

MARKEL CORP
Form 10-Q
July 31, 2018
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the quarterly period
 ended June 30, 2018

or

Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the transition period
from _____ to _____

Commission File Number: 001-15811

MARKEL CORPORATION
(Exact name of registrant as specified in its charter)

Virginia 54-1959284
(State or other jurisdiction of (I.R.S. Employer
incorporation or organization) Identification No.)

4521 Highwoods Parkway, Glen Allen, Virginia 23060-6148
(Address of principal executive offices)
(Zip Code)
(804) 747-0136
(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Website, 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 No

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

Large accelerated filer Accelerated filer Non-accelerated filer

Smaller reporting company Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

Number of shares of the registrant's common stock outstanding at July 24, 2018: 13,885,592

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

MARKEL CORPORATION AND SUBSIDIARIES

Consolidated Balance Sheets
(dollars in thousands)

	June 30, 2018 (unaudited)	December 31, 2017
ASSETS		
Investments, at estimated fair value:		
Fixed maturities, available-for-sale (amortized cost of \$10,025,593 in 2018 and \$9,551,153 in 2017)	\$10,134,073	\$9,940,670
Equity securities, available-for-sale (cost of \$2,667,661 in 2017)	—	5,967,847
Equity securities (cost of \$2,787,763 in 2018)	6,069,245	—
Short-term investments, available-for-sale (estimated fair value approximates cost)	1,947,585	2,160,974
Total Investments	18,150,903	18,069,491
Cash and cash equivalents	1,945,370	2,198,459
Restricted cash and cash equivalents	299,026	302,387
Receivables	1,944,751	1,567,453
Reinsurance recoverable on unpaid losses	4,739,259	4,619,336
Reinsurance recoverable on paid losses	90,649	126,054
Deferred policy acquisition costs	508,214	465,569
Prepaid reinsurance premiums	1,266,916	1,099,757
Goodwill	1,784,667	1,777,464
Intangible assets	1,269,520	1,355,681
Other assets	1,247,756	1,223,365
Total Assets	\$33,247,031	\$32,805,016
LIABILITIES AND EQUITY		
Unpaid losses and loss adjustment expenses	\$13,628,941	\$13,584,281
Life and annuity benefits	1,033,461	1,072,112
Unearned premiums	3,695,040	3,308,779
Payables to insurance and reinsurance companies	422,423	324,304
Senior long-term debt and other debt (estimated fair value of \$3,088,000 in 2018 and \$3,351,000 in 2017)	3,024,306	3,099,230
Other liabilities	1,809,448	1,748,460
Total Liabilities	23,613,619	23,137,166
Redeemable noncontrolling interests	155,998	166,269
Commitments and contingencies		
Shareholders' equity:		
Common stock	3,387,121	3,381,834
Retained earnings	6,184,299	3,776,743
Accumulated other comprehensive income (loss)	(90,560)	) 2,345,571
Total Shareholders' Equity	9,480,860	9,504,148
Noncontrolling interests	(3,446)	) (2,567)
Total Equity	9,477,414	9,501,581
Total Liabilities and Equity	\$33,247,031	\$32,805,016
See accompanying notes to consolidated financial statements.		

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MARKEL CORPORATION AND SUBSIDIARIES

Consolidated Statements of Income and Comprehensive Income (Loss)
(Unaudited)

	Quarter Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
	(dollars in thousands, except per share data)			
OPERATING REVENUES				
Earned premiums	\$1,148,184	\$1,033,574	\$2,299,205	\$2,016,176
Net investment income	105,387	99,299	213,403	199,667
Net investment gains (losses):				
Other-than-temporary impairment losses	—	(604	) —	(3,817
Net realized investment gains (losses), excluding other-than-temporary impairment losses	(7,642	) 4,829	(8,588	) 20,012
Change in fair value of equity securities	112,891	13,402	(9,161	) 22,297
Net investment gains (losses)	105,249	17,627	(17,749	) 38,492
Other revenues	628,193	330,993	1,067,625	638,909
Total Operating Revenues	1,987,013	1,481,493	3,562,484	2,893,244
OPERATING EXPENSES				
Losses and loss adjustment expenses	599,178	522,978	1,214,296	1,134,697
Underwriting, acquisition and insurance expenses	451,570	401,270	875,960	774,548
Amortization of intangible assets	29,641	18,026	58,464	34,796
Other expenses	595,343	298,756	997,473	581,389
Total Operating Expenses	1,675,732	1,241,030	3,146,193	2,525,430
Operating Income	311,281	240,463	416,291	367,814
Interest expense	36,702	31,797	76,761	65,199
Net foreign exchange gains	(86,158	) (879	) (64,044	) (974
Income Before Income Taxes	360,737	209,545	403,574	303,589
Income tax expense	81,150	58,118	189,581	81,122
Net Income	279,587	151,427	213,993	222,467
Net income attributable to noncontrolling interests	1,356	1,767	68	2,938
Net Income to Shareholders	\$278,231	\$149,660	\$213,925	\$219,529
OTHER COMPREHENSIVE INCOME (LOSS)				
Change in net unrealized gains on available-for-sale investments, net of taxes:				
Net holding gains (losses) arising during the period	\$(98,145	) \$190,069	\$(215,067	) \$350,349
Reclassification adjustments for net gains included in net income	(5,891	) (222	) (5,077	) (9,391
Change in net unrealized gains on available-for-sale investments, net of taxes	(104,036	) 189,847	(220,144	) 340,958
Change in foreign currency translation adjustments, net of taxes	(10,450	) 1,962	(5,497	) 3,507
Change in net actuarial pension loss, net of taxes	568	902	1,232	1,618
Total Other Comprehensive Income (Loss)	(113,918	) 192,711	(224,409	) 346,083
Comprehensive Income (Loss)	165,669	344,138	(10,416	) 568,550
Comprehensive income attributable to noncontrolling interests	1,333	1,781	87	2,954
Comprehensive Income (Loss) to Shareholders	\$164,336	\$342,357	\$(10,503) \$565,596

NET INCOME PER SHARE

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Basic	\$20.01	\$10.34	\$15.75	\$14.25
Diluted	\$19.97	\$10.31	\$15.72	\$14.20

See accompanying notes to consolidated financial statements.

