

Note 4. Fair Value

Our available-for-sale and trading securities are recorded at fair value, which is the price that would be received to sell the asset in an orderly transaction between willing market participants as of the measurement date.

Valuation techniques used to derive the fair value of our available-for-sale and trading securities are based upon observable and unobservable inputs. Observable inputs reflect market data obtained from independent sources. Unobservable inputs reflect our own assumptions regarding fair market value for these securities. Although virtually all of our prices are obtained from third-party sources, we also perform an internal pricing review on outliers, which include securities with price changes inconsistent with current market conditions. Financial instruments are categorized based upon the following characteristics or inputs to the valuation techniques:

- Level 1 – Quoted prices (unadjusted) in active markets for identical assets or liabilities that the reporting entity can access at the measurement date.
- Level 2 – Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly.
- Level 3 – Unobservable inputs for the asset or liability.

Estimates of fair values for our investment portfolio are obtained primarily from a nationally recognized pricing service. Our Level 1 category includes those securities valued using an exchange traded price provided by the pricing service. The methodologies used by the pricing service that support a Level 2 classification of a financial instrument include multiple verifiable, observable inputs including benchmark yields, reported trades, broker/dealer quotes, issuer spreads, two-sided markets, benchmark securities, bids, offers, and reference data. Pricing service valuations for Level 3 securities are based upon proprietary models and are used when observable inputs are not available or in illiquid markets.

In limited circumstances we adjust the price received from the pricing service when, in our judgment, a better reflection of fair value is available based upon corroborating information and our knowledge and monitoring of market conditions such as a disparity in price of comparable securities and/or non-binding broker quotes. In other circumstances, certain securities are internally priced because prices are not provided by the pricing service.

We perform continuous reviews of the prices obtained from the pricing service. This includes evaluating the methodology and inputs used by the pricing service to ensure that we determine the proper classification level of the financial instrument. Price variances, including large periodic changes, are investigated and corroborated by market data. We have reviewed the pricing methodologies of our pricing service as well as other observable inputs, such as market data, and transaction volumes and believe that the prices adequately consider market activity in determining fair value.

When a price from the pricing service is not available, values are determined by obtaining broker/dealer quotes and/or market comparables. When available, we obtain multiple quotes for the same security. The ultimate value for these securities is determined based upon our best estimate of fair value using corroborating market information. Our evaluation includes the consideration of benchmark yields, reported trades, issuer spreads, two-sided markets, benchmark securities, bids, offers, and reference data.

The following tables present our fair value measurements on a recurring basis by asset class and level of input:

(in thousands)	At December 31, 2017			
	Fair value measurements using:			
	Total	Quoted prices in active markets for identical assets Level 1	Observable inputs Level 2	Unobservable inputs Level 3
Available-for-sale securities:				
U.S. treasury	\$ 11,734	\$ 0	\$ 11,734	\$ 0
States & political subdivisions	259,264	0	259,264	0
Foreign government securities	503	0	503	0
Corporate debt securities	346,523	0	338,644	7,879
Residential mortgage-backed securities	25,571	0	25,571	0
Commercial mortgage-backed securities	32,804	0	32,804	0
Collateralized debt obligations	58,034	0	55,834	2,200
Other debt securities	11,528	0	11,528	0
Total fixed maturities	745,961	0	735,882	10,079
Nonredeemable preferred stock	12,752	2,015	10,737	0
Total available-for-sale securities	758,713	2,015	746,619	10,079
Other investments ⁽¹⁾	4,816	—	—	—
Total	\$ 763,529	\$ 2,015	\$ 746,619	\$ 10,079

(in thousands)	At December 31, 2016			
	Fair value measurements using:			
	Total	Quoted prices in active markets for identical assets Level 1	Observable inputs Level 2	Unobservable inputs Level 3
Available-for-sale securities:				
U.S. treasury	\$ 5,031	\$ 0	\$ 5,031	\$ 0
Government sponsored entities	2,026	0	2,026	0
States & political subdivisions	253,132	0	253,132	0
Corporate debt securities	322,948	0	313,596	9,352
Residential mortgage-backed securities	16,102	0	16,102	0
Commercial mortgage-backed securities	36,849	0	36,849	0
Collateralized debt obligations	69,253	0	69,253	0
Other debt securities	2,000	0	2,000	0
Total fixed maturities	707,341	0	697,989	9,352
Common stock	5,950	5,950	0	0
Total available-for-sale securities	713,291	5,950	697,989	9,352
Other investments ⁽¹⁾	4,412	—	—	—
Total	\$ 717,703	\$ 5,950	\$ 697,989	\$ 9,352

