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National Interstate CORP
Form 10-Q
October 31, 2014

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

Form 10-Q

Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the quarterly period ended September 30, 2014
OR

Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the transition period from _____ to _____
Commission File Number: 000-51130

National Interstate Corporation
(Exact name of registrant as specified in its charter)

Ohio	34-1607394
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
3250 Interstate Drive, Richfield, OH	44286-9000
(Address of principal executives offices)	(Zip Code)

(330) 659-8900
(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

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

Large Accelerated Filer <input type="checkbox"/>	Accelerated Filer <input type="checkbox"/>
Non-Accelerated Filer <input type="checkbox"/> (Do not check if a smaller reporting company)	Smaller Reporting Company <input type="checkbox"/>

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

The number of shares outstanding of the registrant's sole class of common shares as of October 28, 2014 was 19,781,073.

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PART I—FINANCIAL INFORMATION

ITEM 1. Financial Statements

National Interstate Corporation and Subsidiaries

Consolidated Balance Sheets

(In thousands, except per share data)

	September 30, 2014 (Unaudited)	December 31, 2013
ASSETS		
Investments:		
Fixed maturities available-for-sale, at fair value (amortized cost – \$918,711 and \$914,149, respectively)	\$947,843	\$933,579
Equity securities available-for-sale, at fair value (amortized cost – \$70,433 and \$55,537, respectively)	78,885	65,770
Other invested assets	45,625	40,395
Total investments	1,072,353	1,039,744
Cash and cash equivalents	72,982	35,684
Accrued investment income	8,293	8,644
Premiums receivable, net of allowance for doubtful accounts of \$2,861 and \$3,225, respectively	238,862	244,934
Reinsurance recoverable on paid and unpaid losses	159,858	169,210
Prepaid reinsurance premiums	47,703	37,867
Deferred policy acquisition costs	23,239	23,025
Deferred federal income taxes	20,403	25,826
Property and equipment, net	24,616	24,753
Funds held by reinsurer	4,178	3,780
Intangible assets, net	7,862	8,073
Prepaid expenses and other assets	7,193	2,287
Total assets	\$1,687,542	\$1,623,827
LIABILITIES AND SHAREHOLDERS' EQUITY		
Liabilities:		
Unpaid losses and loss adjustment expenses	\$851,433	\$803,782
Unearned premiums and service fees	284,575	283,582
Long-term debt	12,000	12,000
Amounts withheld or retained for accounts of others	92,985	80,999
Reinsurance balances payable	32,173	26,317
Accounts payable and other liabilities	35,471	44,516
Commissions payable	15,284	13,934
Assessments and fees payable	4,586	6,413
Total liabilities	1,328,507	1,271,543
Shareholders' equity:		
Preferred shares – no par value		
Authorized – 10,000 shares		
Issued – 0 shares	—	—
Common shares – \$0.01 par value		
Authorized – 50,000 shares		
Issued – 23,350 shares, including 3,570 and 3,689 shares, respectively, in treasury	234	234
Additional paid-in capital	58,943	56,481
Retained earnings	280,491	281,518

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Accumulated other comprehensive income	24,430	19,281
Treasury shares	(5,063) (5,230
Total shareholders' equity	359,035	352,284
Total liabilities and shareholders' equity	\$1,687,542	\$1,623,827

See notes to consolidated financial statements.

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National Interstate Corporation and Subsidiaries
Consolidated Statements of Income
(Unaudited)
(In thousands, except per share data)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Revenues:				
Premiums earned	\$ 140,009	\$ 132,748	\$ 412,651	\$ 388,521
Net investment income	9,130	8,302	26,615	24,190
Net realized gains on investments (*)	2,622	1,353	6,294	5,433
Other	941	877	2,487	2,559
Total revenues	152,702	143,280	448,047	420,703
Expenses:				
Losses and loss adjustment expenses	110,755	104,530	346,920	320,098
Commissions and other underwriting expenses	24,058	23,555	70,482	69,847
Other operating and general expenses	4,912	4,625	15,797	15,240
Transaction expenses	—	—	2,163	—
Expense on amounts withheld	1,971	1,080	4,952	3,548
Interest expense	59	184	191	486
Total expenses	141,755	133,974	440,505	409,219
Income before income taxes	10,947	9,306	7,542	11,484
Provision for income taxes	2,154	2,028	1,437	2,469
Net income	\$8,793	\$7,278	\$6,105	\$9,015
Net income per share – basic	\$0.44	\$0.37	\$0.31	\$0.46
Net income per share – diluted	\$0.44	\$0.37	\$0.31	\$0.46
Weighted average of common shares outstanding – basic	19,780	19,657	19,746	19,640
Weighted average of common shares outstanding – diluted	19,853	19,766	19,823	19,770
Cash dividends per common share	\$0.12	\$0.11	\$0.36	\$0.33