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MARKEL CORPORATION AND SUBSIDIARIES

Consolidated Statements of Changes in Equity
(Unaudited)

(in thousands)	Common Shares	Common Stock	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Shareholders' Equity	Noncontrolling Interests	Total Equity	Redeemable Noncontrolling Interests
December 31, 2016	13,955	\$3,368,666	\$3,526,395	\$1,565,866	\$8,460,927	\$6,484	\$8,467,411	\$73,678
Net income (loss)			219,529	—	219,529	(307)	219,222	3,245
Other comprehensive income			—	346,067	346,067	—	346,067	16
Comprehensive Income (Loss)					565,596	(307)	565,289	3,261
Issuance of common stock	24	359	—	—	359	—	359	—
Repurchase of common stock	(61)	—	(59,194)	—	(59,194)	—	(59,194)	—
Restricted stock units expensed	—	10,568	—	—	10,568	—	10,568	—
Adjustment of redeemable noncontrolling interests	—	—	(20,284)	—	(20,284)	—	(20,284)	20,284
Purchase of noncontrolling interest	—	(2,910)	—	—	(2,910)	(8,109)	(11,019)	(6,179)
Other	—	(453)	(200)	—	(653)	39	(614)	(4,353)
June 30, 2017	13,918	\$3,376,230	\$3,666,246	\$1,911,933	\$8,954,409	\$(1,893)	\$8,952,516	\$86,691
December 31, 2017	13,904	\$3,381,834	\$3,776,743	\$2,345,571	\$9,504,148	\$(2,567)	\$9,501,581	\$166,269
Cumulative effect of adoption of ASU No. 2014-09, net of taxes	—	—	325	—	325	—	325	—
Cumulative effect of adoption of ASU No. 2016-01, net of taxes	—	—	2,613,242	(2,613,242)	—	—	—	—
Cumulative effect of	—	—	(401,539)	401,539	—	—	—	—

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adoption of ASU									
No. 2018-02									
Net income			213,925	—	213,925	(910)	213,015	978
(loss)									
Other									
comprehensive			—	(224,428	)	(224,428	)	—	(224,428
income (loss)									19
Comprehensive									
Income (Loss)					(10,178	)	(910	)	(11,088
									997
Issuance of	4	2	—	—	2	—	2	—	—
common stock									
Repurchase of	(22	)	—	(24,257	)	—	(24,257)	—
common stock									
Restricted stock	—	12,229	—	—	12,229	—	12,229	—	—
units expensed									
Adjustment of									
redeemable	—	—	5,414	—	5,414	—	5,414	(5,414)
noncontrolling									
interests									
Purchase of	—	(5,586	)	—	(5,586	)	—	(5,586)
noncontrolling									(39
interest)
Other	—	(1,358	)	446	—	(912	)	31	(881
)
June 30, 2018	13,886	\$3,387,121	\$6,184,299	\$(90,560)	\$9,480,860	\$(3,446)	\$9,477,414
									\$155,998

See accompanying notes to consolidated financial statements.

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MARKEL CORPORATION AND SUBSIDIARIES

Condensed Consolidated Statements of Cash Flows
(Unaudited)

	Six Months Ended June 30,	
	2018	2017
	(dollars in thousands)	
OPERATING ACTIVITIES		
Net income	\$213,993	\$222,467
Adjustments to reconcile net income to net cash provided by operating activities	93,541	15,478
Net Cash Provided By Operating Activities	307,534	237,945
INVESTING ACTIVITIES		
Proceeds from sales of fixed maturities and equity securities	234,442	262,518
Proceeds from maturities, calls and prepayments of fixed maturities	374,719	676,023
Cost of fixed maturities and equity securities purchased	(1,185,375)	(939,314)
Net change in short-term investments	220,428	677,968
Additions to property and equipment	(52,388)	(35,578)
Acquisitions, net of cash acquired	(7,804)	(202,033)
Other	(29,661)	(2,808)
Net Cash Provided (Used) By Investing Activities	(445,639)	436,776
FINANCING ACTIVITIES		
Additions to senior long-term debt and other debt	109,113	29,898
Repayment of senior long-term debt and other debt	(180,158)	(139,564)
Repurchases of common stock	(24,257)	(59,194)
Purchase of noncontrolling interests	(7,058)	(18,068)
Distributions to noncontrolling interests	(5,815)	(4,345)
Other	(3,288)	(7,346)
Net Cash Used By Financing Activities	(111,463)	(198,619)
Effect of foreign currency rate changes on cash, cash equivalents, restricted cash and restricted cash equivalents	(6,882)	24,977
Increase (decrease) in cash, cash equivalents, restricted cash and restricted cash equivalents	(256,450)	501,079
Cash, cash equivalents, restricted cash and restricted cash equivalents at beginning of period	2,500,846	2,085,164
CASH, CASH EQUIVALENTS, RESTRICTED CASH AND RESTRICTED CASH EQUIVALENTS AT END OF PERIOD	\$2,244,396	\$2,586,243

See accompanying notes to consolidated financial statements.

