

Zenith National Insurance Corp. and Subsidiaries

**Consolidated Financial Statements
as of June 30, 2018 and December 31, 2017 and for the three and six
months ended June 30, 2018 and 2017
(unaudited)**

Zenith National Insurance Corp. and Subsidiaries Consolidated Financial Statements (unaudited)

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ZENITH NATIONAL INSURANCE CORP. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(UNAUDITED)

(In thousands, except par value)	June 30, 2018	December 31, 2017
Assets:		
Investments:		
Fixed maturity securities, at fair value (amortized cost \$548,000 in 2018 and \$433,191 in 2017)	\$ 565,653	\$ 460,349
Equity securities, at fair value (cost \$374,423 in 2018 and \$376,920 in 2017)	308,648	326,841
Short-term investments, at fair value which approximates cost	641,327	726,952
Other investments	217,864	220,377
Derivative assets, at fair value (cost \$41,532 in 2018 and \$43,017 in 2017)	5,166	6,804
Assets pledged for derivative obligations, at fair value (amortized cost \$15,527 in 2018 and \$11,858 in 2017)	15,526	11,858
Total investments	1,754,184	1,753,181
Cash	48,567	13,105
Accrued investment income	4,004	5,533
Premiums receivable	47,145	41,686
Reinsurance recoverables	49,048	54,431
Deferred policy acquisition costs	14,293	12,164
Deferred tax asset	57,177	46,140
Income tax receivable	2,593	3,711
Goodwill	20,985	20,985
Other assets	58,273	65,145
Total assets	\$ 2,056,269	\$ 2,016,081
Liabilities:		
Unpaid losses and loss adjustment expenses	\$ 1,181,303	\$ 1,191,531
Unearned premiums	102,920	88,701
Policyholders' dividends accrued	46,138	41,995
Long-term debt	38,210	38,196
Derivative liabilities	4,680	4,280
Other liabilities	70,803	76,294
Total liabilities	1,444,054	1,440,997
Commitments and contingencies (see Note 10)		
Stockholders' equity:		
Common stock, \$1 par value, 40 authorized shares; 39 shares issued and outstanding	39	39
Additional paid-in capital	401,124	398,821
Retained earnings	215,985	180,072
Accumulated other comprehensive loss	(4,933)	(3,848)
Total stockholders' equity	612,215	575,084
Total liabilities and stockholders' equity	\$ 2,056,269	\$ 2,016,081

The accompanying notes are an integral part of these financial statements.

ZENITH NATIONAL INSURANCE CORP. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(UNAUDITED)

(In thousands)	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Revenues:				
Net premiums earned	\$ 199,604	\$ 199,437	\$ 395,705	\$ 387,614
Net investment income	7,221	4,176	11,485	13,306
Net realized gains (losses) on investments	1,786	(1,689)	(607)	7,421
Change in net unrealized gains/losses on fair value option investments	5,113	18,894	(25,046)	17,694
Net gains (losses) on derivatives	10,799	(7,113)	9,396	(10,724)
Service fee income	2,267	2,366	4,606	4,814
Total revenues	226,790	216,071	395,539	420,125
Expenses:				
Losses and loss adjustment expenses incurred	102,557	106,845	197,865	185,612
Underwriting and other operating expenses:				
Policyholder acquisition costs	35,791	35,579	72,301	69,949
Underwriting and other costs	33,095	32,771	66,666	66,612
Policyholders' dividends	7,420	5,812	13,341	12,292
Interest expense	830	830	1,660	1,660
Total expenses	179,693	181,837	351,833	336,125
Income before tax	47,097	34,234	43,706	84,000
Income tax expense	9,569	10,770	8,622	26,919
Net income	\$ 37,528	\$ 23,464	\$ 35,084	\$ 57,081
Net change in unrealized gains/losses on available-for-sale and other investments, net of tax and reclassification adjustment	(1,015)	(2,131)	(1,224)	(879)
Change in unrealized foreign currency translation adjustment, net of tax	(763)	1,016	139	353
Other comprehensive loss	(1,778)	(1,115)	(1,085)	(526)
Total comprehensive income	\$ 35,750	\$ 22,349	\$ 33,999	\$ 56,555

The accompanying notes are an integral part of these financial statements.

ZENITH NATIONAL INSURANCE CORP. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)

(In thousands)	Six Months Ended June 30,	
	2018	2017
Cash flows from operating activities:		
Premiums collected	\$ 405,712	\$ 411,533
Investment income received	9,854	10,024
Losses and loss adjustment expenses paid	(204,798)	(204,300)
Underwriting and other operating expenses paid	(139,315)	(149,510)
Interest paid	(1,646)	(1,646)
Income taxes paid	(18,473)	(36,168)
Net cash provided by operating activities	51,334	29,933
Cash flows from investing activities:		
Purchases of investments:		
Fixed maturity securities – fair value option	(236,514)	(6,798)
Equity securities – fair value option		(15,759)
Corporate loan – affiliate	(6,101)	
Other investments	(270)	(76,148)
Derivatives	(1,226)	(1,383)
Proceeds from maturities and redemptions of investments:		
Fixed maturity securities – fair value option	68,500	25,190
Other investments	432	3,329
Proceeds from sales of investments:		
Fixed maturity securities – fair value option	59,873	85,515
Equity securities – fair value option	3,679	9,985
Other investments	2,058	
Net decrease (increase) in short-term investments	82,529	(9,726)
Net derivative cash settlements	12,660	(11,744)
Capital expenditures and other	(1,334)	(3,439)
Net cash used in by investing activities	(15,714)	(978)
Cash flows from financing activities:		
Dividends paid to common stockholders		(14,561)
Purchase of Fairfax shares for restricted stock awards	(158)	(103)
Net cash used in financing activities	(158)	(14,664)
Net increase in cash	35,462	14,291
Cash at beginning of period	13,105	21,409
Cash at end of period	\$ 48,567	\$ 35,700

The accompanying notes are an integral part of these financial statements.

ZENITH NATIONAL INSURANCE CORP. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS (CONTINUED)
(UNAUDITED)

(In thousands)	Six Months Ended June 30,	
	2018	2017
Reconciliation of net income to net cash provided by operating activities:		
Net income	\$ 35,084	\$ 57,081
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation expense	2,016	1,741
Net accretion	(5,828)	(2,288)
Net realized losses (gains) on investments	607	(7,421)
Change in net unrealized gains/losses on fair value option investments	25,046	(17,694)
Net losses (gains) on derivatives	(9,396)	10,724
Equity in losses/earnings of investee	3,829	(1,627)
Stock-based compensation expense	2,461	1,826
Decrease (increase) in:		
Accrued investment income	1,529	1,015
Premiums receivable	(9,076)	(5,658)
Reinsurance recoverables	5,383	4,534
Deferred policy acquisition costs	(2,129)	(2,909)
Net income taxes	(9,849)	(9,247)
Increase (decrease) in:		
Unpaid losses and loss adjustment expenses	(10,228)	(23,143)
Unearned premiums	14,219	23,434
Policyholders' dividends accrued	4,143	3,742
Accrued expenses	261	1,156
Other	3,262	(5,333)
Net cash provided by operating activities	\$ 51,334	\$ 29,933

The accompanying notes are an integral part of these financial statements.

ZENITH NATIONAL INSURANCE CORP. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
(UNAUDITED)

(In thousands)	Six Months Ended June 30,	
	2018	2017
Common stock:	\$ 39	\$ 39
Additional paid-in capital:		
Beginning of period	398,821	401,249
Stock-based compensation expense	2,461	1,826
Purchases of Fairfax shares for restricted stock awards	(158)	(103)
End of period	401,124	402,972
Retained earnings:		
Beginning of period	180,072	173,430
Net income	35,084	57,081
Reclassification of certain tax effects from accumulated other comprehensive loss at January 1, 2018 (see Note 8)	829	
Dividends declared to common stockholders		(35,000)
End of period	215,985	195,511
Accumulated other comprehensive loss:		
Beginning of period	(3,848)	(6,867)
Reclassification of certain tax effects to retained earnings at January 1, 2018 (see Note 8)	(829)	
Net change in unrealized gains/losses on available-for-sale and other investments, net of tax and reclassification adjustment	(675)	(879)
Change in unrealized foreign currency translation adjustment, net of tax	419	353
End of period	(4,933)	(7,393)
Total stockholders' equity	\$ 612,215	\$ 591,129

The accompanying notes are an integral part of these financial statements.

