

FEDERATED NATIONAL HOLDING CO  
Form 10-K  
April 01, 2013

---

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

FORM 10-K

Annual Report under Section 13 or 15(d) of the Securities Act of 1934  
For the fiscal year ended December 31, 2012

or

Transition Report under Section 13 or 15(d) of the Securities Exchange Act of 1934  
For the transition period of \_\_\_\_\_ to \_\_\_\_\_  
Commission file number: 0-2500111

Federated National Holding Company  
(Exact name of registrant as specified in its Charter)

Florida  
(State or other jurisdiction of  
incorporation or organization)

65-0248866  
(I.R.S. Employer  
Identification No)

14050 N.W. 14th Street, Suite 180, Sunrise, Florida 33323  
(Address of principal executive  
offices) (Zip Code)

Registrant's telephone number, including area code (954)  
581-9993

Securities registered pursuant to Section 12(b) of the Exchange Act:

Title of Each Class	Name of Each Exchange on Which Registered
Common Stock, par value \$0.01 per share	NASDAQ Global Market

Securities registered pursuant to Section 12(g) of the Exchange Act:  
None

Indicate by check mark if the Registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes  No

Indicate by check mark if the Registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes  No

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 electronically submitted 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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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 definition of "large accelerated filer," "accelerated filer," and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller reporting company

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

The aggregate market value of the Registrant's common stock held by non-affiliates was \$29,205,677 on June 30, 2012, computed on the basis of the closing sale price of the Registrant's common stock on that date.

As of March 26, 2013, the total number of common shares outstanding of Registrant's common stock was 8,085,589.

DOCUMENTS INCORPORATED BY REFERENCE

None.

---

---

---

## Federated National Holding Company

## Table of Contents

PART I	3
ITEM 1 <u>BUSINESS</u>	3
ITEM 1A <u>RISK FACTORS</u>	22
ITEM 1B <u>UNRESOLVED STAFF COMMENTS</u>	30
ITEM 2 <u>PROPERTIES</u>	31
ITEM 3 <u>LEGAL PROCEEDINGS</u>	31
ITEM 4 <u>MINE SAFETY DISCLOSURES</u>	31
PART II	31
ITEM 5 <u>MARKET FOR REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES</u>	31
ITEM 6 <u>SELECTED FINANCIAL DATA</u>	32
ITEM 7 <u>MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS</u>	35
ITEM 7A <u>QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK</u>	62
ITEM 8 <u>FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA</u>	63
ITEM 9 <u>CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE</u>	106
ITEM 9A <u>CONTROLS AND PROCEDURES</u>	106
ITEM 9B <u>OTHER INFORMATION</u>	107
PART III	107
ITEM 10 <u>DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE</u>	107

ITEM 11	<u>EXECUTIVE COMPENSATION</u>	112
ITEM 12	<u>SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS</u>	118
ITEM 13	<u>CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE</u>	119
ITEM 14	<u>PRINCIPAL ACCOUNTING FEES AND SERVICES</u>	119
PART IV		121
ITEM 15	<u>EXHIBITS, FINANCIAL STATEMENT SCHEDULES</u>	121
	<u>SIGNATURES</u>	124

---

Table of Contents

Federated National Holding Company

PART I

SPECIAL NOTE ABOUT FORWARD-LOOKING STATEMENTS

Certain statements in this Annual Report on Form 10-K, other than purely historical information, including estimates, projections, statements relating to our business plans, objectives and expected operating results, and the assumptions upon which those statements are based, are “forward-looking statements” within the meaning of the Private Securities Litigation Reform Act of 1995, Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. These forward-looking statements generally are identified by words “believes,” “project,” “expects,” “anticipates,” “estimates,” “intends,” “strategy,” “plan,” “may,” “will,” “would,” “will be,” “will continue,” “will likely result,” and similar expressions. Forward-looking statements are based on current expectations and assumptions that are subject to risks and uncertainties which may cause actual results to differ materially from the forward-looking statements. A detailed discussion of these and other risks and uncertainties that could cause actual results and events to differ materially from such forward-looking statements is included in the section entitled “Risk Factors” in Part I, Item 1A of this Annual Report. We undertake no obligation to update or revise publicly any forward-looking statements, whether as a result of new information, future events or otherwise.

ITEM 1

BUSINESS

GENERAL

Federated National Holding Company (“FNHC”, “Company”, “we”, “us”), formerly known as 21st Century Holding Company is an insurance holding company that controls substantially all steps in the insurance underwriting, distribution and claims processes through our subsidiaries and our contractual relationships with our independent agents and general agents. We changed our name on September 11, 2012, pursuant to approval received at our annual shareholders’ meeting, from 21st Century Holding Company so that our parent company and other subsidiary companies’ names are consistent with our primary insurance subsidiary and the name under which we have been writing insurance for more than 20 years.

We are authorized to underwrite, and/or place through our wholly owned subsidiaries, homeowners’ multi-peril (“homeowners”), commercial general liability, federal flood, personal auto and various other lines of insurance in Florida and various other states. We market and distribute our own and third-party insurers’ products and our other services through a network of independent agents. We also utilize a select number of general agents for the same purpose.

Our primary insurance subsidiary is Federated National Insurance Company (“FNIC”). FNIC is licensed as an admitted carrier in Florida. An admitted carrier is an insurance company that has received a license from the state insurance regulator for authority to write specific lines of insurance in that state. Through contractual relationships with a network of approximately 3,000 independent agents, of which approximately 900 actively sell and service our products, FNIC is authorized to underwrite homeowners’, commercial general liability, fire, allied lines and personal and commercial automobile insurance in Florida. FNIC is also licensed as an admitted carrier in Alabama, Louisiana, Georgia and Texas, and underwrites commercial general liability insurance in those states and personal automobile insurance in Georgia and Texas.

FNIC operates as a non-admitted carrier in Arkansas, California, Kentucky, Maryland, Missouri, Nevada, Oklahoma, South Carolina, Tennessee and Virginia, and can underwrite commercial general liability insurance in all of these states. A non-admitted carrier, sometimes referred to as a “excess and surplus lines” carrier, is permitted to do business

in a state and, although it is strictly regulated to protect policyholders from a variety of illegal and unethical practices, including fraud, non-admitted carriers are subject to considerably less regulation with respect to policy rates and forms. Non-admitted carriers are not required to financially contribute to and benefit from the state guarantee fund, which is used to pay for losses if an insurance carrier becomes insolvent or unable to pay the losses due their policyholders.

In January 2011, we merged FNIC and our other wholly owned insurance subsidiary, American Vehicle Insurance Company (“American Vehicle”), with FNIC continuing the operations of both entities. In connection with this merger, the Company, FNIC and American Vehicle entered into a Consent Order with the Florida Office of Insurance Regulation (“Florida OIR”) pursuant to which we agreed to certain restrictions on our business operations. The Consent Order was amended in February 2013 to lessen or eliminate certain of the original requirements, due to FNIC’s statutory underwriting profit during 2012. See “Regulation– Consent Order.”

We internally process claims made by our insureds through our wholly owned claims adjusting company, Federated National Adjusting, Inc. (“FNA”), formerly known as Superior Adjusting, Inc. Until June 2011, we offered premium financing to our own and third-party insureds through our wholly owned subsidiary, Federated Premium Finance, Inc. (“Federated Premium”).

Table of Contents

Federated National Holding Company

Federated National Underwriters, Inc. (“FNU”), formerly known as Assurance Managing General Agents, a wholly owned subsidiary of the Company, acts as FNIC’s exclusive managing general agent in Florida and is also licensed as a managing general agent in the States of Alabama, Georgia, Illinois, Louisiana, North Carolina, Mississippi, Missouri, New York, Nevada, South Carolina, Texas and Virginia. FNU has contracted with several unaffiliated insurance companies to sell commercial general liability, workers compensation, personal umbrella, inland marine and other various lines of insurance through FNU’s existing network of agents.

FNU earns commissions and fees for providing policy administration, marketing, accounting and analytical services, and for participating in the negotiation of reinsurance contracts. FNU earns a \$25 per policy fee, and traditionally a 6% commission fee from its affiliate, FNIC. During the fourth quarter of 2010, FNU, pursuant to the Consent Order as discussed above, reduced its fee, to earn amounts varying between 2% and 4%, which we anticipate will return to 6% at an unknown future date with approval from the Florida OIR. A formal agreement reflecting this fee modification was executed during January 2011.

Although we are authorized to underwrite the various lines described above, our business is primarily underwriting homeowners’ policies. During 2012, 85.3%, 7.8%, 4.4% and 2.5% of the premiums we underwrote were for homeowners’, commercial general liability, federal flood, and personal automobile insurance, respectively. During 2011, 81.8%, 10.3%, 4.6% and 3.3% of the premiums we underwrote were for homeowners’, commercial general liability, federal flood, and personal automobile insurance, respectively.

During the years ended December 31, 2012, 2011 or 2010, we did not experience any weather-related catastrophic events such as the hurricanes that occurred in Florida during 2005 and 2004. We are not able to predict how hurricanes or other insurable events will affect our future results of operations and liquidity. Loss and loss adjustment expenses (“LAE”) are affected by a number of factors, many of which are partially or entirely beyond our control, including the following.

- the nature and severity of the loss;
- weather-related patterns;
- the availability, cost and terms of reinsurance;
- underlying settlement costs, including medical and legal costs;
- legal and political factors such as legislative initiatives and public opinion;
- macroeconomic issues.

Our business, results of operations and financial condition are subject to fluctuations due to a variety of factors. Abnormally high severity or frequency of claims in any period could have a material adverse effect on us. When our estimated liabilities for unpaid losses and LAE are less than the actuarially determined amounts, we increase the expense in the current period. Conversely, when our estimated liabilities for unpaid losses and LAE are greater than the actuarially determined amounts, we decrease the expense in the current period.

Our goal in our reinsurance strategy is to equalize the liquidity requirements imposed by most severe insurable events and by all other insurable events we manage in the normal course of business. Please see “Reinsurance Agreements” under “Item 1. Business” for a more detailed description of our reinsurance agreements and strategy.

From time to time, new regulations and legislation are proposed to limit damage awards, to control plaintiffs' counsel fees, to bring the industry under regulation by the Federal government, to control premiums, policy terminations and other policy terms and to impose new taxes and assessments. It is not possible to predict whether, in what form or in what jurisdictions, any of these proposals might be adopted, or the effect, if any, on us.

Our executive offices are located at 14050 N.W. 14th Street, Suite 180, Sunrise, Florida 33323 and our telephone number is (954) 581-9993.

Our internet web site is FedNat.com for policy holders, agents and investors. Our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to such reports are available, free of charge, through our website as soon as reasonably practicable after we electronically file or furnish such material to the Securities and Exchange Commission ("SEC"). Further, a copy of this annual report on Form 10-K is located at the SEC's Public Reference Room at 100 F Street, NE, Washington, D.C. 20549. Information on the operation of the Public Reference Room can be obtained by calling the SEC at 1-800-SEC-0330. The SEC maintains an internet site that contains reports, proxy and information statements and other information regarding our filings at [www.sec.gov](http://www.sec.gov).



Table of Contents

Federated National Holding Company

RECENT DEVELOPMENTS

The Company anticipates unfavorable pricing terms on our upcoming reinsurance contracts due to reduced Florida Hurricane Catastrophe Fund (“FHCF”) capacity, though we also anticipate that this higher marginal rate will be mitigated by a reduced reinsurance requirement.

The Board of Directors of FNHC declared a regular quarterly dividend of \$0.03 per common share payable on June 3, 2013 to shareholders of record as of May 6, 2013. This is an increase of 50% over the previously declared regular quarterly dividends of \$0.02 per common share payable on March 4, 2013 and December 28, 2012 to shareholders of record as of February 4, 2013 and December 3, 2012, respectively. This action reflects both our commitment to returning capital to our shareholders and the Board’s confidence in our business plan.”

BUSINESS STRATEGY

We expect that in 2013 we will capitalize on our operational efficiencies and business practices through:

- improved property analytical qualities such as a broader geographical dispersion of risks throughout the state of Florida and avoiding risks that do not yield an underwriting profit;
- continued territorial expansion of our homeowners’, commercial general liability and private passenger automobile insurance products into additional states;
  - employing our business practices developed and used in Florida in our expansion to other selected states;
  - maintaining a commitment to provide high quality customer service to our agents and insureds;
- expansion of our marketing efforts by retaining key personnel and implementing direct marketing technologies;
  - offering attractive incentives to our agents to place a high volume of quality business with our companies;
- offering our employees continuing education classes appropriate to the respective discipline employed within this organization;
  - assumption of existing risks from other carriers; and
- additional strategies that may include possible acquisitions or further dispositions of assets, and development of procedures to improve claims history and mitigate losses from claims.

We expect that in 2013 these strategies have poised us to accelerate the 2012 results trajectory in 2013 and beyond. There can be no assurances, however, that any of the foregoing strategies will be developed or successfully implemented or, if implemented, that they will positively affect our results of operations.

Table of Contents

## Federated National Holding Company

## INSURANCE OPERATIONS AND RELATED SERVICES

## Overview of Insurance Lines of Business

The following tables set forth the amount and percentages of our consolidated gross premiums written, premiums ceded to reinsurers and net premiums written by line of business for the periods indicated.

	2012		Years Ended December 31,				2010		
	Premium	Percent	Premium	Percent	Premium	Percent	Premium	Percent	
(Dollars in Thousands)									
Gross written premiums:									
Automobile	\$2,996	2.5	%	\$3,274	3.3	%	\$3,721	3.9	%
Federal Flood	5,293	4.4	%	4,468	4.5	%	3,951	4.1	%
Homeowners'	101,832	85.3	%	80,403	81.9	%	76,845	79.7	%
Commercial General Liability	9,338	7.8	%	10,125	10.3	%	11,894	12.3	%
Total gross written premiums	\$119,459	100.0	%	\$98,270	100.0	%	\$96,411	100.0	%
Ceded premiums:									
Automobile	\$2,021	4.0	%	\$1,541	3.3	%	\$1,882	3.6	%
Federal Flood	5,293	10.4	%	4,468	9.7	%	3,951	7.5	%
Homeowners'	43,331	84.7	%	40,273	87.0	%	46,893	88.5	%
Commercial General Liability	440	0.9	%	12	0.0	%	238	0.4	%
Total ceded premiums	\$51,085	100.0	%	\$46,294	100.0	%	\$52,964	100.0	%
Net written premiums									
Automobile	\$975	1.4	%	\$1,733	3.3	%	\$1,839	4.3	%
Federal Flood	-	0.0	%	-	0.0	%	-	0.0	%
Homeowners'	58,501	85.6	%	40,130	77.2	%	29,952	68.9	%
Commercial General Liability	8,898	13.0	%	10,113	19.5	%	11,656	26.8	%
Total net written premiums	\$68,374	100.0	%	\$51,976	100.0	%	\$43,447	100.0	%

## Homeowners' Property and Casualty Insurance

FNIC underwrites homeowners' insurance in Florida. Homeowners' insurance generally protects an owner of real and personal property against covered causes of loss to that property. The table that follows reflects the number of homeowner policies in-force by county and reflects our concentrations of risk from catastrophic events.

County	2012		In-Force Policy Count				2010		
	Amount	Percentage	Amount	Percentage	Amount	Percentage	Amount	Percentage	
Years Ended December 31,									
Palm Beach	7,270	11.9	%	8,203	18.7	%	12,221	28.3	%
Lee	5,175	8.5	%	3,133	7.2	%	2,404	5.6	%
Brevard	4,508	7.4	%	2,900	6.6	%	1,598	3.7	%
Pinellas	4,034	6.6	%	3,788	8.6	%	3,437	8.0	%

Edgar Filing: FEDERATED NATIONAL HOLDING CO - Form 10-K

Broward	3,700	6.1	%	4,386	10.0	%	5,008	11.6	%
Collier	3,422	5.6	%	1,583	3.6	%	1,155	2.7	%
Saint Lucie	3,151	5.2	%	1,757	4.0	%	1,278	3.0	%
All others	29,842	48.7	%	18,043	41.3	%	16,031	37.1	%
Total	61,102	100.0	%	43,793	100.0	%	43,132	100.0	%

- 6 -

---

Table of Contents

## Federated National Holding Company

Our homeowner insurance products provide maximum dwelling coverage in the amount of approximately \$3.0 million, with the aggregate maximum policy limit being approximately \$5.0 million. We currently offer dwelling coverage “A” up to \$3.0 million with an aggregate total insured value of \$5.0 million. We continually subject these limits to review; though there were no material changes during 2012. The approximate average premium on the policies currently in-force is \$1,675, as compared with \$1,793 for 2011. The typical deductible is either \$2,500 or \$1,000 for non-hurricane-related claims and generally 2% of the coverage amount for the structure for hurricane-related claims.

Premium rates charged to our homeowner insurance policyholders are continually evaluated to assure that they meet the expectation that they are actuarially sound and produce a reasonable level of profit (neither excessive nor inadequate). Premium rates are regulated and approved by the Florida OIR. Our 13.8% rate increase in connection with our Citizens Property Insurance Corporation (“Citizens”) assumptions was approved during 2011 by the Florida OIR. Additionally, the Florida OIR approved a second 14.1% rate increase in February 2012.

For a further discussion regarding Homeowners’ Property and Casualty Insurance, see “Recent Developments”, above.

## Commercial General Liability

We underwrite commercial general liability insurance for approximately 380 classes of artisan (excluding home-builders and developers) and mercantile trades (such as owners, landlords and tenants). The limits of liability range from \$100,000 per occurrence with a \$200,000 policy aggregate to \$1.0 million per occurrence with a \$2.0 million policy aggregate. We continually subject these limits to review, though there were no changes during 2012. We market the commercial general liability insurance products through independent agents and a limited number of general agencies unaffiliated with the Company. The average annual premium on policies currently in-force during 2012 is approximately \$569, as compared with \$712 in 2011.

The following table sets forth the amounts and percentages of our gross premiums written in connection with our commercial general liability program by state.

State	Years Ended December 31,					
	2012		2011		2010	
	Amount	Percentage	Amount	Percentage	Amount	Percentage
	(Dollars in Thousands)					
Florida	\$8,639	92.52 %	\$8,606	84.99 %	\$9,972	83.85 %
Louisiana	217	2.32 %	916	9.05 %	1,094	9.19 %
Texas	426	4.56 %	534	5.28 %	665	5.59 %
Other	56	0.60 %	69	0.68 %	163	1.37 %
Total	\$9,338	100.00 %	\$10,125	100.00 %	\$11,894	100.00 %

## Personal Automobile

Personal automobile insurance markets can be divided into two categories, standard automobile and nonstandard automobile. Standard personal automobile insurance is principally provided to insureds who present an average risk profile in terms of driving record, vehicle type and other factors. Nonstandard personal automobile insurance is principally provided to insureds that are unable to obtain standard insurance coverage because of their driving record, age, vehicle type or other factors, including market conditions. The average annual nonstandard personal automobile

insurance policy currently in-force is approximately \$1,626, as compared with \$1,104 for 2011, and the nonstandard personal automobile insurance lines represents 100% of our written premiums for personal automobile insurance in 2012 and 2011.

The maximum exposures for the nonstandard policy in Florida are \$10,000 per individual, \$20,000 per accident for bodily injury, \$10,000 per accident for property damage, and predominantly \$50,000 for comprehensive and collision. Beginning in late 2010 we underwrote nonstandard personal automobile insurance in Georgia, where the maximum exposures are \$25,000 per individual, \$50,000 per accident for bodily injury, \$25,000 per accident for property damage, and predominantly \$50,000 for comprehensive and collision. In addition, we write commercial automobile insurance in Florida. The maximum exposure is predominantly \$30,000 on a combined single limit basis.

Table of Contents

Federated National Holding Company

Flood

FNIC writes flood insurance through the National Flood Insurance Program (“NFIP”). We write the policy for the NFIP, which assumes 100% of the flood risk while we retain a commission for our service. The average flood policy premium is approximately \$487 with limits up to \$250,000. Commissions in connection with this program totaled \$0.3 million in 2012, and \$0.2 million in 2011 and 2010, respectively. Pursuant to the Florida OIR regulations, we are required to report write-your-own-flood premiums on a direct and ceded basis for 2008 and subsequent years. Prior to 2008, we reported only the commissions income associated with this program.

Managing General Agent Services

FNU, a wholly owned subsidiary of the Company, acts as FNIC’s exclusive managing general agent in Florida and is also licensed as a managing general agent in the States of Alabama, Georgia, Illinois, Louisiana, North Carolina, Mississippi, Missouri, New York, Nevada, South Carolina, Texas and Virginia. FNU has contracted with several unaffiliated insurance companies to sell commercial general liability, workers compensation, personal umbrella, inland marine and other various lines of insurance through FNU’s existing network of agents.

FNU earns commissions and fees for providing policy administration, marketing, accounting and analytical services, and for participating in the negotiation of reinsurance contracts. FNU earns a \$25 per policy fee, and traditionally a 6% commission fee from its affiliates FNIC and American Vehicle. During the fourth quarter of 2010, FNU, pursuant to the Consent Order as discussed in “Regulation – Consent Order” reduced its fee, to earn amounts varying between 2% and 4%, which we anticipate will return to 6% at an unknown future date with approval from the Florida OIR. A formal agreement reflecting this fee modification was executed during January 2011.

Claims Adjusting

We internally process claims made by our insureds through our wholly owned claims adjusting company, FNA. Our agents have no authority to settle claims or otherwise exercise control over the claims process. Furthermore, we believe that the retention of independent adjusters, in addition to the employment of salaried claims personnel, results in reduced ultimate loss payments, lower LAE and improved customer service for our claimants and policyholders. We also employ an in-house legal department to cost-effectively manage claims-related litigation and to monitor our claims handling practices for efficiency and regulatory compliance.

Premium Finance

Until June 2011, our wholly owned subsidiary, Federated Premium, offered premium financing to our own and third-party insureds. Premium financing was marketed through our distribution network of general agents and independent agents.

Finance contracts receivable totaled less than \$0.2 million as of December 31, 2012, compared with less than \$0.1 million as of December 31, 2011.

The Company anticipates continued use of the direct bill feature associated with our homeowners’, commercial general liability and automobile programs. Direct billing is when the insurance company accepts from the insured, as a receivable, a promise to pay the premium, as opposed to requiring payment of the full amount of the policy. The advantage of direct billing a policyholder by the insurance company is that we are not reliant on a credit facility, but remain able to charge and collect interest from the policyholder. Underwriting criteria are designed with down

payment requirements and monthly payments that create policyholder equity in the insurance policy. The equity in the policy is collateral for the extension of credit to the insured.

Through our monitoring systems, we track delinquent payments and, in accordance with the terms of the extension of credit, cancel if payment is not made. If any excess premium remains after cancellation of the policy and deduction of applicable penalties, this excess is refunded to the policyholder. The direct bill program enables us to closely manage our risk while providing credit to our insureds.

Table of Contents

Federated National Holding Company

Independent Insurance Agency

Insure-Link, Inc. (“Insure-Link”) was formed in March 2008 to serve as an independent insurance agency. The insurance agency markets direct to the public to provide a variety of insurance products and services to individual clients, as well as business clients, by offering a full line of insurance products including, but not limited to, homeowners’, flood, personal and commercial automobile, commercial general liability and workers’ compensation insurance through their agency appointments with over fifty different carriers.

MARKETING AND DISTRIBUTION

We are focusing our marketing efforts on continuing to expand our distribution network and market our products and services throughout Florida and in other states by establishing relationships with additional independent agents and general agents. There can be no assurance, however, that we will be able to obtain the required regulatory approvals to offer additional insurance products or expand into other states.

Our independent agents and general agents have the authority to sell and bind insurance coverage in accordance with procedures established by FNU. FNU reviews all coverage bound by the agents promptly and generally accepts all coverage that falls within stated underwriting criteria. For all policies issued, FNU also has the right, within a period that varies by state between 60 days and 120 days from a policy's inception, to cancel any policy, upon an advanced notice provided in accordance with statutory specific guidelines, even if the risk falls within our underwriting criteria.

We believe that our integrated computer systems, which allow for rapid automated premium quotation and policy issuance by our agents, is a key element in providing quality service to both our agents and insureds for various lines of our business.

We believe that the management of our distribution system now centers on our ability to capture and maintain relevant data by producing agents. We believe that information management of agent production, coupled with loss experience, will enable us to maximize profitability.

REINSURANCE AGREEMENTS

Financing risk generally involves a combination of risk retention and risk transfer techniques. “Retention”, similar to a deductible, involves financing losses by funds internally generated. “Transfer” involves the existence of a contractual arrangement designed to shift financial responsibility to another party in exchange for premium. Secondary to the primary risk-transfer agreements we use reinsurance agreements to transfer a portion of the risks insured under our policies to other companies through the purchase of reinsurance. We utilize reinsurance to reduce exposure to catastrophic and non-catastrophic risks and to help manage the cost of capital. Reinsurance techniques are designed to lessen earnings volatility, improve shareholder return, and to support the required statutory surplus requirements. We also use reinsurance to realize an arbitrage of premium rates, benefit from the availability of our reinsurers’ expertise, and benefit from the management of a profitable portfolio of insureds by way of enhanced analytical capacities. Our primary property line that is subject to catastrophic reinsurance is Homeowners Multiple Peril. FNIC cedes these risks to domestic and foreign reinsurance participants from Bermuda and Europe as well as to the FHCF.

In addition to reinsurance agreements, we also from time to time enter into retro-cessionary reinsurance agreements; each designed to shift financial responsibility based on predefined conditions. Generally, there are three separate kinds of reinsurance structures – quota share, excess of loss, and facultative, each considered either proportional or non-proportional. Our reinsurance structures are maintained to protect our insurance subsidiary against the severity of



losses on individual claims or unusually serious occurrences in which the frequency and or the severity of claims produce an aggregate extraordinary loss from catastrophic events.

Although reinsurance does not discharge us from our primary obligation to pay for losses insured under the policies we issue, reinsurance does make the assuming reinsurer liable to the insurance subsidiary for the reinsured portion of the risk. A credit risk exposure exists with respect to ceded losses to the extent that any reinsurer is unable or unwilling to meet the obligations assumed under the reinsurance contracts. The collectability of reinsurance is subject to the solvency of the reinsurers, interpretation of contract language and other factors. A reinsurer's insolvency or inability to make payments under the terms of a reinsurance contract could have a material adverse effect on our results of operations and financial condition. Our reinsurance structure has significant risks, including the fact that the FHCF may not be able to raise sufficient money to pay its claims or impair its ability to pay its claims in a timely manner. This could result in significant financial, legal and operational challenges to all property and casualty companies associated with FHCF, including our company.

Table of Contents

Federated National Holding Company

The availability and costs associated with the acquisition of reinsurance will vary year to year. These fluctuations, which can be significant, are not subject to our control and may limit our ability to purchase adequate coverage. For example, FHCF continues to restrict its reinsurance capacity and is expected to continue constricting capacity for future seasons. This gradual restriction is requiring us to replace that capacity with more expensive private market reinsurance. Our reinsurance program is subject to approval by the Florida OIR and review by Demotech, Inc. (“Demotech”). The recovery of increased reinsurance costs through rate action is not immediate and cannot be presumed and is subject to Florida OIR approval.

For the 2012–2013 hurricane season, the excess of loss and FHCF treaties insured the property lines for approximately \$328.3 million of aggregate catastrophic losses and LAE with a maximum single event coverage totaling approximately \$246.5 million, with the Company retaining the first \$8.0 million of losses and LAE for each event. The reinsurance program includes coverage purchased from the private market, which affords optional reinstatement premium protection that provides coverage beyond the first event, along with any remaining coverage from the FHCF. Coverage afforded by the FHCF totals approximately \$144.7 million, or 44.1% of the \$328.3 million of aggregate catastrophic losses and LAE. The FHCF affords coverage for the entire season, subject to maximum payouts, without regard to any particular insurable event.

The estimated cost to the Company for the excess of loss reinsurance products for the 2012-2013 hurricane season, inclusive of approximately \$9.6 million payable to the FHCF and the prepaid automatic premium reinstatement protection, is approximately \$41.6 million.

Table of Contents

## Federated National Holding Company

The 2012-2013 private reinsurance companies and their respective A.M. Best Company (“A.M. Best”) rating are listed in the table as follows.

Reinsurer	A.M. Best Rating		S&P Rating
<b>UNITED STATES</b>			
American Agricultural Insurance Company	A-		NR
Everest Reinsurance Company	A+		A+
Houston Casualty Company, (UK Branch)	A+	*	AA
Munich Reinsurance America, Inc.	A+		AA-
Odyssey Reinsurance Company	A		A-
<b>BERMUDA</b>			
ACE Tempest Reinsurance Limited	A+	*	AA-
Arch Reinsurance Limited	A+	*	A+
Ariel Reinsurance Bermuda Limited for and on Behalf of Ariel Syndicate 1910 (ARE)	A-	*	NR
DaVinci Reinsurance Limited	A	*	A+
JC Re Limited (Juniperus & fka Actua Re Limited)	NR	*	** NR
Montpelier Reinsurance Limited	A-		A-
Nephila (via Allianz Risk Transfer AG, Bermuda Branch)	NR		AA-
Platinum Underwriters Bermuda Limited	A	*	A-
Renaissance Reinsurance Limited	A+	*	AA-
<b>UNITED KINGDOM</b>			
Amlin Syndicate No. 2001 (AML)	A		A+
Ariel Syndicate No. 1910 (ARE)	A	*	A+
ARK Syndicate No. 3902 (NOA)	A		A+
Barbican Syndication No. 1955 (BAR)	A		A+
Kiln Syndicate No. 510 (KLN)	A		A+
Liberty Syndicates Services Limited Paris, for and on Behalf of Lloyd's Syndicate No. 4472 (LIB)	NR		A+
MAP Underwriting Syndicate No. 2791 (Parallel) (MAP)	A		A+
Novae Syndicate No. 2007 (NVA)	A		A+
Tokio Marine Kiln Syndicate No. 1880 (TMK)	A		A+
Torus Syndicate No. 1301 (TUL)	A		A+
<b>EUROPE</b>			
Amlin Bermuda (Branch of Amlin AG)	A		A
SCOR Global P&C Zurich Branch	A		A

\* Reinstatement Premium Protection Program Participants

\*\* Participant will fund a trust agreement for their exposure with cash and U.S. Government obligations of American institutions at fair market value.

For the 2011–2012 hurricane season, the excess of loss and FHCF treaties insured the property lines for approximately \$298.0 million of aggregate catastrophic losses and LAE with a maximum single event coverage totaling approximately \$226.0 million, with the Company retaining the first \$7.0 million of losses and LAE for each event. The reinsurance program included coverage purchased from the private market, which affords optional reinstatement premium protection that provides coverage beyond the first event, along with any remaining coverage from the FHCF. Coverage afforded by the FHCF totals approximately \$154.1 million, or 51.7% of the \$298.0 million of aggregate catastrophic losses and LAE. The FHCF affords coverage for the entire season, subject to maximum payouts, without regard to any particular insurable event.

- 11 -

---

Table of Contents

## Federated National Holding Company

The estimated cost to the Company for the excess of loss reinsurance products for the 2011-2012 hurricane season, inclusive of approximately \$11.7 million payable to the FHCF and the prepaid automatic premium reinstatement protection, is approximately \$39.7 million.

The 2011-2012 private reinsurance companies and their respective A.M. Best rating are listed in the table as follows.

Reinsurer	A.M. Best Rating		S&P Rating
<b>UNITED STATES</b>			
American Agricultural Insurance Company	A-		NR
Everest Reinsurance Company	A+		A+
Houston Casualty Company, (UK Branch)	A+		AA
Munich Reinsurance America, Inc.	A+		AA-
Odyssey Reinsurance Company	A		A-
QBE Reinsurance Corporation	A		A+
<b>BERMUDA</b>			
ACE Tempest Reinsurance Limited	A+	*	A+
Arch Reinsurance Limited	A		A+
Ariel Reinsurance Company Limited, Bermuda	A-	*	A-
DaVinci Reinsurance Limited	A	*	A+
D.E. Shaw Re (Bermuda) Limited	NR		** NR
JC Re Ltd (Juniperus & fka Actua Re Limited)	NR	*	** NR
Montpelier Reinsurance Limited	A-		A-
Renaissance Reinsurance Limited	A+	*	AA-
Torus Insurance (Bermuda) Limited	A-	*	NR
<b>UNITED KINGDOM</b>			
Amlin Syndicate No. 2001 (AML)	A	*	A+
Antares Syndicate No. 1274 (AUL)	A		A+
Arrow Syndicate No. 1910 (ARW)	A	*	A+
Broadgate Syndicate No. 1301 (BGT)	A		A+
Liberty Syndicates Services Limited Paris, for and on Behalf of Lloyd's Syndicate No. 4472 (LIB)	A		A+
MAP Underwriting Syndicate No. 2791 (MAP)	A	*	A+
Novae Syndicate No. 2007 (NVA)	A		A+
<b>EUROPE</b>			
Amlin Bermuda ( Branch of Amlin AG)	A		A
Flagstone Reassurance Suisse SA	A-		NR
Lansforsakringar Sak Forsakringsaktiebolag (publ)	NR-5		A
SCOR Global P&C Zurich Branch	A		A

\* Reinstatement Premium Protection Program

Participants

\*\* Participant will fund a trust agreement for their exposure with cash and U.S. Government obligations of American institutions at fair market value.

- 12 -

---

Table of Contents

Federated National Holding Company

Annually, the cost and amounts of reinsurance are based on management's analysis of FNIC's exposure to catastrophic risk as of June 30 and estimated to September 30. Our data is then subjected to actual exposure level analysis as of September 30. This analysis of our exposure level in relation to the total exposures to the FHCF and excess of loss treaties may produce changes in limits and reinsurance premiums as a result of the reconciliation of estimated to actual exposure level. The September 30, 2012 change to total limits was an increase of \$2.1 billion of total insured value or 12.6% and the change to reinsurance premiums was an increase of \$2.4 million or 3.0%. The September 30, 2011 change to total limits was an increase of \$63.1 million of probable maximum loss or 0.5% and the change to reinsurance premiums was an increase of \$3.7 million or 8.7%. These adjustments are amortized over the remaining underlying policy term. The September 30, 2011 change to total limits was an increase of \$172.2 million of total insured value or 1.4 % and the change to reinsurance premiums was an increase of \$0.5 million or 1.1%.

To date, we have made no claims asserted against our reinsurers in connection with the 2012–2013 and 2011–2012 excess of loss and FHCF treaties.

The quota share retrocessionaire reinsurance agreements require FNIC to securitize credit, regulatory and business risk. Fully funded trust agreements totaled \$4.8 million and \$4.7 million as of December 31, 2012 and 2011, respectively.

We are selective in choosing reinsurers and consider numerous factors, the most important of which are the financial stability of the reinsurer, their history of responding to claims and their overall reputation. In an effort to minimize our exposure to the insolvency of a reinsurer, we evaluate the acceptability and review the financial condition of the reinsurer at least annually.

#### LIABILITY FOR UNPAID LOSSES AND LAE

We are directly liable for loss and LAE payments under the terms of the insurance policies that we write. In many cases, there may be a time lag between the occurrence and reporting of an insured loss and our payment of that loss. As required by insurance regulations and accounting rules, we reflect the liability for the ultimate payment of all incurred losses and LAE by establishing a liability for those unpaid losses and LAE for both reported and unreported claims, which represent estimates of future amounts needed to pay claims and related expenses.

When a claim, other than personal automobile, involving a probable loss is reported, we establish a liability for the estimated amount of our ultimate losses and LAE payments. The estimate of the amount of the ultimate loss is based upon such factors as the type of loss, jurisdiction of the occurrence, knowledge of the circumstances surrounding the claim, severity of injury or damage, potential for ultimate exposure, estimate of liability on the part of the insured, past experience with similar claims and the applicable policy provisions.

All newly reported claims received with respect to personal automobile policies are set up with an initial average liability. The average liability for these claims is determined by dividing the number of reported claims into the total amount paid during the same period. If a claim is open more than 45 days, that open case liability is evaluated and the liability is adjusted upward or downward according to the facts and circumstances of that particular claim.

In addition, management provides for a liability on an aggregate basis to provide for incurred but not yet reported (“IBNR”). We utilize independent actuaries to help establish liability for unpaid losses and LAE. We do not discount the liability for unpaid losses and LAE for financial statement purposes.

The estimates of the liability for unpaid losses and LAE are subject to the effect of trends in claims severity and frequency and are continually reviewed. As part of this process, we review historical data and consider various factors, including known and anticipated legal developments, inflation and economic conditions. As experience develops and other data become available, these estimates are revised, as required, resulting in increases or decreases to the existing liability for unpaid losses and LAE. Adjustments are reflected in results of operations in the period in which they are made and the liabilities may deviate substantially from prior estimates.

Among our classes of insurance, the automobile and homeowners' liability claims historically tend to have longer time lapses between the occurrence of the event, the reporting of the claim and the final settlement, than do automobile physical damage and homeowners' property claims. These liability claims often involve parties filing suit and therefore may result in litigation. By comparison, property damage claims tend to be reported in a relatively shorter period of time and settled in a shorter time frame with less occurrence of litigation.

There can be no assurance that our liability for unpaid losses and LAE will be adequate to cover actual losses. If our liability for unpaid losses and LAE proves to be inadequate, we will be required to increase the liability with a corresponding reduction in our net income in the period in which the deficiency is identified. Future loss experience substantially in excess of established liability for unpaid losses and LAE could have a material adverse effect on our business, results of operations and financial condition.



Table of Contents

## Federated National Holding Company

The following table sets forth a reconciliation of beginning and ending liability for unpaid losses and LAE as shown in our consolidated financial statements for the periods indicated.

	Years Ended December 31,		
	2012	2011	2010
	(Dollars in Thousands)		
Balance at January 1	\$59,983	\$66,529	\$70,610
Less reinsurance recoverables	(2,088 )	(6,809 )	(11,594 )
Net balance at January 1	\$57,895	\$59,720	\$59,016
Incurred related to			
Current year	\$31,636	\$31,893	\$37,288
Prior years	(1,427 )	(997 )	2,800
Total incurred	\$30,209	\$30,896	\$40,088
Paid related to			
Current year	\$15,892	\$13,672	\$15,077
Prior years	25,807	19,048	24,308
Total paid	\$41,699	\$32,720	\$39,385
Net balance at period end	\$46,405	\$57,896	\$59,719
Plus reinsurance recoverables	3,503	2,087	6,810
Balance at period end	\$49,908	\$59,983	\$66,529

As shown above, and as a result of review of liability for losses and LAE, which includes a re-evaluation of the adequacy of reserve levels for prior year's claims, we decreased the liability for losses and LAE for claims occurring in prior years by \$1.4 and \$1.0 million for the years ended December 31, 2012 and 2011, respectively, and we increased the liability for losses and LAE for claims occurring in prior years by \$2.8 million for the year ended December 31, 2010.

The liability for losses and LAE decreased by \$4.2 million and \$5.6 million for our homeowners' and commercial general liability lines, respectively, during 2012. These reductions are due to management's continued efforts to manage the claims life cycle more efficiently. Additionally, our underwriting processes are designed to quickly gather the true primary and secondary risk characteristics and provide a profitable quote to the policyholder. This approach helps to reduce the overall frequency and severity of the loss portfolio.

Based upon discussions with our independent actuarial consultants and their statements of opinion on losses and LAE, we believe that the liability for unpaid losses and LAE is currently adequate to cover all claims and related expenses which may arise from incidents reported and IBNR as of December 31, 2012. There can be no assurance concerning future adjustments of reserves, positive or negative, for claims incurred through December 31, 2012.

The following table presents total unpaid losses and LAE, net, and total reinsurance recoverable, on a run-off basis, due from our automobile reinsurers as shown in our consolidated financial statements for the periods indicated.

	As of December 31,	
	2012	2011
	(Dollars in Thousands)	

Transatlantic Reinsurance Company (A+ A.M. Best rated)		
Reinsurance (payable) recoverable on paid losses and LAE	\$8	\$(23 )
Unpaid losses and LAE	62	113
	\$70	\$90

- 14 -

---

Table of Contents

## Federated National Holding Company

The following table presents total unpaid losses and LAE, net, and total reinsurance recoverable due from our catastrophic reinsurers as shown in our consolidated financial statements.

	As of December 31,	
	2012	2011
	(Dollars in Thousands)	
Catastrophe Excess of Loss (various participants) and FHCF		
Reinsurance recoverable on paid losses and LAE	\$47	\$8
Unpaid losses and LAE	94	542
	\$141	\$550
Amounts due from (to) reinsurers consisted of amounts related to:		
Unpaid losses and LAE	\$94	\$542
Reinsurance recoverable on paid LAE	47	8
Reinsurance payable	-	(1 )
	\$141	\$549

Table of Contents

## Federated National Holding Company

The following table presents the statutory liability for unpaid losses and LAE, net of reinsurance recoverable, for the years ended December 31, 2003 through 2012 and does not distinguish between catastrophic and non-catastrophic events. The top line of the table shows the estimated net liabilities for unpaid losses and LAE at the balance sheet date for each of the periods indicated. These figures represent the estimated amount of unpaid losses and LAE for claims arising in all prior years that were unpaid at the balance sheet date, including losses that had been IBNR. The portion of the table labeled "Cumulative paid as of" shows the net cumulative payments for losses and LAE made in succeeding years for losses incurred prior to the balance sheet date. The lower portion of the table shows the re-estimated amount of the previously recorded liability based on experience as of the end of each succeeding year.

	Years Ended December 31, (Dollars in Thousands)							
	2012	2011	2010	2009	2008	2007	2006	2005
Statutory unpaid losses and LAE, net	\$44,255	\$55,567	\$59,655	\$59,016	\$52,070	39,551	\$27,259	\$25,700
Cumulative paid as of:								
One year later		24,476	17,863	22,910	17,264	17,019	19,331	25,400
Two years later			31,498	32,086	29,985	25,692	27,724	34,000
Three years later				40,660	35,367	35,185	33,308	39,700
Four years later					41,669	37,921	40,554	44,000
Five years later						41,577	41,335	49,300
Six years later							43,391	48,800
Seven years later								49,900
Eight years later								
Nine years later								
Re-estimated net liability as of:								
End of year	44,255	55,567	59,655	59,016	52,070	39,551	27,259	25,700
One year later		54,694	58,895	61,567	52,755	44,361	35,315	35,800
Two years later			57,575	61,956	57,791	47,682	38,902	41,400
Three years later				59,509	58,113	53,026	45,507	45,200
Four years later					55,345	53,189	50,980	51,400
Five years later						51,938	50,909	55,700
Six years later							49,787	55,300
Seven years later								54,000
Eight years later								
Nine years later								
Cumulative redundancy (deficiency)		873	2,080	(493 )	(3,276 )	(12,387)	(22,528)	(28,300)
Cumulative redundancy (-) deficiency as a % of reserves originally established		1.6 %	3.5 %	-0.8 %	-6.3 %	-31.3 %	-82.6 %	-110.0 %

The cumulative redundancy or deficiency represents the aggregate change in the estimates over all prior years. A deficiency indicates that the latest estimate of the liability for losses and LAE is higher than the liability that was originally estimated and a redundancy indicates that such estimate is lower. It should be emphasized that the table presents a run-off of balance sheet liability for the periods indicated rather than accident or policy loss development for those periods. Therefore, each amount in the table includes the cumulative effects of changes in liability for all prior periods. Conditions and trends that have affected liabilities in the past may not necessarily occur in the future.

- 16 -

---

Table of Contents

## Federated National Holding Company

As noted above, we have since experienced a \$0.9 million cumulative redundancy in connection with the re-estimation of all losses that occurred in 2011, mainly on our homeowners' losses. Relative to 2010, the cumulative redundancy in connection with the re-estimation of all losses totaled \$2.1 million, from which \$0.2 million relates to our homeowners' losses, \$1.8 million relates to our commercial general liability losses and \$0.1 million relates to our automobile losses.

