44,879,803
Due after ten years	3,388,209	3,804,295
Residential mortgage-backed securities	21,691,287	22,137,125
Commercial mortgage-backed securities	7,209,527	7,172,957
	<u>\$ 117,289,908</u>	<u>\$ 119,461,485</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 following table shows the segregation of the Company's asset restrictions:

<u>Asset Restriction</u>	<u>2015 Book/Adjusted Carrying Value</u>	<u>2015 Percentage to Total Admitted Assets</u>	<u>2014 Book/Adjusted Carrying Value</u>	<u>2014 Percentage to Total Admitted Assets</u>
State deposits	\$ 39,181,686	12.27 %	\$ 23,335,105	8.03 %
Regulatory agency deposits	611,933	0.19	618,377	0.21
Other restricted assets	1,730,877	0.54	1,730,103	0.60
Total restricted assets	<u>\$ 41,524,496</u>	<u>13.00 %</u>	<u>\$ 25,683,585</u>	<u>8.84 %</u>

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

	<u>Year Ended</u>	
	<u>December 31, 2015</u>	<u>December 31, 2014</u>
Interest on investments	\$ 4,305,601	\$ 5,722,092
Dividends	164,562	98,810
Gross investment income	4,470,163	5,820,902
Investment expenses	(2,731,866)	(2,910,860)
Net investment income	<u>\$ 1,738,297</u>	<u>\$ 2,910,042</u>

State National Insurance Company, Inc.  
Notes to Financial Statements – Statutory Basis (continued)

**Summarized Financial Information of Affiliates**

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

	<u>December 31,</u>		<u>December 31,</u>	
	<u>2015</u>		<u>2014</u>	
	<u>NSIC</u>	<u>USIC</u>	<u>NSIC</u>	<u>USIC</u>
Total cash and invested assets	\$ 63,350,963	\$ 109,756,775	\$ 57,310,128	\$ 99,434,443
Other assets	15,189,036	28,092,411	13,808,697	21,872,201
Total admitted assets	<u>\$ 78,539,999</u>	<u>\$ 137,849,186</u>	<u>\$ 71,118,825</u>	<u>\$ 121,306,644</u>
Total liabilities	\$ 32,521,095	\$ 58,013,668	\$ 27,861,044	\$ 46,326,430
Capital and surplus	46,018,904	79,835,518	43,257,781	74,980,214
Total liabilities and capital and surplus	<u>\$ 78,539,999</u>	<u>\$ 137,849,186</u>	<u>\$ 71,118,825</u>	<u>\$ 121,306,644</u>
Net underwriting income	\$ 2,840,791	\$ 4,971,384	\$ 685,345	\$ 1,199,353
Net investment income	1,264,766	2,336,314	1,106,735	2,436,132
Other income	19	35	(122)	(213)
Net income	3,317,678	7,049,065	1,147,338	2,407,872

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

<u>December 31, 2015</u>	<u>Statutory</u> <u>Carrying Value</u>	<u>Cost</u>	<u>Unrealized</u> <u>Gains</u>
National Specialty Insurance Company	\$ 46,018,904	\$ 32,350,000	\$ 13,668,904
United Specialty Insurance Company	79,835,518	53,550,000	26,285,518
	<u>\$ 125,854,422</u>	<u>\$ 85,900,000</u>	<u>\$ 39,954,422</u>
<u>December 31, 2014</u>	<u>Statutory</u> <u>Carrying Value</u>	<u>Cost</u>	<u>Unrealized</u> <u>Gains</u>
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>

State National Insurance Company, Inc.  
Notes to Financial Statements – Statutory Basis (continued)

**3. Real Estate, Equipment, and Depreciation**

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

	<u>2015</u>	<u>2014</u>
Land held for use	\$ 3,443,119	\$ 3,443,119
Land held for sale	1,034,000	1,034,000
Building	15,233,811	15,126,799
Computer equipment and software	74,839	74,839
	<u>19,785,769</u>	<u>19,678,757</u>
Accumulated depreciation and amortization	(5,214,207)	(4,431,307)
Real estate and equipment, net	<u>\$ 14,571,562</u>	<u>\$ 15,247,450</u>
Disclosed as:		
Real estate, net	\$ 14,571,562	\$ 15,247,028
Equipment, net	—	422
Real estate and equipment, net	<u>\$ 14,571,562</u>	<u>\$ 15,247,450</u>
Depreciation Expense	<u>\$ 782,900</u>	<u>\$ 779,999</u>

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 2015 or 2014.