ZENITH NATIONAL INSURANCE CORP. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

Note 1. Basis of Presentation

Zenith National Insurance Corp. (“Zenith National”) is a Delaware holding company, which is a wholly-owned indirect subsidiary of Fairfax Financial Holdings Limited (“Fairfax”). Fairfax is a Canadian financial services holding company, whose common stock is publicly traded on the Toronto Stock Exchange, and is principally engaged in property and casualty insurance, reinsurance and associated investment management. Zenith National’s wholly-owned subsidiaries (primarily Zenith Insurance Company (“Zenith Insurance”)), specialize in the workers’ compensation insurance business, nationally and, since 2010, in the property-casualty business for California agriculture. Unless otherwise indicated, all references to the “Company” refer to Zenith National together with its subsidiaries.

The accompanying unaudited Consolidated Financial Statements of the Company have been prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP”) for interim financial information. Accordingly, they do not include all of the information and notes required by GAAP for complete financial statements. In the opinion of management, all adjustments (including normal, recurring adjustments) necessary for a fair presentation of the Company’s financial position and results of operations for the periods presented have been included. The results of operations for an interim period are not necessarily indicative of the results for an entire year. For further information, refer to the Audited Consolidated Financial Statements and Notes thereto of the Company for the year ended December 31, 2017.

The accompanying Consolidated Financial Statements differ from the financial information published by Fairfax in regards to the Company primarily due to differences between GAAP and International Financial Reporting Standards (“IFRS,” the reporting basis used by Fairfax), intercompany investment transactions and accounting adjustments recorded by Fairfax related to the acquisition of the Company.

Subsequent Events

The Company evaluated subsequent events through the date and time that the Consolidated Financial Statements were issued on August 3, 2018.

Note 2. Investments

As of June 30, 2018 and December 31, 2017, \$1.5 billion of investments in fixed maturities and equity securities and short-term investments were recorded under the fair value option and changes in fair value for these investments are recorded in the change in net unrealized gains/losses on fair value option investments in the Consolidated Statements of Comprehensive Income (Loss). As of June 30, 2018 and December 31, 2017, \$15.9 million and \$16.2 million, respectively, of investments in equity securities were classified as available-for-sale and reported at fair value with changes in unrealized gains/losses excluded from earnings and reported in a separate component of stockholders’ equity, net of tax.

ZENITH NATIONAL INSURANCE CORP. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

The cost or amortized cost and fair value of fixed maturity and equity securities, short-term investments and other investments at June 30, 2018 and December 31, 2017 were as follows:

(In thousands)	Cost or Amortized Cost	Gross Unrealized		Fair Value
		Gains	(Losses)	
June 30, 2018				
Fair value option investments:				
Fixed maturity securities:				
State and local government debt	\$ 268,714	\$ 19,440		\$ 288,154
U.S. Government debt (a)	243,756	117	\$ (418)	243,455
Corporate debt	35,764	2,249	(3,736)	34,277
Total fixed maturity securities (a)	548,234	21,806	(4,154)	565,886
Equity securities	354,060	27,118	(88,394)	292,784
Short-term investments (b)	656,620			656,620
Other investments - affiliate corporate loans	6,112		(226)	5,886
Total fair value option investments	1,565,026	48,924	(92,774)	1,521,176
Available-for-sale investments:				
Equity securities	20,363	23	(4,522)	15,864
Total available-for-sale investments	20,363	23	(4,522)	15,864
Total fixed maturity, equity securities and short-term investments	\$ 1,585,389	\$ 48,947	\$ (97,296)	\$ 1,537,040
December 31, 2017				
Fair value option investments:				
Fixed maturity securities:				
State and local government debt	\$ 388,034	\$ 27,084	\$ (46)	\$ 415,072
U.S. Government debt	23,159	520	(91)	23,588
Corporate debt	21,998	2,869	(3,178)	21,689
Total fixed maturity securities	433,191	30,473	(3,315)	460,349
Equity securities	356,556	32,175	(78,137)	310,594
Short-term investments (b)	738,810			738,810
Total fair value option investments	1,528,557	62,648	(81,452)	1,509,753
Available-for-sale investments:				
Equity securities	20,364	16	(4,133)	16,247
Total available-for-sale investments	20,364	16	(4,133)	16,247
Total fixed maturity, equity securities and short-term investments	\$ 1,548,921	\$ 62,664	\$ (85,585)	\$ 1,526,000

(a) Includes investments with an amortized cost and fair value of \$0.2 million pledged for derivative obligations as of June 30, 2018.

(b) Includes investments of \$15.3 million and \$11.9 million pledged for derivative obligations at June 30, 2018 and December 31, 2017, respectively.

ZENITH NATIONAL INSURANCE CORP. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

Fixed maturity securities, including short-term investments, by contractual maturity at June 30, 2018 were as follows:

(In thousands)	Amortized Cost	Fair Value
Due in one year or less	\$ 741,801	\$ 741,439
Due after one year through five years	180,831	177,467
Due after five years through ten years	10,059	11,800
Due after ten years	272,163	291,800
Total	\$ 1,204,854	\$ 1,222,506

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.

Total investments at June 30, 2018 also include other investments detailed below and derivative contracts described in Note 3.

Other investments consist of the following:

(In thousands)	June 30, 2018	December 31, 2017
Equity-method common stock (a)	\$ 176,476	\$ 169,788
Cost-method partnerships, at fair value (cost \$21,594 in 2018 and \$22,985 in 2017) (b)	21,313	24,220
Equity-method partnerships (a)	14,189	26,369
Affiliate corporate loans, at fair value (cost \$6,112)	5,886	
Total other investments	\$ 217,864	\$ 220,377

(a) Investments in common stock, partnerships and limited liability companies accounted under the equity method are recorded at cost, adjusted for subsequent purchases, distributions, other-than-temporary impairments, if any, and the Company's share of the changes in the investee's net asset value since the initial acquisition.

(b) Partnerships and limited liability company investments where the Company's ownership is minor and the Company does not have significant operating or financial influence are recorded at fair value.

At June 30, 2018, the Company had commitments to invest an additional \$10.8 million in partnerships and limited liability companies.

ZENITH NATIONAL INSURANCE CORP. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

Net realized gains (losses) on investments, excluding derivatives, were as follows:

(In thousands)	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Sales of fixed maturity securities, including short-term investments and other (a)	\$ (12)	\$ 4,485	\$ 210	\$ 11,773
Sale of equity securities (b)	1,184	(10,553)	1,184	(10,553)
Gains (losses) from other investments	614	4,379	(2,001)	6,201
Net realized gains (losses) on investments	\$ 1,786	\$ (1,689)	\$ (607)	\$ 7,421

- (a) Net realized gains on sales of fixed maturity securities, including short-term investments in the six months ended June 30, 2017 included \$12.8 million of gross realized gains and \$1.1 million of gross realized losses, respectively, on sales of fair value option securities. Gross realized gains included \$4.5 million of realized gains for a fixed maturity security transferred to an affiliate of Fairfax as part of a dividend payment (see Note 5).
- (b) Net realized gains on sales of equity securities in the three and six months ended June 30, 2018 represent realized gain on sale of a fair value option security. Net realized losses on sales of equity securities in the three and six months ended June 30, 2017 included \$4.9 million of gross realized gains and \$15.5 million of gross realized losses on sales of fair value option securities. Gross realized losses included \$15.3 million of losses on Exco Resources, Inc. ("Exco") that were reclassified from unrealized losses when the Company commenced applying the equity method of accounting upon increase in ownership interest in Exco during the second quarter of 2017. This reclassification had no impact on the net income or total comprehensive income.