As noted in our Form 10-K for the fiscal year ended December 31, 2011, we experienced a \$0.8 million cumulative redundancy in connection with the re-estimation of all losses that occurred in 2010, mainly on our homeowners' losses. Relative to 2009, the cumulative deficiency in connection with the re-estimation of all losses totaled \$2.9 million, from which \$1.2 million relates to our homeowners' losses, \$1.5 million relates to our commercial general liability losses and \$0.2 million relates to our automobile losses.

As noted in our Form 10-K for the fiscal year ended December 31, 2010, we experienced a \$2.6 million cumulative deficiency in connection with the re-estimation of all loss that occurred in 2009 and a \$5.7 million cumulative deficiency in connection with the re-estimation of all loss that occurred in 2008. Relative to the \$2.6 million deficiency, homeowner and commercial general liability losses totaled \$1.9 million and \$0.7 million, respectively. Relative to the \$5.7 million deficiency, our homeowner losses totaled \$0.3 million, our automobile losses totaled \$1.9 million and our commercial general liability losses totaled \$3.5 million.

The table below sets forth the differences between loss and LAE reserves as disclosed for Generally Accepted Accounting Principles ("GAAP") basis compared with Statutory Accounting Principles ("SAP") basis of presentation for the years ended 2012, 2011 and 2010.

	Years Ended December 31,		
	2012	2011	2010
	(Dollars in Thousands)		
GAAP basis Loss and LAE reserves	\$ 49,908	\$ 59,983	\$ 66,529
Less unpaid Losses and LAE ceded	3,189	2,319	6,810
Balance Sheet Liability	46,719	57,664	59,719
Add Insurance Apportionment Plan	6	17	14
Intercompany Indemnification	(2,470 )	(2,114 )	(78 )
SAP basis Loss and LAE reserves	\$ 44,255	\$ 55,567	\$ 59,655

The table below sets forth the differences between loss and LAE incurred as disclosed for GAAP basis compared with SSAP basis presentation for the years ended 2012, 2011 and 2010.

	Years Ended December 31,		
	2012	2011	2010
	(Dollars in Thousands)		
GAAP basis Loss and LAE incurred	\$30,209	\$30,896	\$40,088
Intercompany adjusting and other expenses	3,744	(726 )	8
Insurance apportionment plan	(4 )	-	(2 )
SAP basis Loss and LAE incurred	\$33,949	\$30,170	\$40,094

Underwriting results of insurance companies are frequently measured by their Combined Ratios. However, investment income, federal income taxes and other non-underwriting income or expense are not reflected in the Combined Ratio. The profitability of property and casualty insurance companies depends on income from underwriting, investment and service operations. Underwriting results are considered profitable when the Combined Ratio is under 100% and unprofitable when the Combined Ratio is over 100%.

- 17 -

---

Table of Contents

## Federated National Holding Company

The following table sets forth Loss Ratios, Expense Ratios and Combined Ratios for the periods indicated for the insurance business of FNIC and American Vehicle for 2012, 2011 and 2010, and are inclusive of Unallocated Loss Adjustment Expenses (“ULAE”).

	Years Ended December 31,		
	2012	2011	2010
Loss Ratio	50.9%	63.7%	89.0%
Expense Ratio	46.3%	58.2%	74.7%
Combined Ratio	97.2%	121.9%	163.7%

## COMPETITION

We operate in highly competitive markets and face competition from national, regional and residual market insurance companies in the homeowners’, commercial general liability, and automobile markets. Our competitors include companies that market their products through agents, as well as companies that sell insurance directly to their customers. Large national writers may have certain competitive advantages over agency writers, including increased name recognition, increased loyalty of their customer base and reduced policy acquisition costs. We compete based on underwriting criteria, our distribution network and superior service to our agents and insureds. Although our pricing is inevitably influenced to some degree by that of our competitors, we believe that it is generally not in our best interest to compete solely on price.

In Florida, more than 200 companies are authorized to underwrite homeowners’ insurance. Several of our competitors include Citizens, Universal Property and Casualty Insurance Company and St. Johns Insurance Company. In Florida, more than one dozen companies compete with us in the commercial general liability insurance market.

Significant competition also emerged because of fundamental changes made to the property and casualty insurance business in Florida in recent years which resulted in a multi-pronged approach to address the cost of residential property insurance in Florida. First, the law increased the capacity of reinsurance that stabilized the reinsurance market to the benefit of the insurance companies writing properties lines in Florida. Secondly, the law provided for rate relief to all policyholders. The law also authorized the state-owned insurance company, Citizens, which is free of many of the restraints on private carriers such as surplus, ratios, income taxes and reinsurance expense, to reduce its premium rates and begin competing against private insurers in the residential property insurance market and expands the authority of Citizens to write commercial insurance.

## REGULATION

## General

We are subject to the laws and regulations in Alabama, Florida, Georgia, Illinois, Kentucky, Louisiana, Maryland, Mississippi, Missouri, New York, Nevada, North Carolina, Ohio, Oklahoma, South Carolina, Tennessee, Texas and Virginia and regulations of any other states in which we seek to conduct business in the future. The regulations cover all aspects of our business and are generally designed to protect the interests of insurance policyholders, as opposed to the interests of shareholders. Such regulations relate to authorized lines of business, capital and surplus requirements, allowable rates and forms, investment parameters, underwriting limitations, transactions with affiliates, dividend limitations, changes in control, market conduct, maximum amount allowable for premium financing service charges and a variety of other financial and non-financial components of our business. Our failure to comply with certain provisions of applicable insurance laws and regulations could have a material adverse effect on our business, results of



operations or financial condition. In addition, any changes in such laws and regulations, including the adoption of consumer initiatives regarding rates charged for coverage, could materially and adversely affect our operations or our ability to expand.

Most states' laws restrict an insurer's underwriting discretion, such as the ability to terminate policies, terminate agents or reject insurance coverage applications, and many state regulators have the power to reduce, or to disallow, increases in premium rates. In addition, state laws generally require that rate schedules and other information be filed with the state's insurance regulatory authority, either directly or through a rating organization with which the insurer is affiliated. The regulatory authority may disapprove a rate filing if it finds that the rates are inadequate, excessive or unfairly discriminatory. Rates, which are not necessarily uniform for all insurers, vary by class of business, hazard covered, and size of risk. Certain states, including Florida, as discussed above, have adopted laws or are considering proposed legislation which, among other things, limit the ability of insurance companies to effect rate increases or to cancel, reduce or non-renew insurance coverage with respect to existing policies, particularly personal automobile insurance.

Table of Contents

Federated National Holding Company

Most states require licensure or regulatory approval prior to the marketing of new insurance products. Typically, licensure review is comprehensive and includes a review of a company's business plan, solvency, reinsurance, character of its officers and directors, rates, forms and other financial and non-financial aspects of a company. The regulatory authorities may prohibit entry into a new market by not granting a license or by withholding approval.

All insurance companies must file quarterly and annual statements with certain regulatory agencies and are subject to regular and special examinations by those agencies. We may be the subject of additional special examinations or analysis. These examinations or analysis may result in one or more corrective orders being issued by the Florida OIR. The most recent balance sheet audit of FNIC by the Florida OIR occurred as of December 31, 2009. There were no material findings by the independent auditors in connection with this examination. FNIC also experienced a regularly scheduled statutory examination by the Florida OIR which occurred during 2010 for the five years ended December 31, 2009. There were no material findings in connection with this examination.

In some instances, various states routinely require deposits of assets for the protection of policyholders either in those states or for all policyholders. As an example, the Florida OIR requires FNIC to have securities with a fair market value of \$2.0 million held in escrow. As of December 31, 2012, FNIC held investment securities with a fair value of approximately \$2.3 million, as a deposit with the State of Florida. Additionally, as of December 31, 2012 FNIC had cash deposits totaling \$415,100 with the State of Alabama, \$150,000 with the State of Arkansas, \$118,700 with the State of Louisiana and \$25,000 with the State of Georgia.

As of December 31, 2011, FNIC held investment securities with a fair value of approximately \$2.1 million, as a deposit with the State of Florida. Additionally, as of December 31, 2011 FNIC had cash deposits totaling \$406,400 with the State of Alabama, \$151,000 with the State of Arkansas, \$118,520 with the State of Louisiana and \$25,000 with the State of Georgia.

Consent Order

In January 2011, we merged FNIC and our other wholly owned insurance subsidiary, American Vehicle Insurance Company ("American Vehicle"), with FNIC continuing the operations of both entities. As part of its approval of the merger between FNIC and American Vehicle, the Florida Office of Insurance Regulation ("Florida OIR"), the Company, FNIC and American Vehicle entered into a consent order with the Florida OIR dated January 25, 2011 (the "Consent Order"), which was amended in February 2013, due to FNIC's statutory underwriting profit during 2012. Pursuant to the amended Consent Order, the Company and the resulting company in the merger (the "Merged Company") have agreed to the following:

- The Merged Company retained the following licenses: (010) Fire, (020) Allied Lines, (040) Homeowners Multi Peril, (050) Commercial Multi Peril, (090) Inland Marine, (170) Other Liability, (192) Private Passenger Auto Liability, (194) Commercial Auto Liability, (211) Private Passenger Auto Physical Damage and (212) Commercial Auto Physical Damage.
- The Merged Company will not write commercial multi peril policy premium without prior approval from the Florida OIR. The Merged Company has no commercial multi peril policy premium in force.
- The Merged Company surrendered its surety license. The Merged Company has no surety policy premium in force.
- The Merged Company will not write new commercial habitation condominium associations without prior approval from the Florida OIR. The current commercial habitation book of business is less than \$0.1 million of policy

premium.

- The Merged Company agreed to maintain the total number of its homeowners' policies in Miami-Dade, Broward and Palm Beach counties (the "Tri-County Area") at 35% of its entire homeowners' book. As of December 31, 2012, the Company had approximately 20.4% of its homeowners' policies located within Tri-County Area.
- The managing general agency fees payable by the Merged Company to Federated National Underwriters, Inc. ("FNU"), formerly known as Assurance Managing General Agents, Inc., a wholly owned subsidiary of the Company, which were traditionally 6% of gross written premium, were reduced and will not exceed 4% without prior approval from the Florida OIR. The Merged Company has lowered the fee to amounts varying between 2% and 4% of gross written to further support the FNIC results of operations. This will have no impact on the Company's consolidated financial results.
- The claims service fees payable by the Merged Company to Federated National Adjusting, Inc. ("FNA"), formerly known as Superior Adjusting, Inc., were reduced from the traditional 4.5% of gross earned premium to 3.6% of gross earned premium. This will have no impact on the Company's consolidated financial results.

- 19 -

---

Table of Contents

Federated National Holding Company

Restrictions in Payments of Dividends by Domestic Insurance Companies

Under Florida law, a domestic insurer may not pay any dividend or distribute cash or other property to its shareholders except out of that part of its available and accumulated capital surplus funds which is derived from realized net operating profits on its business and net realized capital gains. A Florida domestic insurer may not make dividend payments or distributions to shareholders without prior approval of the Florida OIR if the dividend or distribution would exceed the larger of (i) the lesser of (a) 10.0% of its capital surplus or (b) net income, not including realized capital gains, plus a two-year carryforward, (ii) 10.0% of capital surplus with dividends payable constrained to unassigned funds minus 25.0% of unrealized capital gains or (iii) the lesser of (a) 10.0% of capital surplus or (b) net investment income plus a three-year carryforward with dividends payable constrained to unassigned funds minus 25.0% of unrealized capital gains.

Alternatively, a Florida domestic insurer may pay a dividend or distribution without the prior written approval of the Florida OIR (i) if the dividend is equal to or less than the greater of (a) 10.0% of the insurer's capital surplus as regards policyholders derived from realized net operating profits on its business and net realized capital gains or (b) the insurer's entire net operating profits and realized net capital gains derived during the immediately preceding calendar year, (ii) the insurer will have policy holder capital surplus equal to or exceeding 115.0% of the minimum required statutory capital surplus after the dividend or distribution, (iii) the insurer files a notice of the dividend or distribution with the Florida OIR at least ten business days prior to the dividend payment or distribution and (iv) the notice includes a certification by an officer of the insurer attesting that, after the payment of the dividend or distribution, the insurer will have at least 115.0% of required statutory capital surplus as to policyholders. Except as provided above, a Florida domiciled insurer may only pay a dividend or make a distribution (i) subject to prior approval by the Florida OIR or (ii) 30 days after the Florida OIR has received notice of such dividend or distribution and has not disapproved it within such time.

No dividends were paid by FNIC or American Vehicle in 2012, 2011 and 2010, and none are anticipated in 2013. Although we believe that amounts required to meet our financial and operating obligations will be available from sources other than dividends from our insurance subsidiaries, there can be no assurance in this regard. Further, there can be no assurance that, if requested, the Florida OIR will allow any dividends to be paid by FNIC to us, the parent company, in the future. The maximum dividends permitted by state law are not necessarily indicative of an insurer's actual ability to pay dividends or other distributions to a parent company, which also may be constrained by business and regulatory considerations, such as the impact of dividends on capital surplus, which could affect an insurer's competitive position, the amount of premiums that can be written and the ability to pay future dividends. Further, state insurance laws and regulations require that the statutory capital surplus of an insurance company following any dividend or distribution by it be reasonable in relation to its outstanding liabilities and adequate for its financial needs.

While the non-insurance company subsidiaries (FNU, FNA and any other affiliate) are not subject directly to the dividend and other distribution limitations, insurance holding company regulations govern the amount that any affiliate within the holding company system may charge any of the insurance companies for service (e.g., management fees and commissions).

NAIC Risk-Based Capital Requirements

In order to enhance the regulation of insurer solvency, the National Association of Insurance Commissioners ("NAIC") established risk-based capital requirements for insurance companies that are designed to assess capital adequacy and to raise the level of protection that statutory surplus provides for policy holders. These requirements measure three major areas of risk facing property and casualty insurers: (i) underwriting risks, which encompass the risk of adverse

loss developments and inadequate pricing; (ii) declines in asset values arising from credit risk; and (iii) other business risks from investments. Insurers having less statutory surplus than required will be subject to varying degrees of regulatory action, depending on the level of capital inadequacy. The Florida OIR, which follows these requirements, could require FNIC to cease operations in the event they fail to maintain the required statutory capital.

Based upon the 2012 and 2011 statutory financial statements for FNIC, statutory surplus exceeded the regulatory action levels established by the NAIC's risk-based capital requirements.

Based on risk-based capital requirements, the extent of regulatory intervention and action increases as the ratio of an insurer's statutory surplus to its Authorized Control Level ("ACL"), as calculated under the NAIC's requirements, decreases. The first action level, the Company Action Level, requires an insurer to submit a plan of corrective actions to the insurance regulators if statutory surplus falls below 200.0% of the ACL amount. The second action level, the Regulatory Action Level, requires an insurer to submit a plan containing corrective actions and permits the insurance regulators to perform an examination or other analysis and issue a corrective order if statutory surplus falls below 150.0% of the ACL amount. The third action level, ACL, allows the regulators to rehabilitate or liquidate an insurer in addition to the aforementioned actions if statutory surplus falls below the ACL amount. The fourth action level is the Mandatory Control Level, which requires the regulators to rehabilitate or liquidate the insurer if statutory surplus falls below 70.0% of the ACL amount. FNIC's ratio of statutory surplus to its ACL was 474.4%, 409.7% and 222.8% at December 31, 2012, 2011 and 2010, respectively. American Vehicle's ratio of statutory surplus to its ACL was 373.4% at December 31, 2010.

Table of Contents

Federated National Holding Company

Insurance Regulatory Information Systems (“IRIS”) Ratios

The NAIC has also developed IRIS ratios to assist state insurance departments in identifying companies which may be developing performance or solvency problems, as signaled by significant changes in the companies’ operations. Such changes may not necessarily result from any problems with an insurance company, but may merely indicate changes in certain ratios outside the ranges defined as normal by the NAIC. When an insurance company has four or more ratios falling outside “usual ranges”, state regulators may investigate to determine the reasons for the variance and whether corrective action is warranted.

As of December 31, 2012, FNIC was outside NAIC’s usual range for three of thirteen IRIS ratios. These exceptions related to investment yield, net change in adjusted policyholders’ surplus and estimated current reserve deficiency to policyholders’ surplus.

As of December 31, 2011, FNIC was outside NAIC’s usual range for two of thirteen IRIS ratios. These exceptions related to two-years overall operating ratio and investment yield.

As of December 31, 2010, FNIC was outside NAIC’s usual range for four of thirteen IRIS ratios. These exceptions related to two-years overall operating ratio, investment yield, gross change in policyholders’ surplus and change in adjusted policyholders’ surplus. The Florida OIR approved an additional rate increase for our voluntary property book of homeowners’ business which averaged 20.2% statewide and went into effect November 1, 2009 and December 1, 2009 for new and renewed homeowner insurance policies, respectively.

As of December 31, 2010, American Vehicle was outside NAIC’s usual range for four of thirteen IRIS ratios. These exceptions related to two-years overall operating ratio, investment yield, gross change in policyholders’ surplus and change in adjusted policyholders’ surplus.

There was no action taken by the Florida OIR in connection with the December 31, 2010 or 2011 IRIS ratio results. We do not currently believe that the Florida OIR will take any significant action with respect to FNIC regarding the 2012 IRIS ratios, although there can be no assurance that will be the case.

Insurance Holding Company Regulation

We, the parent company, are subject to laws governing insurance holding companies in Florida where FNHC is domiciled. These laws, among other things, (i) require us to file periodic information with the Florida OIR, including information concerning our capital structure, ownership, financial condition and general business operations, (ii) regulate certain transactions between us and our affiliates, including the amount of dividends and other distributions, the terms of surplus notes and amounts that our affiliates can charge the holding company for services such as management fees or commissions, (iii) restrict the ability of any one person to acquire certain levels of our voting securities without prior regulatory approval. Any purchaser of 5% or more of the outstanding shares of our Common Stock will be presumed to have acquired control of FNHC unless the Florida OIR, upon application, determines otherwise.

Underwriting and Marketing Restrictions

During the past several years, various regulatory and legislative bodies have adopted or proposed new laws or regulations to address the cyclical nature of the insurance industry, catastrophic events and insurance capacity and pricing. These regulations include (i) the creation of "market assistance plans" under which insurers are induced to

provide certain coverages, (ii) restrictions on the ability of insurers to rescind or otherwise cancel certain policies in mid-term, (iii) advance notice requirements or limitations imposed for certain policy non-renewals and (iv) limitations upon or decreases in rates permitted to be charged.

- 21 -

---

Table of Contents

Federated National Holding Company

Industry Ratings Services

Third-party rating agencies assess and rate the ability of insurers to pay their claims. These financial strength ratings are used by the insurance industry to assess the financial strength and quality of insurers. These ratings are based on criteria established by the rating agencies and reflect evaluations of each insurer's profitability, debt and cash levels, customer base, adequacy and soundness of reinsurance, quality and estimated market value of assets, adequacy of reserves and management. Ratings are based upon factors of concern to agents, reinsurers and policyholders and are not directed toward the protection of investors, such as purchasers of our common stock.

As of December 31, 2012, FNIC is rated by Demotech as "A" ("Exceptional"), which is the third of seven ratings, and defined as "Regardless of the severity of a general economic downturn or deterioration in the insurance cycle, insurers earning a Financial Stability Rating ("FSR") of "A" possess "Exceptional" financial stability related to maintaining surplus as regards to policyholders". Demotech's ratings are based upon factors of concern to agents, reinsurers and policyholders and are not primarily directed toward the protection of investors. Our Demotech rating could be jeopardized by factors including adverse development and various surplus related ratio exceptions. On November 28, 2012, Demotech reaffirmed FNIC's FSR of "A" ("Exceptional").

The withdrawal of our ratings could limit or prevent us from writing or renewing desirable insurance policies, from competing with insurers who have higher ratings, from obtaining adequate reinsurance, or from borrowing on a line of credit. The withdrawal of our ratings could have a material adverse effect on the Company's results of operations and financial position because the Company's insurance products might no longer be acceptable to the secondary marketplace and mortgage lenders. Furthermore, a withdrawal of our ratings could prevent independent agents from selling and servicing our insurance products.

EMPLOYEES

As of December 31, 2012, we had 116 employees, including two executive officers. We are not a party to any collective bargaining agreement and we have not experienced work stoppages or strikes as a result of labor disputes. We consider relations with our employees to be satisfactory.

ITEMRISK FACTORS

1A

We are subject to certain risks in our business operations which are described below. Careful consideration of these risks should be made before making an investment decision. The risks and uncertainties described below are not the only ones facing FNHC. Additional risks and uncertainties not presently known or currently deemed immaterial may also impair our business operations.

Risks Related to Our Business

Our financial condition could be adversely affected by the occurrence of natural and man-made disasters.

We write insurance policies that cover homeowners', business owners and automobile owners for losses that result from, among other things, catastrophes and sinkholes. Catastrophic losses can be caused by hurricanes, tropical storms, tornadoes, wind, hail, fires, riots and explosions, and their incidence and severity are inherently unpredictable. The extent of losses from a catastrophe is a function of two factors: the total amount of the insurance company's exposure in the area affected by the event and the severity of the event. Our policyholders are disbursed throughout



Florida, which is especially subject to adverse weather conditions such as hurricanes and tropical storms.

The occurrence of claims from catastrophic events could result in substantial volatility in our results of operations or financial condition for any fiscal quarter or year. Increases in the values and concentrations of insured property may also increase the severity of these occurrences in the future. Although we attempt to manage our exposure to such events through the use of underwriting controls and the purchase of third-party reinsurance, catastrophic events are inherently unpredictable and the actual nature of such events when they occur could be more frequent or severe than contemplated in our pricing and risk management expectations. As a result, the occurrence of one or more catastrophic events could have a material adverse effect on our results of operations or financial condition.

- 22 -

---

Table of Contents

Federated National Holding Company

Although Florida has not experienced a hurricane during the last seven hurricane seasons, some weather analysts believe that we have entered a period of greater hurricane activity. To address this risk, we are exploring alternatives to reduce our exposure to these types of storms. Although these measures may increase operating expenses, management believes that they will assist us in protecting long-term profitability, although there can be no assurances that will be the case.

Although we follow the industry practice of reinsuring a portion of our risks, our costs of obtaining reinsurance fluctuates and we may not be able to successfully alleviate risk through reinsurance arrangements.

We have a reinsurance structure that is a combination of private reinsurance and the FHCF. Our reinsurance structure is comprised of several reinsurance companies with varying levels of participation providing coverage for loss and LAE at pre-established minimum and maximum amounts. Losses incurred in connection with a catastrophic event below the minimum and above the maximum are the responsibility of FNIC.

The availability and costs associated with the acquisition of reinsurance will vary year to year. These fluctuations, which can be significant, are not subject to our control and may limit our ability to purchase adequate coverage. The recovery of increased reinsurance costs through rate action is not immediate and cannot be presumed, as it is subject to Florida OIR approval.

We face a risk of non-collectability of reinsurance, which could materially and adversely affect our business, results of operations and/or financial condition.

As is common practice within the insurance industry, we transfer a portion of the risks insured under our policies to other companies through the purchase of reinsurance. This reinsurance is maintained to protect our insurance subsidiary against the severity of losses on individual claims, unusually serious occurrences in which a number of claims produce an aggregate extraordinary loss and catastrophic events. Although reinsurance does not discharge our insurance subsidiary from its primary obligation to pay for losses insured under the policies it issues, reinsurance does make the assuming reinsurer liable to the insurance subsidiary for the reinsured portion of the risk. A credit exposure exists with respect to ceded losses to the extent that any reinsurer is unable or unwilling to meet the obligations assumed under the reinsurance contracts. The collectability of reinsurance is subject to the solvency of the reinsurers, interpretation of contract language and other factors. A reinsurer's insolvency or inability to make payments under the terms of a reinsurance contract could have a material adverse effect on our results of operations and financial condition.

Our reinsurance structure has significant risks, including the fact that the FHCF may not be able to raise sufficient money to pay their claims or impair their ability to pay their claims in a timely manner. This could result in significant financial, legal and operational challenges to our company. Therefore, in the event of a catastrophic loss, we may become dependent upon the FHCF's ability to pay, which may, in turn, be dependent upon the FHCF's ability to issue bonds in amounts that would be required to meet its reinsurance obligations in the event of such a catastrophic loss.

Our January 2011 Consent Order with the Florida OIR, as amended in February 2013, limits our business in certain respects and may prevent us from growing our business.

In January 2011, we entered into a Consent Order with the Florida OIR in connection with our request for approval of the merger of FNIC into American Vehicle. The Consent Order was amended in February 2013 to lessen or eliminate certain of the original requirements, due to FNIC's statutory underwriting profit during 2012. See "Regulation – Consent Order". Among other things, the Consent Order as amended requires us to limit the concentration of our homeowners'

policies in the Tri-County Area. This reduction in concentration could materially adversely affect us by limiting our ability to write policies in the most populous region of the State of Florida, which could materially adversely affect our results of operations if we are not able to replace those policies with policies elsewhere in Florida or the other states in which we do business.

If we are unable to continue our growth because our capital must be used to pay greater than anticipated claims, our financial results may suffer.

Our future growth will depend on our ability to expand the types of insurance products we offer and the geographic markets in which we do business, both balanced by the business risks we choose to assume and cede. We believe that our Company is sufficiently capitalized to operate our business as it now exists and as we currently plan to expand it. Our existing sources of funds include possible sales of our investment securities and our earnings from operations and investments. Unexpected catastrophic events in our market areas, such as the hurricanes experienced in Florida, have resulted and may result in greater claims losses than anticipated, which could require us to limit or halt our growth while we redeploy our capital to pay these unanticipated claims.

Table of Contents

Federated National Holding Company

We may require additional capital in the future which may not be available or only available on unfavorable terms.

Our future capital requirements depend on many factors, including our ability to write new business successfully and to establish premium rates and reserves at levels sufficient to cover losses. Based on our current operating plan, we believe current capital, together with our anticipated retained earnings, will support our operations without the need to raise additional capital. To the extent that our capital may be insufficient to meet future operating requirements and/or cover losses, we may need to raise additional funds through financings or curtail our growth. Many factors will affect the amount and timing of our capital needs, including our growth and profitability, our claims experience, and the availability of reinsurance, as well as possible acquisition opportunities, market disruptions and other unforeseeable developments.

If we were required to raise additional capital, equity or debt financing may not be available at all or may be available only on terms that are not favorable to us. In the case of equity financings, dilution to our stockholders' ownership could result, and in any case such securities may have rights, preferences and privileges that are senior to those of existing shareholders. If we cannot obtain adequate capital on favorable terms or at all, our business, financial condition or results of operations could be materially adversely affected.

Our business is heavily regulated, and changes in regulation may reduce our profitability and limit our growth.

We are subject to extensive regulation in the states in which we conduct business. This regulation is generally designed to protect the interests of policyholders, as opposed to shareholders and other investors, and relates to authorization for lines of business, capital and surplus requirements, investment limitations, underwriting limitations, transactions with affiliates, dividend limitations, changes in control, premium rates and a variety of other financial and non-financial components of an insurance company's business. The NAIC and state insurance regulators are constantly reexamining existing laws and regulations, generally focusing on modifications to holding company regulations, interpretations of existing laws and the development of new laws.

From time to time, some states in which we conduct business have considered or enacted laws that may alter or increase state authority to regulate insurance companies and insurance holding companies. In other situations, states in which we conduct business have considered or enacted laws that impact the competitive environment and marketplace for property and casualty insurance. In addition, in recent years the state insurance regulatory framework has come under increased federal scrutiny. Changes in federal legislation and administrative policies in several areas, including changes in the Gramm-Leach-Bliley Act, financial services regulation and federal taxation, can significantly impact the insurance industry and us.

We cannot predict with certainty the effect any enacted, proposed or future state or federal legislation or NAIC initiatives may have on the conduct of our business. Furthermore, there can be no assurance that the regulatory requirements applicable to our business will not become more stringent in the future or result in materially higher costs than current requirements. Changes in the regulation of our business may reduce our profitability, limit our growth or otherwise adversely affect our operations.

We may experience financial exposure from climate change.

Our financial exposure from climate change is most notably associated with losses in connection with the occurrence of hurricanes striking Florida. We mitigate the risk of financial exposure from climate change by restrictive underwriting criteria, sensitivity to geographic concentrations and reinsurance.

Restrictive underwriting criteria can include, but are not limited to, higher premiums and deductibles and more specifically excluded policy risks such as fences and screened-in enclosures. New technological advances in computer generated geographical mapping afford us an enhanced perspective as to geographic concentrations of policyholders and proximity to flood prone areas. Our amount of maximum reinsurance coverage is determined by subjecting our homeowner and mobile homeowner exposures to statistical forecasting models that are designed to quantify a catastrophic event in terms of the frequency of a storm occurring once in every “n” years. Our reinsurance coverage contemplated a catastrophic event occurring once every 100 years. Our amount of losses retained (our deductible) in connection with a catastrophic event is determined by market capacity, pricing conditions and surplus preservation.

Table of Contents

Federated National Holding Company

Our loss reserves may be inadequate to cover our actual liability for losses, causing our results of operations to be adversely affected.

We maintain reserves to cover our estimated ultimate liabilities for loss and LAE. These reserves are estimates based on historical data and statistical projections of what we believe the settlement and administration of claims will cost based on facts and circumstances then known to us. Actual loss and LAE reserves, however, may vary significantly from our estimates.

Factors that affect unpaid losses and LAE include the estimates made on a claim-by-claim basis known as “case reserves” coupled with bulk estimates known as IBNR. Periodic estimates by management of the ultimate costs required to settle all claim files are based on our analysis of historical data and estimations of the impact of numerous factors such as (i) per claim information; (ii) company and industry historical loss experience; (iii) legislative enactments, judicial decisions, legal developments in the awarding of damages, and changes in political attitudes; and (iv) trends in general economic conditions, including the effects of inflation. Management revises its estimates based on the results of its analysis. This process assumes that past experience, adjusted for the effects of current developments and anticipated trends, is an appropriate basis for estimating the ultimate settlement of all claims. There is no precise method for subsequently evaluating the impact of any specific factor on the adequacy of the reserves, because the eventual redundancy or deficiency is affected by multiple factors.

Because of the uncertainties that surround estimated loss reserves, we cannot be certain that our reserves will be adequate to cover our actual losses. If our reserves for unpaid losses and LAE are less than actual losses and LAE, we will be required to increase our reserves with a corresponding reduction in our net income in the period in which the deficiency is identified. Future loss experience substantially in excess of our reserves for unpaid losses and LAE could substantially harm our results of operations and financial condition.

Our revenues and operating performance will fluctuate due to statutorily approved assessments that support property and casualty insurance pools and associations.

We operate in a regulatory environment where certain entities and organizations have the authority to require us to participate in assessments. Currently these entities and organizations include, but are not limited to, the Florida Joint Underwriters Insurance Association (“JUA”), Florida Insurance Guaranty Association (“FIGA”), Citizens and the FHCF.

The insurance companies currently pass the assessments on to insurance policies, in the form of a policy surcharge, and reflect the collection of these assessments as fully earned credits to operations in the period collected. The collection of these fees may adversely affect our overall marketing strategy due to the competitive landscape in Florida.

During December 2012, the Company was assessed \$0.8 million by FIGA relating to the recent failures of Florida domestic property and casualty insurance companies. Future assessments are likely, although the impact of these assessments on our balance sheet, results of operations or cash flow are undeterminable at this time.

Our investment portfolio may suffer reduced returns or losses, which would significantly reduce our earnings.

As do other insurance companies, we depend on income from our investment portfolio for a substantial portion of our earnings. During the time that normally elapses between the receipt of insurance premiums and any payment of insurance claims, we invest the funds received, together with our other available capital, primarily in debt securities and to a lesser extent in equity securities, in order to generate investment income.

Our investment portfolio contains interest rate sensitive instruments, such as bonds, which may be adversely affected by changes in interest rates. A significant increase in interest rates or decrease in credit worthiness could have a material adverse effect on our financial condition or results of operations. Generally, bond prices decrease as interest rates rise. Changes in interest rates could also have an adverse effect on our investment income and results of operations. For example, if interest rates decline, investment of new premiums received and funds reinvested will earn less than expected.

We may experience a loss due to the concentration of credit risk.

Financial instruments that potentially subject the Company to significant concentration of credit risk consist of cash and cash equivalents held in a mutual fund money market account. The Company had approximately \$10.7 million and \$6.8 million invested in the MTB Prime Money Market-Inst Fund Number 142, for which the NAIC classification is Class 1, as of December 31, 2012 and 2011, respectively. A money market fund is eligible for listing on the Class 1 list if the fund meets certain characteristics relating to the credit rating, net asset value and other criteria demonstrating the financial condition of the fund.

- 25 -

---

Table of Contents

Federated National Holding Company

We face risks in connection with potential material weakness resulting from our Sarbanes-Oxley Section 404 management report and any related remedial measures that we undertake.

In conjunction with our ongoing reporting obligations as a public company and the requirements of Section 404 of the Sarbanes-Oxley Act, management reported on the effectiveness of our internal control over financial reporting as of December 31, 2012. In order to identify any material weaknesses in our internal control over financial reporting, we engaged in a process to document, evaluate and test our internal controls and procedures, including corrections to existing controls and implement additional controls and procedures that we may deem necessary. As a result of this evaluation and testing process, no material financial reporting deficiencies were noted.

Although we did not have any material weaknesses in our internal controls for our fiscal year ended December 31, 2012, we cannot be certain that there will be none in the future. In future periods, if the process required by Section 404 of the Sarbanes-Oxley Act reveals significant deficiencies or material weaknesses, the correction of any such significant deficiencies or material weaknesses could require additional remedial measures that could be costly and time-consuming. In addition, the discovery of material weaknesses could also require the restatement of prior period operating results. If a material weakness exists as of a future period year-end (including a material weakness identified prior to year-end for which there is an insufficient period of time to evaluate and confirm the effectiveness of the corrections or related new procedures), our management will be unable to report favorably as of such future period year-end as to the effectiveness of our control over financial reporting and we could lose investor confidence in the accuracy and completeness of our financial reports, which could have an adverse effect on our stock price and potentially subject us to litigation.

The failure of any of the loss limitation methods we employ could have a material adverse effect on our financial condition or our results of operations.

Various provisions of our policies, such as limitations or exclusions from coverage which have been negotiated to limit our risks, may not be enforceable in the manner we intend. At the present time we employ a variety of exclusions to our policies that limit exposure to known risks, including, but not limited to, exclusions relating to certain named liabilities, types of vehicles and specific artisan activities.

In addition, the policies we issue contain conditions requiring the prompt reporting of claims to us and our right to decline coverage in the event of a violation of that condition. While our insurance product exclusions and limitations reduce the loss exposure to us and help eliminate known exposures to certain risks, it is possible that a court or regulatory authority could nullify or void an exclusion or legislation could be enacted modifying or barring the use of such endorsements and limitations in a way that would adversely affect our loss experience, which could have a material adverse effect on our financial condition or results of operations.

The effects of emerging claim and coverage issues on our business are uncertain.

As industry practices and legal, judicial, social and other conditions change, unexpected and unintended issues related to claims and coverage may emerge. These issues may adversely affect our business by either extending coverage beyond our underwriting intent or by increasing the number or size of claims. In some instances, these changes may not become apparent until sometime after we have issued insurance contracts that are affected by the changes. As a result, the full extent of liability under our insurance contracts may not be known for many years after a contract is issued.



An example of such emerging change was the influence public adjusters have had on property claim patterns. Public adjusters represented the vast majority of new and reopened claims filed during 2011 and 2010 where the cause of loss was asserted as hurricane related. Although the legitimacy of the claim may not prevail we are still required to research, review and sometimes mediate these claims. Several legislative actions in the state of Florida, such as limiting the time a claim can be filed subsequent to the cause of loss, have either passed or remain in legislative sub-committees. Each of these actions is designed to enhance the legitimacy of the public adjusters' influence on the claim process.

Our failure to pay claims accurately could adversely affect our business, financial results and capital requirements.

We must accurately evaluate and pay claims that are made under our policies. Many factors affect our ability to pay claims accurately, including the training and experience of our claims representatives, the culture of our claims organization and the effectiveness of our management, our ability to develop or select and implement appropriate procedures and systems to support our claims functions and other factors. Our failure to pay claims accurately could lead to material litigation, undermine our reputation in the marketplace, impair our image and negatively affect our financial results.

Table of Contents

Federated National Holding Company

In addition, if we do not train new claims adjusting employees effectively or if we lose a significant number of experienced claims adjusting employees, our claims department's ability to handle an increasing workload as we grow could be adversely affected. In addition to potentially requiring that growth be slowed in the affected markets, we could suffer decreased quality of claims work, which in turn could lower our operating margins.

Our insurance company is subject to minimum capital and surplus requirements, and our failure to meet these requirements could subject us to regulatory action.

Our insurance company is subject to risk-based capital standards and other minimum capital and surplus requirements imposed under applicable state laws, including the laws of their state of domicile, Florida. The risk-based capital standards, based upon the Risk Based Capital Model Act adopted by the NAIC require our insurance company to report their results of risk-based capital calculations to state departments of insurance and the NAIC. These risk-based capital standards provide for different levels of regulatory attention depending upon the ratio of an insurance company's total adjusted capital, as calculated in accordance with NAIC guidelines, to its authorized control level risk-based capital. Authorized control level risk-based capital is the number determined by applying the NAIC's risk-based capital formula, which measures the minimum amount of capital that an insurance company needs to support its overall business operations.

Any failure by our insurance company to meet the applicable risk-based capital or minimum statutory capital requirements imposed by the laws of Florida or other states where we do business could subject it to further examination or corrective action imposed by state regulators, including limitations on our writing of additional business, state supervision or liquidation. As of December 31, 2012, FNIC was in compliance with the NAIC risk-based capital requirements (see "Business-Regulation" for further discussion).

Any changes in existing risk-based capital requirements or minimum statutory capital requirements may require us to increase our statutory capital levels, which we may be unable to do.

Our revenues and operating performance may fluctuate with business cycles in the property and casualty insurance industry.

Historically, the financial performance of the property and casualty insurance industry has tended to fluctuate in cyclical patterns characterized by periods of significant competition in pricing and underwriting terms and conditions, which is known as a "soft" insurance market, followed by periods of lessened competition and increasing premium rates, which is known as a "hard" insurance market. Although an individual insurance company's financial performance is dependent on its own specific business characteristics, the profitability of most property and casualty insurance companies tends to follow this cyclical market pattern, with profitability generally increasing in hard markets and decreasing in soft markets. At present, we are experiencing a hardening market in the property and casualty market in Florida because of regulatory changes. We cannot predict, however, how long these market conditions will persist. We do not compete entirely on price or targeted market share. Our ability to compete is governed by our ability to assess and price an insurance product with an acceptable risk for obtaining profit.

We may not obtain the necessary regulatory approvals to expand the types of insurance products we offer or the states in which we operate.

The insurance industry is highly regulated. Prior to selling a new insurance product in a state, we must obtain approval from the applicable state insurance regulators. The insurance regulators in states to which we might apply may request additional information, add conditions to the license that we find unacceptable, or deny our application. This would

delay or prevent us from operating in that state. If we want to operate in any additional states, we must file similar applications for licenses, which we may not be successful in obtaining.

Adverse ratings by insurance rating agencies may adversely impact our ability to write new policies, renew desirable policies or obtain adequate insurance, which could limit or halt our growth and harm our business.

Third-party rating agencies assess and rate the ability of insurers to pay their claims. These financial strength ratings are used by the insurance industry to assess the financial strength and quality of insurers. These ratings are based on criteria established by the rating agencies and reflect evaluations of each insurer's profitability, debt and cash levels, customer base, adequacy and soundness of reinsurance, quality and estimated market value of assets, adequacy of reserves, and management. Ratings are based upon factors of concern to agents, reinsurers and policyholders and are not directed toward the protection of investors, such as purchasers of our common stock.

- 27 -

---

Table of Contents

Federated National Holding Company

The withdrawal of our ratings could limit or prevent us from writing or renewing desirable insurance policies, from competing with insurers who have higher ratings, from obtaining adequate reinsurance, or from borrowing on a line of credit. The withdrawal of our ratings could have a material adverse effect on the Company's results of operations and financial position because the Company's insurance products might no longer be acceptable to the secondary marketplace and mortgage lenders. Furthermore, a withdrawal of our ratings could prevent independent agents from selling and servicing our insurance products.

We rely on independent and general agents to write our insurance policies, and if we are not able to attract and retain independent and general agents, our revenues would be negatively affected.

We currently market and distribute FNIC's products and services through contractual relationships with a network of approximately 3,000 independent agents, of which approximately 900 actively sell and service our products, and a selected number of general agents. Our independent agents are our primary source for our automobile and property insurance policies. Many of our competitors also rely on independent agents. As a result, we must compete with other insurers for independent agents' business. Our competitors may offer a greater variety of insurance products, lower premiums for insurance coverage, or higher commissions to their agents. If our products, pricing and commissions do not remain competitive, we may find it more difficult to attract business from independent agents to sell our products. A material reduction in the amount of our products that independent agents sell could negatively affect our revenues.

We rely on our information technology and telecommunications systems, and the failure of these systems could disrupt our operations.

Our business is highly dependent upon the successful and uninterrupted functioning of our current information technology and telecommunications systems. We rely on these systems to process new and renewal business, provide customer service, make claims payments and facilitate collections and cancellations, as well as to perform actuarial and other analytical functions necessary for pricing and product development. As a result, the failure of these systems could interrupt our operations and adversely affect our financial results. We utilize a third-party to provide certain information security related services designed to prevent an information security event or detect one timely. In addition, although we have implemented security measures to protect our systems from computer viruses and intrusions by third parties, there can be no assurances that these measures will be effective.

Nonstandard automobile insurance historically has a higher frequency of claims than standard automobile insurance, thereby increasing our potential for loss exposure beyond what we would be likely to experience if we offered only standard automobile insurance.

Nonstandard automobile insurance is provided to insureds that are unable to obtain preferred or standard insurance coverage because of their payment histories, driving records, age, vehicle types, or prior claims histories. This type of automobile insurance historically has a higher frequency of claims than does preferred or standard automobile insurance policies, although the average dollar amount of the claims is usually smaller under nonstandard insurance policies. As a result, we are exposed to the possibility of increased loss exposure and higher claims experience than would be the case if we offered only standard automobile insurance.

Florida's personal injury protection insurance statute contains provisions that favor claimants, causing us to experience a higher frequency of claims than might otherwise be the case if we operated only outside of Florida.

Florida's personal injury protection insurance statute limits an insurer's ability to deny benefits for medical treatment that is unrelated to the accident, that is unnecessary, or that is fraudulent. In addition, the statute allows claimants to

obtain awards for attorney's fees. Although this statute has been amended several times in recent years, primarily to address concerns over fraud, the Florida legislature has been only marginally successful in implementing effective mechanisms that allow insurers to combat fraud and other abuses. We believe that this statute contributes to a higher frequency of claims under nonstandard automobile insurance policies in Florida, as compared with claims under standard automobile insurance policies in Florida and nonstandard and standard automobile insurance policies in other states. Although we believe that we have successfully offset these higher costs with premium increases, because of competition, we may not be able to do so with as much success in the future.

Our success depends on our ability to accurately price the risks we underwrite.

The results of our operations and the financial condition of our insurance company depends on our ability to underwrite and set premium rates accurately for a wide variety of risks. Rate adequacy is necessary to generate sufficient premiums to pay losses, LAE and underwriting expenses and to earn a profit. In order to price our products accurately, we must collect and properly analyze a substantial amount of data; develop, test and apply appropriate rating formulas; closely monitor and timely recognize changes in trends; and project both severity and frequency of losses with reasonable accuracy. Our ability to undertake these efforts successfully, and as a result price our products accurately, is subject to a number of risks and uncertainties, some of which are outside our control, including:

Table of Contents

Federated National Holding Company

- the availability of sufficient reliable data and our ability to properly analyze available data;
- the uncertainties that inherently characterize estimates and assumptions;
- our selection and application of appropriate rating and pricing techniques;
- changes in legal standards, claim settlement practices, medical care expenses and restoration costs; and
  - legislatively imposed consumer initiatives.