(1) Other investments measured at fair value represent real estate funds included on the balance sheet as limited partnership investments that are reported under the fair value option using the net asset value practical expedient. These amounts are not required to be categorized in the fair value hierarchy. The investments can never be redeemed with the funds. Instead, distributions are received when liquidation of the underlying assets of the funds occur. It is estimated that the underlying assets will generally be liquidated between 5 and 10 years from the inception of the funds. The fair value of these investments is based on the net asset value (NAV) information provided by the general partner. Fair value is based on our proportionate share of the NAV based on the most recent partners' capital statements received from the general partners, which is generally one quarter prior to our balance sheet date. These values are then analyzed to determine if the NAV represents fair value at our balance sheet date, with adjustment being made where appropriate. We consider observable market data and perform a review validating the appropriateness of the NAV at each balance sheet date. It is likely that all of the investments will be redeemed at a future date for an amount different than the NAV of our ownership interest in partners' capital as of December 31, 2017 and December 31, 2016. During the years ended December 31, 2017 and 2016, no contributions were made and distributions totaling \$0.5 million and \$0.9 million, respectively, were received from these investments. There were no unfunded commitments related to the investments as of December 31, 2017 and \$0.3 million as of December 31, 2016.

We review the fair value hierarchy classifications each reporting period. Transfers between hierarchy levels may occur due to changes in available market observable inputs. Transfers in and out of level classifications are reported as having occurred at the beginning of the quarter in which the transfers occurred.

There were no transfers between Level 1 and Level 2 for the years ended December 31, 2017 and 2016.

Level 3 Assets – Year-to-Date Change:

<i>(in thousands)</i>	Beginning balance at December 31, 2016	Included in earnings ⁽¹⁾	Included in other comprehensive income	Purchases	Sales	Transfers into Level 3 ⁽²⁾	Transfers out of Level 3 ⁽²⁾	Ending balance at December 31, 2017
Available-for-sale securities:								
Corporate debt securities	\$ 9,352	\$ (85)	\$ (41)	\$ 4,954	\$ (5,411)	\$ 11,196	\$ (12,086)	\$ 7,879
Collateralized debt obligations	0	0	0	2,200	0	0	0	2,200
Total fixed maturities	9,352	(85)	(41)	7,154	(5,411)	11,196	(12,086)	10,079
Total available-for-sale securities	9,352	(85)	(41)	7,154	(5,411)	11,196	(12,086)	10,079
Total Level 3 assets	\$ 9,352	\$ (85)	\$ (41)	\$ 7,154	\$ (5,411)	\$ 11,196	\$ (12,086)	\$ 10,079

Level 3 Assets – Year-to-Date Change:

<i>(in thousands)</i>	Beginning balance at December 31, 2015	Included in earnings ⁽¹⁾	Included in other comprehensive income	Purchases	Sales	Transfers into Level 3 ⁽²⁾	Transfers out of Level 3 ⁽²⁾	Ending balance at December 31, 2016
Available-for-sale securities:								
Corporate debt securities	\$ 69	\$ 173	\$ 107	\$ 13,935	\$ (1,854)	\$ 7,532	\$ (10,610)	\$ 9,352
Commercial mortgage-backed securities	0	0	3	1,000	0	0	(1,003)	0
Collateralized debt obligations	8,577	4	(5)	7,722	(54)	2,114	(18,358)	0
Total fixed maturities	8,646	177	105	22,657	(1,908)	9,646	(29,971)	9,352
Total available-for-sale securities	8,646	177	105	22,657	(1,908)	9,646	(29,971)	9,352
Total Level 3 assets	\$ 8,646	\$ 177	\$ 105	\$ 22,657	\$ (1,908)	\$ 9,646	\$ (29,971)	\$ 9,352

(1) These amounts are reported in the Statements of Operations as net investment income and net realized investment gains (losses) for each of the periods presented above.