The changes in net unrealized gains/losses on available-for-sale investments, investments in equity-method common stocks and partnerships and investments in cost-method partnerships are recognized as a separate component of stockholders' equity and were as follows:

(In thousands)	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Equity securities	\$ (980)	\$ 548	\$ (382)	\$ 716
Investments in equity-method partnerships	27	396	1,146	396
Investments in equity-method common stocks	(9)	(1,464)	(103)	(1,330)
Investments in cost-method partnerships	(323)	(2,758)	(1,516)	(1,134)
Total before tax	\$ (1,285)	\$ (3,278)	\$ (855)	\$ (1,352)
After tax	\$ (1,015)	\$ (2,131)	\$ (1,224)	\$ (879)

The change in net unrealized gains/losses on fair value option investments still held was as follows:

(In thousands)	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Change in net unrealized gains/losses recognized on fair value option investments	\$ 5,113	\$ 18,894	\$ (25,046)	\$ 17,694
Less: Net losses (gains) recognized on fair value option investments sold	(964)	11,946	(1,186)	4,538
Change in net unrealized gains/losses recognized on fair value option investments still held at the reporting date	\$ 6,077	\$ 6,948	\$ (23,860)	\$ 13,156

ZENITH NATIONAL INSURANCE CORP. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

Net investment income was as follows:

(In thousands)	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Fixed maturity securities (a)	\$ 4,556	\$ 5,204	\$ 9,069	\$ 10,873
Short-term and other investments (a)	2,580	1,128	5,276	2,284
Derivatives (see Note 3)	1,385	44	2,872	147
Equity securities	725	1,153	1,919	1,882
Income (loss) from equity-method investments (b)	(141)	(1,593)	(3,829)	1,627
Subtotal	9,105	5,936	15,307	16,813
Investment expenses	1,884	1,760	3,822	3,507
Net investment income	\$ 7,221	\$ 4,176	\$ 11,485	\$ 13,306

- (a) Income from fixed maturity securities in the second quarter and six months ended June 30, 2018 decreased slightly compared to prior periods primarily as a result of sales and redemptions of long-dated taxable and tax-exempt municipal bonds in the beginning of 2017. Proceeds from these sales and redemptions have been reinvested in short-term U.S. treasury bonds resulting in higher interest income on short-term investments as short term yields increased.
- (b) Loss from equity-method investments in the second quarter ended June 30, 2018 primarily includes the Company's share of the net losses of \$2.2 million from Peak Achievements Athletics ("PAA") and \$1.3 million from Farmers Edge, Inc. ("Farmers Edge"), largely offset by the Company's share in the net income of \$3.7 million from Fairfax Africa Holdings Corp. (FAH). Loss from equity-method investments in the six months ended June 30, 2018 includes the Company's share of the net losses of \$2.8 million from Farmers Edge, \$2.1 million from PPA, \$1.4 million from Apple Bidco Ltd ("Apple Bidco") and \$1.1 million from Astarta Holdings NV ("Astarta"), partially offset by the Company's share of the net income of \$2.5 million from FAH and \$1.1 million from Fairfax India Holdings Corp. ("FIH").

Loss from equity-method investments in the second quarter ended June 30, 2017 includes the Company's share of the net losses of \$1.1 million from Apple Bidco and \$1.0 million from Davos Brands LLC ("Davos"), partially offset by the Company's share of net income of \$1.4 million from FIH. Income from equity-method investments in the six months ended June 30, 2017 includes the Company's share of net income of \$2.6 million from Apple Bidco and \$1.5 million from FIH, partially offset by the Company's share of the net losses of \$1.2 million from Agrigroupe LP and \$1.0 million from Davos.

At both June 30, 2018 and December 31, 2017, investments with a fair value of approximately \$1.1 billion were on deposit with regulatory authorities in compliance with insurance company regulations. At June 30, 2018, the Company had additional qualifying securities with a fair value of \$98.5 million available for deposit.

Note 3. Derivative Contracts

Derivative contracts entered into by the Company are considered investments or economic hedges and are not designated as accounting hedges. Derivatives are carried at fair value on the Consolidated Balance Sheets with changes in fair value recorded in the Consolidated Statements of Comprehensive Income (Loss) as net gains/losses on derivatives. The fair value of derivatives in a gain position is presented as derivative assets on the Consolidated Balance Sheets. The fair value of derivatives in a loss position are presented as derivative liabilities on the Consolidated Balance Sheets. The initial premium paid for a derivative contract, if any, would be recorded as a derivative asset and subsequently adjusted for changes in the fair value of the contract at each balance sheet date. Cash settlements related to fair value changes on derivative contracts are also recorded in the Consolidated Statements of Comprehensive Income (Loss) as net gains/losses on derivatives and are recorded as an investing activity in the Consolidated Statements of Cash Flows. Securities received from counterparties as collateral are not recorded as assets of the Company. Securities delivered to counterparties as collateral for derivative contracts are reflected as assets pledged for derivative obligations on the Consolidated Balance Sheets.

ZENITH NATIONAL INSURANCE CORP. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

The following table summarizes the notional amount, cost and fair value of derivative contracts:

(In thousands)	Notional Amount	Cost	Fair Value of Derivative	
			Assets	Liabilities
June 30, 2018				
CPI-linked derivative contracts	\$ 7,971,868	\$ 41,058	\$ 1,438	
Foreign exchange forward contracts	68,886		1,231	
U.S. government bond forward contracts	96,000			\$ 3,176 (a)
Equity total return swaps – long positions	70,635		2,488	1,504 (a)
Equity warrants	4,928	474	9	
Total		\$ 41,532	\$ 5,166	\$ 4,680
December 31, 2017				
CPI-linked derivative contracts	\$ 8,041,674	\$ 41,058	\$ 3,445	
Foreign exchange forward contracts	57,638			\$ 677 (a)
U.S. government bond forward contracts	98,000			1,686 (a)
Equity total return swaps – long positions	58,265		2,077	1,917 (a)
Equity warrants	16,774	1,959	1,282	
Total		\$ 43,017	\$ 6,804	\$ 4,280

(a) Represents the change in fair value since inception or the most recent cash settlement date through the reporting date.

The gains (losses) from settlements and changes in fair value of the derivative contracts are recorded as net gains (losses) on derivatives in the Consolidated Statements of Comprehensive Income (Loss) as follows:

(In thousands)	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2018	2017	2018	2017
Gains (losses) on settlements				
Equity derivatives:				
Equity total return swaps – long positions (a)	\$ 4,719	\$ (101)	\$ 4,446	\$ (101)
Equity warrants	(403)		(403)	
Equity call options		1,357		1,357
U.S. government bond forward contracts	1,375	(6,907)	4,972	(9,627)
Foreign exchange forward contracts	3,107	(2,171)	934	(2,016)
Total	8,798	(7,822)	9,949	(10,387)
Change in fair value (b)				
Equity derivatives:				
Equity total return swaps – long positions (a)	3,419	(1,443)	824	(1,628)
Equity warrants	372	(278)	212	(301)
CPI-linked derivative contracts	(774)	263	(2,007)	(1,105)
U.S. government bond forward contracts	(1,700)	2,894	(1,490)	4,013
Foreign exchange forward contracts	684	(727)	1,908	(1,316)
Total	2,001	709	(553)	(337)
Net gains (losses) on derivatives				
Equity derivatives:				
Equity total return swaps – long positions (a)	8,138	(1,544)	5,270	(1,729)
Equity call options and warrants	(31)	1,079	(191)	1,056
CPI-linked derivative contracts	(774)	263	(2,007)	(1,105)
U.S. government bond forward contracts	(325)	(4,013)	3,482	(5,614)
Foreign exchange forward contracts	3,791	(2,898)	2,842	(3,332)
Total net gains (losses) on derivatives	\$ 10,799	\$ (7,113)	\$ 9,396	\$ (10,724)

(a) Amounts for total return swaps include net gains (losses) where the Company and its counterparties are required to cash-settle on a quarterly basis the fair value movement since the previous quarterly reset date notwithstanding that the total return swap positions remain open subsequent to the cash settlement.