Consequently, we could under-price risks, which would negatively affect our profit margins, or we could overprice risks, which could reduce our sales volume and competitiveness. In either event, the profitability of our insurance company could be materially and adversely affected.

Current operating resources are necessary to develop future new insurance products.

We currently intend to expand our product offerings by underwriting additional insurance products and programs, and marketing them through our distribution network. Expansion of our product offerings will result in increases in expenses due to additional costs incurred in actuarial rate justifications, software and personnel. Offering additional insurance products may also require regulatory approval, further increasing our costs. There can be no assurance that we will be successful bringing new insurance products to our marketplace.

Increased competition, competitive pressures, industry developments and market conditions could affect the growth of our business and adversely impact our financial results.

We operate in highly competitive markets and face competition from national, regional and residual market insurance companies in the homeowners', commercial residential property, commercial general liability, and automobile markets, many of whom are larger, have greater financial and other resources, and offer more diversified insurance coverage. Our competitors include companies that market their products through agents, as well as companies that sell insurance directly to their customers. Large national writers may have certain competitive advantages over agency writers, including increased name recognition, increased loyalty of their customer base and reduced policy acquisition costs. Competition could have a material adverse effect on our business, results of operations and financial condition. If we do not meet the prices offered by our competitors, we may lose business in the short term, which could also result in reduced revenues.

Our senior management team is critical to the strategic direction of our company. If there were an unplanned loss of service by any of our officers our business could be harmed.

We depend, and will continue to depend, on the services of our executive management team which includes Michael Braun, our Chief Executive Officer and President of FNHC and FNIC, and Peter Prygelski, our Chief Financial Officer. Our success also will depend in part upon our ability to attract and retain qualified executive officers, experienced underwriting talent and other skilled employees who are knowledgeable about our business. If we were to lose the services of members of our executive management team, our business could be adversely affected. Although we have employment agreements with our executive officers, any unplanned loss of service could substantially harm our business.

Risks Related to an Investment in Our Shares

We have authorized but unissued preferred stock, which could affect rights of holders of common stock.

Our articles of incorporation authorize the issuance of preferred stock with designations, rights and preferences determined from time to time by our board of directors. Accordingly, our board of directors is empowered, without shareholder approval, to issue preferred stock with dividends, liquidation, conversion, voting or other rights that could adversely affect the voting power or other rights of the holders of common stock. In addition, the preferred stock could be issued as a method of discouraging a takeover attempt. Although we do not intend to issue any preferred stock at this time, we may do so in the future.

- 29 -

---

Table of Contents

Federated National Holding Company

Our articles of incorporation, bylaws and Florida law may discourage takeover attempts and may result in entrenchment of management.

- Our articles of incorporation and bylaws contain provisions that may discourage takeover attempts and may result in entrenchment of management.
  - Our board of directors is elected in classes, with only two or three of the directors elected each year. As a result, shareholders would not be able to change the membership of the board in its entirety in any one year. Shareholders would also be unable to bring about, through the election of a new board of directors, changes in our officers.
- Our articles of incorporation prohibit shareholders from acting by written consent, meaning that shareholders will be required to conduct a meeting in order to vote on any proposals or take any action.
- Our bylaws require at least 60 days' notice if a shareholder desires to submit a proposal for a shareholder vote or to nominate a person for election to our board of directors.

In addition, Florida has enacted legislation that may deter or frustrate takeovers of Florida corporations, such as our Company.

- The Florida Control Share Act provides that shares acquired in a "control share acquisition" will not have voting rights unless the voting rights are approved by a majority of the corporation's disinterested shareholders. A "control share acquisition" is an acquisition, in whatever form, of voting power in any of the following ranges: (a) at least 20% but less than 33-1/3% of all voting power, (b) at least 33-1/3% but less than a majority of all voting power; or (c) a majority or more of all voting power.
- The Florida Affiliated Transactions Act requires supermajority approval by disinterested shareholders of certain specified transactions between a public company and holders of more than 10% of the outstanding voting shares of the corporation (or their affiliates).

As a holding company, we depend on the earnings of our subsidiaries and their ability to pay management fees and dividends to the holding company as the primary source of our income.

We are an insurance holding company whose primary assets are the stock of our subsidiaries. Our operations, and our ability to service future potential debt, are limited by the earnings of our subsidiaries and their payment of their earnings to us in the form of management fees, commissions, dividends, loans, advances or the reimbursement of expenses. These payments can be made only when our subsidiaries have adequate earnings. In addition, dividend payments made to us by our insurance subsidiary is restricted by Florida law governing the insurance industry. Generally, Florida law limits the dividends payable by insurance companies under complicated formulas based on the subsidiary's available capital and earnings.

The Board of Directors of FNHC declared a regular quarterly dividend of \$0.03 per common share payable on June 3, 2013 to shareholders of record as of May 6, 2013. This is an increase of 50% over the previously declared regular quarterly dividends of \$0.02 per common share payable on March 4, 2013 and December 28, 2012 to shareholders of record as of February 4, 2013 and December 3, 2012, respectively. This action reflects both our commitment to returning capital to our shareholders and the Board's confidence in our business plan."



In the first quarter of 2010 we paid quarterly dividends of \$0.06 per share. No further dividends were paid in 2010 or 2011 pursuant to applicable regulatory requirements and our Consent Order with the Florida OIR (see “Regulation – Consent Order”), which required that the Company not expend capital on the payment of dividends or the buyback of the Company’s common stock until FNIC experiences two consecutive quarters with an underwriting profit; hence no additional dividends were paid during 2011 or 2010.

Payment of dividends in the future will depend on our earnings and financial position and such other factors, as our Board of Directors deems relevant. Moreover, our ability to continue to pay dividends may be restricted by regulatory limits on the amount of dividends that FNIC is permitted to pay to the parent company.

ITEM 1BUNRESOLVED STAFF COMMENTS

None

- 30 -

---

Table of Contents

## Federated National Holding Company

## ITEM 2 PROPERTIES

Relative to the Company's commitments stemming from operational matters, on or about March 1, 2006 we sold our interest in the building which housed our operations in Lauderdale Lakes through December 16, 2011, to an unrelated party. As part of this transaction, we agreed to lease the same facilities for a five-year term. We amended the lease agreement and the note receivable on September 1, 2010. As part of the amendment, we discounted the note receivable and have discontinued the interest on the note. In consideration, we paid a reduced lease payment for the remainder of the lease. Our lease for this office space expired in December 2011.

Our executive offices are now located at 14050 N.W. 14th Street, Suite 180, Sunrise, Florida 33323 in an 18,500 square foot office facility. All of our operations are consolidated within this facility. We believe that the facilities are well maintained, in substantial compliance with environmental laws and regulations, and adequately covered by insurance. We also believe that these leased facilities are not unique and could be replaced, if necessary, at the end of the lease term. Our lease for this office space will expire in May 2017.

## ITEM 3 LEGAL PROCEEDINGS

See Item 8 of Part II, "Financial Statements and Supplementary Data – Footnote 9 – Commitments and Contingencies".

## ITEM 4 MINE SAFETY DISCLOSURES

Not applicable.

## PART II

ITEM MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND  
ISSUER PURCHASES OF EQUITY SECURITIES

Our common stock is listed for trading on The NASDAQ Global Market under the symbol "FNHC". The following table sets out the high and low closing sale prices as reported on The NASDAQ Global Market. These reported prices reflect inter-dealer prices without adjustments for retail markups, markdowns or commissions.

Quarter Ended	High	Low
March 31, 2012	\$ 4.50	\$ 3.02
June 30, 2012	\$ 4.99	\$ 3.81
September 30, 2012	\$ 6.20	\$ 4.25
December 31, 2012	\$ 6.37	\$ 3.02
March 31, 2011	\$ 3.46	\$ 3.07
June 30, 2011	\$ 3.05	\$ 2.58
September 30, 2011	\$ 2.80	\$ 2.30
December 31, 2011	\$ 2.96	\$ 2.32

As of March 15, 2013, there were 25 holders of record of our common stock. We believe that the number of beneficial owners of our common stock is in excess of 2,700.

## DIVIDENDS

The Board of Directors of FNHC declared a regular quarterly dividend of \$0.03 per common share payable on June 3, 2013 to shareholders of record as of May 6, 2013. This is an increase of 50% over the previously declared regular quarterly dividends of \$0.02 per common share payable on March 4, 2013 and December 28, 2012 to shareholders of record as of February 4, 2013 and December 3, 2012, respectively. This action reflects both our commitment to returning capital to our shareholders and the Board's confidence in our business plan."

In the first quarter of 2010 we paid quarterly dividends of \$0.06 per share. No further dividends were paid in 2010 or 2011 pursuant to applicable regulatory requirements and our Consent Order with the Florida OIR (see "Regulation – Consent Order"), which required that the Company not expend capital on the payment of dividends or the buyback of the Company's common stock until FNHC experiences two consecutive quarters with an underwriting profit; hence no additional dividends were paid during 2011 or 2010.

- 31 -

---

Table of Contents

## Federated National Holding Company

Payment of dividends in the future will depend on our earnings and financial position and such other factors, as our Board of Directors deems relevant. Moreover, our ability to continue to pay dividends may be restricted by regulatory limits on the amount of dividends that FNHC is permitted to pay to the parent company.

## SECURITIES AUTHORIZED FOR ISSUANCE UNDER EQUITY COMPENSATION PLANS

The following table summarizes our equity compensation plans as of December 31, 2012. All equity compensation plans were approved by our shareholders. We have not granted any options, warrants or rights to our shareholders outside of these equity compensation plans.

Plan category	Equity Compensation Plan Information		Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a))
	Number of securities to be issued upon exercise of outstanding options, warrants and rights (a)	Weighted-average exercise price of outstanding options, warrants and rights (b)	
Equity compensation plans approved by stock holders*	781,097	5.93	1,000,000

\* Includes options from the 1998 Stock Option Plan, the 2002 Stock Option Plan and the 2012 Stock Option Plan.

For additional information concerning our capitalization please see Footnote 14 to our Consolidated Financial Statements included under Item 8 of this Annual Report on Form 10-K.

## ISSUER REPURCHASES

During 2012 and 2011, the Company did not repurchase any common stock under previously announced stock repurchase plans.

## SALES OF UNREGISTERED SECURITIES

None.

## ITEM 6 SELECTED FINANCIAL DATA

The following selected consolidated financial data should be read in conjunction with the consolidated financial statements and notes thereto and "Management's Discussion and Analysis of Financial Condition and Results of Operations" appearing elsewhere in this Annual Report on Form 10-K.

Table of Contents

## Federated National Holding Company

As of the Years Ended December 31,  
(Amounts in Thousands except Book Value Per Share)

	2012	2011	2010	2009	2008
Balance Sheet Data					
Total assets	\$185,888	\$179,980	\$184,049	\$202,889	\$197,102
Investments	130,096	129,467	122,485	114,219	26,065
Cash and short term investments	21,143	15,205	16,206	28,197	124,577
Total liabilities	119,983	121,836	126,118	135,447	120,871
Unpaid losses and LAE	49,908	59,983	66,529	70,611	64,775
Unearned premiums	59,006	47,933	47,136	50,857	40,508
Total shareholders' equity	65,905	58,144	57,931	67,442	76,231
Book value per share	\$8.26	\$7.32	\$7.29	\$8.48	\$9.51

Table of Contents

## Federated National Holding Company

Years Ended December 31,  
(Amounts in Thousands except EPS and Dividends)

	2012	2011	2010	2009	2008
Operations Data:					
Revenue:					
Gross premiums written	\$119,459	\$98,269	\$96,410	\$104,379	\$88,248
Gross premiums ceded	(51,085 )	(46,293 )	(52,963 )	(56,217 )	(34,553 )
Net premiums written	68,374	51,976	43,447	48,162	53,695
Increase (decrease) in prepaid reinsurance premiums	2,059	(2,656 )	(2,108 )	10,163	(4,451 )
(Increase) decrease in unearned premiums	(11,074 )	(797 )	3,721	(10,349 )	15,886
Net change in prepaid reinsurance premiums and unearned premiums	(9,015 )	(3,453 )	1,613	(186 )	11,435
Net premiums earned	59,359	48,523	45,060	47,976	65,130
Commission income	1,377	994	1,388	1,362	1,612
Finance revenue	496	518	395	294	350
Managing general agent fees	2,007	1,583	1,609	1,620	1,745
Net investment income	3,819	4,079	3,726	3,397	6,461
Net realized investment gains (losses)	1,072	2,725	6,777	1,117	(10,593 )
Regulatory assessments recovered	-	109	857	2,333	2,104
Other income	517	1,632	792	755	655
Total revenue	68,647	60,163	60,604	58,854	67,464
Expenses:					
Losses and LAE	30,209	30,896	40,088	43,706	41,869
Operating and underwriting expenses	9,996	9,916	10,835	9,681	7,209
Salaries and wages	8,439	8,004	8,611	7,930	7,428
Policy acquisition costs - amortization	13,255	12,347	13,025	13,747	14,760
Total expenses	61,899	61,163	72,559	75,064	71,266
Income (loss) before provision for income tax	6,748	(1,000 )	(11,955 )	(16,210 )	(3,802 )

expense (benefit)

Provision for income tax expense (benefit)	2,435	(570 )	(3,959 )	(5,921 )	(1,324 )
--	-------	--------	----------	----------	----------

Net income (loss)	\$4,313	\$(430 )	\$(7,996 )	\$(10,289 )	\$(2,478 )
-------------------	---------	----------	------------	-------------	------------

## Earnings per share data

Net income (loss) per share - basic	\$0.53	\$(0.05 )	\$(1.01 )	\$(1.29 )	\$(0.31 )
-------------------------------------	--------	-----------	-----------	-----------	-----------

Net income (loss) per share - diluted	\$0.53	\$(0.05 )	\$(1.01 )	\$(1.29 )	\$(0.31 )
---------------------------------------	--------	-----------	-----------	-----------	-----------

Dividends paid per share	\$0.02	\$-	\$0.06	\$0.36	\$0.72
--------------------------	--------	-----	--------	--------	--------

- 34 -

Table of Contents

Federated National Holding Company  
Management's Discussion and Analysis of Financial Condition and Results of Operations

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

OVERVIEW

We are an insurance holding company that controls substantially all steps in the insurance underwriting, distribution and claims processes through our subsidiaries and our contractual relationships with our independent agents and general agents.

We are authorized to underwrite, and/or place through our wholly owned subsidiaries, homeowners' multi-peril ("homeowners"), commercial general liability, federal flood, personal auto and various other lines of insurance in Florida and various other states. We market and distribute our own and third-party insurers' products and our other services through a network of independent agents. We also utilize a select number of general agents for the same purpose.

Our primary insurance subsidiary is Federated National Insurance Company ("FNIC"). FNIC is licensed as an admitted carrier in Florida. An admitted carrier is an insurance company that has received a license from the state insurance regulator for authority to write specific lines of insurance in that state. Through contractual relationships with a network of approximately 3,000 independent agents, of which approximately 900 actively sell and service our products, FNIC is authorized to underwrite homeowners', commercial general liability, fire, allied lines and personal and commercial automobile insurance in Florida. FNIC is also licensed as an admitted carrier in Alabama, Louisiana, Georgia and Texas, and underwrites commercial general liability insurance in those states and personal automobile insurance in Georgia and Texas.

FNIC operates as a non-admitted carrier in Arkansas, California, Kentucky, Maryland, Missouri, Nevada, Oklahoma, South Carolina, Tennessee and Virginia, and can underwrite commercial general liability insurance in all of these states. A non-admitted carrier, sometimes referred to as a "excess and surplus lines" carrier, is permitted to do business in a state and, although it is strictly regulated to protect policyholders from a variety of illegal and unethical practices, including fraud, non-admitted carriers are subject to considerably less regulation with respect to policy rates and forms. Non-admitted carriers are not required to financially contribute to and benefit from the state guarantee fund, which is used to pay for losses if an insurance carrier becomes insolvent or unable to pay the losses due their policyholders.

In January 2011, we merged FNIC and our other wholly owned insurance subsidiary, American Vehicle Insurance Company ("American Vehicle"), with FNIC continuing the operations of both entities. In connection with this merger, the Company, FNIC and American Vehicle entered into a Consent Order with the Florida Office of Insurance Regulation ("Florida OIR") pursuant to which we agreed to certain restrictions on our business operations. The Consent Order was amended in February 2013 to lessen or eliminate certain of the original requirements, due to FNIC's statutory underwriting profit during 2012. See "Regulation– Consent Order."

We internally process claims made by our insureds through our wholly owned claims adjusting company, Federated National Adjusting, Inc. ("FNA"), formerly known as Superior Adjusting, Inc. Until June 2011, we offered premium financing to our own and third-party insureds through our wholly owned subsidiary, Federated Premium Finance, Inc. ("Federated Premium").



Federated National Underwriters, Inc. ("FNU"), formerly known as Assurance Managing General Agents, a wholly owned subsidiary of the Company, acts as FNIC's exclusive managing general agent in Florida and is also licensed as a managing general agent in the States of Alabama, Georgia, Illinois, Louisiana, North Carolina, Mississippi, Missouri, New York, Nevada, South Carolina, Texas and Virginia. FNU has contracted with several unaffiliated insurance companies to sell commercial general liability, workers compensation, personal umbrella, inland marine and other various lines of insurance through FNU's existing network of agents.

FNU earns commissions and fees for providing policy administration, marketing, accounting and analytical services, and for participating in the negotiation of reinsurance contracts. FNU earns a \$25 per policy fee, and traditionally a 6% commission fee from its affiliate, FNIC. During the fourth quarter of 2010, FNU, pursuant to the Consent Order as discussed above, reduced its fee, to earn amounts varying between 2% and 4%, which we anticipate will return to 6% at an unknown future date with approval from the Florida OIR. A formal agreement reflecting this fee modification was executed during January 2011.

Although we are authorized to underwrite the various lines described above, our business is primarily underwriting homeowners' policies. During 2012, 85.3%, 7.8%, 4.4% and 2.5% of the premiums we underwrote were for homeowners', commercial general liability, federal flood, and personal automobile insurance, respectively. During 2011, 81.8%, 10.3%, 4.6% and 3.3% of the premiums we underwrote were for homeowners', commercial general liability, federal flood, and personal automobile insurance, respectively.

Table of Contents

Federated National Holding Company  
Management's Discussion and Analysis of Financial Condition and Results of Operations

During the years ended December 31, 2012, 2011 or 2010, we did not experience any weather-related catastrophic events such as the hurricanes that occurred in Florida during 2005 and 2004. We are not able to predict how hurricanes or other insurable events will affect our future results of operations and liquidity. Loss and loss adjustment expenses (“LAE”) are affected by a number of factors, many of which are partially or entirely beyond our control, including the following.

- the nature and severity of the loss;
- weather-related patterns;
- the availability, cost and terms of reinsurance;
- underlying settlement costs, including medical and legal costs;
- legal and political factors such as legislative initiatives and public opinion;
- macroeconomic issues.

Our business, results of operations and financial condition are subject to fluctuations due to a variety of factors. Abnormally high severity or frequency of claims in any period could have a material adverse effect on us. When our estimated liabilities for unpaid losses and LAE are less than the actuarially determined amounts, we increase the expense in the current period. Conversely, when our estimated liabilities for unpaid losses and LAE are greater than the actuarially determined amounts, we decrease the expense in the current period.

Our goal in our reinsurance strategy is to equalize the liquidity requirements imposed by most severe insurable events and by all other insurable events we manage in the normal course of business. Please see “Reinsurance Agreements” under “Item 1. Business” for a more detailed description of our reinsurance agreements and strategy.

**CRITICAL ACCOUNTING POLICIES**

The preparation of financial statements in conformity with Generally Accepted Accounting Principles (“GAAP”) requires management to make estimates and assumptions about future events that affect the amounts reported in the financial statements and accompanying notes. Future events and their effects cannot be determined with absolute certainty. Therefore, the determination of estimates requires the exercise of judgment. Actual results inevitably will differ from those estimates, and such differences may be material to the financial statements.

The most significant accounting estimates inherent in the preparation of our financial statements include estimates associated with management’s evaluation of the determination of (i) liability for unpaid losses and LAE, (ii) the amount and recoverability of amortization of Deferred Policy Acquisition Costs (“DPAC”), and (iii) estimates for our reserves with respect to finance contracts, premiums receivable and deferred income taxes. Various assumptions and other factors underlie the determination of these significant estimates, which are described in greater detail in Footnote 2 in this Form 10-K.

Except as described below, we believe that in 2012 there were no significant changes in those critical accounting policies and estimates. Senior management has reviewed the development and selection of our critical accounting policies and estimates and their disclosure in this Form 10-K with the Audit Committee of our Board of Directors.

The process of determining significant estimates is fact-specific and takes into account factors such as historical experience, current and expected economic conditions, and in the case of unpaid losses and LAE, an actuarial valuation. Management regularly reevaluates these significant factors and makes adjustments where facts and circumstances dictate. In selecting the best estimate, we utilize various actuarial methodologies. Each of these

methodologies is designed to forecast the number of claims we will be called upon to pay and the amounts we will pay on average to settle those claims. In arriving at our best estimate, our actuaries consider the likely predictive value of the various loss development methodologies employed in light of underwriting practices, premium rate changes and claim settlement practices that may have occurred, and weight the credibility of each methodology. Our actuarial methodologies take into account various factors, including, but not limited to, paid losses, liability estimates for reported losses, paid allocated LAE, salvage and other recoveries received, reported claim counts, open claim counts and counts for claims closed with and without payment for loss.

Accounting for loss contingencies pursuant to Financial Accounting Standards Board (“FASB”) issued guidance involves the existence of a condition, situation or set of circumstances involving uncertainty as to possible loss that will ultimately be resolved when one or more future event(s) occur or fail to occur. Additionally, accounting for a loss contingency requires management to assess each event as probable, reasonably possible or remote. Probable is defined as the future event or events are likely to occur. Reasonably possible is defined as the chance of the future event or events occurring is more than remote but less than probable, while remote is defined as the chance of the future event or events occurring is slight. An estimated loss in connection with a loss contingency shall be recorded by a charge to current operations if both of the following conditions are met: First, the amount can be reasonably estimated, and second, the information available prior to issuance of the financial statements indicates that it is probable that a liability has been incurred at the date of the financial statements. It is implicit in this condition that it is probable that one or more future events will occur confirming the fact of the loss or incurrence of a liability.

Table of Contents

Federated National Holding Company  
Management's Discussion and Analysis of Financial Condition and Results of Operations

FASB issued guidance addresses accounting and reporting for (a) investments in equity securities that have readily determinable fair values and (b) all investments in debt securities. The guidance requires that these securities be classified into one of three categories: Held-to-maturity, Trading, or Available-for-sale securities.

Investments classified as held-to-maturity include debt securities wherein the Company's intent and ability are to hold the investment until maturity. The accounting treatment for held-to-maturity investments is to carry them at amortized cost without consideration to unrealized gains or losses. Investments classified as trading securities include debt and equity securities bought and held primarily for the sale in the near term. The accounting treatment for trading securities is to carry them at fair value with unrealized holding gains and losses included in current period operations. Investments classified as available-for-sale include debt and equity securities that are not classified as held-to-maturity or as trading security investments. The accounting treatment for available-for-sale securities is to carry them at fair value with unrealized holding gains and losses excluded from earnings and reported as a separate component of shareholders' equity, namely "Other Comprehensive Income".

Overview of Management's Loss Reserving Process

The Company's loss reserves can generally be categorized into two distinct groups. One group is short-tail classes of business consisting principally of property risks in connection with homes and automobiles. The other group is long-tail casualty classes of business which include primarily commercial general liability and to a much lesser extent, homeowner and automobile liability. For operations writing short-tail coverages our loss reserves were generally geared toward determining an expected loss ratio for current business rather than maintaining a reserve for the outstanding exposure. Estimations of ultimate net loss reserves for long-tail casualty classes of business is a more complex process and depends on a number of factors including class and volume of business involved. Experience in the more recent accident years of long-tail casualty classes of business shows limited statistical credibility in reported net losses because a relatively low proportion of net losses would be reported claims and expenses and even smaller percentage would be net losses paid. Therefore, incurred but not yet reported ("IBNR") would constitute a relatively high proportion of net losses.

Additionally, the different methodologies are utilized the same, regardless of the line of business. However, the final selection of ultimate loss and LAE is certain to vary by both line of business and by accident period maturity. There is no prescribed combination of line of business, accident year maturity, and methodologies; consistency in results of the different methodologies and reasonableness of the result are the primary factors that drive the final selection of ultimate loss and LAE.

Methods Used to Estimate Loss and LAE Reserves

The methods we use for our short-tail business do not differ from the methods we use for our long-tail business. The Incurred and Paid Development Methods intrinsically recognize the unique development characteristics contained within the historical experience of each material short-tail and long-tail line of business. The Incurred and Paid Cape Cod Methods reflect similar historical development unique to each material short-tail and long-tail line of business.

We apply the following general methods in projecting loss and LAE reserves:

- Paid and Incurred Loss Development Method
- Paid and Incurred Bornhuetter-Ferguson Incurred Method

- Frequency / Severity Method

Table of Contents

Federated National Holding Company  
Management's Discussion and Analysis of Financial Condition and Results of Operations

Description of Ultimate Loss Estimation Methods

The estimated Ultimate Loss and Defense and Cost Containment Expense ("DCCE") is based on an analysis by line of business, coverage and by accident quarter performed using data as of December 31, 2012. The analysis relies primarily on four actuarial methods: Incurred Loss and DCCE Development Method, Paid Loss and DCCE Development Method, Bornhuetter-Ferguson Incurred Method, and Bornhuetter-Ferguson Paid Method. Each method relies on company experience, and, where relevant, the analysis includes comparisons to industry experience. The following is a description of each of these methods:

**Incurred Loss and DCCE Development Method** – This reserving method is based on the assumption that the historical incurred loss and DCCE development pattern as reflected by the Company is appropriate for estimating the future loss & DCCE development. Incurred paid plus case amounts separated by accident quarter of occurrence and at quarterly evaluations are used in this analysis. Case reserves do not have to be adequately stated for this method to be effective; they only need to have a fairly consistent level of adequacy at all stages of maturity. Historical "age-to-age" loss development factors were calculated to measure the relative development of an accident quarter from one maturity point to the next. Loss and DCCE development factors ("LDF") are selected based on a review of the historical relationships between incurred loss & DCCE at successive valuations and based on industry patterns. The LDFs are multiplied together to derive cumulative LDF's that, when multiplied by actual incurred loss and DCCE, produce estimates of ultimate loss and DCCE.

**Paid Loss & DCCE Development Method** – This method is similar to the Incurred Loss & DCCE Development Method only paid loss & DCCE and paid patterns are substituted for the incurred loss & DCCE and incurred patterns.

**Bornhuetter-Ferguson Incurred Method** – This reserving method combines estimated initial expected unreported loss & DCCE with the actual loss & DCCE to yield the ultimate loss & DCCE estimate. Expected unreported loss & DCCE are equal to expected total loss & DCCE times the expected unreported percentage of loss & DCCE for each policy year. The incurred loss & DCCE emergence pattern used to determine the unreported percentages in our projections is based on the selected LDF's from the Incurred Loss & DCCE Development Method described above. The estimate of initial expected total loss & DCCE is based on the historical loss ratio for more mature accident years. While this approach reduces the independence of the Bornhuetter-Ferguson Method from the loss & DCCE development methods for older policy years, it is used primarily for estimating ultimate loss & DCCE for more recent, less mature, policy years.

**Bornhuetter-Ferguson Paid Method** – This method is similar to the Bornhuetter-Ferguson Incurred Method only paid loss & DCCE and paid patterns are substituted for the incurred loss & DCCE and incurred patterns.

We select an estimate of ultimate loss & DCCE for each accident quarter after considering the results of each projection method for the quarter and the relative maturity of the quarter (the time elapsed between the start of the quarter and December 31, 2012). Reserves for unpaid losses & DCCE for each quarter are the differences between these ultimate estimates and the amount already paid. The reserves for each quarter and each coverage are summed, and the result is the overall estimate of unpaid losses & DCCE liability for the company.

We also produce an estimate of unpaid Adjusting and Other Expense ("A&O"), as a reserve is required under Statutory Accounting Principles ("SAP") even if this expense has been pre-paid or with an unconsolidated affiliate. Although we do not prepay for A&O, the majority of the A&O incurred is with an affiliated company and eliminated under the accounting principles for consolidation. The unpaid A&O is added to unpaid losses & DCCE, resulting in total unpaid

losses and LAE.

The validity of the results from using a loss development approach can be affected by many conditions, such as internal claim department processing changes, a shift between single and multiple claim payments, legal changes, or variations in a company's mix of business from year to year. Also, since the percentage of losses paid for immature years is often low, development factors can be volatile. A small variation in the number of claims paid can have a leveraging effect that could lead to significant changes in estimated ultimate values. Accordingly, our reserves are estimates because there are uncertainties inherent in the determination of ultimate losses. Court decisions, regulatory changes and economic conditions can affect the ultimate cost of claims that occurred in the past as well as create uncertainties regarding future loss cost trends. We compute our estimated ultimate liability using the most appropriate principles and procedures applicable to the lines of business written. However, because the establishment of loss reserves is an inherently uncertain process, we cannot be certain that ultimate losses will not exceed the established loss reserves and have a material adverse effect on our results of operations and financial condition.

- 38 -

---

Table of Contents

Federated National Holding Company  
Management's Discussion and Analysis of Financial Condition and Results of Operations

Frequency / Severity Method – This method separately estimates the two components of ultimate losses (the frequency, or number of claims and the severity, or cost per claim) and then combines the resulting estimates in a multiplicative fashion to estimate ultimate losses. The approach is valuable because sometimes there is more inherent stability in the frequency and severity data when viewed separately than in the total losses.

We developed reported claim counts to ultimate levels using the development approach. The mechanics of this approach are the same as we described previously for paid and incurred losses. The validity of the results of this method depends on the stability of claim reporting and settlement rates. Then we developed accident year incurred severities (incurred losses divided by reported claim counts) to ultimate levels using the development approach.

We trended these severities to accident year 2012 levels. Trend rates were selected based on a review of historical severities. Selected severity was chosen based on judgment considering the developed severities and the trended severities, considering industry benchmarks for each segment. The loss & ALAE, claim count and severity triangles are evaluated as of 12 months, 24 months, 36 months etc. We selected loss development factors based on the loss development history, to the extent credible, and supplemented with industry data where appropriate.

A key assumption underlying the estimation of the reserve for loss and LAE is that past experience serves as the most reliable estimator of future events. This assumption may materially affect the estimates when the insurance market, the regulatory environment, the legal environment, the economic environment, the book of business, the claims handling department, or other factors (known or unknown) have varied over time during the experience period and / or will vary (expectedly or unexpectedly) in the future. Changes in estimates, or differences between estimates and amounts ultimately paid, are reflected in the operating results of the period during which such adjustments are made. Therefore, the ultimate liability for unpaid losses and LAE will likely differ from the amount recorded at December 31, 2012.

The following describes the extent of our procedures for determining the reserve for loss and LAE on both an annual and interim reporting basis:

Annually - Our policy is to select a single point estimate that best reflects our in-house actuarial determination for unpaid losses and LAE. Our independent actuarial firm, examining the exact same data set, will independently select a point estimate which determines a high point and low point range. Both processes rely on objective and subjective determinations. If our point estimate falls within the range determined from the point estimate of our actuary, then the Company's policy has been that no adjustments by management would be required. In consideration thereof, the company does not have a policy for adjusting the liability for unpaid losses and LAE to an amount that is different than an amount set forth within the range determined by our independent actuary, although the reserve level ultimately determined by us may not be the mid-point of our independent actuary's range. Further, there can be no assurances that our actual losses will be within our actuary's range. Our independent actuary's report expressly states that the report is based on assumptions developed from its own analysis and based on information provided by management and that notwithstanding its analysis, there is a significant risk of material adverse deviation from its range.

Interim – During 2012 our interim approach was very similar to the annual process noted above.

A number of other actuarial assumptions are generally made in the review of reserves for each class of business.

For each class of business, expected ultimate loss ratios for each accident year are estimated based on loss reserve development patterns. The expected loss ratio generally reflects the projected loss ratio from prior accident years,



adjusted for the loss trend and the effect of rate changes and other quantifiable factors on the loss ratio.

In practice there are factors that change over time; however, many (such as inflation) are intrinsically reflected in the historical development patterns, and others typically do not materially affect the estimate of the reserve for unpaid losses and LAE. Therefore, no specific adjustments have been incorporated for such contingencies projecting future development of losses and LAE. There are no key assumptions as of December 31, 2012 premised on future emergence inconsistent with historical loss reserve development patterns.

- 39 -

---

Table of Contents

Federated National Holding Company  
Management's Discussion and Analysis of Financial Condition and Results of Operations

The table below distinguishes total loss reserves between IBNR, as discussed above, and case estimates for specific claims as established by routine claims management.

Reserves for unpaid loss and LAE net of reinsurance recoverable as of December 31, 2012	Case Loss Reserves	Case LAE Reserves	Total Case Reserves (Dollars in Thousands)	IBNR Reserves (Including LAE)	Reinsurance Recoverable on Unpaid Loss and Expenses	Net Reserves
Homeowners'	\$6,295	\$1,430	\$7,725	\$8,855	\$ 141	\$16,439
Commercial General Liability	1,197	1,509	2,706	22,677	77	25,306
Automobile	3,456	133	3,589	4,259	3,285	4,563
Fire	5	7	12	83	-	95
Inland Marine	-	-	-	2	-	2
<b>Total</b>	<b>\$10,953</b>	<b>\$3,079</b>	<b>\$14,032</b>	<b>\$35,876</b>	<b>\$ 3,503</b>	<b>\$46,405</b>

Reserves for unpaid loss and LAE net of reinsurance recoverable as of December 31, 2011	Case Loss Reserves	Case LAE Reserves	Total Case Reserves (Dollars in Thousands)	IBNR Reserves (Including LAE)	Reinsurance Recoverable on Unpaid Loss and Expenses	Net Reserves
Homeowners'	\$6,719	\$1,571	\$8,290	\$12,328	\$ 480	\$20,138
Commercial General Liability	2,369	1,606	3,975	28,089	(190 )	32,254
Automobile	3,428	113	3,541	3,511	1,797	5,255
Fire	8	2	10	238	-	248
Inland Marine	-	-	-	1	-	1
<b>Total</b>	<b>\$12,524</b>	<b>\$3,292</b>	<b>\$15,816</b>	<b>\$44,167</b>	<b>\$ 2,087</b>	<b>\$57,896</b>

Table of Contents

Federated National Holding Company  
Management's Discussion and Analysis of Financial Condition and Results of Operations

Our reported results, financial position and liquidity would be affected by likely changes in key assumptions that determine our net loss reserves. The table below illustrates the change to equity that would occur as a result of a change in loss and LAE reserves, net of reinsurance.

Change in loss and LAE reserves, net of reinsurance	Years Ended December 31,							
	2012				2011			
		Adjusted loss and LAE reserves, net of reinsurance	Percentage change in equity (1)		Adjusted loss and LAE reserves, net of reinsurance	Percentage change in equity (1)		
			(Dollars in Thousands)					
-10.0	%	41,764	4.5	%	52,107	4.3	%	
-7.5	%	42,925	3.4	%	53,554	3.2	%	
-5.0	%	44,085	2.3	%	55,001	2.1	%	
-2.5	%	45,245	1.1	%	56,449	1.1	%	
Base		46,405	-		57,896	-		
2.5	%	47,565	-1.1	%	59,344	-1.1	%	
5.0	%	48,725	-2.3	%	60,791	-2.1	%	
7.5	%	49,885	-3.4	%	62,238	-3.2	%	
10.0	%	51,045	-4.5	%	63,686	-4.3	%	

## (1) Net of tax

For the year ended December 31, 2012, our actuarial firm determined range of statutory loss and LAE reserves on a net basis range from a low of \$42.2 million to a high of \$53.7 million, with a best estimate of \$45.4 million. The Company's net loss and LAE reserves are carried on a statutory basis at \$44.7 million, and on a GAAP consolidated basis at \$49.9 million which when netted with our \$3.5 million reinsurance recoverable totals \$46.4 million. The Company's statutory point estimate for its reserves as of December 31, 2012 is 1.5% below our actuary's best estimate, which reflects management's current analysis of the status and expected timing of our anticipated claims, our analysis of expected weather patterns in the regions in which we sell policies, our re-focus of our business growth efforts to areas outside of South Florida, and other factors.

We are required to review the contractual terms of all our reinsurance purchases to ensure compliance with FASB issued guidance. The guidance establishes the conditions required for a contract with a reinsurer to be accounted for as reinsurance and prescribes accounting and reporting standards for those contracts. Contracts that do not result in the reasonable possibility that the reinsurer may realize a significant loss from the insurance risk assumed generally do not meet the conditions for reinsurance accounting and must be accounted for as deposits. The guidance also requires us to disclose the nature, purpose and effect of reinsurance transactions, including the premium amounts associated with reinsurance assumed and ceded. It also requires disclosure of concentrations of credit risk associated with reinsurance receivables and prepaid reinsurance premiums.

Please see Footnote 2 of the Notes to Consolidated Financial Statements for additional discussions regarding critical accounting policies.

## RECENT ACCOUNTING PRONOUNCEMENTS

See Note 2(n), “Summary of Significant Accounting Policies – Recent Accounting Pronouncements” in the Notes to the Condensed Consolidated Financial Statements for a discussion of recent accounting pronouncements and their effect, if any, on the Company.

Table of Contents

Federated National Holding Company  
Management's Discussion and Analysis of Financial Condition and Results of Operations

## ANALYSIS OF FINANCIAL CONDITION

As of December 31, 2012 Compared with December 31, 2011

## Total Investments

Total investments increased \$0.6 million, or 0.5%, to \$130.1 million as of December 31, 2012, compared with \$129.5 million as of December 31, 2011.

We account for our investment securities consistent with FASB issued guidance that requires our securities to be classified into one of three categories: (i) held-to-maturity, (ii) trading securities or (iii) available-for-sale.

Investments classified as held-to-maturity include debt securities wherein the Company's intent and ability are to hold the investment until maturity and are carried at amortized cost without consideration to unrealized gains or losses. Investments classified as trading securities include debt and equity securities bought and held primarily for sale in the near term and are carried at fair value with unrealized holding gains and losses included in current period operations. Investments classified as available-for-sale include debt and equity securities that are not classified as held-to-maturity or as trading security investments and are carried at fair value with unrealized holding gains and losses excluded from earnings and reported as a separate component of shareholders' equity, namely "Other Comprehensive Income."

The debt and equity securities that are available for sale and carried at fair value represent 94% of total investments as of December 31, 2012, compared with 94% as of December 31, 2011.

We did not hold any trading investment securities during 2012.

As of December 31, 2012 and 2011, our investments consisted primarily of corporate bonds held in various industries, municipal bonds and United States government bonds. As of December 31, 2012, 69% of our debt portfolio was in diverse industries and 31% is in United States government bonds. As of December 31, 2012, approximately 87% of our equity holdings were in equities related to diverse industries and 13% were in mutual funds. As of December 31, 2011, 61% of our debt portfolio was in diverse industries and 39% is in United States government bonds. As of December 31, 2011, approximately 83% of our equity holdings were in equities related to diverse industries and 17% were in mutual funds.

Below is a summary of net unrealized gains and losses at December 31, 2012 and December 31, 2011 by category.

	Unrealized Gains and (Losses)	
	December 31, 2012	December 31, 2011
	(Dollars in Thousands)	
Debt securities:		
United States government obligations and authorities	\$567	\$659
Obligations of states and political subdivisions	201	138
Corporate	3,760	1,543
International	106	5
	4,634	2,345

Equity securities:		
Common stocks	1,887	(939 )
Total debt and equity securities	\$6,521	\$1,406

The net unrealized gain of \$6.5 million is inclusive of \$0.7 million of unrealized losses. The \$0.7 million of unrealized losses is inclusive of \$0.6 million unrealized losses from equity securities and \$0.1 million unrealized losses from debt securities.

The \$0.6 million of unrealized losses from equity securities is from common stocks and mutual funds held in diverse industries as of December 31, 2012. The Company evaluated the near-term prospects in relation to the severity and duration of the impairment. Based on this evaluation and the Company's ability and intent to hold these investments for a reasonable period of time sufficient for a forecasted recovery of fair value, the Company does not consider these investments to be other-than-temporarily impaired at December 31, 2012.

Table of Contents

Federated National Holding Company  
Management's Discussion and Analysis of Financial Condition and Results of Operations

The \$0.1 million of unrealized losses from debt securities is related to US government bonds. The Company does not expect to settle at prices less than the amortized cost basis. The Company does not consider these investments to be other-than-temporarily impaired at December 31, 2012 because we neither currently intend to sell these investments nor consider it likely that we will be required to sell these investments before recovery of the amortized cost basis.

FASB has also issued guidance regarding when an investment is considered impaired, whether that impairment is other-than temporary, and the measurement of an impairment loss. Management periodically reviews the individual investments that comprise our portfolio in order to determine whether a decline in fair value below our cost either is other-than temporarily or permanently impaired. Factors used in such consideration include the extent and length of time over which the market value has been less than cost, the financial condition and near-term prospects of the issuer and our ability and intent to keep the investment for a period sufficient to allow for an anticipated recovery in market value. In reaching a conclusion that a security is either other-than-temporarily or permanently impaired, we also consider such factors as the timeliness and completeness of expected dividends, principal and interest payments, ratings from nationally recognized statistical rating organizations such as Standard and Poor's ("S&P") and Moody's Investors Service, Inc. ("Moody's"), as well as information released via the general media channels. During 2012, in connection with the process, we have charged to operations \$44,000 of investment losses. During 2011, in connection with the process, we have charged to operations \$0.8 million of investment losses.

As of December 31, 2012 and December 31, 2011, all of our securities are in good standing and not impaired, except as noted above.

The Company records the unrealized gains, net of estimated income taxes, that are associated with that part of our portfolio classified as available-for-sale through the shareholders' equity account titled "Other Comprehensive Income".

The following table summarizes, by type, our investments as of December 31, 2012 and 2011.

	December 31, 2012			December 31, 2011		
	Carrying Amount	Percent of Total		Carrying Amount	Percent of Total	
			(Dollars in Thousands)			
Debt securities, at market:						
United States government obligations and authorities	\$27,392	21.06	%	\$37,217	28.75	%
Obligations of states and political subdivisions	3,939	3.03	%	2,303	1.77	%
Corporate	67,313	51.74	%	63,268	48.87	%
International	3,111	2.39	%	1,523	1.18	%
	101,755	78.22	%	104,311	80.57	%
Debt securities, at amortized cost:						
United States government obligations and authorities	6,016	4.62	%	6,166	4.76	%
Corporate	1,203	0.92	%	962	0.74	%
International	140	0.11	%	-	0.00	%
	7,359	5.65	%	7,128	5.50	%
Total debt securities	109,114	83.87	%	111,439	86.07	%
Equity securities, at market:	20,982	16.13	%	18,028	13.93	%
Total investments	\$130,096	100.00	%	\$129,467	100.00	%





Table of Contents

Federated National Holding Company  
Management's Discussion and Analysis of Financial Condition and Results of Operations

Debt securities are carried on the balance sheet at market. At December 31, 2012 and 2011, debt securities had the following quality ratings by S&P and for securities not assigned a rating by S&P, Moody's or Fitch ratings were used.

	December 31, 2012			December 31, 2011		
	Carrying Amount	Percent of Total		Carrying Amount	Percent of Total	
			(Dollars in Thousands)			
AAA	\$10,967	10.05	%	\$48,686	43.69	%
AA	38,733	35.50	%	6,712	6.02	%
A	31,774	29.12	%	31,960	28.68	%
BBB	27,640	25.33	%	22,193	19.92	%
Not rated	-	0.00	%	1,888	1.69	%
	\$109,114	100.00	%	\$111,439	100.00	%

The following table summarizes, by maturity, the debt securities as of December 31, 2012 and 2011.