(2) Transfers into and/or (out) of Level 3 are primarily attributable to the availability of market observable information and the re-evaluation of the observability of pricing inputs.

Quantitative and Qualitative Disclosures about Unobservable Inputs

When a non-binding broker quote was the only input available, the security was classified within Level 3. Use of non-binding brokers quotes totaled \$10.1 million at December 31, 2017. The unobservable inputs are not reasonably available to us.

The following table presents our fair value measurements on a recurring basis by pricing source:

<i>(in thousands)</i>	At December 31, 2017			
	Total	Level 1	Level 2	Level 3
Fixed maturities:				
Priced via pricing services	\$ 743,761	\$ 0	\$ 735,882	\$ 7,879
Priced via market comparables/broker quotes	2,200	0	0	2,200
Total fixed maturities	745,961	0	735,882	10,079
Nonredeemable preferred stock:				
Priced via pricing services	12,752	2,015	10,737	0
Total nonredeemable preferred stock	12,752	2,015	10,737	0
Other investments:				
Priced via unobservable inputs ⁽¹⁾	4,816	—	—	—
Total other investments	4,816	—	—	—
Total	\$ 763,529	\$ 2,015	\$ 746,619	\$ 10,079

(1) Other investments measured at fair value represent real estate funds included on the balance sheet as limited partnership investments that are reported under the fair value option using the NAV practical expedient. These amounts are not required to be categorized in the fair value hierarchy. The fair value of these investments is based on the NAV information provided by the general partner.

There were no assets measured at fair value on a nonrecurring basis during the year ended December 31, 2017.

Note 5. Investments

Available-for-sale securities

The following tables summarize the cost and fair value of our available-for-sale securities:

<i>(in thousands)</i>	At December 31, 2017			Estimated fair value
	Amortized cost	Gross unrealized gains	Gross unrealized losses	
Available-for-sale securities:				
U.S. treasury	\$ 11,873	\$ 0	\$ 139	\$ 11,734
States & political subdivisions	254,533	5,351	620	259,264
Foreign government securities	501	2	0	503
Corporate debt securities	346,759	1,688	1,924	346,523
Residential mortgage-backed securities	25,324	371	124	25,571
Commercial mortgage-backed securities	33,475	26	697	32,804
Collateralized debt obligations	57,838	237	41	58,034
Other debt securities	11,496	32	0	11,528
Total fixed maturities	<u>741,799</u>	<u>7,707</u>	<u>3,545</u>	<u>745,961</u>
Nonredeemable preferred stock	12,837	15	100	12,752
Total available-for-sale securities	<u>\$ 754,636</u>	<u>\$ 7,722</u>	<u>\$ 3,645</u>	<u>\$ 758,713</u>

<i>(in thousands)</i>	At December 31, 2016			Estimated fair value
	Amortized cost	Gross unrealized gains	Gross unrealized losses	
Available-for-sale securities:				
U.S. treasury	\$ 5,093	\$ 0	\$ 62	\$ 5,031
Government sponsored entities	2,004	22	0	2,026
States & political subdivisions	249,312	6,113	2,293	253,132
Corporate debt securities	321,041	3,293	1,386	322,948
Residential mortgage-backed securities	16,232	61	191	16,102
Commercial mortgage-backed securities	37,723	59	933	36,849
Collateralized debt obligations	68,998	351	96	69,253
Other debt securities	2,000	0	0	2,000
Total fixed maturities	<u>702,403</u>	<u>9,899</u>	<u>4,961</u>	<u>707,341</u>
Common stock	6,152	0	202	5,950
Total available-for-sale securities	<u>\$ 708,555</u>	<u>\$ 9,899</u>	<u>\$ 5,163</u>	<u>\$ 713,291</u>

The amortized cost and estimated fair value of fixed maturities at December 31, 2017, are shown below by remaining contractual term to maturity. Mortgage-backed securities are allocated based upon stated maturity dates. 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.

<i>(in thousands)</i>	At December 31, 2017	
	Amortized cost	Estimated fair value
Due in one year or less	\$ 71,109	\$ 71,190
Due after one year through five years	313,305	315,436
Due after five years through ten years	240,614	242,739
Due after ten years	116,771	116,596
Total fixed maturities	<u>\$ 741,799</u>	<u>\$ 745,961</u>

Available-for-sale securities in a gross unrealized loss position are as follows. Data is provided by length of time for securities in a gross unrealized loss position.