(b) Change in fair value of total return swaps was measured from the contract inception or most recent cash settlement date prior to the reporting date. Change in fair value of equity warrants and U.S. Government bond forwards is measured from the contract inception date. Change in fair value of CPI-linked derivatives and foreign exchange forwards include unrealized foreign exchange gains.

ZENITH NATIONAL INSURANCE CORP. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

Equity Derivative Contracts

The Company's long equity total return swaps allow the company to receive the total return on a notional amount of an individual equity (including dividends and capital gains or losses) in exchange for the payment of a floating rate of interest on the notional amount. Interest and dividends were recorded in investment income in the Consolidated Statements of Comprehensive Income (Loss). These swaps require no initial net cash investment and at inception the fair value was zero. The Company's long equity total return swaps contain contractual reset provisions requiring counterparties to cash-settle on a quarterly basis any fair value movements arising subsequent to the prior settlement date. To the extent that a contractual reset date did not correspond to the balance sheet date, the Company adjusted the carrying value of the corresponding derivative asset or liability associated with each long equity total return swap contracts to reflect its fair value at the balance sheet date with the offset to net gains/losses on derivatives in the Consolidated Statements of Comprehensive Income (Loss).

CPI-linked Derivative Contracts

The Company has purchased derivative contracts referenced to consumer price indexes ("CPI") in the United States and Europe to serve as an economic hedge against the potential adverse financial impact on the Company of decreasing price levels. In the event of a sale, expiration or early settlement of any of these contracts, the Company would receive the fair value of that contract on the date of the transaction. The Company's maximum potential loss on any contract is limited to the original cost of that contract. Net unrealized gains (losses) on CPI-linked derivative contracts typically reflect the market's expectation of decreases (increases) in the values of the CPI indexes underlying these contracts at their respective maturities during the periods presented (these contracts are structured to benefit the Company during periods of decreasing CPI index values). At June 30, 2018, these contracts had a remaining weighted average life of 4 years.

The following table summarizes the notional amounts and underlying CPI Index price ("strike price") for the Company's CPI-linked derivative contracts at initiation and the index value at June 30, 2018 and December 31, 2017:

(Notional amount in thousands)	Notional Amount		Weighted Average Strike Price In Original Currency	Index Value
	Original Currency	US Dollars		
Underlying CPI Index:				
June 30, 2018				
United States	5,520,000	\$ 5,520,000	232.81	251.99
European Union	2,100,000	2,451,868	97.66	103.76
		\$ 7,971,868		
December 31, 2017				
United States	5,520,000	\$ 5,520,000	232.81	246.52
European Union	2,100,000	2,521,674	97.66	102.57
		\$ 8,041,674		

U.S. Government Bond Forward Contracts

To reduce its exposure to interest rate risk (specifically exposure to state and local government bonds and long dated U.S. treasury bonds held in its fixed income portfolio), the Company entered into forward contracts to sell long dated U.S. treasury bonds with a notional amount of \$96.0 million and \$98.0 million at June 30, 2018 and December 31, 2017, respectively. These contracts have an average term to maturity of less than one year and may be renewed at market rates.

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Foreign Exchange Forward Contracts

The Company is currently exposed to currency rate fluctuations through its holding of foreign investments. Foreign currency contracts denominated in Euros are used to manage certain foreign currency exposures arising from foreign currency denominated investments. These foreign currency contracts require no initial net cash investment and at inception the fair value is zero. These contracts have a term to maturity of less than one year and may be renewed at market rates.

Counterparty Risk

The Company endeavors to limit counterparty risk through the terms of master netting agreements negotiated with the counterparties to its derivative contracts. Pursuant to these agreements, the counterparties to these transactions are contractually required to deposit eligible collateral in collateral accounts (subject to certain minimum thresholds) for the benefit of the Company depending on the then current fair value of the derivative contracts. Agreements negotiated with counterparties also provide for a single net settlement of all financial instruments covered by the agreement in the event of default by the counterparty, thereby permitting obligations owed by the Company to a counterparty to be offset to the extent of the aggregate amount receivable by the Company from that counterparty (“net settlement arrangements”).

The following table sets out the Company’s exposure to credit risk related to the counterparties to its derivative contracts:

(In thousands)	June 30, 2018	December 31, 2017
Total derivative assets (a)	\$ 5,157	\$ 5,522
Impact of net settlement arrangements	(3,465)	(3,603)
Fair value of collateral deposited for the benefit of the Company	(461)	(1,919)
Net derivative counterparty exposure after net settlement and collateral arrangements	\$ 1,231	\$

(a) Excludes equity warrants with a fair value of \$9,000 and \$1.3 million at June 30, 2018 and December 31, 2017, respectively, which are not subject to counterparty risk.

The net derivative counterparty exposure after net settlement and collateral arrangements relates principally to the timing of collateral placement.

At June 30, 2018 and December 31, 2017, the Company pledged to its counterparties securities with a fair value of \$15.5 million and \$11.9 million, respectively, as independent and mark-to-market collateral for CPI-linked, U.S. Government bond forward and equity long total return swap derivative contracts and recorded these amounts as assets pledged for derivative obligations in the Company’s Consolidated Balance Sheets.

At June 30, 2018, the counterparties pledged \$0.8 million of cash and \$0.7 million of securities, at fair value for the Company’s benefit, compared to \$0.8 million of cash and \$2.9 million of securities, at fair value, at December 31, 2017. The Company recorded the cash collateral as other assets and recognized a corresponding liability in its Consolidated Balance Sheets. The Company does not record in its Consolidated Balance Sheets securities pledged by counterparties as collateral for derivatives in a gain position.

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Offsetting of Derivative Assets/Liabilities

The Company entered into master netting agreements with certain of its derivative counterparties whereby the collateral provided (held) is calculated on a net basis. In accordance with GAAP, the Company elected not to offset derivative assets and liabilities in the Consolidated Balance Sheets for the counterparties with the master netting agreement. The following table summarizes by counterparty (1) the gross and net amounts reflected as derivative assets (excluding equity warrants) and liabilities in the Consolidated Balance Sheets; (2) the gross amounts of the derivative instruments eligible for netting but not offset in the Consolidated Balance Sheets; and (3) financial collateral received and pledged which is contractually permitted to be offset upon an event of default, but is not allowed to be presented net under GAAP (net amount of exposure).

(In thousands)	Gross and net amounts reflected in the Consolidated Balance Sheets	Gross amounts not offset in the Consolidated Balance Sheets		Net amount of exposure
		Derivative asset (liability)	Collateral provided (held) - financial instruments (a)	
June 30, 2018				
Derivative assets:				
Citibank, N.A.	\$ 3,360	\$ (3,176)	\$ (184)	
Deutsche Bank AG London	277		(277)	
Bank of New York Mellon	1,231			\$ 1,231
Bank of America	289	(289)		
Total derivative assets (c)	\$ 5,157	\$ (3,465)	\$ (461)	\$ 1,231
Derivative liabilities:				
Citibank, N.A.	\$ (3,176)	\$ 3,176		
Bank of America	(1,504)	289	\$ 433	\$ (781)
Total derivative liabilities	\$ (4,680)	\$ 3,465	\$ 433	\$ (781)
December 31, 2017				
Derivative assets:				
Citibank, N.A.	\$ 2,814	\$ (2,303)	\$ (511)	
Deutsche Bank AG London	631		(631)	
Bank of America	2,077	(1,300)	(777)	
Total derivative assets (c)	\$ 5,522	\$ (3,603)	\$ (1,919)	
Derivative liabilities:				
Citibank, N.A.	\$ (2,303)	\$ 2,303		
Bank of America	(1,300)	1,300		
Bank of New York Mellon (b)	(677)			\$ (677)
Total derivative liabilities	\$ (4,280)	\$ 3,603		\$ (677)

(a) Amounts of collateral pledged to the Company by the counterparties (collateral held) and pledged by the Company to the counterparties (collateral provided) reflected above are to the extent of the net counterparty exposure before collateral.

(b) Represents foreign currency contracts that are not subject to a master netting arrangement.

(c) Excludes equity warrants with a fair value of \$9,000 and \$1.3 million at June 30, 2018 and December 31, 2017, respectively, which are not subject to counterparty risk.