State National Insurance Company, Inc.  
Notes to Financial Statements – Statutory Basis (continued)

**4. Unpaid Losses and Loss Adjustment Expenses**

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

	<b>Year Ended December 31</b>	
	<b>2015</b>	<b>2014</b>
Unpaid losses and LAE, net of reinsurance recoverables at January 1	\$ 4,556,337	\$ 4,386,971
Incurred related to:		
Current year	25,813,000	20,068,000
Prior years	804,302	(221,674)
Total incurred	<u>26,617,302</u>	<u>19,846,326</u>
Paid related to:		
Current year	21,887,850	16,889,641
Prior years	3,547,425	2,787,319
Total paid	<u>25,435,275</u>	<u>19,676,960</u>
Unpaid losses and LAE, net of reinsurance recoverables, at December 31	<u>\$ 5,738,364</u>	<u>\$ 4,556,337</u>

The estimate for ultimate losses incurred related to prior years increased by \$804,302 in 2015 and decreased by \$221,674 in 2014. The unfavorable development in 2015 is primarily the result of unpaid losses and loss adjustment expenses on other liability lines of insurance. 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 net changes in 2015 and 2014 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 \$17,413,000 and there were no outstanding billings recoverable.

**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 are included in the consolidated tax return for the period June 26, 2014 through December 31, 2014 and the year ended December 31, 2015. 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. As of December 31, 2015, the Company's U.S. federal income tax returns for tax years that ended December 31, 2012 through December 31, 2014, remain open under the normal three year statute of limitations and, therefore, are subject to examination by the Internal Revenue Service.

State National Insurance Company, Inc.  
Notes to Financial Statements – Statutory Basis (continued)

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

	2015			2014		
	Ordinary	Capital	Total	Ordinary	Capital	Total
Gross deferred tax asset	\$ 6,709,660	\$ 275,084	\$ 6,984,744	\$ 5,604,503	\$ 252,468	\$ 5,856,971
Statutory valuation allowance	—	—	—	—	—	—
Adjusted gross deferred tax asset	6,709,660	275,084	6,984,744	5,604,503	252,468	5,856,971
Gross deferred tax liabilities	(1,239,822)	(35,768)	(1,275,590)	(1,035,400)	(1,575)	(1,036,975)
Net deferred tax asset	5,469,838	239,316	5,709,154	4,569,103	250,893	4,819,996
Nonadmitted deferred tax asset	—	—	—	—	—	—
Net deferred tax asset admitted	\$ 5,469,838	\$ 239,316	\$ 5,709,154	\$ 4,569,103	\$ 250,893	\$ 4,819,996
Change in deferred tax asset nonadmitted	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —

Deferred taxes reflect the effect of temporary differences between the financial statement carrying amounts and the tax bases of assets and liabilities. The Company admits deferred taxes pursuant to SSAP No. 101.

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

	2015			2014		
	Ordinary	Capital	Total	Ordinary	Capital	Total
Federal tax paid in carryback years 11a	\$ 5,908,659	\$ 239,316	\$ 6,147,975	\$ 4,965,191	\$ 252,468	\$ 5,217,659
Lesser of:						
Deferred taxes expected to be realized following the balance sheet due date 11b(i)	711,146	—	711,146	620,261	—	620,261
Or						
Adjusted gross deferred tax assets allowed per limitation threshold 11b(ii)	N/A	N/A	33,618,057	N/A	N/A	31,653,277
Lesser of 11b(i) and 11b(ii)	711,146	—	711,146	620,261	—	620,261
Amount of gross deferred tax assets that can be offset against deferred tax liabilities 11c	89,855	35,768	125,623	19,051	—	19,051
Total of 11a, 11b, 11c	\$ 6,709,660	\$ 275,084	\$ 6,984,744	\$ 5,604,503	\$ 252,468	\$ 5,856,971
Gross admitted deferred tax assets	\$ 6,709,660	\$ 275,084	\$ 6,984,744	\$ 5,604,503	\$ 252,468	\$ 5,856,971
Gross deferred tax liabilities	(1,239,822)	(35,768)	(1,275,590)	(1,035,400)	(1,575)	(1,036,975)
Net admitted deferred tax assets	\$ 5,469,838	\$ 239,316	\$ 5,709,154	\$ 4,569,103	\$ 250,893	\$ 4,819,996