<i>(dollars in thousands)</i>	At December 31, 2017						
	Less than 12 months		12 months or longer		Total		
	Fair value	Unrealized losses	Fair value	Unrealized losses	Fair value	Unrealized losses	No. of holdings
Available-for-sale securities:							
U.S. treasury	\$ 10,237	\$ 110	\$ 1,497	\$ 29	\$ 11,734	\$ 139	4
States & political subdivisions	52,553	288	14,361	332	66,914	620	33
Corporate debt securities	171,154	1,585	31,113	339	202,267	1,924	331
Residential mortgage-backed securities	4,156	29	7,064	95	11,220	124	11
Commercial mortgage-backed securities	10,836	85	11,984	612	22,820	697	19
Collateralized debt obligations	21,598	41	0	0	21,598	41	12
Other debt securities	1,499	0	0	0	1,499	0	1
Total fixed maturities	<u>272,033</u>	<u>2,138</u>	<u>66,019</u>	<u>1,407</u>	<u>338,052</u>	<u>3,545</u>	<u>411</u>
Nonredeemable preferred stock	10,737	100	0	0	10,737	100	6
Total available-for-sale securities	<u>\$ 282,770</u>	<u>\$ 2,238</u>	<u>\$ 66,019</u>	<u>\$ 1,407</u>	<u>\$ 348,789</u>	<u>\$ 3,645</u>	<u>417</u>
Quality breakdown of fixed maturities:							
Investment grade	\$ 214,586	\$ 1,064	\$ 62,193	\$ 985	\$ 276,779	\$ 2,049	158
Non-investment grade	57,447	1,074	3,826	422	61,273	1,496	253
Total fixed maturities	<u>\$ 272,033</u>	<u>\$ 2,138</u>	<u>\$ 66,019</u>	<u>\$ 1,407</u>	<u>\$ 338,052</u>	<u>\$ 3,545</u>	<u>411</u>

<i>(dollars in thousands)</i>	At December 31, 2016						
	Less than 12 months		12 months or longer		Total		
	Fair value	Unrealized losses	Fair value	Unrealized losses	Fair value	Unrealized losses	No. of holdings
Available-for-sale securities:							
U.S. treasury	\$ 5,031	\$ 62	\$ 0	\$ 0	\$ 5,031	\$ 62	1
States & political subdivisions	84,611	2,293	0	0	84,611	2,293	40
Corporate debt securities	112,453	987	8,692	399	121,145	1,386	155
Residential mortgage-backed securities	7,451	60	4,974	131	12,425	191	13
Commercial mortgage-backed securities	26,509	437	4,319	496	30,828	933	28
Collateralized debt obligations	27,470	75	4,208	21	31,678	96	15
Total fixed maturities	<u>263,525</u>	<u>3,914</u>	<u>22,193</u>	<u>1,047</u>	<u>285,718</u>	<u>4,961</u>	<u>252</u>
Common stock	5,950	202	0	0	5,950	202	1
Total available-for-sale securities	<u>\$ 269,475</u>	<u>\$ 4,116</u>	<u>\$ 22,193</u>	<u>\$ 1,047</u>	<u>\$ 291,668</u>	<u>\$ 5,163</u>	<u>253</u>
Quality breakdown of fixed maturities:							
Investment grade	\$ 239,041	\$ 3,605	\$ 16,061	\$ 399	\$ 255,102	\$ 4,004	136
Non-investment grade	24,484	309	6,132	648	30,616	957	116
Total fixed maturities	<u>\$ 263,525</u>	<u>\$ 3,914</u>	<u>\$ 22,193</u>	<u>\$ 1,047</u>	<u>\$ 285,718</u>	<u>\$ 4,961</u>	<u>252</u>

The above securities have been evaluated and determined to be temporary impairments for which we expect to recover our entire principal plus interest. The primary components of this analysis include a general review of market conditions and financial performance of the issuer along with the extent and duration at which fair value is less than cost. Any securities that we intend to sell or will more likely than not be required to sell before recovery are included in other-than-temporary impairments, which are recognized in earnings.