(*) Consists of the following:

Net realized gains before impairment losses	\$2,942	\$1,491	\$6,979	\$5,588
Total losses on securities with impairment charges	(320)	) (138)	) (455)	) (155)
Non-credit portion recognized in other comprehensive income	—	—	(230)) —
Net impairment charges recognized in earnings	(320)	) (138)	) (685)	) (155)
Net realized gains on investments	\$2,622	\$1,353	\$6,294	\$5,433

See notes to consolidated financial statements.

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National Interstate Corporation and Subsidiaries
 Consolidated Statements of Comprehensive Income (Loss)
 (Unaudited)
 (Dollars in thousands)

	Three Months Ended		Nine Months Ended September	
	September 30,		30,	
	2014	2013	2014	2013
Net income	\$8,793	\$7,278	\$6,105	\$9,015
Other comprehensive (loss) income, before tax:				
Net unrealized gains on available-for-sale securities:				
Net unrealized holding (losses) gains on securities arising during the period	(6,947	) 1,052	10,647	(14,820
Reclassification adjustment for net realized gains included in net income	(1,570	) (800	) (2,726	) (2,984
Total other comprehensive (loss) income, before tax	(8,517	) 252	7,921	(17,804
Deferred income tax (benefit) expense on other comprehensive (loss) income	(2,981	) 89	2,772	(6,231
Other comprehensive (loss) income, net of tax	(5,536	) 163	5,149	(11,573
Total comprehensive income (loss)	\$3,257	\$7,441	\$11,254	\$(2,558
See notes to consolidated financial statements.				

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National Interstate Corporation and Subsidiaries
 Consolidated Statements of Shareholders' Equity
 (Unaudited)
 (Dollars in thousands)

	Common Stock	Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income	Treasury Stock	Total
Balance at January 1, 2014	\$234	\$56,481	\$281,518	\$ 19,281	\$(5,230)	\$352,284
Net income			6,105			6,105
Other comprehensive income, net of tax				5,149		5,149
Dividends on common stock			(7,132)			(7,132)
Issuance of 119,651 treasury shares upon exercise of options and restricted stock issued, net of forfeitures		1,976			167	2,143
Net tax effect from exercise/vesting of stock compensation		50				50
Stock-based compensation expense		436				436
Balance at September 30, 2014	\$234	\$58,943	\$280,491	\$ 24,430	\$(5,063)	\$359,035
Balance at January 1, 2013	\$234	\$54,788	\$272,618	\$ 31,634	\$(5,326)	\$353,948
Net income			9,015			9,015
Other comprehensive loss, net of tax				(11,573)		(11,573)
Dividends on common stock			(6,503)			(6,503)
Issuance of 65,483 treasury shares upon exercise of options and restricted stock issued, net of forfeitures		944			91	1,035
Net tax effect from exercise/vesting of stock compensation		21				21
Stock-based compensation expense		515				515
Balance at September 30, 2013	\$234	\$56,268	\$275,130	\$ 20,061	\$(5,235)	\$346,458

See notes to consolidated financial statements.

