National Interstate CORP
Form 10-K
March 06, 2015
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UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 10-K
Annual Report Pursuant to Section 13 or 15(d) of the
Securities Exchange Act of 1934
For the Fiscal Year Ended December 31, 2014

Commission File No. 000-51130

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

Ohio	34-1607394
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

3250 Interstate Drive
Richfield, Ohio 44286-9000
(330) 659-8900
(Address and telephone number of principal executive offices)

Securities Registered Pursuant to Section 12(b) of the Act:

Title of each class	Name of exchange on which registered
Common Shares, $0.01 par value	Nasdaq Global Select Market

Securities registered pursuant to Section 12(g) of the 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 x
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 x
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 x No ¨
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x 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 definitions of “large accelerated filer,” “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act. (Check One):

Large accelerated filer	¨	Accelerated filer	x
Non-accelerated filer	o (Do not check if a smaller reporting company)	Smaller reporting company	¨

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

State the aggregate market value of the voting and non-voting common equity held by non-affiliates computed by reference to the price at which the common equity was last sold, or the average bid and asked price of such common equity, as of the last business day of the registrant’s most recently completed second fiscal quarter: $203.3 million (based upon non-affiliate holdings of 7,254,012 shares and a market price of $28.02 at June 30, 2014).

As of March 4, 2015 there were 19,838,338 shares of the Registrant’s Common Shares ($0.01 par value) outstanding.

Documents Incorporated by Reference:

Proxy Statement for 2015 Annual Meeting of Shareholders (portions of which are incorporated by reference into Part III hereof).

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FORWARD-LOOKING STATEMENTS

The disclosures in this Form 10-K, including information incorporated by reference, contain “forward-looking statements” (within the meaning of the Private Securities Litigation Reform Act of 1995). All statements, trend analyses and other information contained in this Form 10-K relative to markets for our products and trends in our operations or financial results, as well as other statements including words such as “may,” “target,” “anticipate,” “believe,” “plan,” “estimate,” “expect,” “intend,” “project,” and other similar expressions, constitute forward-looking statements. We mad these statements based on our plans and current analyses of our business and the insurance industry as a whole. We caution that these statements may and often do vary from actual results and the differences between these statements and actual results can be material. Factors that could contribute to these differences include, among other things:

- general economic conditions, weakness of the financial markets and other factors, including prevailing interest rate levels and stock and credit market performance, which may affect or continue to affect (among other things) our ability to sell our products and to collect amounts due to us, our ability to access capital resources and the costs associated with such access to capital and the market value of our investments;
- our ability to obtain adequate premium rates and manage our growth strategy;
- performance of securities markets;
- our ability to attract and retain independent agents and brokers;
- customer response to new products and marketing initiatives;
- tax law and accounting changes;
- increasing competition in the sale of our insurance products and services and the retention of existing customers;
- changes in legal environment;
- legal actions brought against us;
- regulatory changes or actions, including those relating to the regulation of the sale, underwriting and pricing of insurance products and services and capital requirements;
- damage to our reputation;
- levels of natural catastrophes, terrorist events, incidents of war and other major losses;
- technology or network security disruptions;
- adequacy of insurance reserves; and
- availability of reinsurance and ability of reinsurers to pay their obligations.

The forward-looking statements herein are made only as of the date of this report. We assume no obligation to publicly update any forward-looking statements.

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PART I

ITEM 1 Business

Introduction

National Interstate Corporation (the "Company", "we", "our") and its subsidiaries operate as an insurance holding company group that underwrites and sells traditional and alternative property and casualty insurance products primarily to the passenger transportation, trucking and moving and storage industries, general commercial insurance to small businesses in Hawaii and Alaska and personal insurance to owners of recreational vehicles throughout the United States. Our principal executive offices are located at 3250 Interstate Drive, Richfield, Ohio, 44286 and our telephone number is (330) 659-8900. Securities and Exchange Commission (the "SEC") filings, news releases, our Code of Ethics and Conduct and other information may be accessed free of charge through our website at http://invest.natl.com. Information on the website is not part of this Form 10-K. We make all documents that we file with, or furnish to, the SEC, including our annual report on Form 10-K, quarterly reports on Form 10-Q, current report on Form 8-K, and any amendments to these reports, available on our website as soon as reasonably practicable. These reports are also available on the SEC's website at http://www.sec.gov.