	December 31, 2012			December 31, 2011		
	Carrying Amount	Percent of Total		Carrying Amount	Percent of Total	
			(Dollars in Thousands)			
Matures In:						
One year or less	\$2,938	2.70	%	\$8,328	7.47	%
One year to five years	51,439	47.14	%	48,176	43.24	%
Five years to 10 years	37,111	34.01	%	37,380	33.54	%
More than 10 years	17,626	16.15	%	17,555	15.75	%
Total debt securities	\$109,114	100.00	%	\$111,439	100.00	%

At December 31, 2012, the weighted average maturity of the debt portfolio was approximately 6.2 years.

As of December 31, 2012 and December 31, 2011, we have classified \$7.4 million and \$7.1 million, respectively, of our bond portfolio as held-to-maturity. We classify bonds as held-to-maturity to support securitization of credit requirements.

During 2012 or 2011, we did not re-classify any of our bond portfolio between available-for-sale and held-to-maturity.

Two reinsurers require FNIC to maintain securities with a fair market value of \$4.6 million. As of December 31, 2012, FNIC maintained fully funded trust agreements that totaled \$4.8 million in favor of the reinsurers. As of December 31, 2011, FNIC maintained fully funded trust agreement that totaled \$4.6 million in favor of the reinsurers.

During April 2006, American Vehicle finalized a \$15.0 million irrevocable letter of credit in conjunction with the 100% Quota Share Reinsurance Agreement with Republic Underwriters Insurance Company ("Republic") which was terminated in April 2007. During 2010, the letter of credit in favor of Republic was replaced by a fully funded trust agreement. As of December 31, 2012 and 2011 respectively, the amount held in trust was \$1.0 million.

## Cash and Short-Term Investments

Cash and short-term investments, which include cash, certificates of deposits, and money market accounts, increased \$5.9 million, or 39.0%, to \$21.1 million as of December 31, 2012, compared with \$15.2 million as of December 31, 2011. The increase in cash and short-term investments is for a planned reinsurance payment. We evaluate our asset class allocation on an ongoing basis continually adjust based on economic and business risk.

#### Prepaid Reinsurance Premiums

Prepaid reinsurance premiums decreased \$1.3 million, or 15.5%, to \$7.0 million as of December 31, 2012, compared with \$8.3 million as of December 31, 2011. We believe concentrations of credit risk associated with our prepaid reinsurance premiums are not significant.

- 44 -

---

Table of Contents

Federated National Holding Company  
Management's Discussion and Analysis of Financial Condition and Results of Operations

Premiums Receivable, Net of Allowance for Credit Losses

Premiums receivable, net of allowance for credit losses, increased \$2.4 million, or 42.9%, to \$8.0 million as of December 31, 2012, compared with \$5.6 million as of December 31, 2011.

Our homeowners' insurance premiums receivable increased \$2.3 million, or 60.0%, to \$6.0 million as of December 31, 2012, compared with \$3.7 million as of December 31, 2011.

Our commercial general liability insurance premiums receivable decreased \$0.7 million, or 58.9%, to \$0.5 million as of December 31, 2012, compared with \$1.2 million as of December 31, 2011.

Premiums receivable in connection with our automobile line of business increased \$0.9 million, or 112.2%, to \$1.7 million as of December 31, 2012, compared with \$0.8 million as of December 31, 2011.

Our allowance for credit losses remained unchanged at \$0.1 million as of December 31, 2012, compared with \$0.1 million as of December 31, 2011.

	Years Ended December 31,	
	2012	2011
	(Dollars in Thousands)	
Allowance for credit losses at beginning of year	\$73	\$68
Additions charged to bad debt expense	161	115
Write-downs charged against the allowance	(165)	(110)
Allowance for credit losses at end of year	\$69	\$73

Reinsurance Recoverable, Net

Reinsurance recoverable, net, increased \$1.4 million, or 67.8%, to \$3.5 million as of December 31, 2012, compared with \$2.1 million as of December 31, 2011. The change is due to the payment patterns by our reinsurers, as influenced by the diminishing catastrophe related claims. All amounts are current and deemed collectable. We believe concentrations of credit risk associated with our reinsurance recoverables, net, are not significant.

DPAC

DPAC increased \$0.8 million, or 9.9%, to \$8.5 million as of December 31, 2012, compared with \$7.7 million as of December 31, 2011. The change is due to the deferral of the actual policy acquisition costs, including commissions, payroll and premium taxes, less commissions earned on reinsurance ceded and policy fees earned. An analysis of deferred acquisition costs follows.

	Years Ended December 31,	
	2012	2011
	(Dollars in Thousands)	

Balance, beginning of year	\$7,718	\$7,879
Acquisition costs deferred	14,016	12,186
Amortization expense during year	(13,255 )	(12,347 )
Balance, end of year	\$8,479	\$7,718

## Deferred Income Taxes, Net

Deferred income taxes, net, decreased \$4.3 million, or 49.6%, to \$4.3 million as of December 31, 2012, compared with \$8.6 million as of December 31, 2011. Deferred income taxes, net, is comprised of approximately \$10.1 million and \$12.1 million of deferred tax assets, net of approximately \$5.7 million and \$3.5 million of deferred tax liabilities as of December 31, 2012 and December 31, 2011. The change in the net deferred tax asset is primarily due to the decrease in the deferred tax assets related to unpaid losses and loss adjustment expenses, allowance for impairments and net operating losses carry forward.

Table of Contents

Federated National Holding Company  
Management's Discussion and Analysis of Financial Condition and Results of Operations

	Years Ended December 31,	
	2012	2011
Deferred tax assets:		
Unpaid losses and loss adjustment expenses	\$1,725	\$2,385
Unearned premiums	2,629	1,950
Discount on advance premiums	167	195
Allowance for credit losses	31	34
Allowance for impairments	91	317
FIGA Guaranty Assessment	306	-
Depreciation & amortization	366	317
Reserve for claims settlements	809	809
NOL Carryforward	3,259	5,696
AMT credit	253	-
Stock option expense per ASC 718	432	410
Total deferred tax assets	10,068	12,113
Deferred tax liabilities:		
Deferred acquisition costs, net	(3,191 )	(2,905 )
Dividends Collected vs. Earned	(18 )	-
Regulatory assessments	(67 )	(67 )
Unrealized Gain on investment securities	(2,454 )	(529 )
Total deferred tax liabilities	(5,730 )	(3,501 )
Net deferred tax asset	\$4,338	\$8,612

## Income Taxes Receivable

Income taxes receivable remained unchanged at nearly nothing as of December 31, 2012, compared with nothing as of December 31, 2011.

The Company's consolidated federal and state income tax returns for 2009–2011 are open for review by the Internal Revenue Service ("IRS") and various state taxing authorities. The 2012 federal and state income tax returns have been extended and will be filed by the extended due date in Q3 of 2013. The 2005 and 2006 income tax returns and net operating loss carry-back from tax year 2009 have been reviewed by the Joint Committee on Taxation. The Joint Committee on Taxation completed its consideration in September 2011 and took no exception to the conclusions reached by the IRS regarding the net operating loss carry-back from tax year 2009.

## Property, Plant and Equipment, net

Property, plant and equipment, net decreased \$0.2 million, or 33.0%, to \$0.6 million as of December 31, 2012, compared with \$0.8 million as of December 31, 2011. The change is due to our sale of a previously occupied retail facility.

Table of Contents

## Federated National Holding Company

## Management's Discussion and Analysis of Financial Condition and Results of Operations

## Other Assets

Other assets increased \$0.6 million, or 26.9%, to \$2.7 million as of December 31, 2012, compared with \$2.1 million as of December 31, 2011. Major components of other assets are shown in the following table; the accrued interest income receivable is primarily investment related.

	December 31, 2012	December 31, 2011
	(Dollars in Thousands)	
Accrued interest income receivable	\$966	\$1,130
Deposits	249	185
Prepaid expenses	478	432
Receivable for investments sold	598	-
Other	367	347
Total	\$2,658	\$2,094

## Unpaid Losses and LAE

Unpaid losses and LAE decreased \$10.1 million, or 16.8%, to \$49.9 million as of December 31, 2012, compared with \$60.0 million as of December 31, 2011. The composition of unpaid losses and LAE by product line is as follows.

	December 31, 2012			December 31, 2011		
	Case	Bulk	Total	Case	Bulk	Total
	(Dollars in Thousands)			(Dollars in Thousands)		
Homeowners'	\$8,276	\$6,637	\$14,913	\$8,795	\$10,652	\$19,447
Commercial General Liability	2,956	22,310	25,266	4,225	27,717	31,942
Automobile	3,643	6,086	9,729	3,533	5,061	8,594
Total	\$14,875	\$35,033	\$49,908	\$16,553	\$43,430	\$59,983

Please see "Liability for Unpaid Losses and LAE" under "Item 1. Business" for a discussion of the factors that affect unpaid losses and LAE.

## Unearned Premium

Unearned premiums increased \$11.1 million, or 23.1%, to \$59.0 million as of December 31, 2012, compared with \$47.9 million as of December 31, 2011. The change was due to a \$10.9 million increase in unearned homeowners' insurance premiums, a \$0.5 million increase in unearned flood insurance premiums, a \$0.2 million decrease in unearned commercial general liability premiums, and a \$0.1 million decrease in unearned automobile insurance premiums. Generally, as is in this case, an increase in unearned premium directly relates to an increase in written premium on a rolling twelve-month basis.

## Premium Deposits and Customer Credit Balances

Premium deposits and customer credit balances decreased \$0.3 million, or 12.4%, to \$2.5 million as of December 31, 2012, compared with \$2.8 million as of December 31, 2011. Premium deposits are monies received on policies not yet in-force as of December 31, 2012.

#### Bank Overdraft

Bank overdraft decreased \$1.9 million, or 24.5%, to \$6.0 million as of December 31, 2012, compared with \$7.9 million as of December 31, 2011. The bank overdraft relates primarily to losses and LAE disbursements paid but not presented for payment by the policyholder or vendor. The change relates to the timing of presentation of claims checks to the issuing bank.

Table of ContentsFederated National Holding Company  
Management's Discussion and Analysis of Financial Condition and Results of Operations

## Accounts Payable and Accrued Expenses

Accounts payable and accrued expenses decreased \$0.5 million, or 15.6%, to \$2.6 million as of December 31, 2012, compared with \$3.1 million as of December 31, 2011. The change from prior year is primarily due to the timing of payments with our trade vendors.

## Results of Operations

## Year Ended December 31, 2012 Compared with Year Ended December 31, 2011

Effective January 26, 2011, FNIC merged with and into American Vehicle, and the resulting entity changed its name to "Federated National Insurance Company".

## Gross Premiums Written

Gross premiums written increased \$21.2 million, or 21.6%, to \$119.5 million for 2012, compared with \$98.3 million for 2011. The following table denotes gross premiums written by major product line. This increase reflected primarily an increase in the sale of homeowners' policies.

	Years Ended December 31,			
	2012		2011	
	(Dollars in Thousands)			
	Amount	Percentage	Amount	Percentage
Homeowners'	\$ 101,832	85.24 %	\$ 80,402	81.82 %
Commercial General Liability	9,338	7.82 %	10,125	10.30 %
Federal Flood	5,293	4.43 %	4,468	4.55 %
Automobile	2,996	2.51 %	3,274	3.33 %
Gross written premiums	\$ 119,459	100.00 %	\$ 98,269	100.00 %

The increase in the sale of homeowners' policies by \$21.4 million, or 26.7%, to \$101.8 million in 2012, compared with \$80.4 million in 2011, is gross of reinsurance costs and net of Florida's mandated homeowners' wind mitigation discounts. We offer premium discounts for wind mitigation efforts by policyholders, as required by Florida law. As of December 31, 2012, 72.7% of our in-force homeowners' policyholders were receiving wind mitigation credits totaling approximately \$61.1 million (a 37.4% reduction of in-force premium), while 63.5% of our in-force homeowners' policyholders were receiving wind mitigation credits totaling approximately \$31.5 million, (a 28.6 % reduction of in-force premium), as of December 31, 2011.

During 2012 and 2011, the change to the cumulative wind mitigation credits afforded our policyholders totaled \$29.6 million and \$4.2 million, respectively.

These premium discounts have had a significant effect on both written and earned premium. Wind mitigation credits are 37.4% of the pre-credit premium, or \$61.1 million, as of December 31, 2012, as compared with 28.6% of the pre-credit premium, or \$31.5 million, as of December 31, 2011.



Our in-force homeowners' policies increased by approximately 17,300, or approximately 40%, to approximately 61,100 as of December 31, 2012, as compared with approximately 43,800 as of December 31, 2011.

We received approval from the Florida OIR in 2010 for a premium rate increase for our voluntary homeowners' program within the State of Florida. That premium rate increase averaged approximately 20.2% and was implemented for policies with effective dates as soon as permitted following approval. In addition, in 2010 we received approval from the Florida OIR for a premium rate increase of approximately 15% for homeowners policies assumed from Citizens Property Insurance Corporation ("Citizens") in Florida beginning July 2010. In February 2012, we received approval from the Florida OIR of a 14.1% rate increase. That rate increase, together with our 2011 rate increase for our voluntary property book of homeowners' business averaged 20.2% statewide, and our assumed property book of homeowners' business, averaged 13.9% statewide.

Table of ContentsFederated National Holding Company  
Management's Discussion and Analysis of Financial Condition and Results of Operations

Our earnings can also be impacted by our ratings, such as the rating of FNIC by Demotech, Inc. ("Demotech"). FNIC's rating as of December 31, 2012 was "A" ("Exceptional"). For more information regarding our rating and the impact of a change or withdrawal of our rating, please see "Business-Regulation-Industry Rating Services."

The Company's sale of commercial general liability policies decreased by \$0.8 million to \$9.3 million for 2012, compared with \$10.1 million for 2011. The primary factor for this decrease has been improvements to our underwriting standards and our decision to restrict underwriting authority within specific commercial general liability classes and geographic areas.

The following table sets forth the amounts and percentages of our gross premiums written in connection with our commercial general liability program by state.

State	Years Ended December 31,		2011	
	2012		Amount	Percentage
	Amount	Percentage	Amount	Percentage
	(Dollars in Thousands)			
Florida	\$8,639	92.52 %	\$8,606	84.99 %
Louisiana	217	2.32 %	916	9.05 %
Texas	426	4.56 %	534	5.28 %
Other	56	0.60 %	69	0.68 %
Total	\$9,338	100.00 %	\$10,125	100.00 %

We are required to report write-your-own flood premiums on a direct and 100% ceded basis.

The Company's sale of auto insurance policies decreased to \$3.0 million for 2012, compared with \$3.3 million for 2011. The Company's sale of auto insurance included new and renewal policies in 2012 and only renewal policies in 2011.

## Gross Premiums Ceded

Gross premiums ceded increased to \$51.1 million for 2012, compared with \$46.3 million for 2011. Gross premiums ceded relating to our homeowners', commercial general liability, write-your-own flood and automobile programs totaled \$43.3 million, \$0.5 million, \$5.3 million and \$2.0 million for 2012. Gross premiums ceded relating to our homeowners', write-your-own flood and automobile programs totaled \$40.3 million, \$4.5 million and \$1.5 million for 2011. The increase to gross premiums ceded relating to our homeowners' program is due to higher gross premium written, net of a reduced marginal cost of reinsurance purchased from the Florida Hurricane Catastrophe Fund ("FHCF"). We are required to report write-your-own flood premiums on a direct and 100% ceded basis.

## Increase (Decrease) in Prepaid Reinsurance Premiums

The increase in prepaid reinsurance premiums was \$2.1 million in 2012, compared with a \$2.7 million decrease in 2011. The benefit to written premium is associated with the timing of our reinsurance payments measured against the term of the underlying reinsurance policies.

## Increase in Unearned Premiums

The increase in unearned premiums was \$11.1 million for 2012, compared with \$0.8 million for 2011. The 2012 charge to written premium was due to a \$10.9 million increase in unearned homeowners' insurance premiums, a \$0.5 million increase in unearned flood premiums, a \$0.1 million decrease in unearned automobile premiums and a \$0.2 million decrease in unearned commercial general liability premiums during 2012. These changes are a result of differences in written premium volume during this period as compared with the same period last year. See "Gross Premiums Written" above.

- 49 -

---

Table of ContentsFederated National Holding Company  
Management's Discussion and Analysis of Financial Condition and Results of Operations

## Net Premiums Earned

Net premiums earned increased \$10.9 million, or 22.3%, to \$59.4 million for 2012, compared with \$48.5 million for 2011. The following table denotes net premiums earned by product line.

	Years Ended December 31,					
	2012		2011			
	Amount	Percentage	Amount	Percentage		
	(Dollars in Thousands)					
Homeowners'	\$49,209	82.90	%	\$35,785	73.75	%
Commercial General Liability	9,196	15.49	%	10,632	21.91	%
Automobile	954	1.61	%	2,106	4.34	%
Net premiums earned	\$59,359	100.00	%	\$48,523	100.00	%

The \$13.4 million increase in homeowners' net premiums earned is due to a \$21.4 million increase in gross written premium as discussed, a \$3.1 million increase in gross premiums ceded and a \$4.9 million increase in the net change to prepaid reinsurance premiums and unearned premium.

The \$1.4 million decrease in commercial general liability net premiums earned is a result of a \$0.8 million decrease in gross written premium, reflecting the impact our decision to restrict underwriting authority within specific commercial general liability classes and geographic areas. The change is also a result of a \$0.4 million increase in gross premiums ceded and a \$0.2 million decrease in the net change to unearned premium.

The \$1.1 million decrease in automobile net premiums earned is a result of a \$0.3 million decrease in gross written premium as discussed, a \$0.4 million increase in gross premiums ceded and a \$0.4 million decrease in the net change to prepaid reinsurance premiums and unearned premium.

## Commission Income

Commission income increased \$0.4 million, or 38.5%, to \$1.4 million for 2012, compared with \$1.0 million for 2011. The primary sources of our commission income are our managing general agent services, write-your-own flood premiums and our independent insurance agency, Insure-Link, Inc. ("Insure-Link").

## Managing General Agent Fees

Managing general agent fees increased \$0.4 million, or 26.8%, to \$2.0 million for 2012, compared with \$1.6 million for 2011. The change is attributed to the increase in gross premiums written during this same period.

## Net Investment Income

Net investment income decreased \$0.3 million, or 6.4%, to \$3.8 million for 2012, compared with \$4.1 million for 2011. Our investment yield, net and gross of investment expenses, excluding equities and including cash, was 2.5% and 2.8%, respectively, for 2012. Our investment yield, net and gross of investment expenses, excluding equities and including cash, was 2.9% and 3.1%, respectively, for 2011.

Our investment yield, net and gross of investment expenses measured against debt securities, excluding equities and cash, was 2.6% and 2.9%, respectively, for 2012. The primary reason for our lower investment yield in 2012 was the result of the Federal Reserve's activity in the bond market, which pushed up bond prices and lowered yields. Our investment yield, net and gross of investment expenses measured against debt securities, excluding equities and cash, was 3.1% and 3.4%, respectively, for 2011.

See also “Analysis of Financial Condition As of December 31, 2012 Compared with December 31, 2011 – Investments” for a further discussion on our investment portfolio.

- 50 -

---

Table of Contents

Federated National Holding Company  
Management's Discussion and Analysis of Financial Condition and Results of Operations

## Net Realized Investment Gains

Net realized investment gains were \$1.1 million for 2012, compared with \$2.7 million for 2011. Specifically, net realized losses for equity securities were \$0.3 million for 2012 and 2011. For debt securities, net realized gains were \$1.4 million for 2012, compared with \$3.0 million for 2011. During 2011, the Company, because of the actions taken by the Federal Reserve to maintain a low interest rate environment, realized significant gains in the fixed income portfolio.

FASB has issued guidance regarding when an investment is considered impaired, whether that impairment is other-than temporary, and the measurement of an impairment loss. Management periodically reviews the individual investments that comprise our portfolio in order to determine whether a decline in fair value below our cost either is other-than temporarily or permanently impaired. During 2012, pursuant to guidelines prescribed in FASB issued guidance, we have charged to operations, realized investment losses of \$44,000. The charges relate to common stock held in diverse industries; during 2011, pursuant to guidelines prescribed in FASB issued guidance, we charged to operations, realized investment losses of \$0.8 million. In reaching a conclusion that a security is either other than temporarily or permanently impaired we consider such factors as the timeliness and completeness of expected dividends, principal and interest payments, ratings from nationally recognized statistical rating organizations such as S&P and Moody's, as well as information released via the general media channels.

The table below depicts the net realized investment gains by investment category during 2012 and 2011.

	Years Ended December	
	31,	
	2012	2011
	(Dollars in Thousands)	
Realized gains:		
Debt securities	\$1,783	\$3,569
Equity securities	1,403	1,240
Total realized gains	3,186	4,809
Realized losses:		
Debt securities	(391 )	(595 )
Equity securities	(1,723 )	(1,489 )
Total realized losses	(2,114 )	(2,084 )
Net realized gains on investments	\$1,072	\$2,725

## Other Income

Other income decreased \$1.1 million, or 68.3%, to \$0.5 million for 2012, compared with \$1.6 million for 2011. Sources of other income for 2012 include the reconciliation of outstanding checks in connection with our accounting for unclaimed property and the recovery of a receivable written off in a prior year. Sources of other income for 2011 include the reconciliation of outstanding checks in connection with our accounting for unclaimed property and the final recognition of our gain on the sale of our Lauderdale Lakes property.

## Losses and LAE

Losses and LAE, our most significant expense, represent actual payments made and changes in estimated future payments to be made to or on behalf of our policyholders, including expenses required to settle claims and losses. We revise our estimates based on the results of analysis of estimated future payments to be made. This process assumes that experience, adjusted for the effects of current developments and anticipated trends, is an appropriate basis for predicting future events.

Losses and LAE decreased by \$0.7 million, or 2.2%, to \$30.2 million for 2012, compared with \$30.9 million for 2011. The overall change includes a \$4.8 million increase in our homeowners' program, a \$3.4 million decrease in our commercial general liability program and a \$2.1 million decrease in connection with our automobile program.

- 51 -

---

Table of Contents

Federated National Holding Company  
Management's Discussion and Analysis of Financial Condition and Results of Operations

The composition of unpaid losses and LAE by product line is as follows.

	December 31, 2012			December 31, 2011		
	Case	Bulk	Total	Case	Bulk	Total
	(Dollars in Thousands)					
Homeowners'	\$8,276	\$6,637	\$14,913	\$8,795	\$10,652	\$19,447
Commercial General Liability	2,956	22,310	25,266	4,225	27,717	31,942
Automobile	3,643	6,086	9,729	3,533	5,061	8,594
Total	\$14,875	\$35,033	\$49,908	\$16,553	\$43,430	\$59,983

Please see "Liability for Unpaid Losses and LAE" under "Item 1 Business" for a discussion of the factors that affect unpaid losses and LAE.

Management revises its estimates based on the results of its analysis. This process assumes that experience, adjusted for the effects of current developments and anticipated trends, is an appropriate basis for estimating the ultimate settlement of all claims. There is no precise method for subsequently evaluating the impact of any specific factor on the adequacy of the reserves, because the eventual redundancy or deficiency is affected by multiple factors. Because of our process, reserves were decreased by approximately \$10.1 million during 2012. This overall change includes a \$4.5 million decrease in reserves for our homeowners' program, a \$6.7 million decrease in reserves for our commercial general liability program and a \$1.1 million increase in reserves for our automobile program. The decreases are due to favorable experience based in part on enhanced underwriting and claim processing techniques.

Our loss ratio is computed as losses and LAE divided by net premiums earned. A lower loss ratio generally results in higher operating income. Our loss ratio for 2012 was 50.9% compared with 63.7% for the same period in 2011. The favorable decrease to our loss ratio is due to the \$0.7 million decrease in losses and LAE measured against the \$10.9 million increase in net premium earned during 2012 as compared with the same period in 2011.

The table below reflects the loss ratios by product line.

	Years Ended December	
	31, 2012	2011
Homeowners'	51.85 %	57.79 %
Commercial		
General Liability	32.85 %	60.11 %
Automobile	175.17 %	181.67 %
All lines	50.89 %	63.67 %

#### Operating and Underwriting Expenses

Operating and underwriting expenses increased \$0.1 million, or 0.8%, to \$10.0 million for 2012, compared with \$9.9 million for 2011.

#### Salaries and Wages



Salaries and wages increased \$0.4 million, or 5.4%, to \$8.4 million for 2012, compared with \$8.0 million for 2011. The charge to operations for stock-based compensation, in accordance with FASB guidance, was approximately \$0.3 million during 2012, compared with approximately \$0.2 million for 2011.

Policy Acquisition Costs - Amortization

Policy acquisition costs - amortization, increased \$1.0 million, or 7.4%, to \$13.3 million for 2012, compared with \$12.3 million for 2011.

Policy acquisition costs - amortization, consists of the actual policy acquisition costs, including commissions, payroll and premium taxes, less commissions earned on reinsurance ceded and policy fees earned.

Table of Contents

Federated National Holding Company  
Management's Discussion and Analysis of Financial Condition and Results of Operations

## Provision for Income Tax Expense (Benefit)

The provision for income tax expense was \$2.4 million for 2012, compared with a benefit of \$0.6 million for 2011. The effective rate for income taxes was 36.1% for 2012, compared with 57.0% for 2011. The 2011 57.0% effective rate reflects the true-up of the 2010 tax return permanent differences.

## Net Income (Loss)

As a result of the foregoing, the Company's net income for 2012 was \$4.3 million, compared with net loss of \$0.4 million for 2011.

## Results of Operations

Year Ended December 31, 2011 Compared with Year Ended December 31, 2010

Effective January 26, 2011, FNIC merged with and into American Vehicle, and the resulting entity changed its name to "Federated National Insurance Company".

## Gross Premiums Written

Gross premiums written increased \$1.9 million, or 1.9%, to \$98.3 million for 2011, compared with \$96.4 million for 2010. The following table denotes gross premiums written by major product line. This increase reflected primarily an increase in the sale of homeowners' policies.

	Years Ended December 31,				
	2011		2010		
	(Dollars in Thousands)				
	Amount	Percentage		Amount	Percentage
Homeowners'	\$80,402	81.82 %		\$76,844	79.70 %
Commercial General Liability	10,125	10.30 %		11,894	12.34 %
Federal Flood	4,468	4.55 %		3,951	4.10 %
Automobile	3,274	3.33 %		3,721	3.86 %
Gross written premiums	\$98,269	100.00 %		\$96,410	100.00 %

The increase in the sale of homeowners' policies by \$3.6 million, or 4.6%, to \$80.4 million in 2011, compared with \$76.8 million in 2010, is gross of reinsurance costs and net of Florida's mandated homeowners' wind mitigation discounts. We offer premium discounts for wind mitigation efforts by policyholders, as required by Florida law. As of December 31, 2011, 63.5% of our in-force homeowners' policyholders were receiving wind mitigation credits totaling approximately \$31.5 million (a 28.6% reduction of in-force premium), while 60.1% of our in-force homeowners' policyholders were receiving wind mitigation credits totaling approximately \$27.3 million, (a 26.0% reduction of in-force premium), as of December 31, 2010.

During 2011 and 2010, the change to the cumulative wind mitigation credits afforded our policyholders totaled \$4.2 million and (\$0.3) million, respectively.

These premium discounts have had a significant effect on both written and earned premium. Wind mitigation credits are 28.6% of the pre-credit premium, or \$31.5 million, as of December 31, 2011, as compared with 26.0% of the pre-credit premium, or \$27.3 million, as of December 31, 2010.

Our in-force homeowners' policies increased by approximately 700, or approximately 2.0%, to approximately 43,800 as of December 31, 2011, as compared with approximately 43,100 as of December 31, 2010.

We received approval from the Florida OIR in 2009 and 2010 for a premium rate increases for our voluntary homeowners' program within the State of Florida. These premium rate increases averaged approximately 19% in 2009 and 20.2% in 2010 and were implemented for policies with effective dates as soon as permitted following approval. In addition, in 2010 we received approval from the Florida OIR for a premium rate increase of approximately 15% for homeowners policies assumed from Citizens in Florida beginning July 2010. In February 2012, we received approval from the Florida OIR of a 14.1% rate increase. That rate increase, together with our 2011 rate increases for our voluntary property book of homeowners' business, averaging 20.2% statewide, and our assumed property book of homeowners' business, averaging 13.9% statewide, gained momentum and accreted throughout 2012.

Table of Contents

Federated National Holding Company  
Management's Discussion and Analysis of Financial Condition and Results of Operations

Our earnings can also be impacted by our ratings, such as the rating of FNIC by Demotech. FNIC's rating as of December 31, 2011 was "A" ("Exceptional"). For more information regarding our rating and the impact of a change or withdrawal of our rating, please see "Business-Regulation-Industry Rating Services."

The Company's sale of commercial general liability policies decreased by \$1.8 million to \$10.1 million for 2011, compared with \$11.9 million for 2010. The primary factor for this decrease has been improvements to our underwriting standards and our decision to restrict underwriting authority within specific commercial general liability classes and geographic areas.

The following table sets forth the amounts and percentages of our gross premiums written in connection with our commercial general liability program by state.

State	Years Ended December 31,			
	2011		2010	
	Amount	Percentage	Amount	Percentage
	(Dollars in Thousands)			
Florida	\$8,606	84.99 %	\$9,972	83.85 %
Louisiana	916	9.05 %	1,094	9.19 %
Texas	534	5.28 %	665	5.59 %
Other	69	0.68 %	163	1.37 %
<b>Total</b>	<b>\$10,125</b>	<b>100.00 %</b>	<b>\$11,894</b>	<b>100.00 %</b>

We are required to report write-your-own flood premiums on a direct and 100% ceded basis.

The Company's sale of auto insurance policies decreased to \$3.3 million for 2011, compared with \$3.7 million 2010. The Company's sale of auto insurance included only renewal policies in 2011 , and new and renewal policies in 2010.

#### Gross Premiums Ceded

Gross premiums ceded decreased to \$46.3 million for 2011, compared with \$53.0 million for 2010. Gross premiums ceded relating to our homeowners', write-your-own flood and automobile programs totaled \$40.3 million, \$4.5 million and \$1.5 million for 2011. Gross premiums ceded relating to our homeowners', commercial general liability, write-your-own flood and automobile programs totaled \$46.9 million, \$0.2 million, \$4.0 million and \$1.9 million for 2010.

The decrease to gross premiums ceded relating to our homeowners' program is primarily due to the reduced cost of reinsurance purchased from the FHCF. The ceded relating to our automobile program is associated with our arrangement to write nonstandard private passenger automobile insurance through a reputable managing general agent familiar with the Georgia market. A quota share treaty cedes 100% of the risk and fully collateralizes for unearned premium and unpaid loss and LAE.

#### Decrease in Prepaid Reinsurance Premiums

The decrease in prepaid reinsurance premiums was \$2.7 million in 2011, compared with a \$2.1 million decrease in 2010. The increased charge to written premium is associated with the timing of our reinsurance payments measured

against the term of the underlying reinsurance policies.

(Increase) Decrease in Unearned Premiums

The increase in unearned premiums was \$0.8 million for 2011, compared with a \$3.7 million decrease for 2010. The 2011 charge to written premium was due to a \$1.5 million increase in unearned homeowners' insurance premiums, a \$0.3 million increase in unearned flood premiums, a \$0.4 million decrease in unearned automobile premiums and a \$0.6 million decrease in unearned commercial general liability premiums during 2011. These changes are a result of differences in written premium volume during this period as compared with the same period last year. See "Gross Premiums Written" above.

- 54 -

---

Table of Contents

Federated National Holding Company  
Management's Discussion and Analysis of Financial Condition and Results of Operations

## Net Premiums Earned

Net premiums earned increased \$3.4 million, or 7.7%, to \$48.5 million for 2011, compared with \$45.1 million for 2010. The following table denotes net premiums earned by product line.

	Years Ended December 31,			
	2011		2010	
	Amount	Percentage	Amount	Percentage
	(Dollars in Thousands)			
Homeowners'	\$35,785	73.75 %	\$30,040	66.67 %
Commercial General Liability	10,632	21.91 %	13,302	29.52 %
Automobile	2,106	4.34 %	1,718	3.81 %
Net premiums earned	\$48,523	100.00 %	\$45,060	100.00 %

The \$5.7 million increase in homeowners' net premiums earned is due to a \$3.6 million increase in gross written premium as discussed, a \$6.5 million decrease in gross premiums ceded and a \$4.4 million decrease in the net change to prepaid reinsurance premiums and unearned premium.

The \$2.7 million decrease in commercial general liability net premiums earned is a result of a \$1.8 million decrease in gross written premium, reflecting the impact our decision to restrict underwriting authority within specific commercial general liability classes and geographic areas. The change is also a result of a \$0.2 million decrease in gross premiums ceded and a \$1.1 million decrease in the net change to unearned premium.

The \$0.4 million increase in automobile net premiums earned is a result of a \$0.4 million decrease in gross written premium as discussed, a \$0.3 million decrease in gross premiums ceded and a \$0.5 million increase in the net change to prepaid reinsurance premiums and unearned premium.

## Commission Income

Commission income decreased \$0.4 million, or 28.4%, to \$1.0 million for 2011, compared with \$1.4 million for 2010. The primary sources of our commission income are our managing general agent services, write-your-own flood premiums and our independent insurance agency, Insure-Link.

## Net Investment Income

Net investment income increased \$0.4 million, or 9.5%, to \$4.1 million for 2011, compared with \$3.7 million for 2010. Our investment yield, net and gross of investment expenses, excluding equities and including cash, was 2.9% and 3.1%, respectively, for 2011. Our investment yield, net and gross of investment expenses, excluding equities and including cash, was 2.5% and 2.7%, respectively, for 2010.

Our investment yield, net and gross of investment expenses measured against debt securities, excluding equities and cash, was 3.1% and 3.4%, respectively, for 2011. The primary reason for our lower investment yield in 2011 was the Company harvested gains that were a result of the Federal Reserve's activity in the bond market, which pushed up bond prices and lowered yields. Hence the proceeds from recognizing the gains were reinvested at yields that were lower than what was sold. Our investment yield, net and gross of investment expenses measured against debt

securities, excluding equities and cash, was 3.4% and 3.7%, respectively, for 2010.

See also “Analysis of Financial Condition As of December 31, 2011 Compared with December 31, 2010 – Investments” for a further discussion on our investment portfolio.

#### Net Realized Investment Gains

Net realized investment gains were \$2.7 million for 2011, compared with net realized investment gains of \$6.8 million for 2010. Specifically, net realized losses for equity securities were \$0.3 million for 2011, compared with \$1.7 million net realized gains for 2010. For debt securities, net realized gains were nearly \$3.0 million for 2011, compared with net realized gains of \$4.0 million for 2010. During 2011, the Company, because of the actions taken by the Federal Reserve to maintain a low interest rate environment, realized significant gains in the fixed income portfolio. During 2010, the Company had an overweight position in corporate bonds that performed well and sold these bonds to lock in gains and bolster the surplus of our insurance companies.

- 55 -

---

Table of Contents

Federated National Holding Company  
Management's Discussion and Analysis of Financial Condition and Results of Operations

FASB has issued guidance regarding when an investment is considered impaired, whether that impairment is other-than temporary, and the measurement of an impairment loss. Management periodically reviews the individual investments that comprise our portfolio in order to determine whether a decline in fair value below our cost either is other-than temporarily or permanently impaired. During 2011, pursuant to guidelines prescribed in FASB issued guidance, we have charged to operations, realized investment losses of \$0.8 million. The charges relate to common stock held in diverse industries; during 2010, we did not mark any investments to market value pursuant to guidelines prescribed in FASB issued guidance. In reaching a conclusion that a security is either other than temporarily or permanently impaired we consider such factors as the timeliness and completeness of expected dividends, principal and interest payments, ratings from nationally recognized statistical rating organizations such as S&P and Moody's, as well as information released via the general media channels.

The table below depicts the net realized investment gains by investment category during 2011 and 2010.

	Years Ended December 31,	
	2011	2010
	(Dollars in Thousands)	
Realized gains:		
Debt securities	\$3,569	\$4,484
Equity securities	1,240	4,228
Total realized gains	4,809	8,712
Realized losses:		
Debt securities	(595 )	(209 )
Equity securities	(1,489 )	(1,726 )
Total realized losses	(2,084 )	(1,935 )
Net realized gains on investments	\$2,725	\$6,777

#### Other Income

Other income increased \$0.8 million, or 100.0%, to \$1.6 million for 2011, compared with \$0.8 million for 2010. The major components of other income for 2011 include \$1.1 million from the reconciliation of outstanding checks in connection with our accounting for unclaimed property and \$0.5 million in partial recognition of our gain on the sale of our Lauderdale Lakes property. The major components of other income for 2010 included approximately \$0.5 million in partial recognition of our gain on the sale of our Lauderdale Lakes property and \$0.3 million in recognition of our gain on the sale of a vacant retail property.

#### Losses and LAE

Losses and LAE, our most significant expense, represent actual payments made and changes in estimated future payments to be made to or on behalf of our policyholders, including expenses required to settle claims and losses. We revise our estimates based on the results of analysis of estimated future payments to be made. This process assumes that experience, adjusted for the effects of current developments and anticipated trends, is an appropriate basis for predicting future events.



Losses and LAE decreased by \$9.2 million, or 22.9%, to \$30.9 million for 2011, compared with \$40.1 million for 2010. The overall change includes a \$7.0 million decrease in our homeowners' program due to favorable experience based in part on enhanced underwriting and claim processing techniques. The overall change also includes a \$2.8 million decrease in our commercial general liability program and a \$0.6 million increase in connection with our automobile program.

- 56 -

---

Table of Contents

Federated National Holding Company  
Management's Discussion and Analysis of Financial Condition and Results of Operations

The composition of unpaid losses and LAE by product line is as follows.

	December 31, 2011			December 31, 2010		
	Case	Bulk	Total	Case	Bulk	Total
	(Dollars in Thousands)					
Homeowners'	\$8,795	\$10,652	\$19,447	\$5,825	\$16,847	\$22,672
Commercial General Liability	4,225	27,717	31,942	8,230	27,819	36,049
Automobile	3,533	5,061	8,594	3,447	4,361	7,808
Total	\$16,553	\$43,430	\$59,983	\$17,502	\$49,027	\$66,529

Please see "Liability for Unpaid Losses and LAE" under "Item 1 Business" for a discussion of the factors that affect unpaid losses and LAE.

Management revises its estimates based on the results of its analysis. This process assumes that experience, adjusted for the effects of current developments and anticipated trends, is an appropriate basis for estimating the ultimate settlement of all claims. There is no precise method for subsequently evaluating the impact of any specific factor on the adequacy of the reserves, because the eventual redundancy or deficiency is affected by multiple factors. Because of our process, reserves were decreased by approximately \$6.5 million during 2011. This overall change includes a \$3.2 million decrease in reserves for our homeowners' program, a \$4.1 million decrease in reserves for our commercial general liability program and a \$0.8 million increase in reserves for our automobile program. The decreases are due to favorable experience based in part on enhanced underwriting and claim processing techniques.

Our loss ratio is computed as losses and LAE divided by net premiums earned. A lower loss ratio generally results in higher operating income. Our loss ratio for 2011 was 63.7% compared with 89.0% for the same period in 2010. The favorable decrease to our loss ratio is due to the \$9.2 million decrease in losses and LAE measured against the \$3.5 million increase in net premium earned during 2011 as compared with the same period in 2010.

The table below reflects the loss ratios by product line.

	Years Ended December	
	31, 2011	2010
Homeowners'	57.79 %	92.06 %
Commercial		
General Liability	60.11 %	69.39 %
Automobile	181.67 %	186.30 %
All lines	63.67 %	88.96 %

For further discussion, see Footnote 6 to the Consolidated Financial Statements included under Part II, Item 8, of this Report.

#### Operating and Underwriting Expenses

Operating and underwriting expenses decreased \$0.9 million, or 8.5%, to \$9.9 million for 2011, compared with \$10.8 million for 2010. The decreases include \$0.4 million in surveys and underwriting reports, \$0.3 million in actuarial fees

and \$0.2 million in insurance expense.

#### Salaries and Wages

Salaries and wages decreased \$0.6 million, or 7.1%, to \$8.0 million for 2011, compared with \$8.6 million for 2010. The charge to operations for stock-based compensation, in accordance with FASB guidance, was approximately \$0.2 million during 2011, compared with approximately \$0.4 million for 2010.

#### Policy Acquisition Costs - Amortization

Policy acquisition costs - amortization, decreased \$0.7 million, or 5.2%, to \$12.3 million for 2011, compared with \$13.0 million for 2010.

- 57 -

---

Table of Contents

Federated National Holding Company  
Management's Discussion and Analysis of Financial Condition and Results of Operations

Policy acquisition costs - amortization, consists of the actual policy acquisition costs, including commissions, payroll and premium taxes, less commissions earned on reinsurance ceded and policy fees earned.

#### Provision for Income Tax Benefit

The provision for income tax benefit was \$0.6 million for 2011, compared with a \$4.0 million for 2010. The effective rate for income taxes was 57.0% for 2011, compared with 33.1% for 2010. The 57.0% effective rate reflects the true-up of the 2010 tax return permanent differences.

#### Net Loss

As a result of the foregoing, the Company's net loss in 2010 was \$8.0 million compared with \$10.3 million in 2009.

### CONTRACTUAL OBLIGATIONS

A summary of long-term contractual obligations as of December 31, 2012 follows. The amounts represent estimates of gross undiscounted amounts payable over time.

Contractual Obligations	Total	(Dollars in Thousands)				
		2013	2014	2015	2016	Thereafter
Unpaid Losses and LAE	\$49,908	\$29,626	\$11,933	\$5,490	\$1,916	\$943
Operating leases	1,687	373	380	388	395	151
<b>Total</b>	<b>\$51,595</b>	<b>\$29,999</b>	<b>\$12,313</b>	<b>\$5,878</b>	<b>\$2,311</b>	<b>\$1,094</b>

### LIQUIDITY AND CAPITAL RESOURCES

In 2012, our primary sources of capital included proceeds from the sale of investment securities, increased unearned premiums, decreased deferred income tax expense, amortization of investment premium discount, net, decreased prepaid reinsurance premiums, depreciation and amortization and non-cash compensation. Additional sources of capital included exercised stock options, a tax benefit related to non-cash compensation, purchases of property and equipment and an increased provision for uncollectible premiums receivable. Because we are a holding company, we are largely dependent upon fees and commissions from our subsidiaries for cash flow.

In 2012, net cash provided by operating activities was \$1.5 million. In 2011 and 2010, net cash provided and used by operating activities was \$4.1 million and \$6.6 million, respectively.

In 2012, operations generated \$20.8 million of gross cash flow, due to an \$11.1 million increase in unearned premiums, a \$2.3 million decrease in deferred income tax expense and \$1.4 million of amortization of investment premium discount, net. Additional sources of cash included a \$1.3 million decrease in prepaid reinsurance premiums, \$0.2 million depreciation and amortization and \$0.2 million non-cash compensation, all in conjunction with \$4.3 million of net income.

In 2012, operations used \$19.2 million of gross cash flow primarily due to a \$10.1 million decrease in unpaid losses and LAE, a \$2.4 million increase in premiums receivable, a \$1.9 million decrease in bank overdraft, a \$1.4 million increase in reinsurance recoverable, net, \$1.1 million of net realized investment gains and a \$0.8 million increase in policy acquisition costs, net of amortization. Additional uses of cash included a \$0.6 million increase in other assets, a

\$0.5 million decrease in accounts payable and accrued expenses, a \$0.3 million decrease in premium deposits and customer credit balances and a \$0.1 million decrease in income taxes payable.

In 2012, net cash provided by investing activities was \$4.3 million. In 2011 and 2010, net cash used by investing activities was \$5.2 million and \$5.1 million. Our available-for-sale investment portfolio is highly liquid as it consists entirely of readily marketable securities. In 2012, investing activities generated \$90.5 million and used \$86.2 million.