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National Interstate Corporation and Subsidiaries
Consolidated Statements of Cash Flows
(Unaudited)
(Dollars in thousands)

	Nine Months Ended September	
	30,	
	2014	2013
Operating activities		
Net income	\$6,105	\$9,015
Adjustments to reconcile net income to net cash provided by operating activities:		
Net amortization of bond premiums and discounts	2,990	5,175
Provision for depreciation and amortization	3,254	2,751
Net realized gains on investment securities	(6,294)	(5,433)
Deferred federal income taxes	2,651	456
Stock-based compensation expense	436	515
(Increase) decrease in deferred policy acquisition costs, net	(214)	2,078
Increase in reserves for losses and loss adjustment expenses	47,651	28,317
Increase in premiums receivable	6,072	690
Increase (decrease) in unearned premiums and service fees	993	(1,556)
(Increase) decrease in interest receivable and other assets	(4,953)	303
Increase in prepaid reinsurance premiums	(9,836)	(5,318)
Increase in accounts payable, commissions and other liabilities and assessments and fees payable	(9,522)	(11,654)
Increase in amounts withheld or retained for accounts of others	11,986	7,819
Decrease in reinsurance recoverable	9,352	4,921
Increase in reinsurance balances payable	5,856	5,231
Other	39	(122)
Net cash provided by operating activities	66,566	43,188
Investing activities		
Purchases of fixed maturities	(125,325)	(184,673)
Purchases of equity securities	(21,678)	(28,422)
Proceeds from sale of fixed maturities	19,985	35,023
Proceeds from sale of equity securities	8,428	6,747
Proceeds from maturities and redemptions of investments	99,344	135,109
Change in other invested assets, net	(2,138)	(1,820)
Capital expenditures	(2,945)	(2,391)
Net cash used in investing activities	(24,329)	(40,427)
Financing activities		
Net tax effect from exercise/vesting of stock-based compensation	50	21
Issuance of common shares from treasury upon exercise of stock options or stock award grants	2,143	1,035
Cash dividends paid on common shares	(7,132)	(6,503)
Net cash used in financing activities	(4,939)	(5,447)
Net increase (decrease) in cash and cash equivalents	37,298	(2,686)
Cash and cash equivalents at beginning of period	35,684	41,981
Cash and cash equivalents at end of period	\$72,982	\$39,295
See notes to consolidated financial statements.		

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NATIONAL INTERSTATE CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. Basis of Presentation

The accompanying unaudited consolidated financial statements of National Interstate Corporation (the “Company”) and its subsidiaries have been prepared in accordance with U.S. generally accepted accounting principles (“GAAP”) and the instructions to Form 10-Q.

The unaudited consolidated financial statements include the accounts of the Company and its subsidiaries, National Interstate Insurance Company (“NIIC”), Hudson Indemnity, Ltd., National Interstate Insurance Company of Hawaii, Inc. (“NIIC-HI”), Triumphe Casualty Company (“TCC”), National Interstate Insurance Agency, Inc. (“NIIA”), Hudson Management Group, Ltd., Vanliner Insurance Company (“VIC”), Vanliner Reinsurance Limited, American Highways Insurance Agency, Inc., Explorer RV Insurance Agency, Inc., Safety, Claims and Litigation Services, LLC and TransProtection Service Company. Significant intercompany transactions have been eliminated.

These interim unaudited consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2013. The interim financial statements reflect all adjustments which are, in the opinion of management, necessary for the fair presentation of the results for the periods presented. Such adjustments are of a normal recurring nature. Operating results for the three and nine month periods ended September 30, 2014 are not necessarily indicative of the results that may be expected for the full year ending December 31, 2014.

The preparation of the financial statements requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Changes in circumstances could cause actual results to differ materially from those estimates.

2. Fair Value Measurements

The Company must determine the appropriate level in the fair value hierarchy for each applicable measurement. The fair value hierarchy prioritizes the inputs, which refer broadly to assumptions market participants would use in pricing an asset or liability, into three levels. It gives the highest priority to quoted prices (unadjusted) in active markets for identical assets or liabilities and the lowest priority to unobservable inputs. The level in the fair value hierarchy within which a fair value measurement in its entirety falls is determined based on the lowest level input that is significant to the fair value measurement in its entirety. The Company’s management is responsible for the valuation process and uses data from outside sources (including nationally recognized pricing services and broker/dealers) in establishing fair value.