Great American Insurance Company ("Great American"), a wholly-owned subsidiary of American Financial Group, Inc. ("AFG"), is our majority shareholder. At December 31, 2014, Great American owned 51.4% of our outstanding shares. Our common shares trade on the Nasdaq Global Select Market under the symbol "NATL."

Property and Casualty Insurance Operations

We are a specialty property and casualty insurance company with a niche orientation and a focus on the transportation industry. Founded in 1989, we have had an uninterrupted record of profitability in every year since 1990, our first full year of operation. We have also reported an underwriting profit in 22 of the 26 years we have been in business. For the year ended December 31, 2014, we had gross premiums written (direct and assumed) of $689.0 million and net income of $11.0 million.

Our Products

We offer approximately 40 product lines in the specialty property and casualty insurance market, which we group into four general business components (alternative risk transfer ("ART"), transportation, specialty personal lines and Hawaii and Alaska) based on the class of business, insureds' risk participation or geographic location.

The following table sets forth an analysis of gross premiums written by business component during the years indicated:

	Year Ended December 31,								
	2014			2013			2012		
	Amount	Percent		Amount	Percent		Amount	Percent	
	(Dollars in thousands)								
Alternative Risk Transfer	$374,152	54.3	%	$326,305	51.7	%	$316,114	55.2	%
Transportation	245,261	35.6	%	228,139	36.1	%	180,786	31.5	%
Specialty Personal Lines	35,597	5.2	%	47,715	7.5	%	51,026	8.9	%
Hawaii and Alaska	21,276	3.1	%	20,096	3.2	%	18,383	3.2	%
Other	12,717	1.8	%	9,738	1.5	%	7,161	1.2	%
Gross premiums written	$689,003	100.0	%	$631,993	100.0	%	$573,470	100.0	%

For 2014, the range of premiums for our business components and their annual premium averages were as follows:

	Premium Range	Annual Averages
Alternative Risk Transfer	$8,200-$5,980,000	$117,600
Transportation	$4,400-$139,100	$24,500

Specialty Personal Lines	\$1,100-\$1,200	\$1,100
Hawaii and Alaska	\$2,200-\$15,800	\$4,400

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Alternative Risk Transfer. We underwrite, market and distribute primarily truck transportation, passenger transportation and moving and storage ART insurance products, also known as captives. ART products function by utilizing insurance or reinsurance companies that are owned or "rented" (as described below) by the participants in the program. Participants may include homogeneous groups of passenger transportation, trucking or moving and storage companies, transportation insurance agencies and individual, larger insureds as single participants in our large account ART products. Program participants share in the underwriting profits or losses and the investment results associated with the risks of being insured through the program. Participants in these programs typically are interested in improved risk control, increased participation in the claims settlement process and asset investment features associated with an ART insurance program.

We support two forms of ART programs – member-owned and rental. In a member-owned ART program, the participants form, capitalize and manage their own reinsurance company. In a rental ART program, the reinsurance company is formed, capitalized and managed by someone other than the participants. The participants in a rental ART program pay a fee to the reinsurance company owner to use the reinsurance facility in their ART program; in other words, the participants "rent" it. For both member-owned and rental ART programs, we typically underwrite and price the risk, issue the policies and adjust the claims. A portion of the risk and premium is ceded to the ART insurance program. The ART insurance program serves the same purpose for the participants regardless of whether they own the reinsurance company or rent it. Hudson Indemnity, Ltd. ("HIL"), our consolidated subsidiary, is "rented" to program participants to facilitate the transfer of risk to the participants and the respective program's results are recorded solely in HIL's financial statements. Captive reinsurance facilities owned and managed directly by the member-owned program participants are not consolidated in our financial results since they are not variable interest entities.

The revenue we earn, our profit margins and the risks we assume are substantially consistent in member-owned and rental ART programs. The primary differences to us are the expenses associated with these programs and who ultimately bears those expenses. In a member-owned ART program, the participants own and manage their own reinsurance company, which includes general management responsibilities, financial statement preparation, actuarial analysis, investment management, corporate governance, regulatory management and legal affairs. If the actual expenses associated with managing a member-owned ART program exceed the funded projections, the participants pay for these added expenses outside the insurance transaction. In our rental ART programs, we include an expense charge in the program premium that we charge participants to fund expenses related to the managing of HIL. Investment management expenses also are included in the program premium and we cap the participant's expense contribution regardless of whether or not we collect adequate funds to operate the off-shore reinsurance company.