In 2012, net cash provided by financing activities was less than \$0.1 million. In 2011 and 2010, net cash provided and used by financing activities was less than \$0.1 million and \$0.4 million, respectively. In 2012, the sources of cash in connection with financing activities included \$0.1 million from exercised stock options and a \$0.1 million tax benefit related to non-cash compensation. In 2012, the use of cash in connection with financing activities was \$0.2 million of dividends paid.

Table of Contents

Federated National Holding Company  
Management's Discussion and Analysis of Financial Condition and Results of Operations

We offer direct billing in connection with our homeowners', commercial general liability and automobile programs. Direct billing is an agreement in which the insurance company accepts from the insured, as a receivable, a promise to pay the premium, as opposed to requiring the full amount of the policy at policy inception, either directly from the insured or from a premium finance company. The advantage of direct billing a policyholder by the insurance company is that we are not reliant on a credit facility, but remain able to charge and collect interest from the policyholder.

We believe that our current capital resources will be sufficient to meet currently anticipated working capital requirements. There can be no assurances, however, that such will be the case. We continue to evaluate our liquidity and the possibility that we may require additional working capital.

FNIC's statutory capital surplus as of December 31, 2012 was approximately \$52.1 million and its statutory net income in 2012 was \$6.6 million. FNIC's statutory capital surplus as of December 31, 2011 was approximately \$39.3 million and its statutory net income in 2011 was \$0.8 million.

As of December 31, 2012, 2011, and 2010, we did not have any relationships with unconsolidated entities or financial partnerships, such as entities often referred to as "structured finance" or "special purpose" entities, which were established for the purpose of facilitating off-balance-sheet arrangements or other contractually narrow or limited purposes. As such, management believes that we currently are not exposed to any financing, liquidity, market or credit risks that could arise if we had engaged in transactions of that type requiring disclosure herein.

#### IMPACT OF INFLATION AND CHANGING PRICES

The consolidated financial statements and related data presented in this Annual Report have been prepared in accordance with GAAP, which requires the measurement of financial position and operating results in terms of historical dollars without considering changes in the relative purchasing power of money over time due to inflation. Our primary assets and liabilities are monetary in nature. As a result, interest rates have a more significant impact on performance than the effects of general levels of inflation. Interest rates do not necessarily move in the same direction or with the same magnitude as the inflationary effect on the cost of paying losses and LAE.

Insurance premiums are established before we know the amount of losses and LAE and the extent to which inflation may affect such expenses. Consequently, we attempt to anticipate the future impact of inflation when establishing rate levels. While we attempt to charge adequate premiums, we may be limited in raising premium levels for competitive and regulatory reasons. Inflation may also affect the market value of our investment portfolio and the investment rate of return. Any future economic changes that result in prolonged and increasing levels of inflation could cause increases in the dollar amount of incurred losses and LAE and thereby materially adversely affect future liability requirements.

Table of Contents

Federated National Holding Company  
Management's Discussion and Analysis of Financial Condition and Results of Operations

## SELECTED QUARTERLY FINANCIAL DATA (Unaudited)

	Year Ended December 31, 2012 (Dollars in Thousands except EPS)			
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Revenue:				
Net premiums earned	\$12,818	\$14,693	\$15,088	\$16,760
Other revenue	1,925	2,130	2,173	3,060
Total revenue	14,743	16,823	17,261	19,820
Expenses:				
Losses and LAE	5,728	7,136	8,049	9,296
Other expenses	7,370	7,347	8,109	8,864
Total expenses	13,098	14,483	16,158	18,160
Income before provision for income tax expense	1,645	2,340	1,103	1,660
Provision for income tax expense	573	918	353	591
Net income	\$1,072	\$1,422	\$750	\$1,069
Basic net income per share	\$0.13	\$0.18	\$0.09	\$0.13
Fully diluted net income per share	\$0.13	\$0.18	\$0.09	\$0.13
Weighted average number of common shares outstanding	7,946	7,947	7,949	7,965
Weighted average number of common shares outstanding (assuming dilution)	7,962	7,994	8,042	8,096

Table of Contents

Federated National Holding Company  
Management's Discussion and Analysis of Financial Condition and Results of Operations

Year Ended December 31, 2011  
(Dollars in Thousands except EPS)

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Revenue:				
Net premiums earned	\$11,144	\$11,660	\$12,892	\$12,827
Other revenue	1,982	2,516	3,302	3,840
Total revenue	13,126	14,176	16,194	16,667
Expenses:				
Losses and LAE	8,447	7,818	7,852	6,779
Other expenses	7,852	7,474	7,800	7,141
Total expenses	16,299	15,292	15,652	13,920
(Loss) income before provision for income tax (benefit) expense	(3,173 )	(1,116 )	542	2,747
Provision for income tax (benefit) expense	(1,166 )	(311 )	114	793
Net (loss) income	\$(2,007 )	\$(805 )	\$428	\$1,954
Basic net (loss) income per share	\$(0.25 )	\$(0.10 )	\$0.05	\$0.25
Fully diluted net (loss) income per share	\$(0.25 )	\$(0.10 )	\$0.05	\$0.25
Weighted average number of common shares outstanding	7,946	7,946	7,946	7,946

## OFF BALANCE SHEET TRANSACTIONS

For the years ended December 31, 2012 and 2011, we had no off balance sheet transactions.



## Federated National Holding Company

## ITEM 7A QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK

Our investment objective is to maximize total rate of return after federal income taxes while maintaining liquidity and minimizing risk. Our current investment policy limits investment in non-investment-grade debt securities (including high-yield bonds), and limits total investments in preferred stock, common stock and mortgage notes receivable. We also comply with applicable laws and regulations that further restrict the type, quality and concentration of our investments. In general, these laws and regulations permit investments, within specified limits and subject to certain qualifications, in federal, state and municipal obligations, corporate bonds, preferred and common equity securities and real estate mortgages.

Our investment policy is established by the Board of Directors Investment Committee and is reviewed on a regular basis. Pursuant to this investment policy, as of December 31, 2012, approximately 86% of investments were in debt securities and cash and cash equivalents, which are considered to be either held until maturity or available for sale, based upon our estimates of required liquidity. Approximately 94% of the debt securities are considered available for sale and are marked to market. We may in the future consider additional debt securities to be held to maturity and carried at amortized cost. We do not use any swaps, options, futures or forward contracts to hedge or enhance our investment portfolio.

The following table provides information about the financial instruments as of December 31, 2012 that are sensitive to changes in interest rates. The table presents principal cash flows and the related weighted average interest rate by expected maturity date based upon par values.

	2013	2014	2015	2016	2017	Thereafter	Total
Principal amount by expected maturity:							
United States government obligations and authorities	\$1,603	\$600	\$1,160	\$435	\$918	\$11,653	\$16,369
Obligations of states and political subdivisions	350	-	-	195	350	2,700	3,595
Corporate securities	739	4,509	4,907	6,986	6,505	31,023	54,669
International securities	-	-	-	790	75	2,000	2,865
Collateralized mortgage obligations	223	965	7,462	11,215	458	0	20,323
Equity securities, at market	-	-	-	-	-	-	-
All investments	\$2,915	\$6,074	\$13,529	\$19,621	\$8,306	\$47,376	\$97,821
Weighted average interest rate by expected maturity:							
United States government obligations and authorities	3.53 %	1.51 %	0.35 %	2.16 %	0.72 %	2.35 %	2.54 %
Obligations of states and political subdivisions	2.04 %	0.00 %	0.00 %	1.60 %	1.65 %	4.14 %	3.75 %
Corporate securities	3.55 %	5.09 %	3.77 %	3.97 %	4.60 %	5.46 %	5.01 %
International securities	0.00 %	0.00 %	0.00 %	1.98 %	1.38 %	4.99 %	4.07 %
Collateralized mortgage obligations	5.07 %	4.59 %	4.54 %	4.57 %	3.50 %	0.00 %	4.60 %
Equity securities, at market	0.00 %	0.00 %	0.00 %	0.00 %	0.00 %	0.00 %	0.00 %
All investments	3.47 %	4.66 %	3.90 %	4.17 %	3.96 %	4.60 %	4.44 %



Table of Contents

Federated National Holding Company

ITEM 8 FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

	PAGE
Report of Independent Registered Public Accounting Firm	64
Consolidated Balance Sheets as of December 31, 2012 and 2011	65
Consolidated Statements of Operations For the years ended December 31, 2012, 2011 and 2010	66
Consolidated Statements of Comprehensive Income (Loss) For the years ended December 31, 2012, 2011 and 2010	67
Consolidated Statements of Changes in Shareholders' Equity and Comprehensive Loss For the years ended December 31, 2012, 2011 and 2010	68
Consolidated Statements of Cash Flows For the years ended December 31, 2012, 2011 and 2010	69
Notes to Consolidated Financial Statements	71

Table of Contents

Federated National Holding Company and Subsidiaries

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and

Stockholders of Federated National Holding Company

We have audited the accompanying consolidated balance sheets of Federated National Holding Company as of December 31, 2012 and 2011, and the related consolidated statements of income, comprehensive income, stockholders' equity and cash flows for each of the years in the three-year period ended December 31, 2012. Federated National Holding Company's management is responsible for these financial statements. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Federated National Holding Company as of December 31, 2012 and 2011, and the results of its operations and its cash flows for each of the years in the three-year period ended December 31, 2012 in conformity with accounting principles generally accepted in the United States of America.

De Meo Young McGrath

Boca Raton, FL

April 1, 2013

Table of Contents

Federated National Holding Company and Subsidiaries  
CONSOLIDATED BALANCE SHEETS  
DECEMBER 31, 2012 AND 2011

	Period Ending	
	December 31, 2012	December 31, 2011
ASSETS	(Dollars in Thousands)	
Investments		
Debt maturities, available for sale, at fair value	\$101,755	\$ 104,311
Debt maturities, held to maturity, at amortized cost	7,359	7,128
Equity securities, available for sale, at fair value	20,982	18,028
<b>Total investments</b>	<b>130,096</b>	<b>129,467</b>
Cash and short term investments	21,143	15,205
Prepaid reinsurance premiums	7,045	8,339
Premiums receivable, net of allowance for credit losses of \$69 and \$73, respectively	8,023	5,616
Reinsurance recoverable, net	3,503	2,087
Deferred policy acquisition costs	8,479	7,718
Deferred income taxes, net	4,338	8,612
Income taxes receivable	39	-
Property, plant and equipment, net	564	842
Other assets	2,658	2,094
<b>Total assets</b>	<b>\$ 185,888</b>	<b>\$ 179,980</b>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Unpaid losses and LAE	\$49,908	\$ 59,983
Unearned premiums	59,006	47,933
Premiums deposits and customer credit balances	2,458	2,804
Bank overdraft	5,987	7,930
Income taxes payable	-	77
Accounts payable and accrued expenses	2,624	3,109
<b>Total liabilities</b>	<b>119,983</b>	<b>121,836</b>
Shareholders' equity:		
Common stock, \$0.01 par value. Authorized 25,000,000 shares; issued and outstanding 7,979,488 and 7,946,384, respectively	80	79
Preferred stock, \$0.01 par value. Authorized 1,000,000 shares; none issued or outstanding	-	-
Additional paid-in capital	51,356	50,940
Accumulated other comprehensive income		
Unrealized net gains on investments, available for sale	4,067	877
<b>Total accumulated other comprehensive income</b>	<b>4,067</b>	<b>877</b>
Retained earnings	10,402	6,248
<b>Total shareholders' equity</b>	<b>65,905</b>	<b>58,144</b>

Total liabilities and shareholders' equity	\$185,888	\$	179,980
--	-----------	----	---------

See accompanying notes to consolidated financial statements.

- 65 -

---

Table of Contents

Federated National Holding Company and Subsidiaries  
CONSOLIDATED STATEMENTS OF OPERATIONS  
YEARS ENDED DECEMBER 31, 2012, 2011 AND 2010

Twelve Months Ended December 31,  
2012                      2011                      2010  
(Dollars in Thousands except EPS and Share and  
Dividend Data)

	2012	2011	2010
Revenue:			
Gross premiums written	\$ 119,459	\$ 98,269	\$ 96,410
Gross premiums ceded	(51,085 )	(46,293 )	(52,963 )
Net premiums written	68,374	51,976	43,447
Increase (decrease) in prepaid reinsurance premiums	2,059	(2,656 )	(2,108 )
(Increase) decrease in unearned premiums	(11,074 )	(797 )	3,721
Net change in prepaid reinsurance premiums and unearned premiums	(9,015 )	(3,453 )	1,613
Net premiums earned	59,359	48,523	45,060
Commission income	1,377	994	1,388
Finance revenue	496	518	395
Managing general agent fees	2,007	1,583	1,609
Net investment income	3,819	4,079	3,726
Net realized investment gains	1,072	2,725	6,777
Regulatory assessments recovered	-	109	857
Other income	517	1,632	792
Total revenue	68,647	60,163	60,604
Expenses:			
Losses and LAE	30,209	30,896	40,088
Operating and underwriting expenses	9,996	9,916	10,835
Salaries and wages	8,439	8,004	8,611
Policy acquisition costs - amortization	13,255	12,347	13,025
Total expenses	61,899	61,163	72,559
Income (loss) before provision for income tax expense (benefit)	6,748	(1,000 )	(11,955 )
Provision for income tax expense (benefit)	2,435	(570 )	(3,959 )
Net income (loss)	\$ 4,313	\$ (430 )	\$ (7,996 )
Net income (loss) per share - basic	\$ 0.53	\$ (0.05 )	\$ (1.01 )
Net income (loss) per share - diluted	\$ 0.53	\$ (0.05 )	\$ (1.01 )

Weighted average number of common shares outstanding - basic	7,951,906	7,946,384	7,946,384
Weighted average number of common shares outstanding - diluted	8,016,110	7,946,384	7,946,384
Dividends paid per share	\$ 0.02	\$ -	\$ 0.06

See accompanying notes to consolidated financial statements.

- 66 -

---



Table of Contents

Federated National Holding Company and Subsidiaries  
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)  
YEARS ENDED DECEMBER 31, 2012, 2011 AND 2010

	Years Ended December 31,		
	2012	2011	2010
	(Dollars in Thousands)		
Net income (loss)	\$4,313	\$(430 )	\$(7,996 )
Change in net unrealized gains (losses) on investments available for sale	5,114	572	(2,415 )
Comprehensive income (loss) before tax	9,427	142	(10,411 )
Income tax (expense) benefit related to items of other comprehensive income (loss)	(1,924 )	(215 )	909
Comprehensive income (loss)	\$7,503	\$(73 )	\$(9,502 )

See accompanying notes to consolidated financial statements.

Table of Contents

Federated National Holding Company and Subsidiaries  
 CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY AND COMPREHENSIVE  
 (LOSS) INCOME

YEARS ENDED DECEMBER 31, 2012, 2011 AND 2010

	Comprehensive (Loss) Income (Dollars in Thousands)	Common Stock	Additional Paid-in Capital	Accumulated Other Comprehensive Deficit	Retained Earnings	Total Shareholder's Equity
Balance as of December 31, 2009		\$ 79	\$ 50,185	\$ 2,026	\$ 15,151	\$ 67,441
Net loss	\$ (7,996 )				(7,996 )	(7,996 )
Cash dividends					(477 )	(477 )
Treasury stock acquired						
Shares based compensation			469			469
Net unrealized change in investments, net of tax effect of \$909	(1,506 )			(1,506 )		(1,506 )
Comprehensive loss	\$ (9,502 )					
Balance as of December 31, 2010		\$ 79	\$ 50,654	\$ 520	\$ 6,678	\$ 57,931
Net loss	\$ (430 )				(430 )	(430 )
Cash dividends						
Treasury stock acquired						
Shares based compensation			286			286
Net unrealized change in investments, net of tax effect of (\$215)	357			357		357
Comprehensive loss	\$ (73 )					
Balance as of December 31, 2011		\$ 79	\$ 50,940	\$ 877	\$ 6,248	\$ 58,144
Net income	\$ 4,313				4,313	4,313
Cash dividends					(159 )	(159 )
Treasury stock acquired						
Stock options exercised		1	128			129
Shares based compensation			288			288
	3,190			3,190		3,190

Net unrealized change in  
investments, net of tax effect  
of (\$1,924)

Comprehensive income           \$ 7,503

Balance as of December 31,  
2012

\$ 80       \$ 51,356       \$ 4,067       \$ 10,402       \$ 65,905

See accompanying notes to consolidated financial statements.

- 68 -

---

Table of Contents

Federated National Holding Company and Subsidiaries  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
YEARS ENDED DECEMBER 31, 2012, 2011 AND 2010

	For the Years Ended December 31,		
	2012	2011	2010
	(Dollars in Thousands)		
Cash flow from operating activities:			
Net income (loss)	\$4,313	\$(430)	\$(7,996)
Adjustments to reconcile net income (loss) to net cash provided (used) by operating activities:			
Amortization of investment premium discount, net	1,356	1,249	1,039
Depreciation and amortization of property plant and equipment, net	195	168	221
Net realized investment gains	(1,072)	(2,725)	(6,777)
Non-cash impairment recognition	(44)	-	-
(Recovery) provision for credit losses, net	(12)	18	23
Provision (recovery) for uncollectible premiums receivable	5	(5)	(44)
Non-cash compensation	188	196	319
Changes in operating assets and liabilities:			
Premiums receivable	(2,412)	29	4,716
Prepaid reinsurance premiums	1,293	2,076	(96)
Reinsurance recoverable, net	(1,415)	5,951	7,264
Income taxes recoverable	(39)	2,393	4,676
Deferred income tax expense, net of other comprehensive income (loss)	2,350	(912)	(2,332)
Policy acquisition costs, net of amortization	(761)	161	388
Other assets	(552)	(308)	837
Unpaid losses and LAE	(10,075)	(6,547)	(4,081)
Unearned premiums	11,074	797	(3,721)
Premium deposits and customer credit balances	(347)	441	234
Income taxes payable	(77)	77	-
Bank overdraft	(1,942)	498	(821)
Accounts payable and accrued expenses	(486)	956	(440)
Net cash provided (used) by operating activities	1,540	4,083	(6,591)
Cash flow provided (used) by investing activities:			
Proceeds from sale of investment securities	90,449	108,318	149,025
Purchases of investment securities available for sale	(86,203)	(113,251)	(153,969)
Purchases of property and equipment	83	(243)	(130)
Net cash provided (used) by investing activities	4,329	(5,176)	(5,074)
Cash flow provided (used) by financing activities:			
Exercised stock options	128	-	-
Dividends paid	(159)	-	(477)
Tax benefit related to non-cash compensation	100	92	151
Net cash provided (used) by financing activities	69	92	(326)
Net increase (decrease) in cash and short term investments	5,938	(1,001)	(11,991)
Cash and short term investments at beginning of period	15,205	16,206	28,197
Cash and short term investments at end of period	\$21,143	\$15,205	\$16,206

See accompanying notes to consolidated financial statements.



Table of Contents

Federated National Holding Company and Subsidiaries  
 CONSOLIDATED STATEMENTS OF CASH FLOWS  
 YEARS ENDED DECEMBER 31, 2012, 2011 AND 2010

(continued)	For the Years Ended December 31,		
	2012	2011	2010
	(Dollars in Thousands)		
Supplemental disclosure of cash flow information:			
Cash paid during the period for:			
Income taxes	\$ 165	\$ -	\$ -
Non-cash investing and finance activities:			
Accrued dividends payable	\$ 159	\$ -	\$ -

See accompanying notes to consolidated financial statements.

Table of Contents

Federated National Holding Company and Subsidiaries  
Notes to Consolidated Financial Statements  
December 31, 2012

(1) ORGANIZATION AND BUSINESS

The accompanying consolidated financial statements include the accounts of the Company and its subsidiaries. All significant intercompany balances and transactions have been eliminated in consolidation.

FNHC is an insurance holding company that controls substantially all steps in the insurance underwriting, distribution and claims processes through our subsidiaries and our contractual relationships with our independent agents and general agents.

We are authorized to underwrite, and/or place through our wholly owned subsidiaries, homeowners', commercial general liability, federal flood, personal auto and various other lines of insurance in Florida and various other states. We are authorized to underwrite in various states on behalf of our wholly owned subsidiary, FNIC and other insurance carriers. FNIC is the resulting entity following the merger of FNIC with and into our other wholly owned subsidiary, American Vehicle in January 2011. In connection with this merger, the Company, FNIC and American Vehicle entered into the Consent Order with the Florida OIR. The Consent Order was amended in February 2013 to lessen or eliminate certain of the original requirements, due to FNIC's statutory underwriting profit during 2012. See "Footnote 8 – Regulatory Requirements and Restrictions". We market and distribute our own and third-party insurers' products and our other services through a network of independent agents. We also utilize a select number of general agents for the same purpose.

The insurable events during 2012, 2011 and 2010 did not include any weather related catastrophic events such as the well publicized series of hurricanes that occurred in Florida during 2005 and 2004. During 2012, 2011 and 2010 we processed property and liability claims stemming from our homeowners', commercial general liability and private passenger automobile lines of business. Our reinsurance strategy serves to smooth the liquidity requirements imposed by most severe insurable events and for all other insurable events we manage, at a micro and macro perspective, in the normal course of business.

We are not certain how hurricanes and other insurable events will affect our future results of operations and liquidity. Loss and loss adjustment expenses ("LAE") are affected by a number of factors including the following.

- the quality of the insurable risks underwritten;
- the nature and severity of the loss;
- weather-related patterns;
- the availability, cost and terms of reinsurance;
- underlying settlement costs, including medical and legal costs;
- legal and political factors such as legislative initiatives and public opinion;
- macroeconomic issues.

We continue to manage the foregoing to the extent within our control. Many of the foregoing are partially, or entirely, outside our control.

FNIC is licensed as an admitted carrier in Florida. Through contractual relationships with a network of approximately 3,000 independent agents, of which approximately 900 actively sell and service our products, FNIC is authorized to underwrite homeowners', commercial general liability, fire, allied lines and personal and commercial automobile insurance in Florida. Effective January 26, 2011, FNIC merged with and into American Vehicle and American

Vehicle changed its name to FNIC.

American Vehicle, prior to the January 2011 merger, was licensed as an admitted carrier in Florida, and underwrote commercial general liability, and personal and commercial automobile insurance. American Vehicle was also licensed as an admitted carrier in Alabama, Louisiana, Georgia and Texas, and underwrote commercial general liability insurance in those states. American Vehicle operated as a non-admitted carrier in Arkansas, California, Kentucky, Maryland, Missouri, Nevada, Oklahoma, South Carolina, Tennessee and Virginia, and could underwrite commercial general liability insurance in all of these states. Subsequent to the merger, these operations may continue under the newly formed FNIC.

An admitted carrier is an insurance company that has received a license from the state department of insurance giving the company the authority to write specific lines of insurance in that state. These companies are also bound by rate and form regulations, and are strictly regulated to protect policyholders from a variety of illegal and unethical practices, including fraud. Admitted carriers are also required to financially contribute to the state guarantee fund, which is used to pay for losses if an insurance carrier becomes insolvent or unable to pay the losses due their policyholders.



Table of Contents

Federated National Holding Company and Subsidiaries  
Notes to Consolidated Financial Statements  
December 31, 2012

A non-admitted carrier is allowed to do business in that state and is strictly regulated to protect policyholders from a variety of illegal and unethical practices, including fraud. Sometimes, non-admitted carriers are referred to as “excess and surplus” lines carriers. Non-admitted carriers are subject to considerably less regulation with respect to policy rates and forms. Non-admitted carriers are not required to financially contribute to and benefit from the state guarantee fund, which is used to pay for losses if an insurance carrier becomes insolvent or unable to pay the losses due their policyholders.

During 2012, 85.3%, 7.8%, 4.4% and 2.5% of the premiums we underwrote were for homeowners’, commercial general liability, federal flood, and personal automobile insurance, respectively. During 2011, 81.8%, 10.3%, 4.6% and 3.3% of the premiums we underwrote were for homeowners’, commercial general liability, federal flood, and personal automobile insurance, respectively.

Our business, results of operations and financial condition are subject to fluctuations due to a variety of factors. Abnormally high severity or frequency of claims in any period could have a material adverse effect on our business, results of operations and financial condition. When our estimated liabilities for unpaid losses and LAE are less than the actuarially determined amounts, we increase the expense in the current period. Conversely, when our estimated liabilities for unpaid losses and LAE are greater than the actuarially determined amounts, we decrease the expense in the current period.

We internally process claims made by our insureds through our wholly owned claims adjusting company, FNA. Until June 2011, we offered premium financing to our own and third-party insureds through our wholly owned subsidiary, Federated Premium.

We are focusing our marketing efforts on continuing to expand our distribution network and market our products and services throughout Florida and in other states by establishing relationships with additional independent agents and general agents. As this occurs, we will seek to replicate our distribution network in those states. There can be no assurance, however, that we will be able to obtain the required regulatory approvals to offer additional insurance products or expand into other states.

FNU, a wholly owned subsidiary of the Company, acts as FNIC’s exclusive managing general agent in Florida and is also licensed as a managing general agent in the States of Alabama, Georgia, Illinois, Louisiana, North Carolina, Mississippi, Missouri, New York, Nevada, South Carolina, Texas and Virginia. FNU has contracted with several unaffiliated insurance companies to sell commercial general liability, workers compensation, personal umbrella, inland marine and other various lines of insurance through FNU’s existing network of agents.

FNU earns commissions and fees for providing policy administration, marketing, accounting and analytical services, and for participating in the negotiation of reinsurance contracts. FNU earns a \$25 per policy fee, and traditionally a 6% commission fee from its affiliates FNIC and American Vehicle. During the fourth quarter of 2010, FNU, pursuant to the Consent Order as discussed in “Regulation – Consent Order” reduced its fee, to earn amounts varying between 2% and 4%, which we anticipate will return to 6% at an unknown future date with approval from the Florida OIR. A formal agreement reflecting this fee modification was executed during January 2011.

The homeowner policy provides FNU the right to cancel any policy within a period of 90 days from the policy's inception with 25 days’ notice, or after 90 days from policy inception with 95 days’ notice, even if the risk falls within our underwriting criteria.

(2) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND PRACTICES

(a) CASH AND SHORT TERM INVESTMENTS

We consider all short-term highly liquid investments with original maturities of less than three months to be short term investments.

(b) INVESTMENTS

Our investment securities have been classified as either available-for-sale or held to maturity in response to our liquidity needs, changes in market interest rates and asset-liability management strategies, among other reasons. Investments available-for-sale are stated at fair value on the balance sheet. Investments designated as held to maturity are stated at amortized cost on the balance sheet. Unrealized gains and losses are excluded from earnings and are reported as a component of other comprehensive income within shareholders' equity, net of related deferred income taxes.

Table of Contents

Federated National Holding Company and Subsidiaries  
Notes to Consolidated Financial Statements  
December 31, 2012

A decline in the fair value of an available-for-sale security below cost that is deemed other than temporary results in a charge to income, resulting in the establishment of a new cost basis for the security. Premiums and discounts are amortized or accreted, respectively, over the life of the related debt security as an adjustment to yield using a method that approximates the effective interest method. Dividends and interest income are recognized when earned. Realized gains and losses are included in earnings and are derived using the specific-identification method for determining the cost of securities sold.

(c) PREMIUM REVENUE

Premium revenue on all lines is earned on a pro-rata basis over the life of the policies. Unearned premiums represent the portion of the premium related to the unexpired policy term.

(d) DEFERRED ACQUISITION COSTS

Deferred acquisition costs primarily represent commissions paid to outside agents at the time of policy issuance (to the extent they are recoverable from future premium income) net of ceded premium commission earned from reinsurers, salaries and premium taxes net of policy fees, and are amortized over the life of the related policy in relation to the amount of premiums earned. The method followed in computing deferred acquisition costs limits the amount of such deferred costs to their estimated realizable value, which gives effect to the premium to be earned, related investment income, unpaid losses and LAE and certain other costs expected to be incurred as the premium is earned. There is no indication that these costs will not be fully recoverable in the near term.

(e) PREMIUM DEPOSITS

Premium deposits represent premiums received primarily in connection with homeowner policies that are not yet effective. We take approximately 30 working days to issue the policy from the date the cash and policy application are received.

(f) UNPAID LOSSES AND LAE

Unpaid losses and LAE are determined by establishing liabilities in amounts estimated to cover incurred losses and LAE. Such liabilities are determined based upon our assessment of claims pending and the development of prior years' loss liability. These amounts include liabilities based upon individual case estimates for reported losses and LAE and estimates of such amounts that are IBNR. Changes in the estimated liability are charged or credited to operations as the losses and LAE are settled.

The estimates of the liability for unpaid losses and LAE are subject to the effect of trends in claims severity and frequency and are continually reviewed. As part of this process, we review historical data and consider various factors, including known and anticipated legal developments, inflation and economic conditions. As experience develops and other data become available, these estimates are revised, as required, resulting in increases or decreases to the existing liability for unpaid losses and LAE. Adjustments are reflected in results of operations in the period in which they are made and the liabilities may deviate substantially from prior estimates.

There can be no assurance that our liability for unpaid losses and LAE will be adequate to cover actual losses. If our liability for unpaid losses and LAE proves to be inadequate, we will be required to increase the liability with a

corresponding reduction in our net income in the period in which the deficiency is identified. Future loss experience substantially in excess of established liability for unpaid losses and LAE could have a material adverse effect on our business, results of operations and financial condition.

Accounting for loss contingencies pursuant to Financial Accounting Standards Board (“FASB”) issued guidance involves the existence of a condition, situation or set of circumstances involving uncertainty as to possible loss that will ultimately be resolved when one or more future event(s) occur or fail to occur. Additionally, accounting for a loss contingency requires management to assess each event as probable, reasonably possible or remote. Probable is defined as the future event or events are likely to occur. Reasonably possible is defined as the chance of the future event or events occurring is more than remote but less than probable, while remote is defined as the chance of the future event or events occurring is slight. An estimated loss in connection with a loss contingency shall be recorded by a charge to current operations if both of the following conditions are met: First, the amount can be reasonably estimated, and second, the information available prior to issuance of the financial statements indicates that it is probable that a liability has been incurred at the date of the financial statements. It is implicit in this condition that it is probable that one or more future events will occur confirming the fact of the loss or incurrence of a liability.

Table of Contents

Federated National Holding Company and Subsidiaries  
Notes to Consolidated Financial Statements  
December 31, 2012

We do not discount unpaid losses and LAE for financial statement purposes.

(g) FINANCE REVENUE

Interest and service income, resulting from the financing of insurance premiums, is recognized using a method that approximates the effective interest method. Late charges are recognized as income when chargeable.

(h) PREMIUMS RECEIVABLE, NET OF ALLOWANCE FOR CREDIT LOSSES

Provisions for credit losses are provided in amounts sufficient to maintain the allowance for credit losses at a level considered adequate to cover anticipated losses. Generally, accounts that are over 90 days old are written off to the allowance for credit losses. We have been increasing our reliance on direct billing of our policyholders for their insurance premiums. Direct billing is when the insurance company accepts from the insured, as a receivable, a promise to pay the premium, as opposed to requiring payment of the full amount of the policy, either directly from the insured or from a premium finance company. We manage the credit risk associated with our direct billing program through our integrated computer system which allows us to monitor the equity in the unearned premium to the underlying policy. Underwriting criteria are designed with down payment requirements and monthly payments that create policyholder equity, also called unearned premium, in the insurance policy. The equity in the policy is collateral for the extension of credit to the insured.

(i) MANAGING GENERAL AGENT (“MGA”) FEES

If all the costs substantially associated with the MGA contracts, which do not involve affiliated insurers, are incurred during the underwriting process, then the MGA fees and the related acquisition costs are recognized at the time the policy is underwritten, net of estimated cancellations. If the MGA contract requires significant involvement subsequent to the completion of the underwriting process, then the MGA fees and related acquisition costs are deferred and recognized over the life of the policy. Included in MGA Fees are policy fees charged by the insurance companies and passed through to FNU. Policy fees are discussed below.

(j) POLICY FEES

Policy fees represent a \$25 non-refundable application fee for insurance coverage, which are intended to reimburse us for the costs incurred to underwrite the policy. The fees and related costs are recognized when the policy is underwritten. These fees are netted against underwriting costs and are included as a component of deferred acquisition costs.

(k) REINSURANCE

We recognize the income and expense on reinsurance contracts principally on a pro-rata basis over the term of the reinsurance contracts or until the reinsurers maximum liability is exhausted, whichever comes first. We are reinsured under separate reinsurance agreements for the different lines of business underwritten. Reinsurance contracts do not relieve us from our obligations to policyholders. We continually monitor our reinsurers to minimize our exposure to significant losses from reinsurer insolvencies. We only cede risks to reinsurers whom we believe to be financially sound. At December 31, 2012, all reinsurance recoverables are considered current and deemed collectable.

(1) INCOME TAXES

Income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for the estimated future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases, and operating loss, capital loss and tax-credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income or expense in the period that includes the enactment date.

- 74 -

---

Table of Contents

Federated National Holding Company and Subsidiaries  
Notes to Consolidated Financial Statements  
December 31, 2012

(m) CONCENTRATION OF CREDIT RISK

FNU earns commissions and fees for providing policy administration, marketing, accounting and analytical services, and for participating in the negotiation of reinsurance contracts. FNU earns a \$25 per policy fee, and traditionally a 6% commission fee from its affiliates FNIC and American Vehicle. During the fourth quarter of 2010, FNU, pursuant to the Consent Order as discussed in “Regulation – Consent Order” reduced its fee, to earn amounts varying between 2% and 4%, which we anticipate will return to 6% at an unknown future date with approval from the Florida OIR. A formal agreement reflecting this fee modification was executed during January 2011.

Financial instruments, which potentially expose us to concentrations of credit risk, consist primarily of investments, premiums receivable, amounts due from reinsurers on paid and unpaid losses and finance contracts. We have not experienced significant losses related to premiums receivable from individual policyholders or groups of policyholders in a particular industry or geographic area. We believe no credit risk beyond the amounts provided for collection losses is inherent in our premiums receivable or finance contracts. In order to reduce credit risk for amounts due from reinsurers, we seek to do business with financially sound reinsurance companies and regularly review the financial strength of all reinsurers used. Additionally, our credit risk in connection with our reinsurers is frequently mitigated by the establishment of irrevocable clean letters of credit in favor of FNIC.

(n) RECENT ACCOUNTING PRONOUNCEMENTS

In July 2012, the FASB issued Accounting Standard Update (“ASU”) No. 2012-02: Intangibles – Goodwill and Other (Topic 350): Testing Indefinite-Lived Intangible Assets for Impairment. The objective of the amendments in this ASU is to reduce the cost and complexity of performing an impairment test for indefinite-lived intangible assets by simplifying how an entity tests those assets for impairment and to improve consistency in impairment testing guidance among long-lived asset categories. The amendments permit an entity first to assess qualitative factors to determine whether it is more likely than not that an indefinite-lived intangible asset is impaired as a basis for determining whether it is necessary to perform the quantitative impairment test in accordance with Subtopic 350-30. The more-likely-than-not threshold is defined as having a likelihood of more than 50 percent. Upon adoption, these amendments are effective for annual and interim impairment tests performed for fiscal years beginning after September 15, 2012; early adoption is permitted. The adoption of these amendments did not have a material impact on our financial condition, results of operations or cash flows.

In June 2011, the FASB issued ASU No. 2011-05: Comprehensive Income (Topic 220): Presentation of Comprehensive Income. The guidance in this ASU is intended to increase the prominence of items reported in other comprehensive income in the financial statements by presenting the total of comprehensive income, the components of net income and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. This ASU eliminates the option to present the components of other comprehensive income as part of the statement of changes in stockholders' equity. The guidance in this ASU does not change the items that must be reported in other comprehensive income or when an item of other comprehensive income must be reclassified to net income. Upon adoption, this update is to be applied retrospectively and is effective during interim and annual periods beginning after December 15, 2011. Early adoption is permitted. The adoption of this ASU did not have a material impact on our financial condition, results of operations or cash flows.

In December 2011, the FASB issued ASU No. 2011-12: Comprehensive Income (Topic 220): Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in Accounting Standards Update No. 2011-05. The guidance defers certain provisions contained in ASU No. 2011-05 requiring the requirement to present components of reclassifications of other comprehensive income on the face of the income statement or in the notes to the financial statements. However, this deferral does not impact the other requirements contained in the new standard on comprehensive income as described above. This ASU is effective during interim and annual periods beginning after December 15, 2011. The adoption of this ASU did not have a material impact on our financial condition, results of operations or cash flows.

In September 2011, the FASB issued ASU No. 2011-08: Intangibles – Goodwill and Other (Topic 350): Testing Goodwill for Impairment, which amends ASC Topic 350, Intangibles-Goodwill and Other. The guidance in this ASU permits an entity to first assess qualitative factors to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount as a basis for determining whether it is necessary to perform the two-step goodwill impairment test described in ASC Topic 350. Under the amendments in this ASU, an entity is not required to calculate the fair value of a reporting unit unless the entity determines that it is more likely than not that its fair value is less than its carrying amount. The amendments are effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011. Early adoption is permitted, including for annual and interim goodwill impairment tests performed as of a date before September 15, 2011, if an entity's financial statements for the most recent annual or interim period have not yet been issued or, for nonpublic entities, have not yet been made available for issuance. The adoption of this ASU did not have a material impact on our financial condition, results of operations or cash flows.



Table of Contents

Federated National Holding Company and Subsidiaries  
Notes to Consolidated Financial Statements  
December 31, 2012

In December 2011, the FASB issued ASU No. 2011-11: Balance Sheet (Topic 210): Disclosures about Offsetting Assets and Liabilities, which requires new disclosure requirements mandating that entities disclose both gross and net information about instruments and transactions eligible for offset in the statement of financial position as well as instruments and transactions subject to an agreement similar to a master netting arrangement. In addition, the standard requires disclosure of collateral received and posted in connection with master netting agreements or similar arrangements. This ASU is effective for annual reporting periods beginning on or after January 1, 2013, and interim periods within those annual periods. The adoption of this ASU will not have a material impact on our financial condition, results of operations or cash flows.

In October 2010, the FASB issued ASU No. 2010-26: Financial Services – Insurance (Topic 944): Accounting for Costs Associated with Acquiring or Renewing Insurance Contracts, a consensus of FASB Emerging Issues Task Force. The amendments in this update modify the definition of the types of costs incurred by insurance entities that can be capitalized in the acquisition of new and renewal contracts. The amendments in this update specify that the costs must be based on successful efforts (that is, acquiring a new or renewal contract). The amendments also specify that advertising costs should be included as deferred acquisition costs under certain circumstances. The amendments in this update are effective for fiscal years, and interim period within those fiscal years, beginning after December 15, 2011. The amendments in this update should be applied prospectively upon adoption. Retrospective application to all prior periods presented upon the date of adoption also is permitted. The adoption of this ASU did not have a material impact on the Company's consolidated financial statements.

Other recent accounting pronouncements issued by FASB, the American Institute of Certified Public Accountants ("AICPA"), and the Securities and Exchange Commission ("SEC") did not or are not believed by management to have a material impact on the Company's present or future financial statements.

(o) USE OF ESTIMATES

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions about future events that affect the amounts reported in the financial statements and accompanying notes. Future events and their effects cannot be determined with absolute certainty. Therefore, the determination of estimates requires the exercise of judgment. Actual results inevitably will differ from those estimates, and such differences may be material to the financial statements.

Similar to other property and casualty insurers, our liability for unpaid losses and LAE, although supported by actuarial projections and other data, is ultimately based on management's reasoned expectations of future events. Although considerable variability is inherent in these estimates, we believe that this liability is adequate. Estimates are reviewed regularly and adjusted as necessary. Such adjustments are reflected in current operations. In addition, the realization of our deferred income tax assets is dependent on generating sufficient future taxable income. It is reasonably possible that the expectations associated with these accounts could change in the near term and that the effect of such changes could be material to the Consolidated Financial Statements.

(p) OPERATIONAL RISKS

We are subject to certain risks in our business operations which are described below. Careful consideration of these risks should be made before making an investment decision. The risks and uncertainties described below are not the only ones facing FNHC. Additional risks and uncertainties not presently known or currently deemed immaterial may

also impair our business operations.

- 76 -

---

Table of Contents

Federated National Holding Company and Subsidiaries  
Notes to Consolidated Financial Statements  
December 31, 2012

Risks Related to Our Business

Effective January 26, 2011, FNIC merged with and into American Vehicle, and the resulting entity changed its name to “Federated National Insurance Company”.

- Our financial condition could be adversely affected by the occurrence of natural and man-made disasters.
- Although we follow the industry practice of reinsuring a portion of our risks, our costs of obtaining reinsurance fluctuates and we may not be able to successfully alleviate risk through reinsurance arrangements.
- We face a risk of non-collectability of reinsurance, which could materially and adversely affect our business, results of operations and/or financial condition.
- Our January 2011 Consent Order with the Florida OIR, as amended in February 2013, limits our business in certain respects and may prevent us from growing our business.
- If we are unable to continue our growth because our capital must be used to pay greater than anticipated claims, our financial results may suffer.
- We may require additional capital in the future which may not be available or only available on unfavorable terms.
- Our business is heavily regulated, and changes in regulation may reduce our profitability and limit our growth.
  - We may experience financial exposure from climate change.
- Our loss reserves may be inadequate to cover our actual liability for losses, causing our results of operations to be adversely affected.
- Our revenues and operating performance may fluctuate due to statutorily approved assessments that support property and casualty insurance pools and associations.
  - Our investment portfolio may suffer reduced returns or losses, which would significantly reduce our earnings.
    - We may experience a loss due to the concentration of credit risk.
- We face risks in connection with potential material weakness resulting from our Sarbanes-Oxley Section 404 management report and any related remedial measures that we undertake.
- The failure of any of the loss limitation methods we employ could have a material adverse effect on our financial condition or our results of operations.
  - The effects of emerging claim and coverage issues on our business are uncertain.
- Our failure to pay claims accurately could adversely affect our business, financial results and capital requirements.

- Our insurance companies are subject to minimum capital and surplus requirements, and our failure to meet these requirements could subject us to regulatory action.
- Our revenues and operating performance may fluctuate with business cycles in the property and casualty insurance industry.
- We may not obtain the necessary regulatory approvals to expand the types of insurance products we offer or the states in which we operate.
- Adverse ratings by insurance rating agencies may adversely impact our ability to write new policies, renew desirable policies or obtain adequate insurance, which could limit or halt our growth and harm our business.

Table of Contents

Federated National Holding Company and Subsidiaries  
Notes to Consolidated Financial Statements  
December 31, 2012

- We rely on independent and general agents to write our insurance policies, and if we are not able to attract and retain independent and general agents, our revenues would be negatively affected.
- We rely on our information technology and telecommunications systems, and the failure of these systems could disrupt our operations.
- Nonstandard automobile insurance historically has a higher frequency of claims than standard automobile insurance, thereby increasing our potential for loss exposure beyond what we would be likely to experience if we offered only standard automobile insurance.
- Florida's personal injury protection insurance statute contains provisions that favor claimants, causing us to experience a higher frequency of claims than might otherwise be the case if we operated only outside of Florida.
  - Our success depends on our ability to accurately price the risks we underwrite.
  - Current operating resources are necessary to develop future new insurance products.
- Increased competition, competitive pressures, industry developments and market conditions could affect the growth of our business and adversely impact our financial results.
- Our senior management team is critical to the strategic direction of our company. If there were an unplanned loss of service by any of our officers our business could be harmed.

Risks Related to an Investment in Our Shares

- We have authorized but unissued preferred stock, which could affect rights of holders of common stock.
- Our articles of incorporation, bylaws and Florida law may discourage takeover attempts and may result in entrenchment of management.
- As a holding company, we depend on the earnings of our subsidiaries and their ability to pay management fees and dividends to the holding company as the primary source of our income.

(q) FAIR VALUE

The fair value of our investments is estimated based on prices published by financial services or quotations received from securities dealers and is reflective of the interest rate environment that existed as of the close of business on December 31, 2012 and 2011. Changes in interest rates subsequent to December 31, 2012 may affect the fair value of our investments. Refer to Footnote 21 of the Notes to Consolidated Financial Statements for details.