State National Insurance Company, Inc.  
Notes to Financial Statements – Statutory Basis (continued)

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

	<u>2015</u>	<u>2014</u>
Admitted deferred tax assets	\$ 5,709,154	\$ 4,819,996
Admitted assets	319,311,121	290,718,867
Statutory surplus	229,829,531	215,841,845
Total adjusted capital and surplus	224,120,377	211,021,849
Authorized control level of risk-based capital	52,123,788	46,445,253
Ratio percentage used to determine recovery period and threshold limitation	430 %	454 %

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

	<u>2015</u>	<u>2014</u>
Deferred income tax assets:		
Capital:		
Bonds	\$ 273,859	\$ 211,167
Stocks	1,225	41,301
Total gross capital deferred tax asset	<u>275,084</u>	<u>252,468</u>
Nonadmitted capital deferred tax asset	<u>—</u>	<u>—</u>
Admitted capital deferred tax asset	275,084	252,468
Ordinary:		
Compensation and benefits	\$ 65,151	\$ 62,470
Unearned premiums	1,862,518	1,722,944
Unpaid losses and LAE	70,088	76,792
Uncollected premiums	3,552	3,552
Deferred ceding fees	4,586,232	3,718,868
Real estate and equipment	122,119	15,211
Other	—	4,666
Total gross ordinary deferred tax asset	<u>6,709,660</u>	<u>5,604,503</u>
Nonadmitted ordinary deferred tax asset	<u>—</u>	<u>—</u>
Admitted ordinary deferred tax asset	6,709,660	5,604,503
Deferred income tax liabilities:		
Capital:		
Stocks	<u>(35,768)</u>	<u>(1,575)</u>
Total gross capital deferred tax liabilities	(35,768)	(1,575)
Ordinary:		
Bonds discount amortization	(60,205)	(53,436)
Management Fee	<u>(1,179,617)</u>	<u>(981,964)</u>
Total ordinary deferred tax liabilities	(1,239,822)	(1,035,400)
Total deferred tax liabilities	<u>\$ (1,275,590)</u>	<u>\$ (1,036,975)</u>
Net admitted deferred tax asset	<u>\$ 5,709,154</u>	<u>\$ 4,819,996</u>

There are no deferred tax liabilities not recognized as of December 31, 2015 and 2014.

State National Insurance Company, Inc.  
Notes to Financial Statements – Statutory Basis (continued)

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

	December		Change
	2015	2014	
Gross deferred tax assets	\$ 6,984,744	\$ 5,856,971	\$ 1,127,773
Gross deferred tax liabilities	(1,275,590)	(1,036,975)	(238,615)
Net deferred tax asset	<u>\$ 5,709,154</u>	<u>\$ 4,819,996</u>	<u>\$ 889,158</u>
Tax effect of change in unrealized gains/losses			(30,255)
Change in net deferred taxes			<u>\$ 858,903</u>

In the second quarter of 2014, the Company revised its provision for income taxes to reflect a change in the federal statutory rate from 34.3% to 35%, effective January 1, 2014. 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:

	2015		2014	
	Amount	Effective Tax Rate	Amount	Effective Tax Rate
Provision computed at statutory rate	\$ 3,368,421	35.0 %	\$ 1,884,164	35.0 %
Tax-exempt interest income, net of proration	(159,317)	(1.7)	(115,958)	(2.1)
Accrual adjustment - prior year	(44,684)	(0.5)	108,384	2.0
Change in federal statutory rate	—	—	(91,040)	(1.7)
Other	45,526	0.6	39,727	0.7
Total income tax expense	<u>\$ 3,209,946</u>	<u>33.4 %</u>	<u>\$ 1,825,277</u>	<u>33.9 %</u>
Federal income tax incurred	\$ 4,068,849		\$ 2,159,029	
Change in net deferred taxes	(858,903)		(333,752)	
Total statutory income taxes	<u>\$ 3,209,946</u>		<u>\$ 1,825,277</u>	

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:

	2015		2014		Change	
	Ordinary	Capital	Ordinary	Capital	Ordinary	Capital
Adjusted gross DTAs	6,709,660	275,084	5,604,503	252,468	1,105,157	22,616
Percentage of adjusted gross DTAs	0.0 %	100 %	0.0 %	100 %	0.0 %	0.0 %
Net admitted adjusted gross DTAs	6,709,660	275,084	5,604,503	252,468	1,105,157	22,616
Percentage of net admitted adjusted gross DTAs	0.0 %	100 %	0.0 %	100 %	0.0 %	0.0 %

State National Insurance Company, Inc.  
Notes to Financial Statements – Statutory Basis (continued)

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

	<u>2015</u>	<u>2014</u>
Current income tax expense (benefit)	\$ 3,648,589	\$ 1,747,562
Tax on capital gains	482,469	331,564
Prior-year (over) under accrual	(62,209)	79,903
Federal income taxes incurred	<u>\$ 4,068,849</u>	<u>\$ 2,159,029</u>

The Company had no net operating loss or capital loss carry-forwards at December 31, 2015.

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

	<u>Ordinary</u>	<u>Capital</u>	<u>Total</u>
2015	\$ 3,648,589	\$ 482,469	\$ 4,131,058
2014	1,691,397	325,520	2,016,917
	<u>\$ 5,339,986</u>	<u>\$ 807,989</u>	<u>\$ 6,147,975</u>

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 2015 and 2014. There were no uncertain tax positions at December 31, 2015.

## 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 2016 of \$22,982,953. The minimum required statutory capital and surplus was \$5,000,000 at December 31, 2015. Unassigned surplus at December 31, 2015, contains net unrealized gains of \$39,877,238. Unassigned surplus has not been reduced for nonadmitted assets at December 31, 2015.

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 2015 or 2014 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 2015 or 2014.

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:

	<u>December 31,</u> <u>2015</u>	<u>December 31,</u> <u>2014</u>
Shareholder's equity:		
Statutory-basis capital and surplus	\$ 229,829,531	\$ 215,841,845
Adjustments for:		
Commissions payable	13,263,602	12,882,778
Allowance for return commissions	28,072,829	26,210,155
Allowance for policy cancellations	(23,710,864)	(21,874,311)
Deferred acquisition costs	13,178,332	11,809,555
GAAP adjustment effects of pooling agreement	(7,113,052)	(6,174,316)
Management fees	(11,077,453)	(10,449,713)
Deferred income taxes	(5,540,175)	(5,959,477)
Unrealized gains on investments	1,228,379	3,568,548
Investment in subsidiaries	5,226,603	5,704,266
Nonadmitted assets	—	13,333
Convertible securities	962,409	—
Other	—	16,158
Shareholder's equity in accordance with GAAP	<u>\$ 244,320,141</u>	<u>\$ 231,588,821</u>
Net income:		
Statutory-basis net income	\$ 5,555,210	\$ 3,224,296
Adjustments for:		
Contingent commissions	380,824	3,234,371
Allowance for return commissions	1,862,674	6,666,354
Allowance for policy cancellations	(1,836,553)	(6,312,820)
Deferred acquisition costs	1,368,777	(276,108)
GAAP adjustment effects of pooling agreement	(938,736)	(1,526,415)
Management fees	(627,740)	(1,339,035)
Deferred income taxes	459,146	128,457
Equity in earnings of subsidiaries	7,990,894	4,167,135
Convertible securities	962,409	—
Other	(16,159)	(128,254)
Net income in accordance with GAAP	<u>\$ 15,160,746</u>	<u>\$ 7,837,981</u>