All other loss, expense and profit margin components are substantially the same for our member-owned or rental ART programs. The advantage of a member-owned ART program to the participants is the ability to change policy issuing companies and service providers without changing the makeup of their group. Rental ART program participants are not obligated to capitalize their own reinsurer. They generally enjoy a slightly lower expense structure and their ART program expenses are fixed for the policy year regardless of the amount of expenses actually incurred to operate the reinsurer and facilitate participant meetings.

The premiums generated by each of the ART insurance programs offered by us are developed in a similar manner. The most important component of the premium charged is the development of the participants' loss fund. The loss fund represents the amount of premium needed to cover the participants' expected losses in the layer of risk being ceded to the captive reinsurer. Participants may assume 100% of the losses in the first loss layer or participate in a quota share arrangement, where the losses are shared between the participants and us. The loss layers typically range from $50,000 to $500,000 per occurrence and our customers' participation percentages in quota share arrangements generally range from 30% to 50%. Once the participants' loss fund is established, all other expenses related to the coverages and services being provided are derived by a formula agreed to in advance by the ART program participants and the service providers. We are the primary or only service provider to every rental ART program we support. The service providers issue policies, adjust claims, provide loss control consulting services, assume the risk for losses exceeding the ART program retention and either manage the member-owned reinsurance company needed to facilitate the transfer of risk to the participants or provide a rental reinsurance facility that serves the same purpose. These items, which are included in premiums charged to the insured, range from approximately 30% to 70% of a $1 million policy premium depending on the program structure and the loss layer ceded to the ART program.

Since our first member-owned ART program in the passenger transportation insurance market was established in 1995, we have established additional ART products for passenger and commercial transportation, including but not limited to, rental cars, paratransit operations, taxi cabs, liquefied petroleum gas distributors, waste haulers, buses, crane and rigging operators, trucks and moving and storage companies. As of December 31, 2014, we insured approximately 420 transportation companies in ART programs. No one customer in our ART business accounted for 10% or more of the revenues of this component of our business during 2014. We also have partnered with insureds and agents in programs, whereby the insured or agent shares in underwriting results and investment income with HIL.

Transportation. We believe that we are one of the largest writers of insurance for the passenger transportation and moving and storage industries in the United States. In our transportation component, we underwrite commercial auto liability, general liability,

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physical damage, workers' compensation and motor truck cargo and related coverages for truck and passenger operators. Passenger transportation operators include charter and tour bus companies, municipal transit systems, school transportation contractors, limousine companies, inter-city bus services and community service and paratransit operations. We also provide tailored coverages to the moving and storage industry including, but not limited to, commercial auto liability, physical damage, workers' compensation, employers' liability, cargo, commercial umbrella, commercial property, general liability, crime, equipment breakdown, inland marine and movers and warehousemen's liability. No one customer in our transportation component accounted for 10% or more of the revenues of this component during 2014.

Specialty Personal Lines. We believe our specialty recreational vehicle, or RV insurance program, differs from those offered by traditional personal auto insurers because we offer coverages written specifically for RV owners, including those who live in their RV full-time. We offer coverage for campsite liability, vehicle replacement coverage and coverage for trailers, golf carts and campsite storage facilities. In addition to our RV product, we also offer companion personal auto coverage to RV policyholders covering automobiles owned by our insured RV policyholders. One feature of our companion auto product that we believe is not generally available from other insurers is the application of a single deductible when an insured RV and the insured companion auto being towed are both damaged in an accident. We also assume all of the net risk related to policies for RV risks underwritten by us and issued by Great American.

During the third quarter of 2013, the Company stopped selling its commercial vehicle product due to unsatisfactory historical underwriting results. This product continues to provide coverage for existing commercial customers with vehicles used by contractors, artisans and other small businesses and range from private passenger autos to customized vans and dump trucks.

Hawaii and Alaska. Our Hawaii office provides general commercial and transportation insurance for business owners in both Hawaii and Alaska. We have become a leading writer of public and truck transportation in both states and continue to look for new opportunities to enhance our general commercial position.