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MARKEL CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Summary of Significant Accounting Policies

Markel Corporation is a diverse financial holding company serving a variety of niche markets. Markel Corporation's principal business markets and underwrites specialty insurance products and programs. Through its wholly-owned subsidiary, Markel Ventures, Inc. (Markel Ventures), Markel Corporation also owns interests in various businesses that operate outside of the specialty insurance marketplace.

a)Basis of Presentation. The consolidated balance sheet as of June 30, 2018 and the related consolidated statements of income and comprehensive income (loss) for the quarters and six months ended June 30, 2018 and 2017, and the consolidated statements of changes in equity and cash flows for the six months ended June 30, 2018 and 2017 are unaudited. In the opinion of management, all adjustments necessary for fair presentation of such consolidated financial statements have been included. Such adjustments consist only of normal, recurring items. Interim results are not necessarily indicative of results of operations for the entire year. The consolidated balance sheet as of December 31, 2017 was derived from Markel Corporation's audited annual consolidated financial statements.

The accompanying consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles (U.S. GAAP) and include the accounts of Markel Corporation and its consolidated subsidiaries, as well as any variable interest entities (VIEs) that meet the requirements for consolidation (the Company). All significant intercompany balances and transactions have been eliminated in consolidation. The Company consolidates the results of its Markel Ventures subsidiaries on a one-month lag, with the exception of significant transactions or events that occur during the intervening period. Certain prior year amounts have been reclassified to conform to the current presentation.

The preparation of financial statements in accordance with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses and the disclosure of contingent assets and liabilities. Actual results may differ materially from the estimates and assumptions used in preparing the consolidated financial statements.

The consolidated financial statements and notes are presented as permitted by Form 10-Q and do not contain certain information included in the Company's annual consolidated financial statements and notes. Readers are urged to review the Company's 2017 Annual Report on Form 10-K for a more complete description of the Company's business and accounting policies.

b)Foreign Currency Transactions. The U.S. Dollar is the Company's reporting currency and the primary functional currency of its foreign underwriting operations. The functional currencies of the Company's other foreign operations are the currencies of the primary economic environments in which the majority of their business is transacted.

Foreign currency transaction gains and losses are the result of exchange rate changes on transactions denominated in currencies other than the functional currency at each foreign entity. Monetary assets and liabilities are remeasured to the functional currency at current exchange rates, with resulting gains and losses included in net foreign exchange losses (gains) within net income. Non-monetary assets and liabilities are remeasured to the functional currency at historic exchange rates. Available-for-sale securities are recorded at fair value with resulting gains and losses, including the portion attributable to movements in exchange rates, included in the change in net unrealized gains on available-for-sale investments, net of taxes within other comprehensive income. While we attempt to naturally hedge our exposure to foreign currency fluctuations by matching assets and liabilities in currency, there is a financial

statement mismatch between the gains or losses recorded in net income related to insurance reserves denominated in non-functional currencies and the gains or losses recorded in other comprehensive income related to the available-for-sale securities supporting the reserves.

Assets and liabilities of foreign operations denominated in a functional currency other than the U.S. Dollar are translated into the U.S. Dollar at current exchange rates, with resulting gains or losses included, net of taxes, in the change in foreign currency translation adjustments within other comprehensive income.

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Historically, the Company also designated certain additional currencies, including the British Pound Sterling, the Euro, and the Canadian Dollar, as functional currencies within its foreign underwriting operations that were deemed to contain distinct and separable operations in those foreign economic environments. However, over time the Company's foreign underwriting operations have evolved and are now managed on a global basis. Effective January 1, 2018, management reassessed its functional currency determination as required by Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 830, Foreign Currency Matters, and concluded that its foreign underwriting operations have evolved to function as an extension, or integral component, of the Company's global underwriting operations, and are no longer deemed to contain distinct and separable operations. As a result, more foreign currency denominated transactions are designated as non-functional, with related remeasurement gains and losses included in net income. The change in the Company's functional currency determination has been applied on a prospective basis in accordance with ASC 830. Therefore, any translation gains and losses that were previously recorded in accumulated other comprehensive income through December 31, 2017 remain unchanged as of June 30, 2018.

c)Revenue Recognition. Effective January 1, 2018, the Company adopted Accounting Standards Update (ASU) No. 2014-09, Revenue from Contracts with Customers (Topic 606), and related amendments, which created a new comprehensive revenue recognition standard, ASC 606, that serves as a single source of revenue guidance for all contracts with customers to transfer goods or services or contracts for the transfer of nonfinancial assets, unless those contracts are within the scope of other standards, such as insurance contracts. ASC 606 is not applicable to the Company's insurance premium revenues or revenues from its investment portfolio but is applicable to most of the Company's other revenues, as described below. See note 2 for further discussion of the impact of adopting this standard.

Other revenues primarily relate to the Company's Markel Ventures segment and consist of revenues from the sale of products and services. Revenues are recognized when, or as, control of the promised goods or services is transferred to the Company's customers, in an amount that reflects the consideration the Company expects to be entitled to in exchange for those goods or services. All contracts with customers either have an original expected length of one year or less or the Company recognizes revenue at the amount for which it has a right to invoice for the products delivered or services performed. Certain customers may receive volume rebates or credits for products and services, which are accounted for as variable consideration. The Company estimates these amounts based on the expected amount to be provided to the customer and reduces revenues recognized by a corresponding amount. The Company does not expect significant changes to its estimates of variable consideration over the term of the contracts.