**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.

State National Insurance Company, Inc.  
Notes to Financial Statements – Statutory Basis (continued)

For the years ended December 31, 2015 and 2014, direct premiums written by unaffiliated program managers or an affiliated agent are shown below:

	<u>December 31,</u> <u>2015</u>	<u>December 31,</u> <u>2014</u>
All Star Risk Managers, Inc.	\$ 79,482,736	\$ 45,386,152
Brit Insurance Services USA, Inc.	15,048,407	14,210,418
Direct General Insurance Company	22,111,505	20,463,322
Knight Management Insurance Services	68,290,936	48,429,621
Meadowbrook Insurance Group	114,421,002	102,998,692
Plymouth Insurance Agency	11,584,322	10,521,975
Sure Products Insurance Agency	16,064,201	14,904,204
T.B.A. Insurance Group, Ltd., affiliate	133,049,158	125,566,083
Trinity Underwriting Managers, Inc.	17,785,233	—
TST, Ltd.	15,547,893	11,607,750
Venture Underwriters, Inc.	2,921,337	29,277,707
Others	79,576,186	67,914,129
	<u>\$ 575,882,916</u>	<u>\$ 491,280,053</u>

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

### 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:

	<u>December 31,</u> <u>2015</u>	<u>December 31,</u> <u>2014</u>
Ceded unearned premiums	\$ 276,642,625	\$ 225,289,742
Ceded unpaid losses and LAE	671,167,504	663,075,822
Total reinsurance recoverables	947,810,129	888,365,564
Less secured reinsurance recoverables	(695,916,119)	(604,496,148)
Unsecured reinsurance recoverables	<u>\$ 251,894,010</u>	<u>\$ 283,869,416</u>

The fair value of the collateral is approximately 153% of the secured reinsurance recoverables as of December 31, 2015.

State National Insurance Company, Inc.  
Notes to Financial Statements – Statutory Basis (continued)

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

	2015		2014	
	Written	Earned	Written	Earned
Direct premiums	\$ 575,882,916	\$ 522,847,915	\$ 491,280,053	\$ 473,610,770
Assumed premiums:				
Affiliates	13,084,002	12,778,197	10,694,957	8,617,903
Nonaffiliates	941,772	935,772	608,305	355,805
Ceded premiums:				
Affiliates	(68,660,069)	(66,223,054)	(63,755,938)	(57,022,183)
Nonaffiliates	(465,072,201)	(416,156,331)	(386,663,428)	(378,907,783)
Total	<u>\$ 56,176,420</u>	<u>\$ 54,182,499</u>	<u>\$ 52,163,949</u>	<u>\$ 46,654,512</u>

At December 31, 2015, the Company has unsecured reinsurance recoverables that exceed 3% of surplus from the following reinsurers:

StarStone National Insurance Company	\$ 28,326,674
United Specialty Insurance Company (affiliate)	25,157,822
Technology Insurance Company, Inc.	21,913,400
Lloyd's Syndicate 5820	21,140,000
Brit Syndicate 2987	18,062,000
California Capital Insurance Company	17,025,000
Tokio Millennium Re AG (US Branch)	16,523,000
North Carolina Reinsurance Facility	16,167,000
Maiden Reinsurance North America, Inc.	14,659,050
National Specialty Insurance Company (affiliate)	14,375,890
CUMIS Insurance Society, Inc.	12,090,981

The net amount of return commissions payable or recoverable at December 31, 2015, if all assumed and ceded reinsurance treaties were cancelled, is summarized as follows:

	Assumed Reinsurance		Ceded Reinsurance		Net	
	Unearned Premium Reserves	Commission Payable	Unearned Premium Reserves	Commission Recoverable	Unearned Premium Reserves	Commission Recoverable
Affiliates	\$ 5,245,858	\$ 2,735,028	\$ 32,520,164	\$ 16,104,940	\$ (27,274,306)	\$ (13,369,912)
Nonaffiliates	317,000	—	244,122,461	65,038,057	(243,805,461)	(65,038,057)
Total	<u>\$ 5,562,858</u>	<u>\$ 2,735,028</u>	<u>\$ 276,642,625</u>	<u>\$ 81,142,997</u>	<u>\$ (271,079,767)</u>	<u>\$ (78,407,969)</u>

State National Insurance Company, Inc.  
Notes to Financial Statements – Statutory Basis (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:

	2015	2014
Direct	\$ (23,159)	\$ 1,861,988
Assumed	71,421	400,023
Ceded	(26,544)	(1,244,106)
Net	\$ 21,718	\$ 1,017,905

### 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.

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, 2015 or 2014.

State National Insurance Company, Inc.  
Notes to Financial Statements – Statutory Basis (continued)

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, 2015 and 2014, have been categorized as follows:

<u>December 31, 2015</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
Investments:				
Bonds:				
Industrial and miscellaneous	\$ —	\$ 5,769,794	\$ —	\$ 5,769,794
Common stocks	—	334,603	—	334,603
Preferred stocks	—	2,318,867	—	2,318,867
	<u>\$ —</u>	<u>\$ 8,423,264</u>	<u>\$ —</u>	<u>\$ 8,423,264</u>
<u>December 31, 2014</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
Investments:				
Bonds:				
Industrial and miscellaneous	\$ —	\$ 1,128,434	\$ —	\$ 1,128,434
Common stocks	—	4,738	—	4,738
Preferred stocks	—	665,612	—	665,612
	<u>\$ —</u>	<u>\$ 1,798,784</u>	<u>\$ —</u>	<u>\$ 1,798,784</u>

The aggregate fair value and related hierarchy for the Company's marketable financial instruments at December 31, 2015 and 2014, is as follows:

<u>December 31, 2015</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
Investments:				
Bonds:				
Government	\$ —	\$ 9,567,067	\$ —	\$ 9,567,067
Government agency	—	208,964	—	208,964
State and municipality	—	31,406,647	—	31,406,647
Industrial and miscellaneous	—	48,968,725	—	48,968,725
Residential mortgage-backed	—	22,137,125	—	22,137,125
Commercial mortgage-backed	—	7,172,957	—	7,172,957
Common stocks	—	334,603	—	334,603
Preferred stocks	—	2,894,169	—	2,894,169
	<u>\$ —</u>	<u>\$ 122,690,257</u>	<u>\$ —</u>	<u>\$ 122,690,257</u>

State National Insurance Company, Inc.  
Notes to Financial Statements – Statutory Basis (continued)

<u>December 31, 2014</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
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>

There was no Level 3 activity including gains or losses recognized, purchases, or sales transactions during the periods ending December 31, 2015 and December 31, 2014.

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 2015 or 2014.

### 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>2015</u>	<u>2014</u>
Earned premiums	\$ 128,181,744	\$ 119,198,524
Commission expense incurred	60,397,946	62,492,350
Net receivable	2,775,608	4,673,096

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 \$19,175,338 and \$4,626,077 during 2015 and 2014, respectively. Payable to affiliates related to the management agreement is \$4,888,030 and \$2,443,710 at December 31, 2015 and 2014, respectively. In addition, the company paid claims processing fees to TBA of \$3,125,250 and \$2,749,050 in 2015 and 2014, respectively.

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

State National Insurance Company, Inc.  
Notes to Financial Statements – Statutory Basis (continued)

At December 31, 2015 and 2014, the net amount payable to NSIC related to intercompany pooling is \$1,209,941 and \$566,005, respectively. At December 31, 2015 and 2014, the net amount due from/(to) USIC related to intercompany pooling is \$2,701,148 and (\$447,442), respectively.