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Note 4. Fair Value Measurements

Fair values for substantially all of the Company's financial instruments are measured using market or income approaches. Considerable judgment may be required in interpreting market data used to develop estimates of fair value. Accordingly, actual values realized in future market transactions may differ from the estimates presented in these consolidated financial statements. In determining fair value, the Company primarily uses prices and other relevant information generated by market transactions involving identical or comparable assets ("market approach"). The Company also considers the impact of a significant decrease in volume and level of activity for an asset or liability when compared with normal activity to identify transactions that are not orderly.

Fair value measurements are determined under a three level hierarchy that prioritizes the inputs to valuation techniques used to measure fair value, distinguishing between market participant assumptions developed based on market data obtained from sources independent of the reporting entity ("observable inputs") and the reporting entity's own assumptions about market participant assumptions developed based on the best information available in the circumstances ("unobservable inputs"). The hierarchy level assigned to each security carried at fair value is based on the Company's assessment of the transparency and reliability of the inputs used in the valuation of each instrument at the measurement date. The highest priority is given to unadjusted quoted prices in active markets for identical assets (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). Securities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement. The Company recognizes transfers between levels at the end of each reporting period in which the transfer is identified. The three hierarchy levels are defined as follows:

Level 1— Inputs represent unadjusted quoted prices for identical instruments exchanged in active markets. The fair values of publicly traded equity securities, highly liquid cash management funds and short-term U.S. Government securities are based on published quotes in active markets.

Level 2— Inputs include directly or indirectly observable inputs (other than Level 1 inputs) such as quoted prices for similar financial instruments exchanged in active markets, quoted prices for identical or similar financial instruments exchanged in inactive markets and other market observable inputs. The fair value of the vast majority of the Company's investments in fixed maturity securities along with most derivative contracts (including long equity total return swaps, foreign exchange forward contracts and U.S. Government bond forward contracts) are priced based on information provided by independent pricing service providers while much of the remainder are based primarily on non-binding third party broker-dealer quotes that are prepared using Level 2 inputs. Where third party broker-dealer quotes are used, typically at least one quote is obtained from a broker-dealer with particular expertise in the instrument being priced. Certain common stock investments which are measured at fair value using the net asset value per share ("NAV") practical expedient have been excluded in accordance with recent accounting guidance.

Level 3— Inputs include unobservable inputs used in the measurement of financial instruments. Management is required to use its own assumptions regarding unobservable inputs as there is little, if any, market activity in these instruments or related observable inputs that can be corroborated at the measurement date. Certain cost-method partnership investments which are measured at fair value using the NAV practical expedient have been excluded due to a change in accounting guidance. Investments for which NAV is only a component of the fair value measurement continue to be included.

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The following table presents the Company's investments measured at fair value on a recurring basis as of June 30, 2018 and December 31, 2017 classified by the valuation hierarchy discussed previously:

(In thousands)	Total	Fair Value Measurement Using		
		Level 1	Level 2	Level 3
June 30, 2018				
Fair value option securities:				
Fixed maturity securities:				
State and local government debt	\$ 288,154		\$ 288,154	
U.S. government debt	243,455		243,455	
Corporate debt	34,277		4,455	\$ 29,822
Total fixed maturity securities	565,886		536,064	29,822
Equity securities (a)	292,784	\$ 239,228		10,782
Short-term investments	656,620	651,759	4,861	
Other investments - affiliate corporate loans	5,886			5,886
Total fair value option investments	\$ 1,521,176	\$ 890,987	\$ 540,925	\$ 46,490
Available-for-sale investments:				
Equity securities	\$ 15,864		\$ 54	\$ 15,810
Total available-for-sale investments	\$ 15,864		\$ 54	\$ 15,810
Derivatives:				
Equity total return swaps – long positions	\$ 2,488		\$ 2,488	
CPI-linked derivative contracts	1,438			\$ 1,438
Foreign exchange forward contracts	1,231		1,231	
Equity warrants	9		9	
Total derivative assets	5,166		3,728	1,438
Equity total return swaps – long positions	(1,504)		(1,504)	
U.S. Government bond forward contracts	(3,176)		(3,176)	
Total derivative liabilities	(4,680)		(4,680)	
Net derivatives	\$ 486		\$ (952)	\$ 1,438
December 31, 2017				
Fair value option securities:				
Fixed maturity securities:				
State and local government debt	\$ 415,072		\$ 415,072	
U.S. government debt	23,588		23,588	
Corporate debt	21,689			\$ 21,689
Total fixed maturity securities	460,349		438,660	21,689
Equity securities (a)	310,594	\$ 250,317		12,106
Short-term investments	738,810	738,810		
Total fair value option investments	\$ 1,509,753	\$ 989,127	\$ 438,660	\$ 33,795
Available-for-sale investments:				
Equity securities	\$ 16,247		\$ 48	\$ 16,199
Total available-for-sale investments	\$ 16,247		\$ 48	\$ 16,199
Derivatives:				
Equity total return swaps – long positions	\$ 2,077		\$ 2,077	
CPI-linked derivative contracts	3,445			\$ 3,445
Equity warrants	1,282		18	1,264
Total derivative assets	6,804		2,095	4,709
Equity total return swaps – long positions	(1,917)		(1,917)	
U.S. Government bond forward contracts	(1,686)		(1,686)	
Foreign exchange forward contracts	(677)		(677)	
Total derivative liabilities	(4,280)		(4,280)	
Net derivatives	\$ 2,524		\$ (2,185)	\$ 4,709

- (a) In accordance with recent accounting guidance, certain common stock investments with a fair value of \$42.7 million and \$48.2 million that are measured using the NAV practical expedient have not been classified in the fair value hierarchy at June 30, 2018 and December 31, 2017, respectively. The fair value amounts presented in the "Total" column are intended to permit reconciliation of the fair value hierarchy to the amounts presented in the Consolidated Balance Sheets.

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The following table presents changes in the Company's Level 3 fixed maturity, equity securities, and derivatives measured at fair value on a recurring basis:

(In thousands)	Corporate Debt	Equity Securities	Derivatives	Affiliate Corporate Loans
Balance at March 31, 2018	\$ 21,334	\$ 28,368	\$ 3,852	\$ 5,950
Purchases	4,812			
Sales			(1,645)	
Realized and unrealized gains/losses included in:				
Other comprehensive loss (a)		(987)		
Change in net unrealized gains/losses on fair value option investments	(928)	(789)		(64)
Accretion of discounts	21			
Net realized loss on investments			(403)	
Net losses on derivatives			(366)	
Transfer from Level 2 to Level 3	4,583			
Balance at June 30, 2018	\$ 29,822	\$ 26,592	\$ 1,438	\$ 5,886
Balance at December 31, 2017	\$ 21,689	\$ 28,305	\$ 4,709	
Purchases	9,395		563	\$ 6,111
Sales			(1,645)	
Realized and unrealized gains/losses included in:				
Other comprehensive loss (a)		(389)		
Change in net unrealized gains/losses on fair value option investments	(1,301)	(1,324)		(225)
Accretion of discounts	39			
Net realized loss on investments			(403)	
Net losses on derivatives			(1,786)	
Balance at June 30, 2018	\$ 29,822	\$ 26,592	\$ 1,438	\$ 5,886

There were no significant changes to the valuation techniques and processes used at June 30, 2018 compared to those described in the Company's Consolidated Financial Statements at December 31, 2017.

Note 5. Related Party Transactions

Investments

Management of all of the Company's investments is centralized at Fairfax through investment management agreements entered into in 2010. The parties to these agreements are Zenith National's insurance subsidiaries, Fairfax and Hamblin Watsa Investment Counsel, Ltd. ("HWIC"), a Fairfax affiliate. Investment management expenses incurred under these agreements for the three and six months ended June 30, 2018 were \$1.3 million and \$2.6 million, respectively, and \$1.2 million and \$2.4 million, respectively, for the comparable periods of 2017.