Pricing services use a variety of observable inputs to estimate the fair value of fixed maturities that do not trade on a daily basis. These inputs include, but are not limited to, recent reported trades, benchmark yields, issuer spreads, bids or offers, reference data and measures of volatility. Included in the pricing of mortgage-backed securities are estimates of the rate of future prepayments and defaults of principal over the remaining life of the underlying collateral. Inputs from brokers and independent financial institutions include, but are not limited to, yields or spreads of comparable investments which have recent trading activity, credit quality, duration, credit enhancements, collateral value and estimated cash flows based on inputs including delinquency rates, estimated defaults and losses and estimates of the rate of future prepayments. Valuation techniques utilized by pricing services and prices obtained from external sources are reviewed by the Company’s internal and affiliated investment professionals who are familiar with the securities being priced and the markets in which they trade to ensure the fair value determination is representative of an exit price. To validate the appropriateness of the prices obtained, the Company’s internal investment professionals, who report to the Chief Investment Officer, compare the valuation received to independent third party pricing sources and consider widely published indices (as benchmarks), recent trades, changes in interest rates, general economic conditions and the credit quality of the specific issuers. If the Company believes that significant discrepancies exist, the Company will perform additional procedures, which may include specific inquiry of the pricing source, to resolve the discrepancies.

Level 1 inputs are quoted prices (unadjusted) in active markets for identical securities that the reporting entity has the ability to access at the measurement date. Level 2 inputs are inputs other than quoted prices within Level 1 that are observable for the security, either directly or indirectly. Level 2 inputs include quoted prices for similar securities in active markets, quoted prices for identical or similar securities that are not active and observable inputs other than quoted prices, such as interest rate and yield curves. Level 3 inputs are unobservable inputs for the asset or liability. Level 1 consists of publicly traded equity securities and highly liquid, direct obligations of the U.S. Government whose fair value is based on quoted prices that are readily and regularly available in an active market. Level 2 primarily consists of financial

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instruments whose fair value is based on quoted prices in markets that are not active and include U.S. government agency securities, fixed maturity investments and nonredeemable preferred stocks that are not actively traded. Included in Level 2 are \$145.4 million of securities, which are valued based upon a non-binding broker quote and validated with other observable market data by management. Level 3 consists of financial instruments that are not traded in an active market, whose fair value is estimated by management based on inputs from independent financial institutions, which include non-binding broker quotes. The Company believes these estimates reflect fair value, but the Company is unable to verify inputs to the valuation methodology. The Company obtained at least one quote or price per instrument from its brokers and pricing services for all Level 3 securities and did not adjust any quotes or prices that it obtained. The Company's internal and affiliated investment professionals review these broker quotes using any recent trades, if such information is available, or market prices of similar investments. The Company primarily uses the market approach valuation technique for all investments.

The following table presents the Company's investment portfolio, categorized by the level within the fair value hierarchy in which the fair value measurements fall as of September 30, 2014:

	Level 1	Level 2	Level 3	Total
	(Dollars in thousands)			
Fixed maturities:				
U.S. Government and government agency obligations	\$1,709	\$103,410	\$—	\$105,119
Foreign government obligations	—	—	—	—
State and local government obligations	—	347,659	887	348,546
Residential mortgage-backed securities	—	196,262	—	196,262
Commercial mortgage-backed securities	—	20,703	—	20,703
Corporate obligations	—	183,330	7,103	190,433
Other debt obligations	—	79,982	2,503	82,485
Redeemable preferred stocks	3,801	—	494	4,295
Total fixed maturities	5,510	931,346	10,987	947,843
Equity securities:				
Common stocks	53,165	—	3,778	56,943
Nonredeemable preferred stocks	18,318	3,624	—	21,942
Total equity securities	71,483	3,624	3,778	78,885
Total fixed maturities and equity securities	76,993	934,970	14,765	1,026,728
Cash and cash equivalents	72,982	—	—	72,982
Total fixed maturities, equity securities and cash and cash equivalents at fair value	\$149,975	\$934,970	\$14,765	\$1,099,710