Payment terms for products and services vary by the type of product or service offered and the location of the customer, and payment is typically received at or shortly after the point of sale. For certain products, the Company requires partial payment in the form of a deposit before the products are delivered to the customer, which is included in other liabilities on the Company's consolidated balance sheet.

Product revenues are primarily generated from the sale of ornamental plants, equipment used in baking systems, portable dredges, over the road transportation equipment, flooring for the trucking industry, and residential homes. Most of the Company's product revenues are recognized when the products are shipped to the customer or the products arrive at the agreed upon destination with the end customer. Some of the Company's contracts include multiple performance obligations. For such arrangements, revenues are allocated to each performance obligation based on the relative standalone selling price, which is derived from amounts stated in the contract.

Service revenues are primarily generated by delivering healthcare services, retail intelligence, consulting services and investment management services. Service revenues are generally recognized over the term of the contracts based on hours incurred or as services are provided. Investment management fee income is recognized over the period in which investment management services are provided and is calculated and recognized monthly based on the net asset value

of the accounts managed. In connection with the investment management services provided, the Company is also entitled to participate, on a fixed-percentage basis, in any net income generated in excess of an agreed-upon threshold as established by the underlying investment management agreements. In general, net income is calculated at the end of each calendar year and performance fees are payable annually. Performance fee income is recognized at the conclusion of the contractual performance period, when the uncertainty related to performance has been resolved.

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2. Recent Accounting Pronouncements

Effective January 1, 2018, the Company adopted FASB ASU No. 2014-09, Revenue from Contracts with Customers (Topic 606) and several other ASU's that were issued as amendments to ASU No. 2014-09, which apply to all contracts with customers to transfer goods or services or for the transfer of nonfinancial assets, unless those contracts are within the scope of other standards. ASU No. 2014-09's core principle is that a company recognizes revenue when it transfers promised goods or services to customers in an amount that reflects the consideration to which the company expects to be entitled in exchange for those goods or services. In adopting this standard, the Company is required to use more judgment and make more estimates than under the previous guidance, including identifying performance obligations in the contract, estimating the amount of variable consideration to include in the transaction price and allocating the transaction price to each separate performance obligation. The Company adopted ASU No. 2014-09 using the modified retrospective method. Prior periods were not restated and a cumulative-effect adjustment of applying the new standard to all open contracts at January 1, 2018 was \$0.3 million, and is included as an adjustment to 2018 beginning retained earnings. The Company's other revenues for the quarter and six months ended June 30, 2018 and its receivables, other assets and other liabilities as of June 30, 2018 were not materially different from the amounts that would have been recognized under the previous guidance. ASU No. 2014-09 also requires expanded revenue disclosures which are included in note 8.

Effective January 1, 2018, the Company adopted FASB ASU No. 2016-01, Financial Instruments (Topic 825): Recognition and Measurement of Financial Assets and Financial Liabilities. As a result of adoption of this ASU, equity instruments that do not result in consolidation and are not accounted for under the equity method are measured at fair value and any changes in fair value are recognized in net income. Previously, the Company's equity securities were classified as available-for-sale and changes in fair value were recorded in other comprehensive income. Upon adoption of this ASU, cumulative net unrealized gains on equity securities of \$2.6 billion, net of deferred income taxes of \$684.4 million, were reclassified from accumulated other comprehensive income into retained earnings. Prior periods have not been restated to conform to the current presentation. See note 4(e) for details regarding the change in net unrealized gains on equity securities included in net income for the quarter and six months ended June 30, 2018 and included in other comprehensive income (loss) for the quarter and six months ended June 30, 2017.

Effective January 1, 2018, the Company early adopted ASU No. 2018-02, Income Statement - Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income. The ASU provides an option to reclassify tax effects remaining in accumulated other comprehensive income as a result of the Tax Cuts and Jobs Act (TCJA) to retained earnings. Upon enactment of the TCJA, the U.S. corporate tax rate was reduced from 35% to 21% and the Company's U.S. deferred tax balances were remeasured to the lower enacted U.S. corporate tax rate. U.S. GAAP requires the effects of changes in tax rates and laws on deferred tax balances to be recorded as a component of income tax expense in the period of enactment, even if the assets and liabilities relate to items of accumulated other comprehensive income. As a result of adopting the ASU, the Company reclassified \$401.5 million of previously recognized deferred taxes from accumulated other comprehensive income into retained earnings as of January 1, 2018.

In February 2016, the FASB issued ASU No. 2016-02, Leases (Topic 842). The ASU requires lessees to record most leases on their balance sheets as a lease liability with a corresponding right-of-use asset, but continue to recognize the related leasing expense within net income. ASU No. 2016-02 becomes effective for the Company during the first quarter of 2019 and will be applied using a modified retrospective approach for leases that exist or are entered into after the beginning of the earliest comparative period in the financial statements. The Company's future minimum lease payments, which represent minimum annual rental commitments excluding taxes, insurance and other operating costs for noncancelable operating leases, and which will be subject to this new guidance, totaled \$311.7 million at December 31, 2017. Adoption of this standard will impact the Company's consolidated balance sheets but is not expected to have a material impact on the Company's results of operations or cash flows. The Company is currently

evaluating ASU No. 2016-02 to determine the magnitude of the impact that adopting this standard will have on its consolidated financial statements.