The carrying amounts for the following financial instrument categories approximate their fair values at December 31, 2012 and 2011 because of their short-term nature: cash and short term investments, premiums receivable, finance contracts, due from reinsurers, revolving credit outstanding, bank overdraft, accounts payable and accrued expenses.

(r) STOCK OPTION PLANS

During the year ended December 31, 2012, the Company had three stock-based employee compensation plans, which are described later in Footnote 14, Stock Compensation Plans. Prior to January 1, 2006, we accounted for the plans under the recognition and measurement provisions of stock-based compensation using the intrinsic value method prescribed by the Accounting Principles Board (“APB”) and related Interpretation, as permitted by FASB issued guidance. Under these provisions, no stock-based employee compensation cost was recognized in the Statement of Operations as all options granted under those plans had an exercise price equal to or less than the market value of the underlying common stock on the date of grant.

- 78 -

---

Table of Contents

Federated National Holding Company and Subsidiaries  
Notes to Consolidated Financial Statements  
December 31, 2012

Effective January 1, 2006, the Company adopted the fair value recognition provisions of FASB issued guidance using the modified-prospective-transition method. Under that transition method, compensation costs recognized during 2012, 2011 and 2010 include:

- Compensation cost for all share-based payments granted prior to, but not yet vested as of January 1, 2006, based on the grant date fair value estimated in accordance with the original provisions of FASB issued guidance, and
- Compensation cost for all share-based payments granted subsequent to January 1, 2006, based on the grant-date fair-value estimated in accordance with the provisions of FASB issued guidance. Results for prior periods have not been restated, as they are not required to be by the pronouncement.

(s) PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment is stated at cost less accumulated depreciation. Depreciation on property, plant and equipment is calculated on a straight-line basis over the following estimated useful lives: building and improvements - 30 years and furniture and fixtures - 7 years. We capitalize betterments and any other expenditure in excess of \$1,000 if the asset is expected to have a useful life greater than one year. The carrying value of property, plant and equipment is periodically reviewed based on the expected future undiscounted operating cash flows of the related item. Based upon our most recent analysis, we believe that no impairment of property, plant and equipment exists at December 31, 2012.

(t) RECLASSIFICATIONS

The 2011 and 2010 financial statement amounts have not been reclassified to conform to the 2012 presentations.

(u) GOODWILL AND INTANGIBLE ASSETS

During 2009, the Company purchased one intangible asset totaling \$0.1 million. In accordance with FASB issued guidance, the accounting for the recognized intangible asset was based on its useful life to the Company. The useful life of the intangible asset was the period over which it was expected to contribute directly or indirectly to the future cash flows of the Company. The intangible asset had a definite finite life ranging from six to twelve months, and was amortized accordingly.

(3) INVESTMENTS

FASB issued guidance addresses accounting and reporting for (a) investments in equity securities that have readily determinable fair values and (b) all investments in debt securities. The guidance requires that these securities be classified into one of three categories: Held-to-maturity, Trading, or Available-for-sale securities.

Investments classified as held-to-maturity include debt securities wherein the Company's intent and ability are to hold the investment until maturity. The accounting treatment for held-to-maturity investments is to carry them at amortized cost without consideration to unrealized gains or losses. Investments classified as trading securities include debt and equity securities bought and held primarily for the sale in the near term. The accounting treatment for trading securities is to carry them at fair value with unrealized holding gains and losses included in current period operations. Investments classified as available-for-sale include debt and equity securities that are not classified as

held-to-maturity or as trading security investments. The accounting treatment for available-for-sale securities is to carry them at fair value with unrealized holding gains and losses excluded from earnings and reported as a separate component of shareholders' equity, namely "Other Comprehensive Income".

Total investments increased \$0.6 million, or 0.5%, to \$130.1 million as of December 31, 2012, compared with \$129.5 million as of December 31, 2011.

The debt and equity securities that are available for sale and carried at fair value represent 94% of total investments as of December 31, 2012, compared with 94% as of December 31, 2011.

We did not hold any trading investment securities during 2012.



Table of Contents

Federated National Holding Company and Subsidiaries  
Notes to Consolidated Financial Statements  
December 31, 2012

The FASB issued guidance also addresses the determination as to when an investment is considered impaired, whether that impairment is other-than temporary, and the measurement of an impairment loss. The Company's policy for the valuation of temporarily impaired securities is to determine impairment based on the analysis of the following factors.

- rating downgrade or other credit event (eg., failure to pay interest when due);
- length of time and the extent to which the fair value has been less than amortized cost;
- financial condition and near term prospects of the issuer, including any specific events which may influence the operations of the issuer such as changes in technology or discontinuance of a business segment;
  - prospects for the issuer's industry segment;
- intent and ability of the Company to retain the investment for a period of time sufficient to allow for anticipated recovery in market value;
  - historical volatility of the fair value of the security.

Pursuant to FASB issued guidance, the Company records the unrealized losses, net of estimated income taxes that are associated with that part of our portfolio classified as available-for-sale through the shareholders' equity account titled "Other Comprehensive Income". Management periodically reviews the individual investments that comprise our portfolio in order to determine whether a decline in fair value below our cost either is other-than temporarily or permanently impaired. Factors used in such consideration include, but are not limited to, the extent and length of time over which the market value has been less than cost, the financial condition and near-term prospects of the issuer and our ability and intent to keep the investment for a period sufficient to allow for an anticipated recovery in market value.

In reaching a conclusion that a security is either other-than-temporarily or permanently impaired we consider such factors as the timeliness and completeness of expected dividends, principal and interest payments, ratings from nationally recognized statistical rating organizations such as S&P and Moody's, as well as information released via the general media channels. During 2012, in connection with the process, we have charged to operations \$44,000 of investment losses. During 2011, in connection with the process, we have charged to operations \$0.8 million of investment losses.

As of December 31, 2012 and December 31, 2011, respectively, all of our securities are in good standing and not impaired, except as noted above, as defined by FASB issued guidance.

As of December 31, 2012 and 2011, our investments consisted primarily of corporate bonds held in various industries, municipal bonds and United States government bonds. As of December 31, 2012, 69% of our debt portfolio was in diverse industries and 31% is in United States government bonds. As of December 31, 2012, approximately 87% of our equity holdings were in equities related to diverse industries and 13% were in mutual funds. As of December 31, 2011, 61% of our debt portfolio was in diverse industries and 39% is in United States government bonds. As of December 31, 2011, approximately 83% of our equity holdings were in equities related to diverse industries and 17% were in mutual funds.

As of December 31, 2012 and December 31, 2011, we have classified \$7.4 million and \$7.1 million, respectively, of our bond portfolio as held-to-maturity. We classify bonds as held-to-maturity to support securitization of credit requirements.

During 2012 and 2011, we did not re-classify any of our bond portfolio between available-for-sale and held-to-maturity.

During April 2006, American Vehicle finalized a \$15.0 million irrevocable letter of credit in conjunction with the 100% Quota Share Reinsurance Agreement with Republic Underwriters Insurance Company (“Republic”) which was terminated in April 2007. During 2010, the letter of credit in favor of Republic was replaced by a fully funded trust agreement. As of December 31, 2012 and 2011 respectively, the amount held in trust was \$1.0 million.

Table of Contents

Federated National Holding Company and Subsidiaries  
Notes to Consolidated Financial Statements  
December 31, 2012

## (a) DEBT AND EQUITY SECURITIES

The following table summarizes, by type, our investments as of December 31, 2012 and 2011.

	December 31, 2012		December 31, 2011		
	Carrying Amount	Percent of Total	Carrying Amount	Percent of Total	
(Dollars in Thousands)					
Debt securities, at market:					
United States government obligations and authorities	\$27,392	21.06 %	\$37,217	28.75 %	
Obligations of states and political subdivisions	3,939	3.03 %	2,303	1.77 %	
Corporate	67,313	51.74 %	63,268	48.87 %	
International	3,111	2.39 %	1,523	1.18 %	
	101,755	78.22 %	104,311	80.57 %	
Debt securities, at amortized cost:					
United States government obligations and authorities	6,016	4.62 %	6,166	4.76 %	
Corporate	1,203	0.92 %	962	0.74 %	
International	140	0.11 %	-	0.00 %	
	7,359	5.65 %	7,128	5.50 %	
Total debt securities	109,114	83.87 %	111,439	86.07 %	
Equity securities, at market:	20,982	16.13 %	18,028	13.93 %	
Total investments	\$130,096	100.00 %	\$129,467	100.00 %	

The following table shows the realized gains (losses) for debt and equity securities for the years ended December 31, 2012 and 2011.

	Years Ended December 31,			
	2012		2011	
	Gains (Losses)	Fair Value at Sale	Gains (Losses)	Fair Value at Sale
(Dollars in Thousands)				
Debt securities	\$1,783	\$50,950	\$3,569	\$66,680
Equity securities	1,403	6,709	1,240	8,305
Total realized gains	3,186	57,659	4,809	74,985
Debt securities	(391 )	13,291	(595 )	18,086
Equity securities	(1,723 )	6,560	(1,489 )	3,510
Total realized losses	(2,114 )	19,851	(2,084 )	21,596
Net realized gains on investments	\$1,072	\$77,510	\$2,725	\$96,581



Table of Contents

Federated National Holding Company and Subsidiaries  
Notes to Consolidated Financial Statements  
December 31, 2012

A summary of the amortized cost, estimated fair value, gross unrealized gains and losses of debt and equity securities at December 31, 2012 and 2011 is as follows.

	Amortized Cost	Gross Unrealized Gains (Dollars in Thousands)	Gross Unrealized Losses	Estimated Fair Value
<b>December 31, 2012</b>				
<b>Debt Securities - Available-For-Sale:</b>				
United States government obligations and authorities	\$26,825	\$632	\$65	\$27,392
Obligations of states and political subdivisions	3,738	202	1	3,939
Corporate	63,553	3,794	34	67,313
International	3,005	107	1	3,111
	\$97,121	\$4,735	\$101	\$101,755
<b>Debt Securities - Held-To-Maturity:</b>				
United States government obligations and authorities	\$6,016	\$149	\$12	\$6,153
Corporate	1,203	61	2	1,262
International	140	-	1	139
	\$7,359	\$210	\$15	\$7,554
Equity securities - common stocks	\$19,095	\$2,505	\$618	\$20,982
<b>December 31, 2011</b>				
<b>Debt Securities - Available-For-Sale:</b>				
United States government obligations and authorities	\$36,558	\$686	\$27	\$37,217
Obligations of states and political subdivisions	2,165	138	-	2,303
Corporate	61,724	1,934	390	63,268
International	1,519	9	5	1,523
	\$101,966	\$2,767	\$422	\$104,311
<b>Debt Securities - Held-To-Maturity:</b>				
United States government obligations and authorities	\$6,166	\$249	\$-	\$6,415
Corporate	962	39	1	1,000
	\$7,128	\$288	\$1	\$7,415
Equity securities - common stocks	\$18,966	\$1,057	\$1,995	\$18,028

Table of Contents

Federated National Holding Company and Subsidiaries  
Notes to Consolidated Financial Statements  
December 31, 2012

The table below reflects our unrealized investment losses by investment class, aged for length of time in an unrealized loss position.

	Unrealized Losses	Less than 12 months (Dollars in Thousands)	12 months or longer
Debt securities:			
United States government obligations and authorities	\$65	\$ 65	\$ -
Obligations of states and political subdivisions	1	1	-
Corporate	34	34	-
International	1	1	-
	101	101	-
Equity securities:			
Common stocks	618	430	188
<b>Total debt and equity securities</b>	<b>\$719</b>	<b>\$ 531</b>	<b>\$ 188</b>

Below is a summary of debt securities at December 31, 2012 and 2011 by contractual or expected maturity periods. 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.

	December 31, 2012		December 31, 2011	
	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
(Dollars in Thousands)				
Due in one year or less	\$2,925	\$2,944	\$8,284	\$8,376
Due after one through five years	49,826	51,523	47,294	48,314
Due after five through ten years	35,070	37,182	36,525	37,448
Due after ten years	16,659	17,660	16,991	17,588
<b>Total</b>	<b>\$104,480</b>	<b>\$109,309</b>	<b>\$109,094</b>	<b>\$111,726</b>

United States Treasury notes with a book value of \$63,481 and \$2,193,300, maturing in 2016 and 2022, respectively, were on deposit with the Florida OIR as of December 31, 2012, as required by law for FNIC, and are included with other investments held until maturity.

United States Treasury notes with a book value of \$2,004,527 and \$64,438, maturing in 2012 and 2016, respectively, were on deposit with the Florida OIR as of December 31, 2011, as required by law for FNIC, and are included with other investments held until maturity.

Table of Contents

Federated National Holding Company and Subsidiaries  
Notes to Consolidated Financial Statements  
December 31, 2012

The table below sets forth investment results for the periods indicated.

	Years Ended December 31,		
	2012	2011	2010
	(Dollars in Thousands)		
Interest on debt securities	\$3,380	\$3,681	\$3,224
Dividends on equity securities	436	394	491
Interest on cash and cash equivalents	3	4	11
<b>Total investment income</b>	<b>\$3,819</b>	<b>\$4,079</b>	<b>\$3,726</b>
<b>Net realized gains</b>	<b>\$1,072</b>	<b>\$2,725</b>	<b>\$6,777</b>

Proceeds from sales, pay downs and maturities of debt securities and proceeds from sales of equity securities in 2012, 2011 and 2010 were approximately \$90.4 million, \$108.3 million and \$149.0 million, respectively.

A summary of net realized investment gains and increases in net unrealized gains follows.

	Years Ended December 31,		
	2012	2011	2010
	(Dollars in Thousands)		
Net realized gains			
Debt securities	\$1,392	\$2,974	\$4,275
Equity securities	(320 )	(249 )	2,502
<b>Total</b>	<b>\$1,072</b>	<b>\$2,725</b>	<b>\$6,777</b>
Net unrealized gains			
Debt securities	\$4,634	\$2,345	\$143
Equity securities	1,887	(939 )	692
<b>Total</b>	<b>\$6,521</b>	<b>\$1,406</b>	<b>\$835</b>

**(4) PROPERTY, PLANT AND EQUIPMENT**

Property, plant and equipment consist of the following.

	Years Ended December	
	2012	2011
	31,	
	(Dollars in Thousands)	
Building and improvements	\$-	\$254
Furniture and fixtures	3,993	4,092

Edgar Filing: FEDERATED NATIONAL HOLDING CO - Form 10-K

Property, plant and equipment, gross	3,993	4,346
Accumulated depreciation	(3,429 )	(3,504 )
Property, plant and equipment, net	\$564	\$842

Depreciation of property, plant, and equipment was \$195,078, \$167,753 and 221,494 during 2012, 2011 and 2010, respectively.

- 84 -

---



Table of Contents

Federated National Holding Company and Subsidiaries  
Notes to Consolidated Financial Statements  
December 31, 2012

## (5) REINSURANCE

We reinsure (cede) a portion of written premiums on an excess of loss or a quota-share basis to nonaffiliated insurance companies in order to limit our loss exposure. To the extent that reinsuring companies are unable to meet their obligations assumed under these reinsurance agreements, we remain primarily liable to our policyholders.

The impact of the excess of loss reinsurance treaties on the financial statements is as follows.

	Years Ended December 31,		
	2012	2011	2010
(Dollars in Thousands)			
Premium written			
Direct and Assumed	\$ 119,459	\$ 98,269	\$ 96,410
Ceded	(51,085 )	(46,293 )	(52,963 )
	\$ 68,374	\$ 51,976	\$ 43,447
Premiums earned			
Direct and Assumed	\$ 109,312	\$ 97,473	\$ 100,131
Ceded	(49,953 )	(48,950 )	(55,071 )
	\$ 59,359	\$ 48,523	\$ 45,060
Losses and LAE incurred			
Direct and Assumed	\$ 33,329	\$ 33,055	\$ 42,723
Ceded	(3,120 )	(2,159 )	(2,635 )
	\$ 30,209	\$ 30,896	\$ 40,088
		As of December 31,	
		2012	2011
		(Dollars in Thousands)	
Unpaid losses and LAE, net			
Direct and Assumed		\$ 49,908	\$ 59,983
Ceded		(3,503 )	(2,087 )
		\$ 46,405	\$ 57,896
Unearned premiums			
Direct and Assumed		\$ 59,006	\$ 47,933
Ceded		(24,083 )	(22,024 )
		\$ 34,923	\$ 25,909

The Company holds collateral under related reinsurance agreements in the form of fully funded trust agreements totaling \$4.8 million that can be drawn on for amounts that remain unpaid for more than 120 days.

The impact of the quota-share reinsurance treaties on the financial statements is as follows.

As of December 31,

	2012	2011
	(Dollars in Thousands)	
Transatlantic Reinsurance Company (A+ A.M. Best rated)		
Reinsurance (payable) recoverable on paid losses and LAE	\$8	\$(23 )
Unpaid losses and LAE	62	113
	\$70	\$90

- 85 -

---

Table of Contents

Federated National Holding Company and Subsidiaries  
Notes to Consolidated Financial Statements  
December 31, 2012

## (6) UNPAID LOSSES AND LAE

The liability for unpaid losses and LAE is determined on an individual-case basis for all incidents reported. The liability also includes amounts for unallocated expenses, anticipated future claim development and IBNR.

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

	Years Ended December 31,		
	2012	2011	2010
(Dollars in Thousands)			
Balance at January 1	\$59,983	\$66,529	\$70,610
Less reinsurance recoverables	(2,088 )	(6,809 )	(11,594 )
Net balance at January 1	\$57,895	\$59,720	\$59,016
Incurring related to			
Current year	\$31,636	\$31,893	\$37,288
Prior years	(1,427 )	(997 )	2,800
Total incurred	\$30,209	\$30,896	\$40,088
Paid related to			
Current year	\$15,892	\$13,672	\$15,077
Prior years	25,807	19,048	24,308
Total paid	\$41,699	\$32,720	\$39,385
Net balance at period end	\$46,405	\$57,896	\$59,719
Plus reinsurance recoverables	3,503	2,087	6,810
Balance at period end	\$49,908	\$59,983	\$66,529

Based upon consultations with our independent actuarial consultants and their statement of opinion on losses and LAE, we believe that the liability for unpaid losses and LAE is adequate to cover all claims and related expenses which may arise from incidents reported.

As a result of our review of liability for losses and LAE, which includes a re-evaluation of the adequacy of reserve levels for prior year's claims, we decreased the liability for losses and LAE for claims occurring in prior years by \$1.4 and \$1.0 million for the years ended December 31, 2012 and 2011, respectively, and we increased the liability for losses and LAE for claims occurring in prior years by \$2.8 million for the year ended December 31, 2010.

We continue to revise our estimates of the ultimate financial impact of claims made resulting from past storms. The revisions to our estimates are based on our analysis of subsequent information that we receive regarding various factors, including: (i) per claim information; (ii) Company and industry historical loss experience; (iii) legislative enactments, judicial decisions, legal developments in the awarding of damages, and (iv) trends in general economic conditions, including the effects of inflation.

For the year ended December 31, 2012, our actuarial firm determined range of statutory loss and LAE reserves on a net basis range from a low of \$42.2 million to a high of \$53.7 million, with a best estimate of \$45.4 million. The Company's net loss and LAE reserves are carried on a statutory basis at \$44.7 million, and on a GAAP consolidated basis at \$49.9 million which when netted with our \$3.5 million reinsurance recoverable totals \$46.4 million. The Company's statutory point estimate for its reserves as of December 31, 2012 is 1.5% below our actuary's best estimate, which reflects management's current analysis of the status and expected timing of our anticipated claims, our analysis of expected weather patterns in the regions in which we sell policies, our re-focus of our business growth efforts to areas outside of South Florida, and other factors.

Table of Contents

Federated National Holding Company and Subsidiaries  
Notes to Consolidated Financial Statements  
December 31, 2012

The following is an overview of management's loss reserving process

The Company's loss reserves can generally be categorized into two distinct groups. One group is short-tail classes of business consisting principally of property risks in connection with homes and automobiles. The other group is long-tail casualty classes of business which include primarily commercial general liability and to a much lesser extent, homeowner and automobile liability. For operations writing short-tail coverages our loss reserves were generally geared toward determining an expected loss ratio for current business rather than maintaining a reserve for the outstanding exposure. Estimations of ultimate net loss reserves for long-tail casualty classes of business is a more complex process and depends on a number of factors including class and volume of business involved. Experience in the more recent accident years of long-tail casualty classes of business shows limited statistical credibility in reported net losses because a relatively low proportion of net losses would be reported claims and expenses and even smaller percentage would be net losses paid. Therefore, incurred but not yet reported ("IBNR") would constitute a relatively high proportion of net losses.

Additionally, the different methodologies are utilized the same, regardless of the line of business. However, the final selection of ultimate loss and LAE is certain to vary by both line of business and by accident period maturity. There is no prescribed combination of line of business, accident year maturity, and methodologies; consistency in results of the different methodologies and reasonableness of the result are the primary factors that drive the final selection of ultimate loss and LAE.

Methods used to estimate Loss & LAE reserves

The methods we use for our short-tail business do not differ from the methods we use for our long-tail business. The Incurred and Paid Development Methods intrinsically recognize the unique development characteristics contained within the historical experience of each material short-tail and long-tail line of business. The Incurred and Paid Cape Cod Methods reflect similar historical development unique to each material short-tail and long-tail line of business.

We apply the following general methods in projecting loss and LAE reserves:

- Paid and Incurred Loss Development Method
- Paid and Incurred Bornhuetter-Ferguson Incurred Method
- Frequency / Severity Method

Description of Ultimate Loss Estimation Methods

The estimated Ultimate Loss and Defense and Cost Containment Expense ("DCCE") is based on an analysis by line of business, coverage and by accident quarter performed using data as of December 31, 2012. The analysis relies primarily on four actuarial methods: Incurred Loss and DCCE Development Method, Paid Loss and DCCE Development Method, Bornhuetter-Ferguson Incurred Method, and Bornhuetter-Ferguson Paid Method. Each method relies on company experience, and, where relevant, the analysis includes comparisons to industry experience. The following is a description of each of these methods:

Incurred Loss and DCCE Development Method – This reserving method is based on the assumption that the historical incurred loss and DCCE development pattern as reflected by the Company is appropriate for estimating the future loss & DCCE development. Incurred paid plus case amounts separated by accident quarter of occurrence and at quarterly evaluations are used in this analysis. Case reserves do not have to be adequately stated for this method to be effective; they only need to have a fairly consistent level of adequacy at all stages of maturity. Historical “age-to-age” loss development factors were calculated to measure the relative development of an accident quarter from one maturity point to the next. Loss and DCCE development factors (“LDF”) are selected based on a review of the historical relationships between incurred loss & DCCE at successive valuations and based on industry patterns. The LDFs are multiplied together to derive cumulative LDF’s that, when multiplied by actual incurred loss and DCCE, produce estimates of ultimate loss and DCCE.

Paid Loss & DCCE Development Method – This method is similar to the Incurred Loss & DCCE Development Method only paid loss & DCCE and paid patterns are substituted for the incurred loss & DCCE and incurred patterns.

- 87 -

---

Table of Contents

Federated National Holding Company and Subsidiaries  
Notes to Consolidated Financial Statements  
December 31, 2012

**Bornhuetter-Ferguson Incurred Method** – This reserving method combines estimated initial expected unreported loss & DCCE with the actual loss & DCCE to yield the ultimate loss & DCCE estimate. Expected unreported loss & DCCE are equal to expected total loss & DCCE times the expected unreported percentage of loss & DCCE for each policy year. The incurred loss & DCCE emergence pattern used to determine the unreported percentages in our projections is based on the selected LDF's from the Incurred Loss & DCCE Development Method described above. The estimate of initial expected total loss & DCCE is based on the historical loss ratio for more mature accident years. While this approach reduces the independence of the Bornhuetter-Ferguson Method from the loss & DCCE development methods for older policy years, it is used primarily for estimating ultimate loss & DCCE for more recent, less mature, policy years.

**Bornhuetter-Ferguson Paid Method** – This method is similar to the Bornhuetter-Ferguson Incurred Method only paid loss & DCCE and paid patterns are substituted for the incurred loss & DCCE and incurred patterns.

We select an estimate of ultimate loss & DCCE for each accident quarter after considering the results of each projection method for the quarter and the relative maturity of the quarter (the time elapsed between the start of the quarter and December 31, 2012). Reserves for unpaid losses & DCCE for each quarter are the differences between these ultimate estimates and the amount already paid. The reserves for each quarter and each coverage are summed, and the result is the overall estimate of unpaid losses & DCCE liability for the company.

We also produce an estimate of unpaid Adjusting and Other Expense (“A&O”), as a reserve is required under Statutory Accounting Principles (“SAP”) even if this expense has been pre-paid or with an unconsolidated affiliate. Although we do not prepay for A&O, the majority of the A&O incurred is with an affiliated company and eliminated under the accounting principles for consolidation. The unpaid A&O is added to unpaid losses & DCCE, resulting in total unpaid losses and LAE.

The validity of the results from using a loss development approach can be affected by many conditions, such as internal claim department processing changes, a shift between single and multiple claim payments, legal changes, or variations in a company's mix of business from year to year. Also, since the percentage of losses paid for immature years is often low, development factors can be volatile. A small variation in the number of claims paid can have a leveraging effect that could lead to significant changes in estimated ultimate values. Accordingly, our reserves are estimates because there are uncertainties inherent in the determination of ultimate losses. Court decisions, regulatory changes and economic conditions can affect the ultimate cost of claims that occurred in the past as well as create uncertainties regarding future loss cost trends. We compute our estimated ultimate liability using the most appropriate principles and procedures applicable to the lines of business written. However, because the establishment of loss reserves is an inherently uncertain process, we cannot be certain that ultimate losses will not exceed the established loss reserves and have a material adverse effect on our results of operations and financial condition.

**Frequency / Severity Method** – This method separately estimates the two components of ultimate losses (the frequency, or number of claims and the severity, or cost per claim) and then combines the resulting estimates in a multiplicative fashion to estimate ultimate losses. The approach is valuable because sometimes there is more inherent stability in the frequency and severity data when viewed separately than in the total losses.

We developed reported claim counts to ultimate levels using the development approach. The mechanics of this approach are the same as we described previously for paid and incurred losses. The validity of the results of this method depends on the stability of claim reporting and settlement rates. Then we developed accident year incurred

severities (incurred losses divided by reported claim counts) to ultimate levels using the development approach.

We trended these severities to accident year 2012 levels. Trend rates were selected based on a review of historical severities. Selected severity was chosen based on judgment considering the developed severities and the trended severities, considering industry benchmarks for each segment. The loss & ALAE, claim count and severity triangles are evaluated as of 12 months, 24 months, 36 months etc. We selected loss development factors based on the loss development history, to the extent credible, and supplemented with industry data where appropriate.

A key assumption underlying the estimation of the reserve for loss and LAE is that past experience serves as the most reliable estimator of future events. This assumption may materially affect the estimates when the insurance market, the regulatory environment, the legal environment, the economic environment, the book of business, the claims handling department, or other factors (known or unknown) have varied over time during the experience period and / or will vary (expectedly or unexpectedly) in the future. Changes in estimates, or differences between estimates and amounts ultimately paid, are reflected in the operating results of the period during which such adjustments are made. Therefore, the ultimate liability for unpaid losses and LAE will likely differ from the amount recorded at December 31, 2012.



Table of Contents

Federated National Holding Company and Subsidiaries  
Notes to Consolidated Financial Statements  
December 31, 2012

The following describes the extent of our procedures for determining the reserve for loss and LAE on both an annual and interim reporting basis:

Annually - Our policy is to select a single point estimate that best reflects our in-house actuarial determination for unpaid losses and LAE. Our independent actuarial firm, examining the exact same data set, will independently select a point estimate which determines a high point and low point range. Both processes rely on objective and subjective determinations. If our point estimate falls within the range determined from the point estimate of our actuary, then the Company's policy has been that no adjustments by management would be required. In consideration thereof, the company does not have a policy for adjusting the liability for unpaid losses and LAE to an amount that is different than an amount set forth within the range determined by our independent actuary, although the reserve level ultimately determined by us may not be the mid-point of our independent actuary's range. Further, there can be no assurances that our actual losses will be within our actuary's range. Our independent actuary's report expressly states that the report is based on assumptions developed from its own analysis and based on information provided by management and that notwithstanding its analysis, there is a significant risk of material adverse deviation from its range.

Interim – During 2012 our interim approach was very similar to the annual process noted above.

A number of other actuarial assumptions are generally made in the review of reserves for each class of business.

For each class of business, expected ultimate loss ratios for each accident year are estimated based on loss reserve development patterns. The expected loss ratio generally reflects the projected loss ratio from prior accident years, adjusted for the loss trend and the effect of rate changes and other quantifiable factors on the loss ratio.

In practice there are factors that change over time; however, many (such as inflation) are intrinsically reflected in the historical development patterns, and others typically do not materially affect the estimate of the reserve for unpaid losses and LAE. Therefore, no specific adjustments have been incorporated for such contingencies projecting future development of losses and LAE. There are no key assumptions as of December 31, 2012 premised on future emergence inconsistent with historical loss reserve development patterns.

**(7) INCOME TAXES**

A summary of the provision for income tax expense (benefit) is as follows.

	Years Ended December 31,		
	2012	2011	2010
	(Dollars in Thousands)		
Federal			
Current	\$63	\$310	\$(1,701 )
Deferred	2,052	(490 )	(1,928 )
Provision for Federal income tax expense (benefit)	2,115	(180 )	(3,629 )
State			
Current	-	-	-
Deferred	320	(390 )	(330 )
Provision for state income tax expense (benefit)	320	(390 )	(330 )
Provision for income tax expense (benefit)	\$2,435	\$(570 )	\$(3,959 )



Table of Contents

Federated National Holding Company and Subsidiaries  
Notes to Consolidated Financial Statements  
December 31, 2012

The actual income tax expense (benefit) differs from the "expected" income tax expense (benefit) (computed by applying the combined applicable effective federal and state tax rates to income before provision for income tax expense (benefit) as follows.

	Years Ended December 31,		
	2012	2011	2010
(Dollars in Thousands)			
Computed expected tax expense (benefit) provision, at federal rate	\$2,294	\$(341 )	\$(4,065 )
State tax, net of federal deduction expense (benefit)	245	(36 )	(434 )
Tax-exempt interest	(26 )	(41 )	(211 )
Dividend received deduction	(88 )	(80 )	(99 )
Stock option expense and other permanent differences	72	87	114
Intercompany	-	-	223
AMT tax credit	(113 )	-	-
Other	51	(159 )	513
Provision for income tax expense (benefit)	\$2,435	\$(570 )	\$(3,959 )

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Significant components of our net deferred tax asset are as follows.

	Years Ended December	
	31,	
	2012	2011
Deferred tax assets:		
Unpaid losses and loss adjustment expenses	\$1,725	\$2,385
Unearned premiums	2,629	1,950
Discount on advance premiums	167	195
Allowance for credit losses	31	34
Allowance for impairments	91	317
FIGA Guaranty Assessment	306	-
Depreciation & amortization	366	317
Reserve for claims settlements	809	809
NOL Carryforward	3,259	5,696
AMT credit	253	-
Stock option expense per ASC 718	432	410
Total deferred tax assets	10,068	12,113
Deferred tax liabilities:		
Deferred acquisition costs, net	(3,191 )	(2,905 )
Dividends Collected vs. Earned	(18 )	-
Regulatory assessments	(67 )	(67 )
Unrealized Gain on investment securities	(2,454 )	(529 )
Total deferred tax liabilities	(5,730 )	(3,501 )

Net deferred tax asset	\$4,338	\$8,612
------------------------	---------	---------

Based upon the results of our analysis and the application of ASC 740-10, we have determined that all material tax positions meet the recognition threshold and can be considered as highly certain tax positions. This is based on clear and unambiguous tax law, and we are highly confident that the full amount of each tax position will be sustained upon possible examination. Accordingly, the full amount of the tax positions will be recognized in the financial statements.

- 90 -

---

Table of Contents

Federated National Holding Company and Subsidiaries  
Notes to Consolidated Financial Statements  
December 31, 2012

The Company has recorded a net deferred tax asset of \$4.3 million and \$8.6 million as of December 31, 2012 and 2011, respectively. Realization of net deferred tax asset is dependent on generating sufficient taxable income in future periods. Management believes that it is more likely than not that the deferred tax assets will be realized and as such no valuation allowance has been recorded against the net deferred tax asset. Management considers the scheduled reversal of deferred tax liabilities, projected future taxable income and tax planning strategies in making this assessment. At December 31, 2012 and 2011, based upon the level of historical taxable income and projections for future taxable income over the periods in which the deferred tax assets are deductible, management believes it is more likely than not that the Company will realize the benefits of these deductible differences. When assessing the need for valuation allowances, the Company considers future taxable income and ongoing prudent and feasible tax planning strategies. Should a change in circumstances lead to a change in judgment about the realizability of deferred tax assets in future years, the Company would record valuation allowances as deemed appropriate in the period that the change in circumstances occurs, along with a corresponding increase or charge to net income. The resolution of tax reserves and changes in valuation allowances could be material to the Company's results of operations for any period, but is not expected to be material to the Company's financial position.

The Company's consolidated federal and state income tax returns for 2009-2011 are open for review by the Internal Revenue Service ("IRS") and various state taxing authorities. The 2012 federal and state income tax returns have been extended and will be filed by the extended due date in Q3 of 2013. The 2005 and 2006 income tax returns and net operating loss carry-back from tax year 2009 have been reviewed by the Joint Committee on Taxation. The Joint Committee on Taxation completed its consideration in September 2011 and took no exception to the conclusions reached by the IRS regarding the net operating loss carry-back from tax year 2009.

(8) REGULATORY REQUIREMENTS AND RESTRICTIONS

Effective January 26, 2011, FNIC merged with and into American Vehicle, and the resulting entity changed its name to "Federated National Insurance Company".

Consent Order

As part of its approval of the January 2011 merger between FNIC and American Vehicle, the Florida OIR, the Company, FNIC and American Vehicle entered into a consent order with the Florida OIR dated January 25, 2011 (the "Consent Order"), which was amended in February 2013, due to FNIC's statutory underwriting profit during 2012. Pursuant to the amended Consent Order, the Company and the resulting company in the merger (the "Merged Company") agreed to the following:

- The Merged Company retained the following licenses: (010) Fire, (020) Allied Lines, (040) Homeowners Multi Peril, (050) Commercial Multi Peril, (090) Inland Marine, (170) Other Liability, (192) Private Passenger Auto Liability, (194) Commercial Auto Liability, (211) Private Passenger Auto Physical Damage and (212) Commercial Auto Physical Damage.
- The Merged Company will not write commercial multi peril policy premium without prior approval from the Florida OIR. The Merged Company has no commercial multi peril policy premium in force.
- The Merged Company surrendered its surety license. The Merged Company has no surety policy premium in force.

- The Merged Company will not write new commercial habitation condominium associations without prior approval from the Florida OIR. The current commercial habitation book of business is less than \$0.1 million of policy premium.
  - The Merged Company agreed to maintain the total number of its homeowners' policies in Miami-Dade, Broward and Palm Beach counties (the "Tri-County Area") at 35% of its entire homeowners' book. As of December 31, 2012, the Company had approximately 20.4% of its homeowners' policies located within Tri-County Area.
- The managing general agency fees payable by the Merged Company to Federated National Underwriters, Inc. ("FNU"), formerly known as Assurance Managing General Agents, Inc., a wholly owned subsidiary of the Company, which were traditionally 6% of gross written premium, were reduced and will not exceed 4% without prior approval from the Florida OIR. The Merged Company has lowered the fee to amounts varying between 2% and 4% of gross written to further support the FNIC results of operations. This will have no impact on the Company's consolidated financial results.
- The claims service fees payable by the Merged Company to Federated National Adjusting, Inc. ("FNA"), formerly known as Superior Adjusting, Inc., were reduced from the traditional 4.5% of gross earned premium to 3.6% of gross earned premium. This will have no impact on the Company's consolidated financial results.

Table of Contents

Federated National Holding Company and Subsidiaries  
Notes to Consolidated Financial Statements  
December 31, 2012

Other Regulatory Requirements and Restrictions

To retain our certificate of authority, the Florida Insurance Code (the "Code") requires FNIC to maintain capital and surplus equal to the greater of 10% of its' liabilities or a statutory minimum capital and surplus as defined in the Code. FNIC is required to have a minimum capital surplus of \$5.0 million.

At December 31, 2012, 2011 and 2010, FNIC's statutory capital surplus was \$52.1 million, \$39.3 million and \$18.7 million, respectively. At December 31, 2010, American Vehicle had statutory capital surplus of \$21.9 million.

An insurance company is also required to adhere to prescribed premium-to-capital surplus ratios. As of December 31, 2012, 2011 and 2010, FNIC was in compliance with the prescribed premium-to-surplus ratio. As of December 31, 2010, American Vehicle was in compliance with the prescribed premium-to-surplus ratio.

We had bonds with a carrying value of approximately \$2.2 million and \$2.1 million pledged to the Florida OIR, as of December 31, 2012 and 2011, respectively, in accordance with regulatory requirements.

Under Florida law, a domestic insurer may not pay any dividend or distribute cash or other property to its shareholders except out of that part of its available and accumulated capital surplus funds which is derived from realized net operating profits on its business and net realized capital gains. A Florida domestic insurer may not make dividend payments or distributions to shareholders without prior approval of the Florida OIR if the dividend or distribution would exceed the larger of (i) the lesser of (a) 10.0% of its capital surplus or (b) net income, not including realized capital gains, plus a two-year carryforward, (ii) 10.0% of capital surplus with dividends payable constrained to unassigned funds minus 25% of unrealized capital gains or (iii) the lesser of (a) 10.0% of capital surplus or (b) net investment income plus a three-year carryforward with dividends payable constrained to unassigned funds minus 25.0% of unrealized capital gains.

Alternatively, a Florida domestic insurer may pay a dividend or distribution without the prior written approval of the Florida OIR (i) if the dividend is equal to or less than the greater of (a) 10.0% of the insurer's capital surplus as regards policyholders derived from realized net operating profits on its business and net realized capital gains or (b) the insurer's entire net operating profits and realized net capital gains derived during the immediately preceding calendar year, (ii) the insurer will have policy holder capital surplus equal to or exceeding 115.0% of the minimum required statutory capital surplus after the dividend or distribution, (iii) the insurer files a notice of the dividend or distribution with the Florida OIR at least ten business days prior to the dividend payment or distribution and (iv) the notice includes a certification by an officer of the insurer attesting that, after the payment of the dividend or distribution, the insurer will have at least 115% of required statutory capital surplus as to policyholders. Except as provided above, a Florida domiciled insurer may only pay a dividend or make a distribution (i) subject to prior approval by the Florida OIR or (ii) 30 days after the Florida OIR has received notice of such dividend or distribution and has not disapproved it within such time.

No dividends were paid by FNIC or American Vehicle in 2012, 2011 and 2010, and none are anticipated in 2013. Although we believe that amounts required to meet our financial and operating obligations will be available from sources other than dividends from our insurance subsidiaries, there can be no assurance in this regard. Further, there can be no assurance that, if requested, the Florida OIR will allow any dividends to be paid by FNIC to us, the parent company, in the future. The maximum dividends permitted by state law are not necessarily indicative of an insurer's actual ability to pay dividends or other distributions to a parent company, which also may be constrained by business

and regulatory considerations, such as the impact of dividends on capital surplus, which could affect an insurer's competitive position, the amount of premiums that can be written and the ability to pay future dividends. Further, state insurance laws and regulations require that the statutory capital surplus of an insurance company following any dividend or distribution by it be reasonable in relation to its outstanding liabilities and adequate for its financial needs.

Insurance holding company regulations govern the amount that non-insurance company subsidiaries (FNU, FNA and any other affiliate) may charge any of the insurance companies for service (e.g., management fees and commissions).

- 92 -

---



Table of Contents

Federated National Holding Company and Subsidiaries  
Notes to Consolidated Financial Statements  
December 31, 2012

In order to enhance the regulation of insurer solvency, the National Association of Insurance Commissioners (“NAIC”) established risk-based capital requirements for insurance companies that are designed to assess capital adequacy and to raise the level of protection that statutory surplus provides for policy holders. These requirements measure three major areas of risk facing property and casualty insurers: (i) underwriting risks, which encompass the risk of adverse loss developments and inadequate pricing; (ii) declines in asset values arising from credit risk; and (iii) other business risks from investments. Insurers having less statutory surplus than required will be subject to varying degrees of regulatory action, depending on the level of capital inadequacy. The Florida OIR, which follows these requirements, could require FNIC to cease operations in the event they fail to maintain the required statutory capital.

Based upon the 2012 and 2011 statutory financial statements for FNIC, statutory surplus exceeded the regulatory action levels established by the NAIC’s risk-based capital requirements.

Based on risk-based capital requirements, the extent of regulatory intervention and action increases as the ratio of an insurer’s statutory surplus to its Authorized Control Level (“ACL”), as calculated under the NAIC’s requirements, decreases. The first action level, the Company Action Level, requires an insurer to submit a plan of corrective actions to the insurance regulators if statutory surplus falls below 200.0% of the ACL amount. The second action level, the Regulatory Action Level, requires an insurer to submit a plan containing corrective actions and permits the insurance regulators to perform an examination or other analysis and issue a corrective order if statutory surplus falls below 150.0% of the ACL amount. The third action level, ACL, allows the regulators to rehabilitate or liquidate an insurer in addition to the aforementioned actions if statutory surplus falls below the ACL amount. The fourth action level is the Mandatory Control Level, which requires the regulators to rehabilitate or liquidate the insurer if statutory surplus falls below 70.0% of the ACL amount. FNIC’s ratio of statutory surplus to its ACL was 474.4%, 409.7% and 222.8% at December 31, 2012, 2011 and 2010, respectively. American Vehicle’s ratio of statutory surplus to its ACL was 373.4% at December 31, 2010.

Most recently the Florida OIR subjected FNIC to a balance sheet audit as of December 31, 2009. There were no material findings by the independent auditors in connection with this examination. FNIC also experienced a regularly scheduled statutory examination by the Florida OIR which occurred during 2010 for the five years ended December 31, 2009. There were no material findings in connection with this examination. The previous regulatory examination conducted by the Florida OIR on FNIC covered the three-year period ended on December 31, 2004.

American Vehicle also experienced a regularly scheduled statutory examination by the Florida OIR which occurred during 2011 for the five years ended December 31, 2010. There were no material findings in connection with this examination. The previous regulatory examination conducted by the Florida OIR on American Vehicle covered the three-year period ended on December 31, 2005.

The NAIC has also developed Insurance Regulatory Information Systems (“IRIS”) ratios to assist state insurance departments in identifying companies which may be developing performance or solvency problems, as signaled by significant changes in the companies’ operations. Such changes may not necessarily result from any problems with an insurance company, but may merely indicate changes in certain ratios outside the ranges defined as normal by the NAIC. When an insurance company has four or more ratios falling outside “usual ranges”, state regulators may investigate to determine the reasons for the variance and whether corrective action is warranted.

As of December 31, 2012, FNIC was outside NAIC’s usual range for three of thirteen IRIS ratios. These exceptions related to investment yield, net change in adjusted policyholders’ surplus and estimated current reserve deficiency to

policyholders' surplus.

As of December 31, 2011, FNIC was outside NAIC's usual range for two of thirteen IRIS ratios. These exceptions related to two-years overall operating ratio and investment yield.

There was no action taken by the Florida OIR in connection with the December 31, 2010 or 2011 IRIS ratio results. We do not currently believe that the Florida OIR will take any significant action with respect to FNIC regarding the 2012 IRIS ratios, although there can be no assurance that will be the case.

- 93 -

---

Table of Contents

Federated National Holding Company and Subsidiaries  
Notes to Consolidated Financial Statements  
December 31, 2012

The table below reflects the range and test results for FNIC for the years ended December 31, 2012 and 2011, respectively.