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The following table presents the Company's investment portfolio, categorized by the level within the fair value hierarchy in which the fair value measurements fell as of December 31, 2013:

	Level 1	Level 2	Level 3	Total
	(Dollars in thousands)			
Fixed maturities:				
U.S. Government and government agency obligations	\$1,486	\$92,871	\$—	\$94,357
Foreign government obligations	—	3,553	—	3,553
State and local government obligations	—	355,944	859	356,803
Residential mortgage-backed securities	—	202,225	—	202,225
Commercial mortgage-backed securities	—	34,963	—	34,963
Corporate obligations	—	187,481	4,969	192,450
Other debt obligations	—	41,805	3,311	45,116
Redeemable preferred stocks	3,625	—	487	4,112
Total fixed maturities	5,111	918,842	9,626	933,579
Equity securities:				
Common stocks	48,145	—	1,500	49,645
Nonredeemable preferred stocks	11,972	3,570	583	16,125
Total equity securities	60,117	3,570	2,083	65,770
Total fixed maturities and equity securities	65,228	922,412	11,709	999,349
Cash and cash equivalents	35,684	—	—	35,684
Total fixed maturities, equity securities and cash and cash equivalents at fair value	\$100,912	\$922,412	\$11,709	\$1,035,033

The tables above exclude other invested assets of \$45.6 million and \$40.4 million at September 30, 2014 and December 31, 2013, respectively. Other invested assets include investments in limited partnerships which are accounted for under the equity method. Equity method investments are not reported at fair value.

The Company uses the end of the reporting period as its policy for determining transfers into and out of each level. During the three and nine months ended September 30, 2014, the Company transferred seven nonredeemable preferred stocks, with an aggregate value of \$6.1 million, from Level 2 to Level 1 due to increases in trading activity. Conversely, during the same nine month period, the Company transferred six other nonredeemable preferred stocks, with an aggregate value of \$5.0 million, from Level 1 to Level 2 due to decreases in trading activity. There were no transfers from Level 1 to Level 2 during the three months ended September 30, 2014.

During the nine months ended September 30, 2013, the Company transferred \$3.8 million of nonredeemable preferred stocks and \$1.0 million of redeemable preferred stocks from Level 2 to Level 1 due to increases in trading activity. Of these transfers, \$3.5 million of the nonredeemable preferred stocks were transferred in the third quarter of 2013. There were no transfers from Level 1 to Level 2 during the three or nine months ended September 30, 2013.

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The following tables present a reconciliation of the beginning and ending balances for all investments measured at fair value on a recurring basis using Level 3 inputs for the three and nine months ended September 30, 2014 and 2013. The transfers into Level 3 during the three and nine months ended September 30, 2014 and 2013 were due to decreases in the availability of market observable inputs. All transfers are reflected in the table at fair value as of the end of the reporting period.

	Three Months Ended September 30, 2014					
	State and Local Government Obligations	Corporate Obligations	Other Debt Obligations	Redeemable Preferred Stock	Common Stock	
	(Dollars in thousands)					
Beginning balance at July 1, 2014	\$887	\$6,019	\$2,510	\$493		\$3,844
Total gains or (losses):						
Included in earnings	—	—	—	—		—
Included in other comprehensive income	—	128	(7	) 1		(66)
Purchases and issuances	—	—	—	—		—
Sales, settlements and redemptions	—	(59) —	—		—
Transfers in and/or (out) of Level 3	—	1,015	—	—		—
Ending balance at September 30, 2014	\$887	\$7,103	\$2,503	\$494		\$3,778
The amount of total gains or (losses) for the period included in earnings and attributable to the change in unrealized gains or (losses) relating to assets still held at the reporting date	\$—	\$—	\$—	\$—		\$—
	Nine Months Ended September 30, 2014					
	State and Local Government Obligations	Corporate Obligations	Other Debt Obligations	Redeemable Preferred Stock	Common Stock	Nonredeemable Preferred Stock
	(Dollars in thousands)					
Beginning balance at January 1, 2014	\$859	\$4,969	\$3,311	\$487	\$1,500	\$ 583
Total gains or (losses):						
Included in earnings	—	—	24	—	—	—
Included in other comprehensive income	28	280	(21	) 7	12	—
Purchases and issuances	—	1,000	—	—	2,266	—
Sales, settlements and redemptions	—	(161	) (811	) —	—	(583)
Transfers in and/or (out) of Level 3	—	1,015	—	—	—	—
Ending balance at September 30, 2014	\$887	\$7,103	\$2,503	\$494	\$3,778	\$ —
The amount of total gains or (losses) for the period included in earnings and attributable to the change in unrealized gains or (losses) relating	\$—	\$—	\$—	\$—	\$—	\$ —