Geographic Concentration

The following table sets forth the geographic distribution of our direct premiums written for the years indicated:

	Year Ended December 31,					
	2014			2013		
	Volume	Percent of Total		Volume	Percent of Total	
	(Dollars in thousands)					
California	$102,328	15.1	%	$94,852	15.3	%
New York	39,093	5.8	%	34,511	5.6	%
North Carolina	34,183	5.1	%	28,841	4.6	%
Texas	33,784	5.0	%	43,469	7.0	%
Florida	32,491	4.8	%	31,426	5.1	%
New Jersey	30,668	4.5	%	26,987	4.3	%
Pennsylvania	29,846	4.4	%	22,328	3.6	%
Missouri	27,960	4.1	%	23,954	3.9	%
Tennessee	24,699	3.7	%	20,138	3.2	%
All other states	321,769	47.5	%	295,026	47.4	%
Direct premiums written	$676,821	100.0	%	$621,532	100.0	%

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Concentration by Statutory Line of Business

The following table sets forth our direct premiums written by statutory line of business for the years indicated:

	Year Ended December 31,			
	2014		2013	
	Volume	Percent of Total	Volume	Percent of Total
	(Dollars in thousands)			
Auto and other liability	$359,569	53.1%	$338,359	54.4%
Workers' compensation	217,455	32.1%	187,014	30.1%
Auto physical damage	82,375	12.2%	80,287	12.9%
All other lines	17,422	2.6%	15,872	2.6%
Direct premiums written	$676,821	100.0%	$621,532	100.0%

Product Management Organization

We believe we have a competitive advantage in our major lines of business, in part, as a result of our product management focus. Each of our product lines is headed by a manager who assists in determining and is solely responsible for achieving that product line's planned results. We believe that the use of a product management organization provides the focus required to successfully offer and manage a diverse set of product lines. We offer our large transportation customers flexibility based on their needs by, for example, designing custom insurance programs, such as unique billing plans and deductibles. Our claims, accounting, information technology and other support functions are organized to align their resources with specific product line initiatives and needs. Our product managers are responsible for the underwriting, pricing and marketing and they are held accountable for underwriting profitability of a specific insurance product. Other required services and support are provided across product lines by functional managers.

Underwriting

We employ a pricing segmentation approach in our underwriting that makes extensive use of proprietary data and pricing methodologies. Our pricing strategy enables our product managers to manage rate structures by evaluating detailed policyholder information, such as loss experience based on driver characteristics, financial responsibility scores (where legally permissible) and the make/model of vehicles. This pricing segmentation approach requires extensive involvement of the product managers, who are responsible for the underwriting profitability of a specific product line with direct oversight of product design and rate level structure by our most senior managers. Individual product managers work closely with our pricing and database managers to generate rate level indications and other relevant data. We use this data coupled with information from the National Council on Compensation Insurance and the actuarial loss costs obtained from the Insurance Services Office, an insurance industry advisory service organization, as a benchmark in pricing our products. We believe the quality of our proprietary data, combined with our rigorous approach, has permitted us to generally respond more quickly than our competitors to adverse trends and to obtain appropriate pricing and risk selection for each individual account.

Risk selection and pricing decisions are discussed regularly by product line underwriters and product managers. We believe this group's input and deliberation on pricing and risk selection reaffirms our philosophy and underwriting culture and aids in avoiding unknown exposures. Underwriting files at both our regional and corporate offices are audited by senior management on a regular basis for compliance with our price and risk selection criteria. Product managers are responsible for the underwriting profitability resulting from these risk selection and pricing decisions and the incentive-based portion of their compensation is based, in part, on that profitability.

Marketing and Distribution

We offer our products through multiple distribution channels including independent agents and brokers, program administrators, affiliated agencies and agent internet initiatives. During the year ended December 31, 2014, approximately 89% of our gross premiums written were generated by unaffiliated producers (i.e., independent agents, brokers and program administrators) and approximately 11% were generated by our affiliated agencies. Together, our top two unaffiliated producers accounted for approximately 13% of our gross premiums written during 2014.