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In June 2016, the FASB issued ASU No. 2016-13, Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments. The ASU replaces the current incurred loss model used to measure impairment losses with an expected loss model for trade, reinsurance, and other receivables as well as financial instruments measured at amortized cost. For available-for-sale debt securities, which are measured at fair value, the ASU requires entities to record impairments as an allowance, rather than a reduction of the amortized cost, as is currently required under the other-than-temporary impairment model. ASU No. 2016-13 becomes effective for the Company during the first quarter of 2020 and will be applied using a modified retrospective approach through a cumulative-effect adjustment to retained earnings as of the beginning of the first reporting period in which the guidance is effective. The Company is currently evaluating ASU No. 2016-13 to determine the potential impact that adopting this standard will have on its consolidated financial statements. Application of the new expected loss model for measuring impairment losses will not impact the Company's investment portfolio, none of which is measured at amortized cost, but will impact the Company's other financial assets, including its reinsurance recoverables. Upon adoption of this ASU, any impairment losses on the Company's available-for-sale debt securities will be recorded as an allowance, subject to reversal, rather than as a reduction in amortized cost.

The following ASU's relate to topics relevant to the Company's operations and were adopted effective January 1, 2018. These ASU's did not have a material impact on the Company's financial position, results of operations or cash flows:

- ASU No. 2016-16, Income Taxes (Topic 740): Intra-entity Transfers of Assets Other Than Inventory
- ASU No. 2017-07, Compensation - Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost
- ASU No. 2017-09, Stock Compensation (Topic 718): Scope of Modification Accounting

The following ASU is relevant to the Company's operations and is not yet effective. This ASU is not expected to have a material impact on the Company's financial position, results of operations or cash flows:

- ASU No. 2017-08, Receivables - Nonrefundable Fees and Other Costs (Subtopic 310-20): Premium Amortization on Purchased Callable Debt Securities

3. Acquisitions

In November 2017, the Company completed its acquisition of 100% of the issued and outstanding common stock of State National Companies, Inc. (State National). Results attributable to State National's collateral protection insurance coverages are included in the Insurance segment, which was redefined during the first quarter of 2018. Results attributable to State National's program services (fronting) business are not included in a reportable segment. See note 6 for further discussion of the Company's reportable segments. Total consideration for this acquisition was \$918.8 million, all of which was cash consideration.

As of December 31, 2017, the purchase price was preliminarily allocated to the acquired assets and liabilities of State National based on estimated fair value at the acquisition date. During the first quarter of 2018, the Company completed the process of determining the fair value of the assets and liabilities acquired with State National. The Company recognized goodwill of \$379.2 million, none of which is expected to be deductible for income tax purposes. The Company also recognized indefinite lived intangible assets of \$32.0 million and other intangible assets of \$338.5 million, which are being amortized over a weighted average period of 13 years.

The following table summarizes the intangible assets recorded in connection with the acquisition, and as of June 30, 2018.

(dollars in thousands)

Amount Economic

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		Useful Life
Customer relationships	\$289,000	13 years
Trade names	22,500	13 years
Technology	27,000	Nine years
Insurance licenses	32,000	Indefinite
Intangible assets, before amortization, as of the acquisition date	370,500	
Amortization (from the acquisition date through June 30, 2018)	18,478	
Net intangible assets as of June 30, 2018	\$352,022	

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4. Investments

a)The following tables summarize the Company's available-for-sale investments. Commercial and residential mortgage-backed securities include securities issued by U.S. government-sponsored enterprises and U.S. government agencies.

(dollars in thousands)	June 30, 2018				
	Amortized Cost	Gross Unrealized Holding Gains	Gross Unrealized Holding Losses	Unrealized Other-Than Temporary Impairment Losses	Estimated Fair Value
Fixed maturities:					
U.S. Treasury securities	\$ 184,972	\$ 23	\$(2,797)	) \$	—\$182,198
U.S. government-sponsored enterprises	360,192	5,719	(5,544)	) —	360,367
Obligations of states, municipalities and political subdivisions	4,379,175	107,644	(33,843)	) —	4,452,976
Foreign governments	1,454,335	113,963	(12,188)	) —	1,556,110
Commercial mortgage-backed securities	1,668,547	668	(58,319)	) —	1,610,896
Residential mortgage-backed securities	910,466	2,564	(20,875)	) —	892,155
Asset-backed securities	30,229	1	(455)	) —	29,775
Corporate bonds	1,037,677	25,776	(13,857)	) —	1,049,596
Total fixed maturities	10,025,593	256,358	(147,878)	) —	10,134,073
Short-term investments	1,948,806	203	(1,424)) —	1,947,585
Investments, available-for-sale	\$ 11,974,399	\$ 256,561	\$(149,302)) \$	—\$12,081,658