to assets still held at the reporting
date

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	Three Months Ended September 30, 2013				
	State and Local Government Obligations	Corporate Obligations	Other Debt Obligations	Redeemable Preferred Stock	Nonredeemable Preferred Stock
	(Dollars in thousands)				
Beginning balance at July 1, 2013	\$844	\$8,617	\$—	\$481	\$ 963
Total gains or (losses):					
Included in earnings	—	—	—	—	—
Included in other comprehensive income	13	(240)	—	4	12
Purchases and issuances	—	—	—	—	—
Sales, settlements and redemptions	—	(55)	—	—	—
Transfers in and/or (out) of Level 3	—	—	2,510	—	—
Ending balance at September 30, 2013	\$857	\$8,322	\$2,510	\$485	\$ 975
The amount of total gains or (losses) for the period included in earnings and attributable to the change in unrealized gains or (losses) relating to assets still held at the reporting date	\$—	\$—	\$—	\$—	\$ —

	Nine Months Ended September 30, 2013				
	State and Local Government Obligations	Corporate Obligations	Other Debt Obligations	Redeemable Preferred Stock	Nonredeemable Preferred Stock
	(Dollars in thousands)				
Beginning balance at January 1, 2013	\$837	\$7,658	\$—	\$483	\$ —
Total gains or (losses):					
Included in earnings	—	—	—	—	—
Included in other comprehensive income	20	(189)	—	2	6
Purchases and issuances	—	1,000	—	—	969
Sales, settlements and redemptions	—	(147)	—	—	—
Transfers in and/or (out) of Level 3	—	—	2,510	—	—
Ending balance at September 30, 2013	\$857	\$8,322	\$2,510	\$485	\$ 975
The amount of total gains or (losses) for the period included in earnings and attributable to the change in unrealized gains or (losses) relating to assets still held at the reporting date	\$—	\$—	\$—	\$—	\$ —

At September 30, 2014, the Company had 14 securities with a fair value of \$14.8 million that are included in Level 3, which represented 1.4% of its total investments reported at fair value. The significant unobservable inputs used by the brokers and pricing services in establishing fair values of the Company's Level 3 securities are primarily spreads to U.S. Treasury rates and discounts to comparable securities. The specifics of such spreads and discounts were not made available to the Company. Significant increases (decreases) on spreads to U.S. Treasury rates and discount spreads to comparable securities would result in lower (higher) fair value measurements. Generally, a change in the assumption used for determining a spread is accompanied by market factors that warrant an adjustment for the credit risk and liquidity premium of the security. As the total fair value of Level 3 securities is 4.1% of the Company's shareholders'

equity at September 30, 2014, any change in unobservable inputs would not have a material impact on the Company's financial position.

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3. Investments

Under other-than-temporary impairment accounting guidance, if management can assert that it does not intend to sell an impaired fixed maturity security and it is not more likely than not that it will be required to sell the security before recovery of its amortized cost basis, then an entity may separate the other-than-temporary impairments into two components: 1) the amount related to credit losses (recorded in earnings) and 2) the amount related to all other factors (recorded in other comprehensive income (loss)). The credit related portion of an other-than-temporary impairment is measured by comparing a security's amortized cost to the present value of its current expected cash flows discounted at its effective yield prior to the impairment charge. If management intends to sell an impaired security, or it is more likely than not that it will be required to sell the security before recovery, an impairment charge recorded in earnings is required to reduce the amortized cost of that security to fair value.