The Company owns common shares in various mutual fund classes of HWIC Asia which is a wholly-owned subsidiary of Fairfax. At June 30, 2018 and December 31, 2017, the aggregate fair value of these investments was \$42.7 million and \$48.2 million, respectively. Changes in fair value for these investments are recorded in the change in net unrealized gains/losses on fair value option investments in the Consolidated Statements of Comprehensive Income (Loss). During the six months ended June 30, 2018, the Company recorded a net decrease in unrealized gains/losses of \$5.4 million on these investments, compared to a net increase in unrealized gains/losses of \$1.4 million during the six months ended June 30, 2017.

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The Company owns common stock in publicly-traded and private companies and invests in limited partnerships which are affiliates of Fairfax (including but not limited to investments described in the following paragraphs). These investments are recorded under the equity method of accounting. At June 30, 2018 and December 31, 2017, the aggregate value of its equity-method investments in Fairfax affiliates recorded in the Consolidated Balance Sheets was \$190.6 million and \$196.2 million, respectively. The Company's share of net income/loss of the equity-method investees was recorded in net investment income. Net realized gains/losses on sales and on dilution resulting from additional shares issued or bought back by equity-method investees are recorded in net realized gains/losses on investments. The Company's share of other changes in investees' equity was recorded in net change in net unrealized gain/losses in Other Comprehensive Loss. Net unrealized gains/losses on foreign currency translation adjustment related to the Company's equity-method investments are recorded in the change in unrealized foreign currency translation adjustment Other Comprehensive Loss. The following table summarizes impact from the Company's investments in equity-method common stocks and partnerships on various components of Comprehensive Loss:

(In thousands)	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Equity-method common stocks and partnerships:				
Net investment income/loss	\$ (141)	\$ (1,593)	\$ (3,829)	\$ 1,627
Net realized gains/losses on sales and dilution	33	2,059	(1,516)	1,598
Change in unrealized gains/losses, before tax	18	(1,068)	1,043	(934)
Change in unrealized foreign currency translation adjustment, before tax	(966)	1,562	530	542

In January 2018, Fairfax and the Company entered into an agreement with Exco Resources, Inc. ("Exco"), an affiliate of Fairfax and the Company, to extend a private debtor-in-possession loan to Exco ("Exco DIP Loan") who is in the process of bankruptcy restructuring. Investment in this affiliated private loan, at fair value at June 30, 2018 was \$2.7 million and was recorded in other investments in the Consolidated Balance Sheets.

In February 2018, Fairfax and the Company entered into a private loan agreement with Farmers Edge, Inc. ("Farmers Edge"), an affiliate of Fairfax and the Company ("Farmers Edge Loan"). Fairfax and the Company also received warrants to purchase Farmers Edge common stock ("Farmers Edge Warrants") in connection with this loan. The Company's share of this investment was \$4.1 million, allocated between \$3.4 million (Canadian \$5.0 million par value) in Farmers Edge Loan and \$0.7 million Farmers Edge Warrants, as estimated by HWIC. The Company sold Farmers Edge Warrants to Wentworth Insurance Company Ltd. ("Wentworth"), an affiliate of Fairfax, on the same day they were acquired, substantially at cost. Investment in this affiliated private loan at June 30, 2018 was \$3.2 million, and was recorded in other investments in the Consolidated Balance Sheets.

In February 2018, Fairfax and the Company invested in private placement debt securities issued by Seaspan Corporation ("Seaspan"), a publicly traded company domiciled in the Marshall Islands. Fairfax and The Company received warrants to purchase Seaspan common stock in connection with this investment ("Seaspan Warrants"). Seaspan became an affiliate of Fairfax and the Company simultaneously with this investment. The Company's share of this investment was \$5.0 million, allocated between \$4.4 million (\$5.0 million par value) in Seaspan corporate bonds and \$0.6 million in Seaspan Warrants, as estimated by HWIC. The Company sold Seaspan warrants to Wentworth in April 2018, substantially at cost. Investment in these affiliated fixed maturity securities was \$4.6 million at June 30, 2018.

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In February 2018, Fairfax completed the sale of its 51.0% ownership interest in Keg Restaurants Ltd. (“The Keg”) to Cara Operations Limited (“Cara”), a subsidiary of Fairfax domiciled in Canada, for consideration that comprised of cash and Cara common stock. In 2014, the Company invested in FFHL LP, a wholly-owned limited partnership subsidiary of Fairfax formed to hold The Keg common stock. As a result of the sale of The Keg to Cara, the Company received \$0.6 million cash dividend distribution from FFHL LP, and the Company’s remaining equity interest in the FFHL LP was redeemed in full in the form of \$11.7 million of Cara common stock. The Company recorded its share of the FFHL LP realized loss on the sale of The Keg to Cara of \$0.3 million as part of equity in losses of FFHL LP in investment income. The Company recognized realized losses on foreign exchange of \$1.2 million upon final redemption of its investment in FFHL LP that were reclassified from unrealized foreign currency translation adjustment previously recorded in accumulated other comprehensive loss component of Stockholders’ Equity. Cara was subsequently renamed Recipe Unlimited Corp. Investment in this equity-method common stock was \$11.6 million at June 30, 2018.

The Company owns investment in common stock of Boat Rocker Media Inc. (“Boat Rocker”), a majority-owned subsidiary of Fairfax. In June 2018, Boat Rocker declared a return of capital distribution to be settled in July 2018. As a result, the Company recorded a return of capital distribution and corresponding intercompany receivable from Boat Rocker of \$0.4 million as of June 30, 2018. Investment in this equity-method common stock was \$15.1 million at June 30, 2018.

Other

The Company continues to be a party to various reinsurance treaties with affiliates of Fairfax that were entered into in the ordinary course of business, primarily excess of loss reinsurance agreements with Odyssey Re for 2010 through 2017. At June 30, 2018 and December 31, 2017, the Company recorded net reinsurance recoverables of \$1.1 million and \$0.7 million, respectively, related to the reinsurance transactions with the affiliates of Fairfax.

Zenith National paid Fairfax \$0.1 million in each of the six months ended June 30, 2018 and 2017, respectively, for the cost of the open market purchase made by Fairfax on Zenith National’s behalf of Fairfax Subordinate Voting Shares granted to certain officers under the Restricted Stock Plan.

In April 2015, Zenith National entered into an agreement with MFXchange US, Inc., an indirect, wholly-owned subsidiary of Fairfax, to provide information technology services to Zenith National. The Company recorded expenses of \$22,000 and \$44,000 in the three and six months ended June 30, 2018, and 2017, respectively.

In November 2014, the Company entered into a Master Administrative Services Agreement with various affiliates of Fairfax. Under the agreement, the affiliated parties provide and receive administration services such as accounting, underwriting, claims, reinsurance, preparation of regulatory reports, and actuarial services. The Company began providing claims processing services for Seneca Insurance Company, Inc. (“Seneca”) under this agreement in March 2016 and recorded service fee income of \$0.1 million and \$0.2 million and \$0.1 million and \$0.3 million in the three and six months ended June 30, 2018 and 2017, respectively, in the Consolidated Statements of Comprehensive Income (Loss) which was substantially offset by costs of dedicated staff and allocated shared services. Other liabilities at both June 30, 2018 and December 31, 2017 include a loss fund of \$0.6 million maintained by the Company to process future workers’ compensation claim payments on behalf of Seneca.

In March 2013, the Company entered into an agreement with TIG Insurance Company (“TIG”) to become their primary workers’ compensation claims service provider. The Company recorded service fee income of \$2.2 million and \$4.4 million and \$2.2 million and \$4.5 million, in the three and six months ended June 30, 2018 and 2017, respectively, in the Consolidated Statements of Comprehensive Income (Loss) which is substantially offset by costs of dedicated staff and allocated shared services. Other liabilities at June 30, 2018

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include a net liability of \$1.1 million which includes net loss fund liability of \$3.8 million reduced by a service fee income receivable of \$2.7 million. Other liabilities at December 31, 2017 include a net liability of \$2.3 million which includes net loss fund liability of \$3.3 million reduced by a service fee income receivable of \$1.0 million.