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(dollars in thousands)	December 31, 2017			
	Amortized Cost	Gross Unrealized Holding Gains	Gross Unrealized Holding Losses	Unrealized Other-Than Temporary Impairment Losses Estimated Fair Value
Fixed maturities:				
U.S. Treasury securities	\$ 162,378	\$ 54	\$(1,819)	\$ —
U.S. government-sponsored enterprises	352,455	11,883	(818)	—
Obligations of states, municipalities and political subdivisions	4,381,358	193,120	(7,916)	—
Foreign governments	1,341,628	150,010	(2,410)	—
Commercial mortgage-backed securities	1,244,777	6,108	(16,559)	—
Residential mortgage-backed securities	846,916	14,115	(4,863)	—
Asset-backed securities	34,942	8	(222)	—
Corporate bonds	1,186,699	51,563	(2,737)	—
Total fixed maturities	9,551,153	426,861	(37,344)	—
Equity securities: ⁽¹⁾				
Insurance, banks and other financial institutions	899,324	1,209,162	(5,453)	—
Industrial, consumer and all other	1,768,337	2,110,959	(14,482)	—
Total equity securities	2,667,661	3,320,121	(19,935)	—
Short-term investments	2,161,017	26	(69)	—
Investments, available-for-sale	\$ 14,379,831	\$ 3,747,008	\$(57,348)	\$ —

⁽¹⁾ Effective January 1, 2018, the Company adopted ASU No. 2016-01 and equity securities are no longer classified as available-for-sale. Prior periods have not been restated to conform to the current presentation. See note 2.

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b)The following tables summarize gross unrealized investment losses on available-for-sale investments by the length of time that securities have continuously been in an unrealized loss position.

	June 30, 2018				Total	Gross Unrealized Holding and Other-Than- Temporary Impairment Losses
	Less than 12 months	12 months or longer	Estimated Fair Value	Estimated Fair Value		
(dollars in thousands)						
Fixed maturities:						
U.S. Treasury securities	\$102,764	\$ (1,397)	\$78,840	\$ (1,400)	\$181,604	\$ (2,797)
U.S. government-sponsored enterprises	115,354	(2,714)	94,301	(2,830)	209,655	(5,544)
Obligations of states, municipalities and political subdivisions	855,186	(15,141)	402,553	(18,702)	1,257,739	(33,843)
Foreign governments	328,049	(6,714)	75,799	(5,474)	403,848	(12,188)
Commercial mortgage-backed securities	962,732	(24,757)	497,169	(33,562)	1,459,901	(58,319)
Residential mortgage-backed securities	590,710	(14,181)	126,355	(6,694)	717,065	(20,875)
Asset-backed securities	14,389	(277)	14,316	(178)	28,705	(455)
Corporate bonds	401,878	(9,366)	153,196	(4,491)	555,074	(13,857)
Total fixed maturities	3,371,062	(74,547)	1,442,529	(73,331)	4,813,591	(147,878)
Short-term investments	177,977	(1,424)	—	—	177,977	(1,424)
Total	\$3,549,039	\$ (75,971)	\$1,442,529	\$ (73,331)	\$4,991,568	\$ (149,302)

At June 30, 2018, the Company held 1,120 fixed maturities with a total estimated fair value of \$5.0 billion and gross unrealized losses of \$149.3 million. Of these 1,120 securities, 275 securities had been in a continuous unrealized loss position for one year or longer and had a total estimated fair value of \$1.4 billion and gross unrealized losses of \$73.3 million. The Company does not intend to sell or believe it will be required to sell these fixed maturities before recovery of their amortized cost.

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	December 31, 2017					
	Less than 12 months		12 months or longer		Total	
	Estimated	Gross Unrealized	Estimated	Gross Unrealized	Estimated	Gross Unrealized
(dollars in thousands)	Fair Value	Holding and Other-Than-Temporary Impairment Losses	Fair Value	Holding and Other-Than-Temporary Impairment Losses	Fair Value	Holding and Other-Than-Temporary Impairment Losses
Fixed maturities:						
U.S. Treasury securities	\$78,756	\$ (659)	\$78,298	\$ (1,160)	\$157,054	\$ (1,819)
U.S. government-sponsored enterprises	11,593	(79)	89,194	(739)	100,787	(818)
Obligations of states, municipalities and political subdivisions	80,654	(789)	404,814	(7,127)	485,468	(7,916)
Foreign governments	31,752	(452)	63,406	(1,958)	95,158	(2,410)
Commercial mortgage-backed securities	253,936	(1,980)	481,216	(14,579)	735,152	(16,559)
Residential mortgage-backed securities	157,508	(1,345)	148,960	(3,518)	306,468	(4,863)
Asset-backed securities	14,263	(123)	15,165	(99)	29,428	(222)
Corporate bonds	149,345	(863)	187,754	(1,874)	337,099	(2,737)
Total fixed maturities	777,807	(6,290)	1,468,807	(31,054)	2,246,614	(37,344)
Equity securities: ⁽¹⁾						
Insurance, banks and other financial institutions	60,848	(4,843)	1,291	(610)	62,139	(5,453)
Industrial, consumer and all other	78,552	(11,798)	11,243	(2,684)	89,795	(14,482)
Total equity securities	139,400	(16,641)	12,534	(3,294)	151,934	(19,935)
Short-term investments	369,104	(69)	—	—	369,104	(69)
Total	\$1,286,311	\$ (23,000)	\$1,481,341	\$ (34,348)	\$2,767,652	\$ (57,348)

⁽¹⁾ Effective January 1, 2018, the Company adopted ASU No. 2016-01 and equity securities are no longer classified as available-for-sale. Prior periods have not been restated to conform to the current presentation. See note 2.

At December 31, 2017, the Company held 739 securities with a total estimated fair value of \$2.8 billion and gross unrealized losses of \$57.3 million. Of these 739 securities, 272 securities had been in a continuous unrealized loss position for one year or longer and had a total estimated fair value of \$1.5 billion and gross unrealized losses of \$34.3 million. Of these securities, 258 securities were fixed maturities and 14 were equity securities.