**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.

The terms of the Alliance with CUNA Mutual were modified on May 19, 2014 whereby CUNA Mutual's quota share percentage under the reinsurance agreement was reduced; the Alliance was extended through July 31, 2018 with an automatic three-year renewal (subject to the rights of either party to give notice of nonrenewal); the termination rights for each party were modified, and the purchase price calculation was modified. In consideration of these changes, the Company paid contract modification expense of \$17.8 million in 2014. The following table shows the effect of the contract modification expense in 2014:

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		(6,007,500)
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 \$2,068,394 and \$2,077,578 for the years ended December 31, 2015 and 2014, respectively. Future minimum lease payments associated with the TBA lease are \$2,008,958 for each of the succeeding five years.

In November 2013, the Company received an early termination notice from the unaffiliated third party relating to the operating lease between the parties and recognized \$1.5 million in lease termination fees in 2014 due to the early termination of the lease.

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, Texas, Florida, and North Carolina. During 2015, three program managers comprised approximately 59% of the Company's program writings and three unaffiliated reinsurers represented 28% 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 Department completed its examination of the December 31, 2006 through December 31, 2010, statutory-basis financial statements in 2012, with no significant findings reported. The Department has notified the Company of its intent to examine the Company's statutory-basis financial statements as of December 31, 2015.

**16. Transferable State Tax Credits**

The Company did not purchase any tax credits in 2015 and 2014. In 2014, the Company fully utilized \$165,000 of transferrable Louisiana CAPCO credits purchased at a discount in 2013.

**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 all officers and employees who are at least 18 years of age. Effective January 1, 2015, the Company is required to make matching contribution of 100% of the first 1% and 50% of the next 5% of employees' contributions. For employee contributions made prior to January 1, 2015, the Company was required to make 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 \$238,211 and \$198,396 for the years ended December 31, 2015 and 2014, respectively.

**18. Subsequent Events**

The Company currently has a significant program with Nephila Capital, Ltd. ("Nephila") under which the Company granted Nephila the exclusive right to utilize the Company as issuing carrier for U.S. catastrophe exposed property insurance from 2015 through 2019. The Company entered into an agreement with Nephila under which the Company will use commercially reasonable efforts to acquire one admitted and one non-admitted property and casualty insurance shell company, which will be used exclusively to write the direct business produced by Nephila. Nephila will have a three year option to purchase these companies beginning three years after the shell companies first write premium. In the event that the option is exercised, contractual minimum payments to the Company will extend for an additional two years. On May 12, 2016, the Company entered into an agreement to acquire United National Specialty Insurance Company ("UNSI") from Diamond State Insurance Company for \$7,350,000, excluding capital and surplus. UNSI is an admitted shell company with licenses in 49 states. Subject to regulatory approvals and customary closing conditions, the transaction is expected to close by the end of the third quarter of 2016.

State National Insurance Company, Inc.  
Notes to Financial Statements – Statutory Basis (continued)

The Company has evaluated subsequent events from the balance sheet date through May 13, 2016, which is the date the accompanying statutory-basis financial statements were available to be issued.

## Supplementary Information



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## **Report of Independent Auditors on Supplementary Information**

The Audit Committee of the 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.

Dallas, Texas  
May 13, 2016

State National Insurance Company, Inc.  
Investment Risk Interrogatories

December 31, 2015

1. The reporting entity's total admitted assets as reported on page 2 of the Annual Statement as of December 31, 2015, were \$319,311,121.
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)	\$ 79,835,518	25.00 %
b. Stocks – National Specialty Insurance Company (affiliate)	46,018,904	14.41
c. Bonds – Collierville, Town of	1,862,206	0.58
d. Bonds – Wisconsin, State of	1,324,868	0.42
e. Bonds – New Castle, County of	1,239,395	0.39
f. Bonds – Hawaii, State of	1,224,496	0.38
g. Bonds – Seattle, City of	1,192,312	0.37
h. Bonds – Intel Corporation	1,170,938	0.37
i. Bonds – The Charles County Government	1,141,771	0.36
j. Bonds – Austin, City of	1,138,840	0.36

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	\$ 104,890,158	32.85 %	P/PSF-1	\$ —	— %
NAIC-2	12,560,893	3.93	P/PSF-2	1,042,385	0.33
NAIC-3	4,802,182	1.50	P/PSF-3	1,832,573	0.57
NAIC-4	1,519,972	0.48	P/PSF-4	—	—
NAIC-5	—	—	P/PSF-5	—	—
NAIC-6	—	—	P/PSF-6	—	—

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.