Note 6. Reinsurance Recoverable

Amounts recoverable for paid and unpaid losses from reinsurers at June 30, 2018 and December 31, 2017 and their respective A.M. Best ratings were as follows:

(In thousands)	June 30, 2018 (a)	December 31, 2017 (a)	A.M. Best Rating (b)	A.M. Best Rating Date
General Reinsurance Corp.	\$ 39,448	\$ 43,567	A++	1/2018
Lloyds Underwriters	1,471	1,025	A	7/2018
Factory Mutual Insurance Company	1,165	492	A+	2/2018
Inter-Ocean Re Ins Co. Ltd. (c)		2,799	NR	
All others (d)	6,964	6,548		
Total	\$ 49,048	\$ 54,431		

- (a) Under insurance regulations in California, reinsurers placed securities on deposit equal to the California component of the Company's ceded workers' compensation loss reserves.
- (b) A.M. Best, in assigning ratings, is primarily concerned with the ability of insurance and reinsurance companies to pay the claims of policyholders. In the A.M. Best ratings scheme, ratings of B+ to A++ are considered "Secure" and ratings of B and below are considered "Vulnerable." NR means A.M. Best does not rate the reinsurer.
- (c) Reinsurance recoverable from the Inter-Ocean Re Ins Co. Ltd. at December 31, 2018 was fully secured by an investment grade security held in a bank trust account on the Company's behalf. In May 2018, the Company commuted this retroactive reinsurance agreement, received \$3.0 million, eliminated a deferred gain of \$0.4 million and recorded a total gain of \$0.6 million.
- (d) No individual reinsurer in excess of \$1.0 million at June 30, 2018 and December 31, 2017, respectively.

Note 7. Unpaid Losses and Loss Adjustment Expenses

The following table represents a reconciliation of changes in the liability for unpaid losses and loss adjustment expenses:

(In thousands)	June 30, 2018	June 30, 2017
Beginning of year, net of reinsurance	\$ 1,139,372	\$ 1,144,409
Incurring claims:		
Current accident year	234,578	231,429
Prior accident years	(36,713)	(45,817)
Total incurred claims	197,865	185,612
Payments:		
Current accident year	(44,474)	(44,764)
Prior accident years	(160,391)	(160,610)
Total payments	(204,865)	(205,374)
End of year, net of reinsurance	1,132,372	1,124,647
Receivable from reinsurers for unpaid losses	48,931	60,782
End of year, gross of reinsurance	\$ 1,181,303	\$ 1,185,429

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Note 8. Other Comprehensive Income (Loss)

Other comprehensive income (loss) is comprised of changes in unrealized gains/losses on investments classified as available-for-sale, other investments in cost-method partnerships, other investments in equity-method common stocks and foreign currency translation adjustments. The following table summarizes the components of the Company's other comprehensive income:

(In thousands)	Pre-Tax	Income Tax Effect	After-Tax
Three months ended June 30, 2018			
Net unrealized losses arising during the period	\$ (704)	\$ (148)	\$ (556)
Less: reclassification adjustment for net realized gains included in net income	(581)	(122)	(459)
Net changes in unrealized gains/losses on available-for-sale and other investments	(1,285)	(270)	(1,015)
Change in unrealized foreign currency translation adjustment	(966)	(203)	(763)
Total other comprehensive loss	\$ (2,251)	\$ (473)	\$ (1,778)
Six months ended June 30, 2018			
Net unrealized losses arising during the period	\$ (222)	\$ (47)	\$ (175)
Less: reclassification adjustment for net realized gains included in net income	(633)	(133)	(500)
Reclassification of certain tax effects to retained earnings at January 1, 2018 (a)		549	(549)
Net changes in unrealized gains/losses on available-for-sale and other investments	(855)	369	(1,224)
Unrealized foreign currency translation adjustment arising during the period	(625)	(131)	(494)
Less: reclassification adjustment for net realized foreign exchange gains included in net income	1,155	242	913
Reclassification of certain tax effects to retained earnings at January 1, 2018 (a)		280	(280)
Change in unrealized foreign currency translation adjustment	530	391	139
Total other comprehensive loss	\$ (325)	\$ 760	\$ (1,085)
Three months ended June 30, 2017			
Net unrealized losses arising during the period	\$ (528)	\$ (184)	\$ (344)
Less: reclassification adjustment for net realized gains included in net income	(2,750)	(963)	(1,787)
Net changes in unrealized gains/losses on available-for-sale and other investments	(3,278)	(1,147)	(2,131)
Change in unrealized foreign currency translation adjustment	1,562	546	1,016
Total other comprehensive loss	\$ (1,716)	\$ (601)	\$ (1,115)
Six months ended June 30, 2017			
Net unrealized gains arising during the period	\$ 1,390	\$ 487	\$ 903
Less: reclassification adjustment for net realized gains included in net income	(2,742)	(960)	(1,782)
Net changes in unrealized gains/losses on available-for-sale and other investments	(1,352)	(473)	(879)
Change in unrealized foreign currency translation adjustment	542	189	353
Total other comprehensive loss	\$ (810)	\$ (284)	\$ (526)

- (a) In February 2018, the Financial Accounting Standards Board ("FASB") issued updated guidance that allows a reclassification from accumulated other comprehensive loss to retained earnings for the stranded tax effects resulting from the enactment of the Tax Cuts and Jobs Act of 2017, which was signed into law on December 22, 2017. The Company early adopted this amended guidance on January 1, 2018, and as a result, elected to reclassify total \$0.8 million of stranded tax effects from accumulated other comprehensive loss to retained earnings as of January 1, 2018.

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The following table summarizes the net unrealized gains (losses) on available-for-sale securities, other investments in cost-method partnerships, other investments in equity-method common stocks and partnerships, and foreign currency translation adjustment recognized in accumulated other comprehensive loss:

(In thousands)	June 30, 2018	December 31, 2017
Equity securities	\$ (4,499)	\$ (4,117)
Other investments in equity-method common stocks	(1,537)	(1,434)
Other investments in cost-method partnerships	(281)	1,235
Other investments in equity-method partnerships	1,542	396
Net unrealized loss on investments, before tax	(4,775)	(3,920)
Deferred tax benefit	(1,003)	(1,372)
Net unrealized loss on investments, after tax	(3,772)	(2,548)
Net unrealized loss on foreign currency translation adjustment, before tax	(1,470)	(2,000)
Deferred tax benefit	(309)	(700)
Net unrealized loss on foreign currency translation adjustment, after tax	(1,161)	(1,300)
Total accumulated other comprehensive loss	\$ (4,933)	\$ (3,848)

Note 9. Stock-Based Compensation

The following table provides information regarding the Fairfax Subordinate Voting Shares under the Restricted Stock Plan:

	Number of Shares
Authorized for purchases and grants at plan inception in 2010	200,000
Purchased and restricted	(56,243)
Vested	(39,432)
Purchased and available for future grants	(150)
Available for future purchases at June 30, 2018	104,175

The following represents open market purchases of Fairfax Subordinate Voting Shares under the Restricted Stock Plan which also resulted in charges to the Company's Stockholders' equity:

(Dollars in thousands, except share data)	Number of Shares	Weighted Average Purchase Price Per Share	Total Purchase Price
Purchased through December 31, 2011	29,970	\$ 388.11	\$ 11,632
Purchased in 2012	10,554	381.59	4,027
Purchased in 2013	6,145	390.86	2,402
Purchased in 2014	5,898	501.47	2,958
Purchased in 2015	19,844	486.34	9,651
Purchased in 2016	10,191	443.31	4,518
Purchased in 2017	12,908	509.28	6,574
Purchased in 2018	315	502.69	158
Total purchased since plan inception	95,825	437.46	\$ 41,920

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Changes in the restricted shares outstanding were as follows:

(Dollars in thousands, except share data)	Number of Shares	Weighted Average Grant Date Fair Value Per Share	Grant Date Fair Value
Restricted Shares at December 31, 2015	35,799	\$ 443.01	\$ 15,859
Granted during 2016	10,183	449.52	4,577
Forfeited during 2016	(240)	479.30	(115)
Vested during 2016	(4,296)	394.01	(1,692)
Restricted Shares at December 31, 2016	41,446	449.48	18,629
Granted during 2017	14,335	447.71	6,418
Forfeited during 2017	(2,267)	421.59	(956)
Vested during 2017	(3,227)	384.96	(1,242)
Restricted Shares at December 31, 2017	50,287	454.37	22,849
Granted during 2018	11,608	508.90	5,907
Forfeited during 2018	(305)	474.43	(144)
Vested during 2018	(5,347)	384.87	(2,058)
Restricted Shares at June 30, 2018	56,243	472.13	\$ 26,554

Stock-based compensation expense before tax was \$1.2 million and \$2.5 million for the three and six months ended June 30, 2018, respectively, compared to \$1.0 million and \$1.8 million in the corresponding periods of 2017, respectively.