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Reinsurance
We are involved in both the cession and assumption of reinsurance. We reinsure a portion of our business to other insurance companies. Ceding reinsurance permits diversification of our risks and limits our maximum loss arising from large or unusually hazardous risks or catastrophic events. We are subject to credit risk with respect to our reinsurers, because the ceding of risk to a reinsurer generally does not relieve us of liability to our insureds until claims are fully settled. To mitigate this credit risk, we cede business only to reinsurers if they meet our credit ratings criteria of an A.M. Best rating of “A-” or better. If a reinsurer is not rated by A.M. Best or their rating falls below “A-”, our contract with them generally requires that they secure outstanding obligations with cash, a trust or a letter of credit that we deem acceptable.
Claims Management and Administration
We believe that effective claims management is critical and has contributed to our success, and that our process is cost efficient, delivers the appropriate level of claims service and produces superior claims results. We are focused on controlling claims from their inception with thorough investigation, accelerated communication to insureds and claimants and compressing the cycle time of claim resolution to control both loss cost and claim handling cost. Claims arising under our insurance policies are reviewed, supervised and handled by our internal claims department. As of December 31, 2014, our claims organization employed 201 people (32% of our employee group) and operated out of three regional offices. All of our claims employees have been trained to handle claims according to our customer-focused claims management processes and procedures and are subject to periodic audit. We systematically conduct continuing education for our claims staff in the areas of best practices, fraud awareness, legislative changes and litigation management. All large claim reserves are reviewed on a quarterly basis by executive claims management, and adjusters frequently participate in audits and large loss reviews with participating reinsurers. We also employ a formal large loss review methodology that involves senior company management, executive claims management and adjusting staff in a quarterly review of all large loss exposures.
We provide 24-hour, 7 days per week, toll-free service for our policyholders to report claims. When we receive the first notice of loss, our claims personnel open a file and establish appropriate reserving to maximum probable exposure (based on our historical claim settlement experience) as soon as practicable and continually revise case reserves as new information develops. We maintain and implement a fraud awareness program designed to educate our claims employees and others throughout the organization of fraud indicators. Potentially fraudulent claims are referred for special investigation and fraudulent claims are contested.
Our physical damage claims processes involve the utilization and coordination of internal staff, vendor resources and property specialists. We pay close attention to the vehicle repair process, which we believe reduces the amount we pay for repairs, storage costs and auto rental costs.
Our ART programs have dedicated claims personnel and claims services tailored to each program. Each ART program has a dedicated claims manager, receives extra communications pertaining to reserve changes and/or payments and has dedicated staff resources.
We employ highly qualified and experienced liability adjusters who are responsible for overseeing all injury-related losses including those in litigation. We identify and retain specialized outside defense counsel to litigate such matters. We negotiate fee arrangements with retained defense counsel and attempt to limit our litigation costs. The liability focused adjusters manage these claims by placing a priority on detailed file documentation and emphasizing investigation, evaluation and negotiation of liability claims.
Reserves for Unpaid Losses and Loss Adjustment Expenses (“LAE”)
We record our best estimate of liabilities for the costs of losses and LAE for both reported and unreported claims based on historical trends adjusted for changes in loss costs, underwriting standards, policy provisions, product mix and other factors. Estimating the liability for unpaid losses and LAE is inherently judgmental and is influenced by factors that are subject to significant variation. We monitor factors such as the effect of inflation on medical, hospitalization, material repair and replacement costs, general economic trends and the legal environment. While the ultimate liability may be greater than recorded loss reserves, the reserve tail for transportation coverage is generally shorter than that associated with many other casualty coverages and, therefore, generally can be established with less

uncertainty than coverages having longer reserve tails.

We review loss reserve adequacy and claims adjustment effectiveness quarterly. We focus significant management attention on claims reserved above $100,000. Further, our reserves are reviewed quarterly and opined upon annually by accredited actuaries from Great American. Reserves are routinely adjusted as additional information becomes known. Such routine adjustments are reflected in quarterly results in the period of adjustment.

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The following tables present the development of our loss reserves, net of reinsurance, on a U.S. generally accepted accounting principles (“GAAP”) basis for the calendar years 2004 through 2014. The top line of each table shows the estimated liability for unpaid losses and LAE recorded at the balance sheet date for the indicated year. The next line, “As re-estimated at December 31, 2014,” shows the re-estimated liability as of December 31, 2014. The remainder of the table presents intervening development from the initially estimated liability. This development results from additional information and experience in subsequent years. The middle line shows a net cumulative redundancy (deficiency) which represents the aggregate percentage change in the liability initially estimated. The lower portion of the table indicates the cumulative amounts paid as of successive periods.