The cost or amortized cost and fair value of investments in fixed maturities and equity securities are as follows:

	Cost or Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(Dollars in thousands)			
September 30, 2014				
Fixed maturities:				
U.S. Government and government agency obligations	\$ 102,225	\$ 2,952	\$(58)	) \$ 105,119
State and local government obligations	336,897	12,130	(481)	) 348,546
Residential mortgage-backed securities	189,788	8,221	(1,747)	) 196,262
Commercial mortgage-backed securities	19,672	1,036	(5)	) 20,703
Corporate obligations	183,142	7,793	(502)	) 190,433
Other debt obligations	82,819	219	(553)	) 82,485
Redeemable preferred stocks	4,168	133	(6)	) 4,295
Total fixed maturities	918,711	32,484	(3,352)	) 947,843
Equity securities:				
Common stocks	49,743	9,290	(2,090)	) 56,943
Nonredeemable preferred stocks	20,690	1,505	(253)	) 21,942
Total equity securities	70,433	10,795	(2,343)	) 78,885
Total fixed maturities and equity securities	\$ 989,144	\$ 43,279	\$(5,695)	) \$ 1,026,728
December 31, 2013				
Fixed maturities:				
U.S. Government and government agency obligations	\$ 91,360	\$ 3,282	\$(285)	) \$ 94,357
Foreign government obligations	3,529	24	—	) 3,553
State and local government obligations	351,866	8,155	(3,218)	) 356,803
Residential mortgage-backed securities	197,376	8,034	(3,185)	) 202,225
Commercial mortgage-backed securities	33,503	1,483	(23)	) 34,963
Corporate obligations	186,899	7,060	(1,509)	) 192,450
Other debt obligations	45,448	146	(478)	) 45,116
Redeemable preferred stocks	4,168	72	(128)	) 4,112
Total fixed maturities	914,149	28,256	(8,826)	) 933,579
Equity securities:				
Common stocks	39,755	10,842	(952)	) 49,645
Nonredeemable preferred stocks	15,782	1,047	(704)	) 16,125
Total equity securities	55,537	11,889	(1,656)	) 65,770
Total fixed maturities and equity securities	\$ 969,686	\$ 40,145	\$(10,482)	) \$ 999,349

The table above excludes other invested assets of \$45.6 million and \$40.4 million at September 30, 2014 and December 31, 2013, respectively. Other invested assets include investments in limited partnerships which are accounted for under the equity method. Equity method investments are not reported at fair value.

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State and local government obligations represented approximately 36.8% of the Company's fixed maturity portfolio at September 30, 2014, with approximately \$286.5 million, or 82.2%, of the Company's state and local government obligations held in special revenue obligations, and the remaining amount held in general obligations. The Company's state and local government obligations portfolio is high quality, as 98.8% of such securities were rated investment grade (as determined by nationally recognized agencies) at September 30, 2014. The Company had no state and local government obligations for any state, municipality or political subdivision that comprised 10% or more of the total amortized cost or fair value of such obligations at September 30, 2014.

The non-credit portion of other-than-temporary impairment charges is included in other comprehensive income. Cumulative non-credit charges taken for securities still owned at September 30, 2014 and December 31, 2013 were \$3.3 million and \$3.5 million, respectively.

The amortized cost and fair value of fixed maturities at September 30, 2014, by contractual maturity, are shown below. Other debt obligations, which are primarily comprised of asset-backed securities other than mortgage-backed securities are categorized based on their average maturity. Expected maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties. The average life of mortgage-backed securities is 4.0 years in the Company's investment portfolio.