Unrecognized compensation expense before tax under the Restricted Stock Plan was \$16.8 million and \$13.5 million at June 30, 2018 and December 31, 2017, respectively.

Note 10. Commitments and Contingencies

The Company is involved in various litigation proceedings that arise in the ordinary course of business. Disputes adjudicated in the workers' compensation administrative systems may be appealed to review boards or civil courts, depending on the issues and local jurisdictions involved. From time to time, plaintiffs also sue the Company on theories falling outside of the exclusive jurisdiction and remedies of the workers' compensation claims adjudication systems. Certain of these legal proceedings seek injunctive relief or substantial monetary damages, including claims for punitive damages, which may not be covered by reinsurance agreements. Historically, the Company has not experienced any material exposure or damages from any of these legal proceedings. In addition, in the opinion of management, after consultation with legal counsel, currently outstanding litigation is either without merit or the ultimate liability, if any, is not expected to have a material adverse effect on the Company's consolidated financial condition, results of operations or cash flows.

Note 11. Recent Accounting Guidance Not Yet Adopted

In May 2014, the Financial Accounting Standards Board issued new guidance on how an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. This guidance does not apply to contracts within the scope of other standards (for example, insurance contracts or lease contracts). In August 2015, the FASB deferred the effective date of this new guidance by one year. This guidance is now effective for annual reporting periods beginning after December 15, 2018 and interim periods thereafter. Early adoption is not permitted. The guidance is not expected to have a material impact on the Company's consolidated financial position, results of operations or cash flows.

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In January 2016, the FASB issued updated guidance to address the recognition, measurement, presentation, and disclosure of certain financial instruments. The updated guidance requires equity investments, except those accounted for under the equity method of accounting, that have readily determinable fair value to be measured at fair value with changes in fair value recognized in net income. Equity investments that do not have readily determinable fair values may be remeasured at fair value either upon the occurrence of an observable price change or upon identification of impairment. A qualitative assessment for impairment is required for equity investments without readily determinable fair values. The updated guidance also eliminates the requirement to disclose the method and significant assumptions used to estimate the fair value of financial instruments measured at amortized cost on the balance sheet. The updated guidance is effective for annual periods beginning after December 15, 2018 and interim periods thereafter and will require recognition of a cumulative effect adjustment at adoption. In February 2018, the FASB issued technical corrections and improvements intended to clarify certain aspects of the guidance on recognizing and measuring financial assets and liabilities. The guidance is not expected to have a material impact on the Company's consolidated financial position, results of operations or cash flows.

In February 2016, the FASB issued updated guidance to require lessees to recognize a right-to-use asset and a lease liability for leases with terms of more than 12 months. The updated guidance retains the two classifications of a lease as either an operating or finance lease (previously referred to as a capital lease). Both lease classifications require the lessee to record the right-to-use asset and the lease liability based upon the present value of cash flows. Finance leases will reflect the financial arrangement by recognizing interest expense on the lease liability separately from the amortization expense of the right-to-use asset. Operating leases will recognize lease expense (with no separate recognition of interest expense) on a straight-line basis over the term of the lease. The accounting by lessors is not significantly changed by the updated guidance. The updated guidance requires expanded qualitative and quantitative disclosures, including additional information about the amounts recorded in the financial statements. In July 2018, the FASB issued Codification Improvements to the leasing standard issued in February 2016 which provides narrow amendments to clarify how to apply certain aspects of the new lease standard. Both standards are effective for annual periods beginning after December 15, 2019 and interim periods thereafter, and will require that the earliest comparative period presented include the measurement and recognition of existing leases with an adjustment to equity as if the updated guidance had always been applied. Early adoption is permitted. The adoption of this guidance is not expected to have a material impact on the Company's consolidated financial position, results of operations or cash flows.

In June 2016, the FASB issued new guidance which requires a financial asset (or a group of financial assets) measured at amortized cost to be presented at the net amount expected to be collected. The allowance for credit losses is a valuation account that is deducted from the amortized cost basis of the financial asset(s) to present the net carrying value of the amount expected to be collected on the financial asset. The guidance broadens the information that an entity must consider in developing its expected credit loss estimate for assets measured either collectively or individually; measurement of expected credit losses will be based on relevant information about past events, including historical experience, current conditions, and reasonable and supportable forecasts that affect the collectability of the reported amount. Furthermore, the new guidance requires credit losses relating to available-for-sale securities to be recorded through an allowance for credit losses, and an entity will be able to record reversals of credit losses in current period net income. The guidance is effective for annual periods beginning after December 15, 2020 and interim periods thereafter. All entities may adopt this guidance as early as periods beginning after December 15, 2018. The guidance is not expected to have a material impact on the Company's consolidated financial position, results of operations or cash flows.

In August 2016, the FASB issued new guidance which addresses how certain cash receipts and cash payments are presented and classified on the statement of cash flows. The guidance will be effective for annual periods beginning after December 15, 2018 and interim periods thereafter. Early adoption is permitted. This guidance is not expected to have a material impact on the Company's financial statements.

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In October 2016, the FASB issued new guidance which requires recognition of current and deferred income taxes resulting from an intra-entity transfer of any asset (excluding inventory) when the transfer occurs. This is a change from existing GAAP which prohibits recognition of current and deferred income taxes until the asset is sold to a third party. The guidance will be effective for annual periods beginning after December 15, 2018 and interim periods thereafter. Early adoption is permitted. This guidance is not expected to have a material impact on the Company's consolidated financial position, results of operations or cash flows.

In November 2016, the FASB issued new guidance on how entities should present restricted cash and restricted cash equivalents in the statement of cash flows. The guidance requires entities to present the changes in the total of cash, cash equivalents, restricted cash and restricted cash equivalents in the statement of cash flows. As a result, entities will no longer present transfers between cash and cash equivalents and restricted cash and restricted cash equivalents in the statement of cash flows. The guidance will be effective for annual periods beginning after December 15, 2018 and interim periods thereafter. Early adoption is permitted. The guidance is not expected to have a material impact on the Company's consolidated financial position, results of operations or cash flows.

In January 2017, the FASB issued new guidance to simplify how an entity is required to test goodwill for impairment by eliminating Step 2 from the goodwill impairment test. Step 2 measures a goodwill impairment loss by comparing the implied fair value of a reporting unit's goodwill with the carrying amount of that goodwill. Under the new guidance, entities will record an impairment charge based on the excess of a reporting unit's carrying amount over its fair value. The guidance will be effective for annual periods or any interim goodwill impairment tests beginning after December 15, 2021. Early adoption is permitted. The guidance is not expected to have a material impact on the Company's consolidated financial position, results of operations or cash flows.

In March 2017, the FASB issued updated guidance to shorten the amortization period for certain callable debt securities held at a premium. The guidance requires the premium to be amortized to the earliest call date, however, securities held at a discount will continue to be amortized to maturity. The guidance will be effective for annual periods beginning after December 15, 2019, and interim periods thereafter. Early adoption is permitted. This guidance is not expected to have a material impact on the Company's consolidated financial position, results of operations or cash flows.

In May 2017, the FASB issued guidance to provide clarity when changes to the terms or conditions of a share-based payment award must be accounted for as a modification. The new guidance requires that modification accounting will be applied only if there is a change in fair value, vesting conditions or classification. The guidance will be effective for annual periods beginning after December 15, 2017, and interim periods thereafter. Early adoption is permitted. This guidance is not expected to have a material impact on the Company's consolidated financial position, results of operations or cash flows.