IRIS Ratios	Unusual Values Equal to		2012 FNIC	2011 FNIC	
	Or Over	Under			
Gross Premiums to Policyholders' Surplus	900	-	233	253	
Net Premium to Policyholders' Surplus	300	-	135	136	
Change in Net Writings	33	(33 )	32	18	
Surplus Aid to Policyholders' Surplus	15	-	1	1	
Two-year Overall Operating Ratio	100	-	92	123	*
Investment Yield	6.5	3.0	2.4	* 2.7	*
Gross Change in Policyholders' Surplus	50	(10 )	32	(3 )	
Net Change in Adjusted Policyholders' Surplus	25	(10 )	32	* (3 )	
Liabilities to Liquid Assets	105	-	69	75	
Gross Agents' Balance to Policyholders' Surplus	40	-	3	3	
One-Year Reserve Development to Policyholders' Surplus	20	-	(3 )	0	
Two-Year Reserve Development to Policyholders' Surplus	20	-	(2 )	8	
Estimated Current Reserve Deficiency to Policyholders' Surplus	25	-	50	* 15	

\* indicates an unusual value

GAAP differs in some respects from reporting practices prescribed or permitted by the Florida OIR. FNIC's statutory capital and surplus was \$52.1 million and \$39.3 million as of December 31, 2012 and 2011, respectively. FNIC's statutory net income was \$6.6 million and \$0.8 million for 2012 and 2011, respectively. FNIC's statutory net loss was \$12.0 million for 2010. FNIC's statutory non-admitted assets were nearly nothing and approximately \$5.7 million as of December 31, 2012 and 2011, respectively.

American Vehicle's statutory capital and surplus was \$21.9 million as of December 31, 2010. American Vehicle's statutory net income was approximately \$1.6 million for 2010. American Vehicle's statutory non-admitted assets were approximately \$5.6 million as of December 31, 2010.

#### (9) COMMITMENTS AND CONTINGENCIES

Management has a responsibility to continually measure and monitor its commitments and its contingencies. The nature of the Company's commitments and contingencies can be grouped into three major categories: insured claim activity, assessment related activities and operational matters.

##### (A) Insured Claim Activity

We are involved in claims and legal actions arising in the ordinary course of business. The amount of liability for these claims and lawsuits is uncertain. Revisions to our estimates are based on our analysis of subsequent information that we receive regarding various factors, including: (i) per claim information; (ii) company and industry historical

loss experience; (iii) legislative enactments, judicial decisions, legal developments in the awarding of damages; and (iv) trends in general economic conditions, including the effects of inflation. Management revises its estimates based on the results of its analysis. This process assumes that experience, adjusted for the effects of current developments and anticipated trends, is an appropriate basis for estimating the ultimate settlement of all claims. There is no precise method for subsequently evaluating the impact of any specific factor on the adequacy of the reserves, because the eventual redundancy or deficiency is affected by multiple factors. In the opinion of management, the ultimate disposition of these matters may have a material adverse effect on our consolidated financial position, results of operations, or liquidity.

The Company's subsidiaries are, from time to time, named as defendants in various lawsuits incidental to their insurance operations. Legal actions relating to claims made in the ordinary course of seeking indemnification for a loss covered by the insurance policy are considered by the Company in establishing loss and LAE reserves.

Table of Contents

Federated National Holding Company and Subsidiaries  
Notes to Consolidated Financial Statements  
December 31, 2012

The Company also faces, in the ordinary course of business, lawsuits that seek damages beyond policy limits. The Company continually evaluates potential liabilities and reserves for litigation of these types using the criteria established by FASB issued guidance. Under this guidance, reserves for a loss are recorded if the likelihood of occurrence is probable and the amount can be reasonably estimated. If a loss, while not probable, is judged to be reasonably possible, management will make an estimate of a possible range of loss or state that an estimate cannot be made. Management considers each legal action using this guidance and records reserves for losses as warranted.

(B) Assessment Related Activity

We operate in a regulatory environment where certain entities and organizations have the authority to require us to participate in assessments. Currently these entities and organizations include, but are not limited to, Florida Insurance Guaranty Association (“FIGA”), Citizens Property Insurance Corporation (“Citizens”), Florida Hurricane Catastrophe Fund (“FHCF”) and Florida Joint Underwriters Insurance Association (“JUA”). As a direct premium writer in the state of Florida, we are required to participate in certain insurer solvency associations under Florida Statutes Section 631.57(3) (a), administered by FIGA.

During December 2012, the Company was assessed \$0.8 million by FIGA relating to the recent failures of Florida domestic property and casualty insurance companies. Future assessments are likely, although the impact of these assessments on our balance sheet, results of operations or cash flow are undeterminable at this time.

FNIC is also required to participate in an insurance apportionment plan under Florida Statutes Section 627.351, which is referred to as a JUA Plan. The JUA Plan provides for the equitable apportionment of any profits realized, or losses and expenses incurred, among participating automobile insurers. In the event of an underwriting deficit incurred by the JUA Plan which is not recovered through the policyholders in the JUA Plan, such deficit shall be recovered from the companies participating in the JUA Plan in the proportion that the net direct written premiums of each such member during the preceding calendar year bear to the aggregate net direct premiums written in this state by all members of the JUA Plan. FNIC was not assessed by the JUA Plan during 2012 or 2011. Future assessments by this association are undeterminable at this time.

(C) Operational Matters

The Company’s consolidated federal and state income tax returns for 2009-2011 are open for review by the IRS and various state taxing authorities. The 2012 federal and state income tax returns have been extended and will be filed by the extended due date in Q3 of 2013. The 2005 and 2006 income tax returns and net operating loss carry-back from tax year 2009 have been reviewed by the Joint Committee on Taxation. The Joint Committee on Taxation completed its consideration in September 2011 and took no exception to the conclusions reached by the IRS regarding the net operating loss carry-back from tax year 2009.

The Company has recorded a net deferred tax asset of \$4.3 million and \$8.6 million as of December 31, 2012 and December 31, 2011, respectively. Realization of net deferred tax asset is dependent on generating sufficient taxable income in future periods. Management believes that it is more likely than not that the deferred tax assets will be realized and as such no valuation allowance has been recorded against the net deferred tax asset. Management considers the scheduled reversal of deferred tax liabilities, projected future taxable income and tax planning strategies in making this assessment. At December 31, 2012, based upon the level of historical taxable income and projections for future taxable income over the periods in which the deferred tax assets are deductible, management believes it is

more likely than not that the Company will realize the benefits of these deductible differences. When assessing the need for valuation allowances, the Company considers future taxable income and ongoing prudent and feasible tax planning strategies. Should a change in circumstances lead to a change in judgment about the realizability of deferred tax assets in future years, the Company would record valuation allowances as deemed appropriate in the period that the change in circumstances occurs, along with a corresponding increase or charge to net income. The resolution of tax reserves and changes in valuation allowances could be material to the Company's results of operations for any period, but is not expected to be material to the Company's financial position.

The Company is not currently involved in any material legal actions arising from the ordinary course of business that are not related to insured claims activity.

- 95 -

---

Table of Contents

Federated National Holding Company and Subsidiaries  
Notes to Consolidated Financial Statements  
December 31, 2012

**(10) LEASES**

Relative to the Company's commitments stemming from operational matters, on or about March 1, 2006 we sold our interest in the building that housed our operations in Lauderdale Lakes through December 16, 2011, to an unrelated party. As part of this transaction, we agreed to lease the same facilities for a five-year term. We amended the lease agreement and the note receivable on September 1, 2010. As part of the amendment, we discounted the note receivable and have discontinued the interest on the note. In consideration, we paid a reduced lease payment for the remainder of the lease. Our lease for this office space expired in December 2011.

Our executive offices are now located at 14050 N.W. 14th Street, Suite 180, Sunrise, Florida 33323 in an 18,500 square feet office facility. All of our operations are consolidated within this facility. We believe that the facilities are well maintained, in substantial compliance with environmental laws and regulations, and adequately covered by insurance. We also believe that these leased facilities are not unique and could be replaced, if necessary, at the end of the lease term. Our lease for this office space will expire in May 2017.

The expected future lease payouts in connection with this lease are as follows.

Fiscal Year	Payments (Dollars in Thousands)
2013	373
2014	380
2015	388
2016	395
2017	151
Total	\$ 1,687

Rent expense was \$0.2 million in 2012 and \$0.7 million in 2011 and 2010.

**(11) RELATED PARTY TRANSACTIONS**

One of our directors is a partner at a law firm that handles some of the Company's claims litigation. Fees paid to this law firm amounted to approximately \$27,175, \$3,349 and \$40,000 in 2012, 2011 and 2010, respectively, and is included in LAE.

**(12) NET INCOME PER SHARE**

Net income per share is computed by dividing net income by the weighted average number of shares of common stock and common stock equivalents outstanding during the periods presented. In accordance with GAAP, net loss per share would be antidilutive; therefore the basic and diluted loss per share is the same.

Table of Contents

Federated National Holding Company and Subsidiaries  
Notes to Consolidated Financial Statements  
December 31, 2012

A summary of the numerator and denominator of the basic and fully diluted 2012, 2011 and 2010 net income (loss) per share is presented below.

	Income (loss) (Numerator)	Shares Outstanding (Denominator)	Per-share Amount
	(Amounts in Thousands)		
For the year ended December 31, 2012			
Basic net income per share	\$4,313	7,952	\$0.53
Fully diluted income per share	\$4,313	8,016	\$0.53
For the year ended December 31, 2011			
Basic net loss per share	\$(430 )	7,946	\$(0.05 )
Fully diluted loss per share	\$(430 )	7,946	\$(0.05 )
For the year ended December 31, 2010			
Basic net loss per share	\$(7,996 )	7,946	\$(1.01 )
Fully diluted loss per share	\$(7,996 )	7,946	\$(1.01 )

**(13) SEGMENT INFORMATION**

FASB issued guidance requires that the amount reported for each segment item be based on what is used by the chief operating decision maker in formulating a determination as to how many resources to assign to a segment and how to appraise the performance of that segment. The term chief operating decision maker may apply to the chief executive officer or chief operating officer or to a group of executives. Note: The term of chief operating decision maker may apply to a function and not necessarily to a specific person. This is a management approach rather than an industry approach in identifying segments. The segments are based on the Company's organizational structure, revenue sources, nature of activities, existence of responsible managers, and information presented to the Board of Directors.

If any one of the following exists, a segment must be reported on.

- Revenue, including unaffiliated and inter-segment sales or transfers, is 10% or more of total revenue of all operating segments.
- Operating profit or loss is 10% or more of the greater, in absolute amount, of the combined operating profit (or loss) of all industry segments with operating profits (or losses).
  - Identifiable assets are 10% or more of total assets of all operating segments.

Operating segments that are not reportable should be combined and disclosed in the "all other" category. Disclosure should be made of the sources of revenue for these segments.

Accordingly, we have no segment information to report.

**(14) STOCK COMPENSATION PLANS**



We implemented a stock option plan in September 1998, which expired in September 2008, and provided for the granting of stock options to officers, key employees and consultants. The objectives of this plan included attracting and retaining the best personnel, providing for additional performance incentives, and promoting our success by providing employees the opportunity to acquire common stock. Options outstanding under this plan were granted at prices either equal to or above the market value of the stock on the date of grant, typically vest over a four-year or five-year period and expire six or ten years after the grant date. Under this plan, we were authorized to grant options to purchase up to 900,000 common shares, and as of December 31, 2012 and 2011 we had outstanding exercisable options to purchase 78,500 shares and 89,750 shares, respectively.

- 97 -

---

Table of Contents

Federated National Holding Company and Subsidiaries  
Notes to Consolidated Financial Statements  
December 31, 2012

In 2002, we implemented the 2002 Stock Option Plan, which expired in April 2012. The purpose of this plan was to advance our interests by providing an additional incentive to attract, retain and motivate highly qualified and competent persons who are key to the Company, including employees, consultants, independent contractors, officers and directors. Our success is largely dependent upon their efforts and judgment; therefore, by authorizing the grant of options to purchase common stock, we encourage stock ownership. Options outstanding under the plan were granted at prices either equal to or above the market value of the stock on the date of grant, expire six or ten years after the grant date and have vesting periods determined by the Compensation Committee of our Board of Directors. Under this plan, we were authorized to grant options to purchase up to 1,800,000 common shares, and as of December 31, 2012 and 2011 we had outstanding exercisable options to purchase 702,597 and 624,700 shares, respectively.

In April 2012, our Board of Directors adopted, and in September 2012 our shareholders approved, the Company's 2012 Stock Incentive Plan (the "2012 Plan"). The 2012 Plan permits the issuance of up to 1,000,000 shares of our common stock, subject to adjustment as provided for in the 2012 Plan, in connection with the grant of a variety of equity incentive awards, such as incentive stock options, non-qualified stock options, stock appreciation rights, dividend equivalent rights, restricted stock, restricted stock units, and performance shares. Officers, directors and executive, managerial, administrative and professional employees of the Company and its subsidiaries are eligible to participate in the 2012 Plan. Awards may be granted singly, in combination, or in tandem. As of December 31, 2012, no awards had been granted under the 2012 Plan. The 2012 Plan was amended and restated in March 2013 to clarify the plan administrator's authority to permit the vesting of unvested restricted shares in the event of the death of the grantee. The 2012 Plan will expire on April 5, 2022. Please see Footnote 22 of the Notes to Consolidated Financial Statements for additional discussions regarding the granting of shares from the 2012 Plan.

Activity in our stock option plans for the period from January 1, 2009 to December 31, 2012 is summarized below.

	1998 Plan		2002 Plan		2012 Plan	
	Number of Shares	Weighted Average Option Exercise Price	Number of Shares	Weighted Average Option Exercise Price	Number of Shares	Weighted Average Option Exercise Price
Outstanding at January 1, 2010	124,599	\$15.88	736,951	\$12.03	-	\$-
Granted	-	\$-	109,500	\$3.59	-	\$-
Exercised	-	\$-	-	\$-	-	\$-
Cancelled	(34,849 )	\$23.74	(271,651 )	\$14.78	-	\$-
Outstanding at January 1, 2011	89,750	\$12.83	574,800	\$9.12	-	\$-
Granted	-	\$-	179,000	\$2.45	-	\$-
Exercised	-	\$-	-	\$-	-	\$-
Cancelled	-	\$-	(129,100 )	\$14.29	-	\$-
Outstanding at January 1, 2012	89,750	\$12.83	624,700	\$6.15	-	\$-
Granted	-	\$-	181,500	\$4.40	-	\$-
Exercised	-	\$-	(33,104 )	\$3.86	-	\$-
Cancelled	(11,250 )	\$13.54	(70,499 )	\$12.45	-	\$-
Outstanding at December 31, 2012	78,500	\$12.73	702,597	\$5.17	-	\$-



Table of Contents

Federated National Holding Company and Subsidiaries  
Notes to Consolidated Financial Statements  
December 31, 2012

Options outstanding as of December 31, 2012 are exercisable as follows.

Options Exercisable at:	1998 Plan		2002 Plan		2012 Plan	
	Number of Shares	Weighted Average Option Exercise Price	Number of Shares	Weighted Average Option Exercise Price	Number of Shares	Weighted Average Option Exercise Price
December 31, 2012	77,800	\$12.73	314,825	\$5.17	-	\$-
December 31, 2013	700	\$12.73	164,458	\$5.17	-	\$-
December 31, 2014	-	\$12.73	145,114	\$5.17	-	\$-
December 31, 2015	-	\$12.73	78,200	\$5.17	-	\$-
December 31, 2016	-	\$12.73	-	\$5.17	-	\$-
Thereafter	-	\$12.73	-	\$5.17	-	\$-
<b>Total options exercisable</b>	<b>78,500</b>		<b>702,597</b>		<b>-</b>	

Prior to January 1, 2006, we accounted for the plans under the recognition and measurement provisions of stock-based compensation using the intrinsic value method prescribed by the APB and related Interpretation, as permitted by FASB issued guidance. Under these provisions, no stock-based employee compensation cost was recognized in the Statement of Operations as all options granted under those plans had an exercise price equal to or less than the market value of the underlying common stock on the date of grant.

Upon the exercise of options, the Company issues authorized shares.

Effective January 1, 2006, the Company adopted the fair value recognition provisions of FASB issued guidance using the modified-prospective-transition method. Under that transition method, compensation costs recognized during 2012 and 2011 include the following.

- Compensation cost for all share-based payments granted prior to, but not yet vested as of January 1, 2006, based on the grant date fair value estimated in accordance with the original provisions of FASB issued guidance, and
- Compensation cost for all share-based payments granted subsequent to January 1, 2006, based on the grant-date fair-value estimated in accordance with the provisions of FASB issued guidance. Results for prior periods have not been restated, as they are not required to be by the pronouncement.

As a result of adopting FASB issued guidance on January 1, 2006, the Company's income from continuing operations before provision for income tax expense and net income for 2012 are lower by approximately \$265,900 and \$165,700, respectively, than if it had continued to account for share-based compensation under APB guidance.

As a result of adopting FASB issued guidance on January 1, 2006, the Company's loss from continuing operations before provision for income tax benefit and net loss for 2011 are higher by approximately \$240,000 and \$150,000, respectively, than if it had continued to account for share-based compensation under APB guidance.

Basic and diluted income per share for 2012 would have been \$0.55, if the Company had not adopted FASB issued guidance, compared with reported basic and diluted income per share of \$0.53.

Basic and diluted loss per share for 2011 would have been \$0.03, if the Company had not adopted FASB issued guidance, compared with reported basic and diluted loss per share of \$.05.

Because the change in income taxes receivable includes the effect of excess tax benefits, those excess tax benefits also must be shown as a separate operating cash outflow so that operating cash flows exclude the effect of excess tax benefits. FASB issued guidance requires the cash flows resulting from the tax benefits resulting from tax deductions in excess of the compensation cost recognized for those options (excess tax benefits) to be classified as financing cash flows.

The weighted average fair value of options granted during 2012, 2011 and 2010 estimated on the date of grant using the Black-Scholes option-pricing model was \$1.45, \$0.72 to \$0.78 and \$1.54 to \$1.81, respectively.

Table of Contents

Federated National Holding Company and Subsidiaries  
Notes to Consolidated Financial Statements  
December 31, 2012

The fair value of options granted is estimated on the date of grant using the following assumptions.

	December 31, 2012	December 31, 2011	December 31, 2010
Dividend yield	N/A	N/A	1.78% - 5.80%
Expected volatility	39.79%	35.21% - 39.08%	73.13% - 82.36%
Risk-free interest rate	0.28%	0.20% - 0.25%	0.99% - 1.33%
Expected life (in years)	4.45	4.29 - 4.35	3.06 - 3.78

Summary information about the Company's stock options outstanding at December 31, 2012 follows.

	Range of Exercise Price	Outstanding at December 31, 2012	Weighted Average Contractual Periods in Years	Weighted Average Exercise Price	Exercisable at December 31, 2012
1998 Plan	8.67 - \$16.59	78,500	0.71	\$12.73	77,800
2002 Plan	2.45 - \$13.24	702,597	5.90	\$5.17	314,825
2012 Plan	N/A	-	N/A	N/A	-

**(15) EMPLOYEE BENEFIT PLAN**

We have established a profit sharing plan under Section 401(k) of the Internal Revenue Code. This plan allows eligible employees to contribute up to 100 percent of their compensation, not to exceed statutory limits. The Company match totaled \$0.1 million during each of the years 2012, 2011 and 2010.

Through December 31, 2010, the Company matched 50% of the first 6% of a participant's elective contributions. Effective January 1, 2011, the Board of Directors approved an amendment to our 401(k) plan to be a qualified automatic contribution arrangement with an employer match of 100% of the first 1% of elective contributions and an employer match of 50% of the next 2% to 6% of elective contributions, which is vested 100% after 2 years of service.

**(16) ACQUISITIONS**

We made no acquisitions during 2012 or 2011.

Effective January 26, 2011, FNIC merged with and into American Vehicle, and the resulting entity changed its name to "Federated National Insurance Company". See "Footnote 8 - Regulation – Consent Order".

**(17) COMPREHENSIVE INCOME (LOSS)**

For the years ended December 31, 2012, 2011 and 2010, comprehensive income (loss) consisted of the following.

Years Ended December 31,

Edgar Filing: FEDERATED NATIONAL HOLDING CO - Form 10-K

	2012	2011	2010
	(Dollars in Thousands)		
Net income (loss)	\$4,313	\$(430 )	\$(7,996 )
Change in net unrealized gains (losses) on investments available for sale	5,114	572	(2,415 )
Comprehensive income (loss) before tax	9,427	142	(10,411 )
Income tax (expense) benefit related to items of other comprehensive income (loss)	(1,924 )	(215 )	909
Comprehensive income (loss)	\$7,503	\$(73 )	\$(9,502 )

- 100 -

---

Table of Contents

Federated National Holding Company and Subsidiaries  
Notes to Consolidated Financial Statements  
December 31, 2012

## (18) AUTHORIZATION OF PREFERRED STOCK

Our Amended and Restated Articles of Incorporation authorize the issuance of one million shares of preferred stock with designations, rights and preferences determined from time to time by our board of directors. Accordingly, our Board of Directors is empowered, without shareholder approval, to issue preferred stock with dividends, liquidation, conversion, voting or other rights that could adversely affect the voting power or other rights of the holders of common stock. We have not issued preferred shares as of December 31, 2012.

## (19) FEDERATED NATIONAL HOLDING COMPANY (UNAUDITED)

FNHC (the parent company only) has no long term obligations, guarantees or material contingencies as of December 31, 2012. The following summarizes the major categories of the parent company's financial statements.

Condensed Balance Sheets (Unaudited)	Period Ending December 31,	
ASSETS	2012	2011
	(Dollars in Thousands)	
Cash and short term investments	\$1,494	\$2,283
Investments and advances to subsidiaries	61,005	60,554
Deferred income taxes receivable	4,338	8,612
Income taxes receivable	9,515	9,474
Property, plant and equipment, net	98	260
Other assets	4,069	4,024
<b>Total assets</b>	<b>\$80,519</b>	<b>\$85,207</b>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Income taxes payable	-	78
Other liabilities	125	143
<b>Total liabilities</b>	<b>125</b>	<b>221</b>
Shareholders' equity:		
Common stock	80	80
Additional paid-in capital	45,378	45,250
Accumulated other comprehensive (loss) income	(1,039 )	494
Retained earnings	35,975	39,162
<b>Total shareholders' equity</b>	<b>80,394</b>	<b>84,986</b>
<b>Total liabilities and shareholders' equity</b>	<b>\$80,519</b>	<b>\$85,207</b>



Table of Contents

## Federated National Holding Company and Subsidiaries

Notes to Consolidated Financial Statements

December 31, 2012

## Condensed Statements of Operations (Unaudited)

Years Ended December 31,  
2012            2011            2010  
(Dollars in Thousands)

## Revenue:

Management fees from subsidiaries	\$1,228	\$1,734	\$1,669
Equity in income of subsidiaries	8,787	(48 )	(10,080 )
Net investment income	34	31	2
Other income	476	1,345	518
Total revenue	10,525	3,062	(7,891 )

## Expenses:

Salaries and wages	1,853	1,775	1,930
Legal fees	198	54	19
Other expenses	1,726	2,233	2,114
Total expenses	3,777	4,062	4,063
Income (loss) before provision for income tax expense (benefit)	6,748	(1,000 )	(11,955 )
Provision for income tax expense (benefit)	2,435	(570 )	(3,959 )
Net income (loss)	\$4,313	\$(430 )	\$(7,996 )

-102-

Table of Contents

## Federated National Holding Company and Subsidiaries

Notes to Consolidated Financial Statements

December 31, 2012

## Condensed Statements of Cash Flow (Unaudited)

	Years Ended December 31,		
	2012	2011	2010
	(Dollars in Thousands)		
Cash flow from operating activities:			
Net income (loss)	\$4,313	\$(430 )	\$(7,996 )
Adjustments to reconcile net income (loss) to net cash provided by operating activities:			
Equity in (income) loss of subsidiaries	(8,787 )	48	10,080
Depreciation and amortization of property plant and equipment, net	23	7	13
Deferred income tax (benefit) expense	(4,274 )	696	3,241
Income tax (payable) recoverable	(78 )	78	-
Change in dividends payable	-	-	(477 )
Non-cash compensation	188	263	431
Changes in operating assets and liabilities:			
Property, plant and equipment	(138 )	73	(259 )
Deferred gain on sale of assets	(30 )	(506 )	(500 )
Other assets	45	(292 )	(301 )
Other liabilities	(18 )	(770 )	(675 )
Net cash provided by operating activities	(8,756 )	(833 )	3,557
Cash flow used in investing activities:			
Purchases of investment securities available for sale	(451 )	(846 )	(5,024 )
Increased capital of subsidiaries	-	-	(5,025 )
Cash flow used in investing activities:	(451 )	(846 )	(10,049 )
Net cash used in financing activities:			
Dividends paid	(159 )	-	(477 )
Stock options exercised	128	-	-
Tax benefit related to non-cash compensation	100	92	151
Advances (to) from subsidiaries	8,349	668	3,832
Net cash used in financing activities:	8,418	760	3,506
Net decrease in cash and short term investments	(789 )	(919 )	(2,986 )
Cash and short term investments at beginning of year	2,283	3,202	6,188
Cash and short term investments at end of year	\$1,494	\$2,283	\$3,202

Table of Contents

## Federated National Holding Company and Subsidiaries

## Notes to Consolidated Financial Statements

December 31, 2012

## (20) SCHEDULE VI – SUPPLEMENTAL INFORMATION CONCERNING PROPERTY-CASUALTY INSURANCE OPERATIONS (UNAUDITED)

	Loss and LAE - Current Year	Loss and LAE - Prior year	Amortization of deferred policy acquisition expenses (Dollars in Thousands)	Paid losses and LAE expenses	Net premiums written
2012	\$31,636	\$(1,427 )	\$ 13,255	\$15,892	\$68,374
2011	\$31,893	\$(997 )	\$ 12,347	\$13,672	\$51,976
2010	\$37,288	\$2,800	\$ 13,025	\$15,077	\$43,447

Affiliation with registrant	Deferred policy acquisition costs	Reserves for losses and LAE	Discount, if any, deducted from previous column (Dollars in Thousands)	Unearned premiums	Net premiums earned
-----------------------------	---	--------------------------------------	--	----------------------	---------------------------

Consolidated Property and Casualty  
Subsidiaries

2012	\$8,479	\$49,908	\$ -	\$59,006	\$59,359
2011	\$7,718	\$59,983	\$ -	\$47,933	\$48,523
2010	\$7,879	\$66,529	\$ -	\$47,136	\$45,060

## (21) FAIR VALUE DISCLOSURE

In April 2009, the FASB issued accounting guidance that if an entity determines that either the volume and/or level of activity for an investment security has significantly decreased (from normal conditions for that investment security) or price quotations or observable inputs are not associated with orderly transactions, increased analysis and management judgment will be required to estimate fair value. This guidance was effective for interim and annual periods ending after June 15, 2009, with early adoption permitted. This guidance was applied prospectively. The adoption of this guidance did not have an impact on the Company's financial statements or condition.

In October 2008, the FASB issued accounting guidance to clarify the application of GAAP in determining fair value of financial instruments in a market that is not active. The guidance was effective upon issuance, including prior periods for which financial statements had not been issued. Our adoption of this guidance does not have a material effect on our financial position, results of operations, cash flows or disclosures.

In September 2006, FASB issued accounting guidance that defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for an asset or liability in an orderly transaction between market participants on the measurement date. This guidance also establishes a fair value hierarchy that requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The guidance also categorizes assets and liabilities at fair value into one of three different levels depending on the observation of the inputs employed in the measurement, as follows.

-104-

---

Table of Contents

## Federated National Holding Company and Subsidiaries

## Notes to Consolidated Financial Statements

December 31, 2012

Level 1 — inputs to the valuation methodology are quoted prices (unadjusted) for identical assets or liabilities in active markets. A quoted price for an identical asset or liability in an active market provides the most reliable fair value measurement because it is directly observable to the market.

Level 2 — inputs to the valuation methodology include quoted prices for similar assets and liabilities in active markets, and inputs are observable for an asset or liability, either directly or indirectly, for substantially the full term of the financial instrument.

Level 3 — inputs to the valuation methodology are unobservable and significant to the fair value measurement.

Securities available for sale: The fair value of securities available for sale is determined by obtaining quoted prices on nationally recognized security exchanges.

Assets measured at fair value on a recurring basis as of December 31, 2012, presented in accordance with this guidance, are as follows.

	As of December 31, 2012			
	Level 1	Level 2	Level 3	Total
	(Dollars in Thousands)			
Debt securities:				
United States government obligations and authorities	\$12,464	\$14,928	\$-	\$27,392
Obligations of states and political subdivisions	-	3,939	-	3,939
Corporate	67,313	-	-	67,313
International	-	3,111	-	3,111
	79,777	21,978	-	101,755
Equity securities:				
Common stocks	20,982	-	-	20,982
	20,982	-	-	20,982
<b>Total debt and equity securities</b>	<b>\$100,759</b>	<b>\$21,978</b>	<b>\$-</b>	<b>\$122,737</b>

## (22) SUBSEQUENT EVENTS

On March 4, 2013, a total of 100,000 restricted shares from the 2012 Plan were granted pursuant to the vesting requirements and other terms and conditions set forth in Restricted Stock Agreements. Of the total, 25,000 shares were granted to the Company's Chief Executive Officer and President and 15,000 shares were granted to the Company's Chief Financial Officer. An aggregate of 20,000 shares were granted to the Company's directors and the remaining 40,000 shares were granted to other employees of the Company.

On February 15, 2013, Federated National entered into a Reimbursement Contract and Addendum No. 1 thereto (together, the "Reimbursement Contract") with the SBA for the 2013-2014 hurricane season. This Reimbursement Contract is part of the Company's reinsurance program and will reimburse Federated National for covered property losses under its homeowners' insurance policies resulting from hurricanes that cause damage in the State of Florida through May 31, 2014.

Under this Reimbursement Contract, the FHCF will provide approximately \$167.3 million of aggregate seasonal coverage for covered losses in excess of approximately \$62.8 million, subject to a 10.0% Company participation. Federated National's premium for the FHCF reinsurance coverage will be approximately \$11.2 million payable in three installments between August 2013 and December 2013. The actual attachment point, total coverage and cost will not be finalized until December 31, 2013.

-105-

---

Table of Contents

Federated National Holding Company and Subsidiaries

ITEM 9 CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None

ITEM 9A CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in the reports that we file or submit under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

As of the end of the period covered by this report, we carried out an evaluation, under the supervision and with the participation of our principal executive officer and principal financial officer, of the effectiveness of the design and operation of our disclosure controls and procedures. Based on that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective as of December 31, 2012.

Management's Report on Internal Control over Financial Reporting

Because of its inherent limitations, internal controls over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in condition, or that the degree of compliance with the policies or procedures may deteriorate.

Our management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Exchange Act Rule 13a-15(f). Under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, we conducted an evaluation of the effectiveness of our internal control over financial reporting based on the framework in Internal Control — Integrated Framework issued by the COSO.

Based on the results of this evaluation, our management has concluded that our internal control over financial reporting was effective as of December 31, 2012 to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external reporting purposes in accordance with GAAP. We reviewed the results of management's assessment with the Company's Audit Committee.

Changes in Internal Control over Financial Reporting

There were no changes in our internal control over financial reporting that occurred during the year ended December 31, 2012 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Limitations on Effectiveness

Our management and our audit committee do not expect that our disclosure controls and procedures or internal control over financial reporting will prevent all errors or all instances of fraud. A control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that the control system's objectives will be met. Further, the design of the control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control gaps and instances of fraud have been detected. These inherent limitations include the realities that judgments and decision-making can be faulty, and that breakdowns can occur because of simple errors or mistakes. Controls can also be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the controls. The design of any system of controls is based in part upon certain assumptions about the likelihood of future events, and any design may not succeed in achieving its stated goals under all potential future conditions.



Table of Contents

## Federated National Holding Company and Subsidiaries

## ITEM 9BOTHER INFORMATION

None

## PART III

## ITEM 10 DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

The following table sets forth certain information with respect to our executive officers and directors as of April 1, 2013:

Name	Age	Position with the Company
Michael H. Braun(5)(6)	45	Chief Executive Officer, President, Class I Director
Peter J. Prygelski, III(2)	44	Chief Financial Officer, Treasurer, Class I Director
Bruce F. Simberg(2)(3)(4)(5)	64	Chairman, Class II Director
Richard W. Wilcox, Jr.(1)(3)(4)(6)	1	Class II Director
Carl Dorf(1)(2)(3)(4)	72	Class III Director
Charles B. Hart, Jr.(2)(3)(4)(5)(6)	74	Class III Director
Jenifer G. Kimbrough(1)(3)(4)	41	Class I Director

(1)	Audit Committee Member
(2)	Investment Committee Member
(3)	Compensation Committee Member
(4)	Nominating Committee Member
(5)	Directors Compensation Committee Member
(6)	Strategic Initiatives Committee Member

Our Articles of Incorporation provide that our Board of Directors shall consist of three classes of directors, as nearly equal in number as possible, designated Class I, Class II and Class III, and provides that the exact number of directors comprising our Board of Directors will be determined from time to time by resolution adopted by the Board. At each annual meeting of shareholders, successors to the class of directors whose term expires at that annual meeting are elected for a three-year term. The current term of the Class I directors terminates on the date of our 2013 annual meeting. The current term of the Class II directors terminates on the date of our 2015 annual meeting and the current term of the Class III directors terminates as of the date of our 2014 annual meeting.

The following is a brief description of the business experience of each director and executive officer of the Company.

Michael H. Braun was appointed Chief Executive Officer of the Company in July 2008, President in June 2009, and elected to the Board of Directors in December 2005. Previously, Mr. Braun was Chief Operating Officer, where he was responsible for the Company's day-to-day operations and strategic product portfolio. Mr. Braun has also served as President of Federated National Insurance Company ("Federated National"), a subsidiary of the Company, since September 2003, a position that he continues to hold. Previously, he held key management positions within Federated National, responsible for operations, marketing and underwriting. Prior to joining the Company, Mr. Braun was Managing Partner for an independent chain of insurance agencies, which was acquired by the Company in 1998.

Peter J. Prygelski, III was named Chief Financial Officer in June 2007 after serving as an independent director from January 2004 through June 2007. Mr. Prygelski was re-nominated to the Board in June 2008 and has served as an inside director since that time. Mr. Prygelski has spent his entire career in the financial services industry. He spent 12 years at American Express in various capacities including; Director of Internal Audit and Assistant General Auditor of American Express Centurion Bank. In this capacity, Mr. Prygelski was responsible for the monitoring of internal controls for a bank with \$45 billion in assets, and assessing and mitigating operational, reputational, regulatory and strategic risk. After leaving American Express, he spent the next three years at Ernst & Young and Deloitte and Touche. At both firms, Mr. Prygelski served as a senior manager responsible for growing the financial services practice in the Southeast. He managed teams that provided Fortune 500 companies with consulting services in the following areas; Finance Transformation, Finance Operations Effectiveness, Financial Reporting, Cost Optimization, Governance, Risk and Compliance Services, and Board of Directors Performance.

Table of Contents

Federated National Holding Company and Subsidiaries

Bruce F. Simberg has served as a director of the Company since January 1998. Mr. Simberg has been a practicing attorney since October 1975, most recently as managing partner of Conroy, Simberg, Ganon, Krevans, Abel, Lurvey, Morrow & Schefer, P.A. (“Conroy Simberg”), a law firm in Ft. Lauderdale, Florida founded by him, since October 1979.

Richard W. Wilcox, Jr. has served as a director of the Company since January 2003. Mr. Wilcox has been in the insurance industry for more than 40 years. In 1963, Mr. Wilcox started an insurance agency that eventually developed into a business generating \$10 million in annual revenue. In 1991, Mr. Wilcox sold his agency to Hilb, Rogal and Hamilton Company (“HRH”) of Fort Lauderdale, for which he retained the position of President through 1998. In 1998, HRH of Fort Lauderdale merged with Poe and Brown of Fort Lauderdale, and Mr. Wilcox served as the Vice President of Poe and Brown until 1999, when he retired. Mr. Wilcox holds an Advanced Professional Director Certification from the American College of Corporate Directors, a national public company director education and credentialing organization.

Carl Dorf has served as a director of the Company since August 2001. Mr. Dorf has over forty years of diversified investment experience as a security analyst, portfolio manager, mutual fund manager and hedge fund manager. He earned the Chartered Financial Analyst (CFA) designation and in the past served as director of the Los Angeles Society of Security Analysts. Since April 2001, Mr. Dorf has been the principal of Dorf Asset Management, LLC, and is responsible for all investment decisions made by that company. From January 1991 to February 2001, Mr. Dorf served as the Fund Manager of ING Pilgrim Bank and Thrift Fund. Prior to his experience at Pilgrim, Mr. Dorf was a principal in Dorf & Associates, an investment management company.

Charles B. Hart, Jr. has served as a director of the Company since March 2002. Mr. Hart has more than forty (40) years of experience in the insurance industry. From 1973 to 1999, Mr. Hart served as President of Public Assurance Group and as General Manager of Operations for Bristol West Insurance Services. Since 1999, Mr. Hart has acted as an insurance consultant.

Jenifer G. Kimbrough has served as a director of the Company since April 2009. Ms. Kimbrough has served as the Vice President of Compliance and Audit for Surgical Care Affiliates since March 2010, prior to which Ms. Kimbrough served as the Vice President of Assurance and Process Improvement. Prior to 2007, Ms. Kimbrough was the Senior Vice President of Investor Relations at Regions Financial Corporation. From 1993 to 2003, Ms. Kimbrough served as an Audit Senior Manager at Ernst & Young LLP. Ms. Kimbrough received her certification as a certified public accountant from the Alabama State Board of Public Accountancy in 1994. Ms. Kimbrough is an active member of several societies, including: American Woman’s Society of CPAs, Institute of Internal Auditors, Alabama State Society of CPAs and American Institute of CPAs. Additionally, she recently served on the AICPA Women’s Initiative Executive Committee and as National President of the AWSCPA.

Board Committees

The standing committees of the Board of Directors in 2012 were the Audit Committee, the Compensation Committee, the Nominating Committee, the Investment Committee, the Directors Compensation Committee and the Strategic Initiatives Committee. Charters for the Audit, Compensation and Nominating Committees are available upon the Company’s website at FedNat.com. The charter of the Audit, Compensation and Nominating Committees is also available in print to any shareholder who requests it from our Corporate Secretary.

Audit Committee. As of December 31, 2012, the Audit Committee was composed of Jenifer G. Kimbrough, who served as the Chairman of the Audit Committee, Richard W. Wilcox, Jr. and Carl Dorf. Each member was

determined to be “independent” as defined under the listing and maintenance rules of The Nasdaq Stock Market (the “Nasdaq Rules”) and SEC rules for Audit Committee membership. Ms. Kimbrough was designated as a “financial expert” as that term is defined in the applicable rules and regulations of the Securities Exchange Act of 1934 (the “Exchange Act”). The Board determined that Ms. Kimbrough was a "financial expert" as defined in the applicable rules and regulations of the Exchange Act based on her understanding of GAAP and financial statements; her ability to assess the general application of GAAP in connection with the accounting for estimates, accruals and reserves; her experience preparing, auditing, analyzing or evaluating financial statements that present a breadth and level of complexity of accounting issues that are generally comparable to the breadth and complexity of issues that can reasonably be expected to be raised by the Company’s financial statements, or experience actively supervising one or more persons engaged in such activities; her understanding of internal controls and procedures for financial reporting; and her understanding of audit committee functions.

-108-

---

Table of Contents

Federated National Holding Company and Subsidiaries

Pursuant to its written charter, the duties and responsibilities of the Audit Committee include, but are not limited to, (a) the appointment of the independent certified public accountants and any termination of such engagement, (b) reviewing the plan and scope of independent audits, (c) reviewing significant accounting and reporting policies and operating controls, (d) having general responsibility for all related auditing and financial statement matters, and (e) reporting its recommendations and findings to the full Board of Directors. The Audit Committee pre-approves all auditing services and permitted non-audit services (including the fees and terms thereof) to be performed by the independent accountants, subject to the de minimus exceptions for non-audit services described in Section 10A(i)(1)(B) of the Exchange Act that are approved by the Audit Committee prior to the completion of the audit.

To ensure prompt handling of unexpected matters, the Audit Committee delegates to the Chair the authority to amend or modify the list of approved permissible non-audit services and fees. The Chair will report action taken to the Audit Committee at the next committee meeting. The Chief Financial Officer is responsible for tracking all independent auditor fees against the budget for such services and reports at least annually to the Audit Committee.

Compensation Committee. As of December 31, 2012, the Company's Compensation Committee was composed of Richard W. Wilcox, Jr., Bruce F. Simberg, Charles B. Hart, Jr., and Jenifer G. Kimbrough. Each member is independent as defined by the Nasdaq Rules. The Compensation Committee performs the duties and responsibilities pursuant to its charter, which includes reviewing and approving the compensation of the Company's executive officers. Mr. Wilcox serves as the Chairman.

Nominating Committee. As of December 31, 2012, the Company's Nominating Committee was composed of Bruce F. Simberg, Jenifer G. Kimbrough, Carl Dorf, Charles B. Hart, Jr. and Richard W. Wilcox, Jr. Each member is independent as defined by the Nasdaq Rules. Mr. Simberg serves as the Chairman.

The Nominating Committee will consider candidates for director who are recommended by its members, by other Board members and by management of the Company. The Nominating Committee will consider nominees recommended by our shareholders if the shareholder submits the nomination in compliance with the advance notice, information and other requirements described in our bylaws and applicable securities laws. The Nominating Committee evaluates director candidates recommended by shareholders in the same way that it evaluates candidates recommended by its members, other members of the Board, or other persons.

It is the Board's policy to identify qualified potential candidates without regard to any candidate's race, color, disability, gender, national origin, religion or creed. In recommending proposed nominees to the full Board, the Nominating Committee is charged with building and maintaining a Board that has an ideal mix of talent and experience to achieve the Company's business objectives. In particular, the Nominating Committee considers all aspects of a candidate's qualifications in the context of the needs of the Company at that point in time with a view to creating a Board with a diversity of experience and perspectives. Among the qualifications, qualities and skills of a candidate considered important by the Nominating Committee is a person with strength of character, mature judgment, familiarity with the Company's business and industry, independence of thought and an ability to work collegially.

Shareholders who wish to recommend nominees to the Nominating Committee should submit their recommendation in writing to the Secretary of the Company at its executive offices pursuant to the requirements contained in Article III, Section 13 of the Company's Bylaws. This section provides that the notice shall include: (a) as to each person who the shareholder proposed to nominate for election, (i) name, age, business address and residence address of the person, (ii) the principal occupation or employment of the person, (iii) the class and number of shares of capital stock of the Company which are beneficially owned by the person, (iv) the consent of each nominee to serve as a director of the Company if so elected and (v) any other information relating to the person that is required to be disclosed in

solicitation for proxies for the election of directors pursuant to Rule 14A under the Exchange Act; and (b) as to the shareholder giving the notice, the name and record address of the shareholder, and (ii) the class and number of shares of capital stock of the Company which are beneficially owned by the shareholder. The Company may require any proposed nominee to furnish such other information as may reasonably be required by the Company to determine the eligibility of such proposed nominee to serve as a director of the Company.

Investment Committee. As of December 31, 2012, the Company's Investment Committee was composed of Peter J. Prygelski, III, Bruce F. Simberg, Carl Dorf and Charles B. Hart, Jr. The Investment Committee manages our investment portfolio pursuant to its adopted Investment Policy Statement. Mr. Dorf serves as the Chairman.

Table of Contents

Federated National Holding Company and Subsidiaries

Directors Compensation Committee. As of December 31, 2012, the Company's Directors Compensation Committee was composed of Michael H. Braun, Bruce F. Simberg and Charles B. Hart, Jr. The Directors Compensation Committee performs the duties and responsibilities pursuant to its charter, which includes reviewing and approving the compensation of the Company's independent directors. Mr. Braun serves as the Chairman.