State National Insurance Company, Inc.  
Investment Risk Interrogatories (continued)

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:

<b>Investment Category</b>	<b>Amount</b>	<b>Percentage of Total Admitted Assets</b>
a. Stocks – United Specialty Insurance Company (affiliate)	\$ 79,835,518	25.00 %
b. Stocks – National Specialty Insurance Company (affiliate)	46,018,904	14.41
c. Stocks – Welltower Inc	778,740	0.24
d. Stocks – Amg Cap Tr II	692,021	0.22
e. Stocks – New York Cmnty Cap Tr V Pfd	538,855	0.17
f. Stocks – Bunge Limited	514,978	0.16
g. Stocks – Centerpoint Energy Inc Convertible	350,364	0.11
h. Stocks – Stanley Black & Decker Inc	252,737	0.08
i. Stocks – Host Hotels & Resorts Inc	76,654	0.02
j. Stocks – Emerald Plantation Holdings Ltd	5,212	—

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.
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, 2015

<u>Investment Categories</u>	<u>Gross Investment Holdings*</u>		<u>Admitted Assets as Reported in the Annual Statement</u>	
Bonds:				
U.S. Treasury securities	\$	9,556,792	3.5 %	\$ 9,556,792 3.5 %
U.S. Government agency and corporate obligations (excluding mortgage-backed securities):				
Issued by U.S. Government sponsored agencies		209,888	0.1	209,888 0.1
Securities issued by states, territories and possessions, and political subdivisions in the U.S.:				
States, territories, and possessions general obligations		4,581,818	1.7	4,581,818 1.7
Political subdivisions of states, territories and possessions, and political subdivisions general obligations		13,497,498	4.9	13,497,498 4.9
Revenue and assessment obligations		11,822,819	4.3	11,822,820 4.3
Industrial development and similar obligations		657,558	0.2	657,558 0.2
Mortgage-backed securities (includes residential and commercial MBS):				
Pass-through securities:				
Issued or guaranteed by GNMA		762,512	0.3	762,512 0.3
Issued or guaranteed by FNMA and FHLMC		9,926,777	3.6	9,926,777 3.6
CMOs and REMICs:				
Issued or guaranteed by GNMA, FNMA, FHLMC, or VA		9,134,307	3.3	9,134,307 3.3
Issued by non-U.S. Government issuers and collateralized by mortgage-based securities issued or guaranteed		442,564	0.2	442,564 0.2
All other		8,634,654	3.0	8,634,655 3.1
Other debt and other fixed-income securities (excluding short term):				
Unaffiliated domestic securities (includes credit tenant loans rated by the SVO)		43,190,856	15.6	43,190,855 15.6
Unaffiliated non-U.S. securities (including Canada)		4,871,865	1.7	4,871,865 1.8
Equity interests:				
Preferred stocks:				
Unaffiliated		2,874,958	1.0	2,874,958 1.0
Publicly traded equity securities:				
Unaffiliated		334,603	0.1	334,603 0.1
Other equity securities:				
Affiliated		125,854,422	45.5	125,854,422 45.5
Real estate investments:				
Property occupied by Company		13,537,562	4.9	13,537,562 4.9
Property held for sale		1,034,000	0.4	1,034,000 0.4
Cash, cash equivalents, and short-term investments		15,698,301	5.7	15,698,301 5.7
Total invested assets	\$	276,623,754	100.0 %	\$ 276,623,754 100.0 %

\*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, 2015

State National Insurance Company, Inc. (the Company) has fifteen 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, 2015, 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, 2015, 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, 2015, 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, 2015

**1. Basis of Presentation**

The accompanying supplemental schedules present selected statutory-basis financial data as of December 31, 2015, 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 2015 Statutory Annual Statement as filed with the Texas Department of Insurance.