Net Liability for Unpaid Losses And LAE:	2004		2005		2006		2007		2008		2009		2010		2011		2012
	(Dollars in thousands)																
As originally estimated	$111,644		$151,444		$181,851		$210,302		$262,440		$276,419		$596,136		$594,448		$607,60
As re-estimated at December 31, 2014	97,775		135,293		164,230		197,774		251,645		266,482		543,274		592,175		633,458
Liability re-estimated as of:																	
One year later	106,409		143,991		176,179		209,448		261,154		269,747		583,663		578,705		609,889
Two years later	103,416		142,929		173,860		207,281		250,185		267,995		553,526		579,048		633,458
Three years later	99,768		139,994		169,879		199,142		248,851		266,085		538,746		592,175		
Four years later	99,487		138,108		166,043		198,852		248,675		263,346		543,274				
Five years later	99,362		135,635		163,855		197,482		248,903		266,482						
Six years later	98,005		134,328		163,279		196,405		251,645								
Seven years later	97,312		134,686		163,055		197,774										
Eight years later	97,368		134,553		164,230												
Nine years later	97,375		135,293														
Ten years later	97,775																
Net cumulative redundancy (deficiency) [1]	13,869		16,151		17,621		12,528		10,795		9,937		52,862		2,273		(25,854
Net cumulative redundancy (deficiency)	12.4	%	10.7	%	9.7	%	6.0	%	4.1	%	3.6	%	8.9	%	0.4	%	(4.3

— %

Cumulative paid of:									
One year later	37,049	51,901	63,314	67,673	91,615	90,410	182,652	201,717	240,981
Two years later	59,038	85,193	95,752	111,841	145,279	146,378	302,821	357,834	412,687
Three years later	76,617	101,340	119,984	141,484	182,163	189,177	399,997	466,486	
Four years later	84,070	112,474	133,976	159,410	209,272	213,198	460,765		
Five years later	89,821	117,073	140,160	170,085	220,421	227,573			
Six years later	91,206	119,461	144,133	174,896	227,565				
Seven years later	91,919	121,566	145,996	177,646					
Eight years later	93,116	122,205	147,134						
Nine years later	93,165	122,768							
Ten years later	93,514								

[1] — No development associated with Vanliner's guaranteed reserves was recorded in 2014. Favorable development associated with Vanliner’s guaranteed reserves recorded in 2013, 2012, and 2011 were $20.8 million, $19.0 million, and $9.8 million, respectively. Vanliner guaranteed reserve development related to accident years 2010 and prior is required to be reflected in calendar year 2010, which was the year of acquisition. See Note 2 to our consolidated financial statements - "Significant Accounting Policies" for a discussion of the contingent consideration related to the Vanliner guaranty. Excluding the Vanliner guaranty, we recorded unfavorable development of $30.6 million, $23.1 million and $3.3 million, for the years ending December 31, 2014, 2013 and 2012, respectively, in our Consolidated Statements of Income. See Note 12 to our consolidated financial statements- "Unpaid Losses and LAE," for a discussion of the impact on our unpaid losses and LAE.

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The following is a reconciliation of our net liability to the gross liability for unpaid losses and LAE:

	2004	2005	2006	2007	2008	2009	2010	2011	2012
	(Dollars in thousands)								
As originally estimated:									
Net liability shown above	$111,644	$151,444	$181,851	$210,302	$262,440	$276,419	$596,136	$594,448	$607,60
Add reinsurance recoverables	59,387	71,763	84,115	91,786	137,561	140,841	202,509	182,128	167,701
Gross liability	$171,031	$223,207	$265,966	$302,088	$400,001	$417,260	$798,645	$776,576	$775,30
As re-estimated at December 31, 2014									
Net liability shown above	$97,775	$135,293	$164,230	$197,774	$251,645	$266,482	$543,274	$592,175	$633,45
Add reinsurance recoverables re-estimated	56,845	60,824	58,761	53,150	101,518	80,072	134,639	161,112	170,838
Gross liability	$154,620	$196,117	$222,991	$250,924	$353,163	$346,554	$677,913	$753,287	$804,29
Gross cumulative (deficiency) redundancy	$16,411	$27,090	$42,975	$51,164	$46,838	$70,706	$120,732	$23,289	$(28,99
Gross cumulative (deficiency) redundancy — %	9.6 %	12.1 %	16.2 %	16.9 %	11.7 %	16.9 %	15.1 %	3.0 %	(3.7

These tables do not present accident or policy year development data. Furthermore, in evaluating the re-estimated liability and cumulative (deficiency) redundancy, we note that each amount includes the effects of changes in amounts for prior periods. Conditions and trends that affected development of the liability in the past may not necessarily exist in the future. Accordingly, extrapolating redundancies and or deficiencies based on this table is inherently uncertain.