Amortized cost and fair value of the fixed maturities in the Company's investment portfolio were as follows:

	Amortized Cost	Fair Value
	(Dollars in thousands)	
Due in one year or less	\$22,206	\$22,458
Due after one year through five years	291,379	301,098
Due after five years through ten years	300,223	308,683
Due after ten years	95,443	98,639
	709,251	730,878
Mortgage-backed securities	209,460	216,965
Total	\$918,711	\$947,843

Gains and losses on the sale of investments, including other-than-temporary impairment charges and other invested assets' gains or losses, were as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
	(Dollars in thousands)			
Fixed maturity gains	\$172	\$405	\$1,079	\$2,104
Fixed maturity losses	(32)	(33)	(262)	(38)
Equity security gains	1,827	625	2,766	1,835
Equity security losses	(319)	(147)	(530)	(216)
Other invested assets, net gains	974	503	3,241	1,748
Net realized gains on investments	\$2,622	\$1,353	\$6,294	\$5,433

Pre-tax net realized gains on investments of \$2.6 million and \$6.3 million for the three and nine months ended September 30, 2014 were partially generated from net realized gains associated with the sales or redemptions of securities of \$1.9 million and \$3.8 million, respectively. The gains on equity and fixed maturity securities were primarily due to favorable market conditions that increased the value of securities over book value. Other invested assets generated net gains of \$1.0 million and \$3.2 million for the three and nine months ended September 30, 2014, respectively. Offsetting these gains for the three and nine months ended September 30, 2014, were other-than-temporary impairment charges of \$0.3 million and \$0.7 million, respectively, related to several securities due to the uncertainty surrounding the timing and extent of recovery.

Pre-tax net realized gains on investments of \$1.4 million and \$5.4 million for the three and nine months ended September 30, 2013 were primarily generated from net realized gains associated with the sales or redemptions of securities of \$1.0 million and \$3.8 million, respectively. The gains on equity and fixed maturity securities were

primarily due to favorable market conditions that increased the value of securities over book value. Other invested assets generated net gains of \$0.5 million and \$1.8 million for the three and nine months ended September 30, 2013, respectively. Offsetting these gains were other-than-temporary impairment

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charges of \$0.1 million and \$0.2 million for the three and nine months ended September 30, 2013 on several equity securities due to the uncertainty surrounding the timing and extent of recovery.

The following table summarizes the Company's gross unrealized losses on fixed maturities and equity securities and the length of time that individual securities have been in a continuous unrealized loss position:

	Less than Twelve Months				Twelve Months or More			
	Fair Value	Unrealized Losses	Fair Value as % of Cost	Number of Holdings	Fair Value	Unrealized Losses	Fair Value as % of Cost	Number of Holdings
(Dollars in thousands)								
September 30, 2014								
Fixed maturities:								
U.S. Government and government agency obligations								
	\$9,195	\$(57)	99.4 %	11	\$48	\$(1)	98.0 %	1
State and local government obligations								
	22,208	(205)	99.1 %	18	12,151	(276)	97.8 %	10
Residential mortgage-backed securities								
	36,520	(321)	99.1 %	31	39,568	(1,426)	96.5 %	34
Commercial mortgage-backed securities								
	1,055	(2)	99.8 %	1	1,048	(3)	99.7 %	1
Corporate obligations								
	16,834	(151)	99.1 %	20	13,161	(351)	97.4 %	11
Other debt obligations								
	47,713	(374)	99.2 %	51	10,863	(179)	98.4 %	11
Redeemable preferred stocks								
	999	(1)	99.9 %	1	494	(5)	99.0 %	1
Total fixed maturities								
	134,524	(1,111)	99.2 %	133	77,333	(2,241)	97.2 %	69
Equity securities:								
Common stocks								
	20,707	(2,090)	90.8 %	35	—	—	0.0 %	—
Nonredeemable preferred stocks								
	5,521	(84)	98.5 %	11	2,832	(169)	94.4 %	3
Total equity securities								
	26,228	(2,174)	92.3 %	46	2,832	(169)	94.4 %	3
Total fixed maturities and equity securities								
	\$160,752	\$(3,285)	98.0 %	179	\$80,165	\$(2,410)	97.1 %	72
December 31, 2013								
Fixed maturities:								
U.S. Government and government agency obligations								
	\$19,307	\$(285)	98.5 %	19	\$—	\$—	0.0 %	—
State and local government obligations								
	110,694	(3,077)	97.3 %	81	859	(141)	85.9 %	1
Residential mortgage-backed securities								
	64,858	(2,286)	96.6 %	55	12,445	(899)	93.3 %	9
Commercial mortgage-backed securities								
	2,773	(23)						