The Company completes a detailed analysis each quarter to assess whether the decline in the fair value of any investment below its cost basis is deemed other-than-temporary. All available-for-sale securities with unrealized losses are reviewed. The Company considers many factors in completing its quarterly review of securities with unrealized losses for other-than-temporary impairment, including the length of time and the extent to which fair value has been below cost and the financial condition and near-term prospects of the issuer.

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For fixed maturities, the Company considers whether it intends to sell the security or if it is more likely than not that it will be required to sell the security before recovery, the implied yield-to-maturity, the credit quality of the issuer and the ability to recover all amounts outstanding when contractually due. For fixed maturities where the Company intends to sell the security or it is more likely than not that the Company will be required to sell the security before recovery of its amortized cost, a decline in fair value is considered to be other-than-temporary and is recognized in net income based on the fair value of the security at the time of assessment, resulting in a new cost basis for the security. If the decline in fair value of a fixed maturity below its amortized cost is considered to be other-than-temporary based upon other considerations, the Company compares the estimated present value of the cash flows expected to be collected to the amortized cost of the security. The extent to which the estimated present value of the cash flows expected to be collected is less than the amortized cost of the security represents the credit-related portion of the other-than-temporary impairment, which is recognized in net income, resulting in a new cost basis for the security. Any remaining decline in fair value represents the non-credit portion of the other-than-temporary impairment, which is recognized in other comprehensive income. The discount rate used to calculate the estimated present value of the cash flows expected to be collected is the effective interest rate implicit for the security at the date of purchase. When assessing whether it intends to sell a fixed maturity or if it is likely to be required to sell a fixed maturity before recovery of its amortized cost, the Company evaluates facts and circumstances including decisions to reposition the investment portfolio, potential sales of investments to meet cash flow needs and, ultimately, current market prices.

Prior to the adoption of ASU No. 2016-01, equity securities were considered available-for-sale and were included in the analysis of other than temporary impairments. For equity securities, the ability and intent to hold the security for a period of time sufficient to allow for anticipated recovery was considered. A decline in fair value of equity securities that was considered to be other-than-temporary was recognized in net income based on the fair value of the security at the time of assessment, resulting in a new cost basis for the security.

c)The amortized cost and estimated fair value of fixed maturities at June 30, 2018 are shown below by contractual maturity.

(dollars in thousands)	Amortized Cost	Estimated Fair Value
Due in one year or less	\$222,476	\$221,579
Due after one year through five years	1,354,381	1,366,516
Due after five years through ten years	1,845,977	1,876,279
Due after ten years	3,993,517	4,136,873
	7,416,351	7,601,247
Commercial mortgage-backed securities	1,668,547	1,610,896
Residential mortgage-backed securities	910,466	892,155
Asset-backed securities	30,229	29,775
Total fixed maturities	\$10,025,593	\$10,134,073

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d)The following table presents the components of net investment income.

(dollars in thousands)	Quarter Ended June		Six Months Ended	
	30, 2018	2017	June 30, 2018	2017
Interest:				
Municipal bonds (tax-exempt)	\$20,287	\$22,758	\$41,222	\$45,130
Municipal bonds (taxable)	18,220	17,793	35,853	35,298
Other taxable bonds	39,548	36,296	77,017	71,184
Short-term investments, including overnight deposits	11,915	5,834	22,505	10,783
Dividends on equity securities	20,474	19,017	44,481	39,623
Income (loss) from equity method investments	(1,490)	1,802	288	6,395
Other	97	24	(13)	(205)
	109,051	103,524	221,353	208,208
Investment expenses	(3,664)	(4,225)	(7,950)	(8,541)
Net investment income	\$105,387	\$99,299	\$213,403	\$199,667

e)The following table presents net investment gains (losses) and the change in net unrealized gains on available-for-sale investments.

(dollars in thousands)	Quarter Ended June		Six Months Ended	
	30, 2018	2017	June 30, 2018	2017
Realized gains on available-for-sale investments:				
Sales of fixed maturities	\$242	\$554	\$1,765	\$757
Sales of equity securities ⁽¹⁾	—	1,295	—	16,533
Other	810	4,259	891	4,826
Total realized gains	1,052	6,108	2,656	22,116
Realized losses on available-for-sale investments:				
Sales of fixed maturities	(7,706)	(412)	(8,198)	(602)
Sales of equity securities ⁽¹⁾	—	(786)	—	(1,216)
Other-than-temporary impairments	—	(604)	—	(3,817)
Other	(988)	(81)	(3,046)	(286)
Total realized losses	(8,694)	(1,883)	(11,244)	(5,921)
Net realized investment gains (losses)	(7,642)	4,225	(8,588)	16,195
Change in fair value of equity securities: ⁽¹⁾				
Change in fair value of equity securities sold during the period ⁽¹⁾	9,631	—	13,897	—
Change in fair value of equity securities held at the end of the period	103,260	13,402	(23,058)	22,297
Change in fair value of equity securities ⁽¹⁾	112,891	13,402	(9,161)	22,297
Net investment gains (losses)	\$105,249	\$17,627	\$(17,749)	\$38,492
Change in net unrealized gains on available-for-sale investments included in other comprehensive income:				
Fixed maturities	\$(143,593)	\$79,413	\$(281,093)	\$84,060
Equity securities ⁽¹⁾	—	204,372	—	423,424
Short-term investments	5,499	133	(1,178)	6
Net increase (decrease)	\$(138,094)	\$283,918	\$(282,271)	\$507,490

Effective January 1, 2018, the Company adopted ASU No. 2016-01. As a result, equity securities are no longer ⁽¹⁾ classified as available-for-sale with unrealized gains and losses recognized in other comprehensive income; rather, all changes in the fair value of equity securities are now recognized in net income. Prior periods have not been restated to conform to the current presentation. See note 2.