Strategic Initiatives Committee. As of December 31, 2012, the Company's Strategic Initiatives Committee was composed of Michael H. Braun, Richard W. Wilcox, Jr. and Charles B. Hart, Jr. The Strategic Initiatives Committee performs the duties and responsibilities pursuant to its charter, which includes developing, adopting and modifying strategic initiatives of the Company. Mr. Hart serves as the Chairman.

Corporate Governance/Code of Conduct

We have adopted a Code of Conduct for all employees, officers and directors of the Company. A copy of our Code of Conduct policy is available on our web site at FedNat.com.

Leadership Structure and Risk Oversight

The Chairman of the Board typically presides at all meetings of the Board. The Chairman is elected to serve by the directors. Currently, the offices of Chairman of the Board and Chief Executive Officer are separated. The Chief Executive Officer and Chief Financial Officer currently serve as the only members of management on the Board. Based on the current size, organizational structure and nature of operations of the Company, the Board believes that maintaining the separation of the offices of the Chairman of the Board and Chief Executive Officer is in the best interests of the Company.

The Company believes that its Board as a whole should encompass a range of talent, skill, diversity, and expertise enabling it to provide sound guidance with respect to the Company's operations and interests. The Company's policy is to have at least a majority of Directors qualify as independent as defined by the "Nasdaq Rules". The Nominating Committee identifies candidates for election to the Board of Directors; reviews their skills, characteristics and experience; and recommends nominees for director to the Board for approval. The Nominating Committee's Charter provides that the Board of Directors as a whole should be diverse and consist of individuals with various and relevant career experience, relevant technical skills, industry knowledge and experience, financial expertise and local or community ties. Minimum individual requirements include strength of character, mature judgment, familiarity with the Company's business and industry, independence of thought and an ability to work collegially. The Board believes that the qualifications of the directors, as set forth in their biographies set forth above provides them with the qualifications and skills to serve as a director of our Company.

To facilitate the Board's oversight functions and to take advantage of the knowledge and experience of its members, the Board has created several standing committees. These committees, the Audit, Investment, Nominating, Compensation Directors Compensation and Strategic Initiatives Committees, allow regular risk oversight and monitoring, and deeper analysis of issues before the Board. The Audit and Compensation committee structures also require committees to be comprised exclusively of independent directors. The membership of the standing committees is reviewed from time to time, and specific committee assignments are proposed and appointed by the Board. In addition, among their other respective duties, the Board and Audit Committee each conduct an annual assessment to evaluate their effectiveness.

The Board's role in connection with risk oversight is to oversee and monitor the management of risk practiced by the Company's management in the performance of their duties. The Board does this in a number of ways, principally

through the oversight responsibility of committees of the Board, but also as part of the strategic planning process. For example, our Audit Committee oversees management of risks related to accounting, auditing and financial reporting and maintaining effective internal controls over financial reporting. Our Nominating Committee oversees risk associated with corporate governance and the Company's code of conduct, including compliance with listing standards for independent directors and conflicts of interest. Our Compensation Committee oversees the risk related to our executive compensation plans and arrangements. Our Investment Committee oversees the risks related to managing our investment portfolio. Our Directors Compensation Committee oversees the risk related to our non-employee director compensation plans and arrangements. Our Strategic Initiatives Committee oversees the development and implementation of strategic initiatives of the Company . The full Board receives reports on a regular basis regarding each committee's oversight from the chairperson of each committee when reporting on their committee's actions at regular Board meetings.



Table of Contents

Federated National Holding Company and Subsidiaries

Subsidiary Presidents

James Gordon Jennings, III (age 55) has served as the President of Federated National Underwriters, Inc. since May 2008 and as the Company's Vice President of Risk Management since April 2008. He was employed from 1990 through 2000 by American Vehicle, one of our wholly owned subsidiaries, where he was involved in all aspects of property and casualty insurance. Mr. Jennings served as our Controller from May 2000 through August 2002, as our Chief Financial Officer from August 2002 through June 2007, and as our Chief Accounting Officer from June 2007 through March 2008. Mr. Jennings, formerly a certified public accountant, also holds a Certificate in General Insurance and an Associate in Insurance Services as designated by the Insurance Institute of America. Mr. Jennings maintains a Florida General Lines Insurance License since 2009 and also carries a 1-20 Florida Surplus Lines License.

C. Brian Turnau (age 46) has served as the President of Federated National Adjusting, Inc. since July 2006. Mr. Turnau served as the Litigation Manager of FNA from June 2000 until his promotion to President. He has over 10 years' experience in the insurance industry. Prior to joining the Company, Mr. Turnau worked for private practice insurance defense litigation law firms for over fifteen years. Mr. Turnau earned his Bachelor of Arts degree in History in 1989 from Washington and Lee University. He currently serves on the Board of Directors of the Florida High School for Accelerated Learning, a nonprofit charter school that serves the needs of underprivileged students.

Christopher Clouse (age 45) has served as the President of Insure-Link, Inc. since its incorporation in March 2008. Mr. Clouse has over 22 years of experience in the insurance industry and has maintained a Florida General Lines Insurance License since 1991. He also carries a 2-14 Life including Variable Annuity License, 1-20 Florida Surplus Lines License, and is an Accredited Advisor in Insurance as designated by The Institutes. Prior to joining the Company Mr. Clouse served as an agent and/or managing agent for several private agencies with a primary focus on personal lines of insurance including homeowners, auto and flood insurance.

Stephen C. Young (age 38) has served as President of Federated Premium Finance, Inc., a wholly-owned subsidiary of the Company, from January 1998 through the present date and as the Company's President from June 2007 through June 2009. Mr. Young has served as Vice President of Operations of the Company since June 2009, and previously from June 2006 through May 2007.

Section 16(a) Beneficial Ownership Reporting Compliance

Section 16(a) of the Exchange Act requires that our executive officers, directors, and persons who own more than 10% of a registered class of our equity securities to file reports of beneficial ownership and certain changes in beneficial ownership with the SEC and to furnish us with copies of those reports. To our knowledge, based solely on a review of the copies of such reports furnished to us or written representations that no other reports were required, we believe that during the year ended December 31, 2012, our officers, directors and greater than 10% shareholders timely filed all reports required by Section 16(a), except Bruce Simberg reported one transaction for the purchase of 130 shares of common stock late on a Form 4.

Table of Contents

## Federated National Holding Company and Subsidiaries

## ITEM 11

## EXECUTIVE COMPENSATION

## Summary Compensation Table

The following table sets forth information regarding compensation earned by, awarded to or paid to our Chief Executive Officer and President, and Chief Financial Officer, for the years ended December 31, 2012 and 2011. We refer to these officers as our Named Executive Officers in other parts of this Form 10-K. We currently do not have any other individual employee of the Company designated as an executive officer.

## SUMMARY COMPENSATION

Name and Principal Position	Year	Salary	Bonus	Stock Awards	Non-Equity Nonqualified			All Other Compensation (2)	Total
					Option Awards (1)	Incentive Plan Compensation	Deferred Compensation Earnings		
Michael H. Braun Chief Executive Officer, President	2012	\$278,261	\$70,800	--	\$21,743	--	--	\$ 27,821	\$398,625
	2011	\$236,002	\$44,250	--	\$7,823	--	--	\$ 36,369	\$324,444
Peter J. Prygelski, III Chief Financial Officer, Treasurer	2012	\$222,535	\$59,400	--	\$21,743	--	--	\$ 27,573	\$331,251
	2011	\$198,000	\$29,700	--	\$7,823	--	--	\$ 35,223	\$270,746

(1) This amount reflects the aggregate grant date fair value computed in accordance with FASB ASC Topic 718. Assumptions used in the calculation of this amount are included in Footnote 14 to the Company's audited financial statements for fiscal years ended December 31, 2012 and December 31, 2011, respectively.

(2) See table "All Other Compensation" for an itemized disclosure of this element of compensation.

## ALL OTHER COMPENSATION

Name	Year	Auto	Club Member Fees	Insurance Benefits (1)	Contribution		All Other Compensation Total
					to 401(k) Plan (2)		
Michael H. Braun	2012	\$ 9,578	--	\$ 8,313	\$ 9,930	\$ 27,821	
	2011	\$ 10,994	--	\$ 20,078	\$ 8,297	\$ 36,369	
Peter J. Prygelski, III	2012	\$ 6,000	\$ 8,100	\$ 6,018	\$ 7,455	\$ 27,573	
	2011	\$ 6,000	\$ 7,284	\$ 14,667	\$ 7,272	\$ 35,223	

(1) Represents premiums for life, medical and dental insurance.

(2) Represents matching contributions made by the Company on behalf of the Named Executive Officers to the Company's 401(k) plan.

Employment Agreements

Michael H. Braun. We entered into a second amended and restated employment agreement with Michael H. Braun, the Company's Chief Executive Officer and President, effective as of January 18, 2012, which amends and restates Mr. Braun's prior employment agreement. Under his agreement, Mr. Braun was entitled to receive an annual salary of \$280,000 and a \$500 monthly automobile allowance. Additionally, under the agreement, Mr. Braun's annual salary may be increased at any time during the term of the agreement. Mr. Braun's annual salary was increased to \$350,000 effective January 1, 2013. The agreement is for a term of two years, which term shall automatically be extended so that at all times the balance of the term shall not be less than two years unless sooner terminated as provided in the second amended and restated employment agreement. Mr. Braun is also entitled to receive such bonuses and increases as may be awarded by the Board of Directors. It also contains customary confidentiality and non-solicitation provisions. Additionally, we entered into a non-compete agreement with Mr. Braun effective December 19, 2005. The non-compete agreement prohibits Mr. Braun from directly or indirectly competing with us for a period of one (1) year after the termination of his employment for any reason. If Mr. Braun's employment with the Company is terminated, he is entitled to certain payments described below.

-112-

---

Table of Contents

Federated National Holding Company and Subsidiaries

Peter J. Prygelski, III. We entered into a second amended and restated employment agreement with Peter J. Prygelski, III, the Company's Chief Financial Officer and Treasurer, effective as of January 18, 2012, which amends and restates Mr. Prygelski's prior employment agreement. Under his agreement, Mr. Prygelski was entitled to receive an annual salary of \$223,000 and a \$500 monthly automobile allowance. Additionally, under the agreement, Mr. Prygelski's annual salary may be increased at any time during the term of the agreement. Mr. Prygelski's annual salary was increased to \$250,000 effective January 1, 2013. The agreement is for a term of two years, which term shall automatically be extended so that at all times the balance of the term shall not be less than two years unless sooner terminated as provided in the second amended and restated employment agreement. Mr. Prygelski is also entitled to receive such bonuses and increases as may be awarded by the Board of Directors. It also contains customary confidentiality and non-solicitation provisions. Additionally, we entered into a non-compete agreement and an annual review agreement with Mr. Prygelski effective June 25, 2007. The non-compete agreement prohibits Mr. Prygelski from directly or indirectly competing with us for a period of one year after the termination of his employment for any reason. If Mr. Prygelski's employment with the Company is terminated, he is entitled to certain payments described below.

Mr. Braun and Mr. Prygelski are each entitled to receive certain payments upon the termination of employment under certain circumstances as set forth in their respective agreements, both under the agreements as in effect during 2011 and as amended and restated in 2012. If the executive's employment is terminated by us without Cause (as defined in the respective agreements), we must make a lump sum payment to the executive equal to two years' base salary (the "Termination Severance"). In addition, all unvested stock options and any other equity awards held by him will become vested.

If Mr. Braun's or Mr. Prygelski's employment with us is terminated for Cause or as a result of his death or disability, he will be entitled to his base salary prorated through the date of the termination and any benefits due him as may be provided under the applicable plan, program or arrangement.

The agreements also provide for payments to the executives if employed by us on the date on which a Change of Control occurs. Under the agreements, a "Change of Control" will be deemed to have occurred if: (i) any person, including a "group" as defined in Section 13(d)(3) of the Securities Exchange Act of 1934, as amended, becomes the owner or beneficial owner of our securities having 50% (which was increased from 30% in the agreements in effect during 2011) or more of the combined voting power of our then-outstanding securities that may be voted for the election of our directors (other than as a result of an issuance of securities initiated by us, or open market purchases approved by our Board, as long as the majority of the Board approving the purchases is the majority at the time the purchases are made), or (ii) the persons who were our directors before such transactions shall cease to constitute a majority of our Board, or any successor to us, as the direct or indirect result of or in connection with, any cash tender or exchange offer, merger or other business combination, sale of assets or contested election, or any combination of the foregoing transactions. If, following a Change in Control, Mr. Braun's or Mr. Prygelski's employment is terminated by us (or any successor or subsidiary) without Cause or by the executive for Good Reason (as defined in the respective agreements), we will make a lump sum payment to the executive in an amount equal to two times the sum of his base salary in effect immediately prior to the Change of Control plus his actual bonus for the fiscal year immediately preceding the Change of Control (the "Change of Control Severance"). In addition, all unvested stock options and any other equity awards held by him will become vested.

If either Mr. Braun or Mr. Prygelski is terminated by us without Cause prior to a Change of Control, and a Change of Control occurs within six months following such termination, then in addition to the Termination Severance described above, the executive will be entitled to an additional lump sum payment in an amount equal to (i) the Change of Control Severance, less (ii) the Termination Severance.

As a condition to Messrs. Braun and Prygelski's entitlement to receive the base salary amounts and equity award acceleration referenced above, each is bound by the terms of an agreement that sets forth certain restrictive covenants. Pursuant to the non-competition provisions of these agreements, each are prohibited from working in the insurance industry in any territories where the Company has been doing business for a period of one year from the date on which he terminates employment with the Company for any reason (other than without cause). For a period of one year after his employment is terminated, he is also prohibited from soliciting directly for himself or for any third person any employees or former employees of the Company, unless the employees have not been employed by the Company for a period in excess of six months, and from disclosing any confidential information that he learned about the Company during his employment.

-113-

---

Table of Contents

## Federated National Holding Company and Subsidiaries

## Grants of Plan Based Awards

The following table provides information regarding stock options granted to Named Executive Officers during 2012 under the Company's 2002 Stock Option Plan:

GRANTS OF PLAN-BASED AWARDS				
Name	Grant Date	All Other Option Awards / Number of Securities Underlying Options	Exercise or Base Price of Option Awards	Grant Date Fair Value of Stock and Option Awards (1)
Michael H. Braun	04/6/2012	15,000	\$ 4.40	\$ 21,742.50
Peter J. Prygelski, III	04/6/2012	15,000	\$ 4.40	\$ 21,742.50

(1) This amount reflects the aggregate grant date fair value computed in accordance with FASB ASC Topic 718. Assumptions used in the calculation of this amount are included in Footnote 14 to the Company's audited financial statements for fiscal year ended December 31, 2012.

## Stock Incentive Plans

Our 2012 Stock Incentive Plan (the "2012 Plan") administered by the Compensation Committee and Directors Compensation Committee (together the "Committees"). The objectives of the 2012 Plan includes attracting, motivating and retaining key personnel and promoting our success by linking the interests of our employees, directors and consultants with our success.

Awards may be made under the 2012 Plan in the form of (a) incentive stock options, (b) non-qualified stock options, (c) stock appreciation rights, (d) dividend equivalent rights, (e) restricted stock, (f) unrestricted stock, (g) restricted stock units, and (h) performance shares. No incentive stock option may be granted to a person who is not an employee of the Company or one of its subsidiaries on the date of grant. In addition, both incentive stock options and non-statutory stock options were granted under our 1998 and 2002 stock option plans, both of which has expired, although certain options remain outstanding under these plans.

Options Available for Issuance. As of December 31, 2012, all 900,000 shares of common stock authorized for issuance upon exercise of options granted under the 1998 plan and 1,800,000 total shares authorized for issuance under the 2002 plan have been issued or are issuable upon exercised of outstanding options, and there were 1,000,000 shares available to be awarded under the 2012 Plan. The shares to be delivered upon exercise of options or awards will be made available, at the discretion of the Committees, from authorized but unissued shares or outstanding options or awards that expire or are cancelled. If shares covered by an option or award cease to be issuable for any reason, such number of shares will no longer count against the shares authorized under the plan and may again be granted under the 2012 Plan.

Term of Options. The term of each outstanding option granted to our officers and employees is currently 10 years.

Vesting Schedule. Options or awards granted under our stock plans, unless waived or modified in a particular option agreement or by action of the Committees, typically vest according to the following schedule:

## Vesting Schedule

From the Grant Date	Portion of Grant Vested
Less than 1 year	0%
1 year	33 1/3%
2 years	33 1/3%
3 years	33 1/3%

Options or awards granted under the stock plans require that the recipient of a grant be continuously employed or otherwise provide services to us or our subsidiaries. Failure to be continuously employed or in another service relationship generally results in the forfeiture of options or awards not vested at the time the employment or other service relationship ends. Termination of a recipient's employment or other service relationship for cause generally results in the forfeiture of all of the recipient's unexercised options or awards.

Table of Contents

Federated National Holding Company and Subsidiaries

Adjustments in Our Capital Structure. The number and kind of shares available for grants under our stock plans and any outstanding options or awards under the plans, as well as the exercise price of outstanding options or awards, will be subject to adjustment by the Committees in the event of any merger, consolidation, reorganization, stock split, stock dividend or other event causing a capital adjustment affecting the number of outstanding shares of common stock. In the event of a business combination or in the event of a sale of all or substantially all of our assets, the Committees may cash out some or all of the unexercised, vested options or awards under the plan, or allow some or all of the options or awards to remain outstanding, subject to certain conditions. Unless otherwise provided in individual option agreements, the vesting of outstanding options or awards will not accelerate in connection with a business combination or in the event of a sale of all or substantially all of our assets.

Administration. The Committees have full discretionary authority to determine all matters relating to options and awards granted under the stock plans, including the persons eligible to receive options or awards, the number of shares subject to each option or award, the exercise price of each option or award, any vesting schedule, any acceleration of the vesting schedule and any extension of the exercise period. The Committees have granted limited authority to executive management members to grant awards to eligible individuals.

Amendment and Termination. Our Board of Directors has authority to suspend, amend or terminate the 2012 Plan, except as would adversely affect participants rights to outstanding awards without their consent. The 2012 Plan was amended and restated in March 2013 to clarify the plan administrator's authority to permit the vesting of unvested restricted shares in the event of the death of the grantee. As the plan administrator, our Committees have the authority to interpret the plans and options or awards granted under the stock plans and to make all other determinations necessary or advisable for plan administration.



Table of Contents

## Federated National Holding Company and Subsidiaries

## Outstanding Equity Awards at Fiscal Year-End; Option Exercises and Stock Vested

The following table summarizes the holdings held by our Chief Executive Officer and President, and Chief Financial Officer for the year ended December 31, 2012.

## OUTSTANDING EQUITY AWARDS AT FISCAL YEAR-END

Name	Option Awards		Option Exercise Price (\$)	Option Expiration Date
	Number of Securities Underlying Unexercised Options-Exercisable	Number of Securities Underlying Unexercised Options-Unexercisable		
Michael H. Braun	5,000	0	16.59	10/25/2013 (1)
	20,000	0	14.36	11/08/2013 (2)
	500	0	13.17	12/06/2013 (3)
	3,600	900	12.58	01/30/2014 (4)
	32,000	8,000	8.32	07/01/2014 (5)
	500	0	4.59	12/12/2018 (6)
	24,000	8,000	4.73	01/02/2015 (7)
	6,000	9,000	4.36	03/03/2020 (8)
	3,334	6,666	2.45	08/22/2021 (9)
	0	15,000	4.40	04/06/2022 (10)
Peter J. Prygelski, III	20,000	0	11.11	06/25/2013 (11)
	500	0	13.17	12/06/2013 (3)
	3,600	900	12.58	01/30/2014 (4)
	8,000	2,000	8.32	07/01/2014 (5)
	500	0	4.59	12/12/2014 (6)
	6,000	9,000	4.36	03/03/2020 (8)
	3,334	6,666	2.45	08/22/2021 (9)
	0	15,000	4.40	04/06/2022 (10)

- (1) Options vested as to 100% of the underlying shares on December 31, 2012.
- (2) Options vested as to 100% of the underlying shares on December 31, 2012.
- (3) Options vested as to 100% of the underlying shares on December 31, 2012.
- (4) Options vested as to 80% of the underlying shares on December 31, 2012, the remaining 20% vest on 1/30/2013.
- (5) Options vested as to 80% of the underlying shares on December 31, 2012, the remaining 20% vest on 7/1/2013.
- (6) Options vested as to 100% of the underlying shares on December 31, 2012.
- (7) Options vested as to 60% of the underlying shares on December 31, 2012, the remaining 40% vest as follows:  
20% on 1/2/2013 and 20% on 1/2/2014.
- (8) Options vested as to 40% of the underlying shares on December 31, 2012, the remaining 60% vest as follows:  
20% on 3/3/2013, 20% on 3/3/2014 and 20% on 3/3/2015.
- (9) Options vested as to 33 1/3% of the underlying shares on December 31, 2012, the remaining 66 2/3% vest as follows:  
33 1/3% on 8/22/2013 and 33 1/3% on 8/22/2014.
- (10) Options vested as to 0% of the underlying shares on December 31, 2012, the remaining 100% vest as follows:  
33 1/3% on 4/6/2013, 33 1/3% on 4/6/2014 and 33 1/3% on 4/6/2015.
- (11) Options vested as to 100% of the underlying shares on December 31, 2012.

## Option Exercises and Stock Vested

None of our Named Executive Officers exercised stock options during the year ended December 31, 2012. No other equity compensation was received by or awarded to our Named Executive Officers during the year ended December 31, 2013.

#### Pension Benefits and Other Nonqualified Deferred Compensation

None of our Named Executive Officers participate in or have account balances in qualified or non-qualified defined benefit or contribution plans or other deferred compensation plans maintained by us. The Compensation Committee, which is composed solely of outside directors as defined for purposes of Section 162(m) of the Internal Revenue Code, may elect to provide our officers and other employees with qualified or non-qualified defined benefit or contribution or other deferred compensation benefits if the Compensation Committee determines that doing so is in our best interests.

-116-

---

Table of Contents

## Federated National Holding Company and Subsidiaries

## Director Compensation

During 2012, we had five non-employee directors that qualified for compensation. Non-employee directors receive an initial stock option grant upon appointment to the board of directors and subsequent option grants as may be granted at the discretion of the Board. In addition, non-employee directors receive annual cash compensation, perquisites as approved by the Directors Compensation Committee, and reimbursement of actual out-of-pocket expenses. During 2012, in lieu of per meeting directors' fees, the non-employee directors received an annual retainer of \$40,000, payable in quarterly installments of \$10,000 in January, April, and July and October. In September 2012, the Directors Compensation Committee recommended, and the Board approved, an increase of the annual retainer fee to \$48,000 effective October 1, 2012. In addition the Directors Compensation Committee recommended, and the Board approved, annual retainer fees to each chairperson of committees and the Board effective October 1, 2012 and payable in quarterly installments. The Chairman of the Board of Directors annual fee is \$15,000, the chairperson of the Audit Committee's annual fee is \$8,000, the chairperson of the Investment's fee is \$7,000, the chairperson of the Compensation Committee's annual fee is \$6,000 and the chairperson of the Strategic Initiatives Committee's fee is \$6,000. The chairperson of the Directors Compensation Committee is an employee director, therefore there is no annual retainer fee paid. Directors who are also employees do not receive this compensation.

We also grant options to our non-employee directors as part of their compensation. Stock options granted to non-employee directors in 2012 are shown in the table below.

## NON-EMPLOYEE DIRECTORS' COMPENSATION SUMMARY

Name	Fees Earned or Paid in Cash	Stock Awards	Option Awards (2)	Non-Equity Incentive Plan Compensation	Non-Qualified Deferred Compensation Earnings	All Other Compensation	Total
Carl Dorf	\$43,750	--	\$21,743	--	--	--	\$65,493
Charles B. Hart, Jr.	\$43,500	--	\$21,743	--	--	\$ 5,300(1)	\$70,543
Bruce F. Simberg	\$45,750	--	\$21,743	--	--	--	\$67,493
Richard W. Wilcox, Jr.	\$43,500	--	\$21,743	--	--	--	\$65,243
Jenifer G. Kimbrough	\$44,000	--	\$21,743	--	--	--	\$65,743

(1) Includes \$1,000 paid for country club membership and \$4,300 for events attended by director in 2012.

(2) The following table provides certain additional information concerning the currently outstanding options held by our non-employee directors as of the end of 2012:

Name	Total Stock Option Awards Outstanding at 2012 Fiscal Year End (Shares)	Option Awards Granted During 2012 (a) Fiscal Year (Shares)	Grant Date Fair Value of Option Awards Granted During 2012 (\$)

Carl Dorf	45,000 (b)	15,000 (a)	\$21,743
Charles B. Hart, Jr.	45,000 (b)	15,000 (a)	\$21,743
Bruce F. Simberg	55,000 (c)	15,000 (a)	\$21,743
Richard W. Wilcox, Jr.	45,000 (b)	15,000 (a)	\$21,743
Jenifer G. Kimbrough	35,000 (d)	15,000 (a)	\$21,743

- (a)The stock options reported in this column were granted in April 2012 and vest 33 1/3% per year over three years on each anniversary of the date of grant.
- (b)Includes 500 options granted on 12/6/2007 with an exercise price of \$13.17, vest 20% per year, and expire on 12/6/2013; 4,500 options granted on 1/30/2008 with an exercise price of \$12.58, vest 20% per year and expire on 1/30/2014; 15,000 options granted on 1/2/2009 with an exercise price of \$4.73, vest 33 1/3% per year and expire on 1/2/2015; 10,000 options granted on 8/22/2011 with an exercise price of \$2.45, vest 33 1/3% per year, and expire on 8/22/2021; and 15,000 options granted on 4/6/2012 with an exercise price of \$4.40, vest 33 1/3% per year, and expire on 4/6/2022.
- (c)Includes 500 options granted on 12/6/2007 with an exercise price of \$13.17, vest 20% per year, and expire on 12/6/2013; 4,500 options granted on 1/30/2008 with an exercise price of \$12.58, vest 20% per year and expire on 1/30/2014; and 25,000 options granted on 1/2/2009 with an exercise price of \$4.73, vest 33 1/3% per year and expire on 1/2/2015; 10,000 options granted on 8/22/2011 with an exercise price of \$2.45, vest 33 1/3% per year, and expire on 8/22/2021; and 15,000 options granted on 4/6/2012 with an exercise price of \$4.40, vest 33 1/3% per year, and expire on 4/6/2022.
- (d)Includes 10,000 options granted on 4/1/2009 with an exercise price of \$3.30, vest 20% per year and expire on 4/1/2015; 10,000 options granted on 8/22/2011 with an exercise price of \$2.45, vest 33 1/3% per year, and expire on 8/22/2021; and 15,000 options granted on 4/6/2012 with an exercise price of \$4.40, vest 33 1/3% per year, and expire on 4/6/2022.

Table of Contents

## Federated National Holding Company and Subsidiaries

ITEM SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND  
12 RELATED STOCKHOLDER MATTERS

The following table sets forth, as of April 1, 2013, information with respect to the beneficial ownership of our common stock by (i) each person who is known by us to beneficially own 5% or more of our outstanding common stock, (ii) each of our executive officers named in the Summary Compensation Table in the section "Executive Compensation," (iii) each of our directors, and (iv) all directors and executive officers as a group.

As used herein, the term "beneficial ownership" with respect to a security is defined by Rule 13d-3 under the Exchange Act as consisting of sole or shared voting power (including the power to vote or direct the vote) and/or sole or shared investment power (including the power to dispose or direct the disposition of) with respect to the security through any contract, arrangement, understanding, relationship or otherwise, including a right to acquire such power(s) during the next 60 days. Unless otherwise noted, beneficial ownership consists of sole ownership, voting and investment rights and the address for each person is c/o Federated National Holding Company, 14050 NW 14 Street, Suite 180, Sunrise, Florida 33323.

Name and Address of Beneficial Owner	Number of Shares Beneficially Owned	Percent of Class Outstanding (1)
Bruce F. Simberg (2)	363,517	4.47%
Richard W. Wilcox, Jr. (3)	168,918	2.08%
Michael H. Braun (4)	154,734	1.89%
Carl Dorf (5)	147,622	1.82%
Peter J. Prygelski, III (6)	71,034	*
Charles B. Hart, Jr. (7)	32,334	*
Jenifer G. Kimbrough (8)	21,244	*
All directors and executive officers as a group (seven persons) (9)	959,403	11.44%
5% or greater holders:		
Lloyd I. Miller, III (10) 4550 Gordon Drive Naples, FL 34102	775,809	9.59%
Dimensional Fund Advisors LP (11) Palisades West, Building One 6300 Bee Cave Road Austin, TX 78746	551,527	6.82%

\* Less than 1%.

(1) Based on 8,085,589 shares outstanding as of March 26, 2013.

(2) Includes 4,000 shares of restricted stock, one-third of which vest each year beginning on March 4, 2014, and 38,334 shares of common stock issuable upon the exercise of vested stock options held by Mr. Simberg.

- (3) Includes 3,000 shares of common stock held in Mr. Wilcox's IRA, 40,000 shares of common stock held by Mr. Wilcox's spouse, 4,000 shares of restricted stock, one-third of which vest each year beginning on March 4, 2014, and 28,334 shares of common stock issuable upon the exercise of vested stock options held by Mr. Wilcox.
- (4) Includes 25,000 shares of restricted stock, one-third of which vest each year beginning on March 4, 2014, and 111,834 shares of common stock issuable upon the exercise of vested stock options held by Mr. Braun.
- (5) Includes 59,624 shares of common stock held by Carl Dorf Rollover IRA, 54,164 shares of common stock held by Dorf Trust, 4,000 shares of restricted stock, one-third of which vest each year beginning on March 4, 2014, and 28,334 shares of common stock issuable upon the exercise of vested stock options held by Mr. Dorf.
- (6) Includes 4,000 shares of common stock held in Mr. Prygelski's IRA, 15,000 shares of restricted stock, one-third of which vest each year beginning on March 4, 2014, and 50,834 shares of common stock issuable upon the exercise of vested stock options held by Mr. Prygelski.
- (7) Includes 4,000 shares of restricted stock, one-third of which vest each year beginning on March 4, 2014, and 28,334 shares of common stock issuable upon the exercise of vested stock options held by Mr. Hart.
- (8) Includes 4,000 shares of restricted stock one-third of which vest each year beginning on March 4, 2014, and 16,334 shares of common stock issuable upon the exercise of vested stock options held by Ms. Kimbrough.
- (9) Includes 60,000 shares of restricted stock, one-third of which vest each year beginning on March 4, 2014, and 302,338 shares of common stock issuable upon the exercise of vested stock options.
- (10) Includes 12,000 shares of common stock that Lloyd I. Miller, III has shared voting and dispositive power as co-trustee of a certain trust. This information is based on an Amendment No. 2 to Schedule 13G filed with the SEC on February 14, 2012.
- (11) This information is based on an Amendment No. 3 to Schedule 13G filed with the SEC on February 11, 2013.

Table of Contents

Federated National Holding Company and Subsidiaries

ITEM 13 CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE

Family Relationships

There are no family relationships between or among our current executive officers and directors.

Related Transactions

The following is a summary of transactions during 2011 and 2012 between the Company and its executive officers, directors, nominees for director, principal shareholders and other related parties involving amounts in excess of \$120,000 or that the Company has chosen to voluntarily disclose.

Bruce F. Simberg, a director, is a partner of the Fort Lauderdale, Florida law firm of Conroy, Simberg, which renders legal services to the Company. The Company paid legal fees to Conroy, Simberg for services rendered in the amount of approximately \$3,349 and \$27,175 in 2011 and 2012, respectively. We believe that the fees charged for services provided by Conroy, Simberg are on terms at least as favorable as those that we could secure from a non-affiliated law firm.

During 2011 and 2012, Michael H. Braun, the Company's Chief Executive Officer and President, received the compensation described in "Executive Compensation" on pages 112 through 117 of this Form 10-K. Mr. Braun's brother received salary compensation of \$130,385 and \$134,308 for his services as the Vice President of Accounting and Finance in 2011 and 2012, respectively. We believe that the compensation provided to this individual is comparable to that paid by other companies in our industry and market for similar positions.

We have adopted a written policy that any transactions between the Company and executive officers, directors, principal shareholders or their affiliates take place on an arm's-length basis and require the approval of a majority of our independent directors, as defined in the Nasdaq Rules.

The Board has determined that the following directors are independent pursuant to the Nasdaq Rules: Carl Dorf, Charles B. Hart, Jr., Richard W. Wilcox, Jr., Bruce F. Simberg, and Jenifer G. Kimbrough. In making the independence determination with respect to Mr. Simberg, the Board considered the fact that Conroy Simberg has provided legal services to the Company during the past 16 years. Nevertheless, the fees paid by the Company in connection with the legal services provided by Conroy Simberg during the past three fiscal years do not exceed the amounts set forth in Nasdaq Rule 5605(a)(2)(D) and, therefore, the Board has determined that Mr. Simberg qualifies as an independent director under Nasdaq Rule 5605(a)(2).

ITEM 14

PRINCIPAL ACCOUNTING FEES AND SERVICES

The Audit Committee selected DeMeo Young McGrath ("DeMeo") as the independent registered public accounting firm to perform the audit of the Company's consolidated financial statements and management's assessment of the effectiveness of internal control over financial reporting for the 2013 fiscal year.

Our Audit Committee requires that management obtain the prior approval of the Audit Committee for all audit and permissible non-audited services to be provided by DeMeo. The Audit Committee considers and approves at each meeting, as needed, anticipated audit and permissible non-audit services to be provided by DeMeo during the year and estimated fees. The Audit Committee Chairman may approve permissible non-audit services with subsequent notification to the full Audit Committee. All services rendered to us by DeMeo in 2012 were pre-approved in

accordance with these procedures.

-119-

---



Table of Contents

## Federated National Holding Company and Subsidiaries

DeMeo has served as the Company's independent auditors for each fiscal year since 2002. DeMeo has advised the Company that neither it, nor any of its members, has any direct financial interest in the Company as a promoter, underwriter, voting trustee, director, officer or employee. All professional services rendered by DeMeo during the fiscal year ended December 31, 2012 were furnished at customary rates and were performed by full-time, permanent employees.

The following table shows fees that we paid (or accrued) for professional services rendered by DeMeo for fiscal 2012 and 2011.

	Fiscal 2012	Fiscal 2011
Audit Fees (1)	\$ 372,168	\$ 317,278
Audit-Related Fees (2)	\$ 15,953	\$ 9,700
Tax Fees (3)	\$ 0	\$ 0
<b>Total</b>	<b>\$ 388,121</b>	<b>\$ 326,978</b>

(1) Audit fees consisted of audit work performed in the preparation of financial statements, as well as work generally only the independent auditor can reasonably be expected to provide, such as statutory audits.

(2) Audit-related fees consisted primarily of audits of employee benefit plans and special procedures related to regulatory filings in 2012 and 2011.

(3) Tax fees consisted primarily of assistance with tax compliance and reporting.

Table of Contents

Federated National Holding Company and Subsidiaries

PART IV

ITEM 15 EXHIBITS, FINANCIAL STATEMENT SCHEDULES, AND REPORTS ON FORM 10-K

(a) The following documents are filed as part of this report.

(1) Financial Statements

The following consolidated financial statements of the Company and the reports of independent auditors thereon are filed with this report:

Independent Auditors' Report (De Meo, Young, McGrath)

Consolidated Balance Sheets as of December 31, 2012 and 2011

Consolidated Statements of Operations for the years ended December 31, 2012, 2011 and 2010.

Consolidated Statements of Comprehensive Income (loss) for the years ended December 31, 2012, 2011 and 2010.

Consolidated Statements of Shareholders' Equity and Comprehensive Income (loss) for the years ended December 31, 2012, 2011 and 2010.

Consolidated Statements of Cash Flows for the years ended December 31, 2012, 2011 and 2010.

Notes to Consolidated Financial Statements for the years ended December 31, 2012, 2011 and 2010.

(2) Financial Statement Schedules.

Schedule VI, Supplemental information concerning property-casualty insurance operations, is included herein under Item 8, Financial Statements and Supplementary Data.

(3) Exhibits.

Table of Contents

Federated National Holding Company and Subsidiaries

Exhibit Description

- 3.1 Amended and Restated Articles of Incorporation, as amended (incorporated by reference to Exhibit 3.1 in the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2012 filed with the SEC on November 14, 2012).
- 3.2 Amended and Restated Bylaws of the Company (incorporated by reference to Exhibit 10.1 in the Company's Current Report on Form 8-K filed with the SEC on November 28, 2007).
- 4.1 Specimen of Common Stock Certificate (incorporated by reference to Exhibit 4.1 in Amendment No. 1 to the Company's Registration Statement on Form SB-2 filed with the SEC on October 7, 1998 [File No. 333-63623]).
- 10.1 Non-Compete Agreement dated December 19, 2005 between the Company and Michael Braun dated December 19, 2005 (incorporated by reference to Exhibit 10.2 in the Company's Current Report on Form 8-K filed with the SEC on December 29, 2005).+
- 10.2 Non-Compete Agreement between the Company and Peter J. Prygelski, effective June 25, 2007 (incorporated by reference to Exhibit 10.3 contained in the Company's Form 8-K filed on June 19, 2007).+
- 10.3 Amended and Restated 2012 Stock Incentive Plan.+\*
- 10.4 Form of Restricted Stock Agreement between the Company and individuals awarded restricted stock from the 2012 Stock Incentive Plan, as amended (incorporated by reference to Exhibit 10.1 in the Company's Current Report on Form 8-K filed with the SEC on March 8, 2012).+
- 10.5 Federated National Holding Company 2002 Stock Option Plan, as amended, and Stock Plan Acknowledgment (incorporated by reference to Annex A in the Company's Definitive Proxy Statement for its 2009 Annual Meeting of Stockholders filed with the SEC on April 2, 2009).+
- 10.6 Federated National Holding Company 1998 Stock Option Plan, as amended, and Stock Plan Acknowledgment (incorporated by reference to Annex A in the Company's Definitive Proxy Statement filed with the SEC on May 12, 2000).+
- 10.7 Form of Indemnification Agreement between the Company and its directors and executive officers (incorporated by reference from Exhibit 10.15 in the Company's Annual Report on Form 10-K for its year ended December 31, 1007 filed with the SEC on March 17, 2008).
- 10.8 Consent Order for Case Number 114165-10-CO between Federated National Insurance Company, American Vehicle Insurance Company, 21st Century Holding Company and the Florida Office of Insurance Regulation filed January 25, 2011 to approve of the merger of Federated National Insurance Company with and into American Vehicle Insurance Company (incorporated by reference to Exhibit 10.1 in the Company's Current Report on Form 8-K filed with the SEC on January 27, 2011).
- 10.9 Amended Consent Order dated February 5, 2013 between the Florida Office of Insurance Regulation and Federated National Insurance Company (incorporated by reference to Exhibit 10.1 in the Company's Current Report on Form 8-K filed with the SEC on February 8, 2013).

- 10.10 Reimbursement Contract between Federated National Insurance Company and The State Board of Administration of Florida (SBA) which administers the Florida Hurricane Catastrophe Fund (FHCF) and Addendum No. 1 effective June 1, 2012 (incorporated by reference to Exhibit 10.1 – 10.2 in the Company’s Current Report on Form 8-K filed with the SEC on March 2, 2012).
- 10.11 Excess Catastrophe Reinsurance Contract, effective July 1, 2012, between Federated National Insurance Company and subscribing reinsurers (incorporated by reference to Exhibit 10.1 in the Company’s Quarterly Report on Form 10-Q for the quarter ended September 30, 2012 filed with the SEC on November 14, 2012).
- 10.12 Reinstatement Premium Protection Reinsurance Contract, effective July 1, 2012, between Federated National Insurance Company and subscribing reinsurers (incorporated by reference to Exhibit 10.2 in the Company’s Quarterly Report on Form 10-Q for the quarter ended September 30, 2012 filed with the SEC on November 14, 2012).

Table of Contents

Federated National Holding Company and Subsidiaries

10.13	INCR 5th Layer Excess Catastrophe Reinsurance Contract, effective July 1, 2012, between Federated National Insurance Company and subscribing reinsurers (incorporated by reference to Exhibit 10.3 in the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2012 filed with the SEC on November 14, 2012).
10.14	Second Amended and Restated Employment Agreement dated January 18, 2012 between the Company and Michael H. Braun (incorporated by reference to Exhibit 10.1 in the Company's Current Report on Form 8-K filed with the SEC on January 20, 2012).+
10.15	Second Amended and Restated Employment Agreement dated January 18, 2012 between the Company and Peter J. Prygelski, III (incorporated by reference to Exhibit 10.2 in the Company's Current Report on Form 8-K filed with the SEC on January 20, 2012).+
10.16	Reimbursement Contract between Federated National Insurance Company and The State Board of Administration of Florida (SBA) which administers the Florida Hurricane Catastrophe Fund (FHCF) and Addendum No. 1 effective June 1, 2013 (incorporated by reference to Exhibits 10.1 – 10.2 in the Company's Current Report on Form 8-K filed with the SEC on February 21, 2013).
21.1	Subsidiaries of the Company *
23.1	Consent of De Meo, Young, McGrath, Independent Certified Public Accountants *
31.1	Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act *
31.2	Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act *
32.1	Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act *
32.2	Certification of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act *
101.INS-XBRL Instance Document. **	
101.SCH-XBRL Taxonomy Extension Schema Document. **	
101.CAL-XBRL Taxonomy Extension Calculation Linkbase Document. **	
101.LAB-XBRL Taxonomy Extension Label Linkbase Document. **	

101.PRE-XBRL Taxonomy Extension Presentation Linkbase Document. \*\*

+ Management Compensation Plan or Arrangement

\* Filed herewith

\*\* In accordance with Rule 406T of Regulation S-T, these interactive data files are deemed not filed for purposes of Section 18 of the Exchange Act, or otherwise subject to the liability of that section, and shall not be part of any registration statement or other document filed under the Securities Act of Exchange Act, except as shall be expressly set forth by specific reference in such filing.

-123-

---

Table of Contents

Federated National Holding Company and Subsidiaries

SIGNATURES

Pursuant to the requirements of Section 13 or 15 (d) of the Securities Exchange Act of 1934, the registrant has duly caused this Form 10-K report to be signed on its behalf by the undersigned, thereto duly authorized.

FEDERATED NATIONAL HOLDING  
COMPANY

By: /s/ Michael H. Braun  
Michael H. Braun, Chief  
Executive Officer  
(Principal Executive  
Officer)

/s/ Peter J. Prygelski, III  
Peter J. Prygelski, III,  
Chief Financial Officer  
(Principal Financial and  
Accounting Officer)

Dated: April 1, 2013

Pursuant to the requirements of the Securities Exchange Act of 1934, this Report has been signed by the following persons on behalf of the registrant and in the capacities and on the date indicated.

Signature	Title	Date
/s/ Michael H. Braun Michael H. Braun	Chief Executive Officer (Principal Executive Officer)	April 1, 2013
/s/ Peter J. Prygelski, III Peter J. Prygelski, III	Chief Financial Officer (Principal Financial and Accounting Officer)	April 1, 2013
/s/ Carl Dorf Carl Dorf	Director	April 1, 2013
/s/ Bruce F. Simberg Bruce F. Simberg	Director Chairman of the Board	April 1, 2013
/s/ Charles B. Hart, Jr. Charles B. Hart, Jr.	Director	April 1, 2013
/s/ Richard W. Wilcox, Jr. Richard W. Wilcox, Jr.	Director	April 1, 2013
/s/ Jenifer G. Kimbrough	Director	April 1, 2013

Jenifer G. Kimbrough

-124-

---



Table of Contents

Federated National Holding Company and Subsidiaries

EXHIBIT INDEX

<u>10.3</u>	Amended and Restated 2012 Stock Incentive Plan
<u>21.1</u>	Subsidiaries
<u>23.1</u>	Consent of DeMeo, Young, McGrath, Independent Certified Public Accountants
<u>31.1</u>	Certification of the Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act
<u>31.2</u>	Certification of the Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act
<u>32.1</u>	Certification of the Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act
<u>32.2</u>	Certification of the Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act