The preceding tables show our calendar year development for each of the last ten years resulting from reevaluating the original estimate of the loss and LAE liability on both a net and gross basis. Gross reserves are liabilities for direct and assumed losses and LAE before a reduction for amounts ceded. At December 31, 2014, our liability on a gross basis was $883.1 million and our asset for ceded reserves was $169.4 million. The difference between gross development and net development is ceded loss and LAE reserve development. The range of dollar limits ceded by us is much greater and therefore more volatile than the range of dollar limits we retain, which could cause more volatility in estimates for ceded losses. Therefore, ceded reserves are more susceptible to development than net reserves. Net calendar year reserve development affects our income for the year while ceded reserve development or savings affects the income of reinsurers.

Investments

General

We approach investment and capital management with the intention of supporting insurance operations by providing a stable source of income to supplement underwriting income. We strive to protect capital while optimizing investment income, capital appreciation and maintaining appropriate liquidity. Our Board of Directors has established investment guidelines and reviews the portfolio performance at least quarterly for compliance with its established guidelines.

During 2014, we reinvested cash flows from sold and matured investments across all asset classes, including increased allocation to equity securities and asset backed securities, which are categorized as other debt obligations, as these securities generally offered the best combination of yield, duration, and credit risk when considering other market opportunities and our existing holdings.

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The following table presents the percentage distribution of our investment portfolio for the dates given based upon fair value:

	At December 31,			
	2014		2013	
Fixed maturities:				
State and local government obligations	30.9	%	34.3	%
Corporate obligations	18.0	%	18.6	%
Residential mortgage-backed securities	17.4	%	19.4	%
U.S. Government and government agency obligations	10.3	%	9.1	%
Other debt obligations	9.6	%	4.3	%
Commercial mortgage-backed securities	1.5	%	3.4	%
Redeemable preferred stock	0.4	%	0.4	%
Foreign government obligations	0.0	%	0.3	%
Total fixed maturities	88.1	%	89.8	%
Equity securities:				
Common stocks	5.7	%	4.8	%
Nonredeemable preferred stocks	2.0	%	1.5	%
Total equity securities	7.7	%	6.3	%
Other invested assets	4.2	%	3.9	%
Total	100.0	%	100.0	%

The following table presents the yields of our investment portfolio exclusive of changes in unrealized gains and losses:

	Year Ended December 31,					
	2014		2013		2012	
Yield on fixed maturities:						
Excluding realized gains and losses	3.5	%	3.5	%	3.7	%
Including realized gains and losses	3.6	%	3.8	%	4.2	%
Yield on equity securities:						
Excluding realized gains and losses	4.2	%	4.1	%	2.6	%
Including realized gains and losses	7.2	%	8.5	%	6.5	%
Yield on other invested assets:						
Excluding realized gains and losses	0.0	%	0.0	%	0.0	%
Including realized gains and losses	7.6	%	3.9	%	1.5	%
Yield on all investments:						
Excluding realized gains and losses	3.4	%	3.4	%	3.5	%
Including realized gains and losses	4.1	%	4.0	%	4.1	%

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The table below compares total returns on our fixed maturities and equity securities to comparable public indices. We benchmark our fixed maturity portfolio, excluding redeemable preferred stock, to the Barclays Intermediate Aggregate Index because we believe it best matches our investment strategy and the resulting composition of our portfolio. For similar reasons we benchmark our equity securities, including other invested assets, against the Standard & Poor’s ("S&P") 500 Index. Both our performance and the indices include investment income, realized gains and losses and changes in unrealized gains and losses.

	Year Ended December 31,					
	2014		2013		2012	
Fixed maturities:						
National Interstate Total Return on Fixed Maturities	5.3	%	1.6	%	6.8	%
Barclays Intermediate Aggregate Index	4.1	%	(1.0	)%	3.5	%
Equity securities:						
National Interstate Total Return on Equity Securities	6.9	%	15.1	%	9.7	%
S&P 500 Index	13.7	%				