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5. Fair Value Measurements

FASB ASC 820-10, Fair Value Measurements and Disclosures, establishes a three-level hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The fair value hierarchy gives the highest priority to quoted prices in active markets for identical assets or liabilities (Level 1) and the lowest priority to unobservable inputs (Level 3). If the inputs used to measure the assets or liabilities fall within different levels of the hierarchy, the classification is based on the lowest level input that is significant to the fair value measurement of the asset or liability.

Classification of assets and liabilities within the hierarchy considers the markets in which the assets and liabilities are traded and the reliability and transparency of the assumptions used to determine fair value. The hierarchy requires the use of observable market data when available. The levels of the hierarchy are defined as follows:

Level 1 – Inputs to the valuation methodology are quoted prices (unadjusted) for identical assets or liabilities traded in active markets.

Level 2 – Inputs to the valuation methodology include quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active, inputs other than quoted prices that are observable for the asset or liability and market-corroborated inputs.

Level 3 – Inputs to the valuation methodology are unobservable for the asset or liability and are significant to the fair value measurement.

In accordance with FASB ASC 820, the Company determines fair value based on the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. In determining fair value, the Company uses various methods, including the market, income and cost approaches. The Company uses valuation techniques that maximize the use of observable inputs and minimize the use of unobservable inputs. The following section describes the valuation methodologies used by the Company to measure assets and liabilities at fair value, including an indication of the level within the fair value hierarchy in which each asset or liability is generally classified.

Investments available-for-sale and equity securities. Equity securities and available-for-sale investments are recorded at fair value on a recurring basis. Available-for-sale investments include fixed maturities and short-term investments. Short-term investments include certificates of deposit, commercial paper, discount notes and treasury bills with original maturities of one year or less. Fair value for investments available-for-sale and equity securities are determined by the Company after considering various sources of information, including information provided by a third party pricing service. The pricing service provides prices for substantially all of the Company's fixed maturities and equity securities. In determining fair value, the Company generally does not adjust the prices obtained from the pricing service. The Company obtains an understanding of the pricing service's valuation methodologies and related inputs, which include, but are not limited to, reported trades, benchmark yields, issuer spreads, bids, offers, duration, credit ratings, estimated cash flows and prepayment speeds. The Company validates prices provided by the pricing service by reviewing prices from other pricing sources and analyzing pricing data in certain instances.

The Company has evaluated the various types of securities in its investment portfolio to determine an appropriate fair value hierarchy level based upon trading activity and the observability of market inputs. Level 1 investments include those traded on an active exchange, such as the New York Stock Exchange. Level 2 investments include U.S. Treasury securities, U.S. government-sponsored enterprises, municipal bonds, foreign government bonds, commercial mortgage-backed securities, residential mortgage-backed securities, asset-backed securities and corporate debt securities. Level 3 investments include the Company's investments in insurance-linked securities funds (ILS Funds), as further described in note 11, which are not traded on an active exchange and are valued using unobservable inputs.

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Fair value for investments available-for-sale and equity securities is measured based upon quoted prices in active markets, if available. Due to variations in trading volumes and the lack of quoted market prices, fixed maturities are classified as Level 2 investments. The fair value of fixed maturities is normally derived through recent reported trades for identical or similar securities, making adjustments through the reporting date based upon available market observable data described above. If there are no recent reported trades, the fair value of fixed maturities may be derived through the use of matrix pricing or model processes, where future cash flow expectations are developed based upon collateral performance and discounted at an estimated market rate. Significant inputs used to determine the fair value of obligations of states, municipalities and political subdivisions, corporate bonds and obligations of foreign governments include reported trades, benchmark yields, issuer spreads, bids, offers, credit information and estimated cash flows. Significant inputs used to determine the fair value of commercial mortgage-backed securities, residential mortgage-backed securities and asset-backed securities include the type of underlying assets, benchmark yields, prepayment speeds, collateral information, tranche type and volatility, estimated cash flows, credit information, default rates, recovery rates, issuer spreads and the year of issue.

Due to the significance of unobservable inputs required in measuring the fair value of the Company's investments in the ILS Funds, these investments are classified as Level 3 within the fair value hierarchy. Changes in fair value of the ILS Funds are included in the change in fair value of equity securities in net income. The fair value of the securities are derived using their reported net asset value (NAV) as the primary input, as well as other observable and unobservable inputs as deemed necessary by management. Management has obtained an understanding of the inputs, assumptions, process, and controls used to determine NAV, which is calculated by an independent third party. Unobservable inputs to the NAV calculations include assumptions around premium earnings patterns and loss reserve estimates for the underlying securitized reinsurance contracts in which the ILS Funds invest. The Company's investments in the ILS Funds are redeemable annually as of January 1st of each calendar year.

The Company's valuation policies and procedures for Level 3 investments are determined by management. Fair value measurements are analyzed quarterly to ensure the change in fair value from prior periods is reasonable relative to management's understanding of the underlying investments, recent market trends and external market data, which includes the price of a comparable security and an insurance-linked security index.

Senior long-term debt and other debt. Senior long-term debt and other debt is carried at amortized cost with the estimated fair value disclosed on the consolidated balance sheets. Senior long-term debt and other debt is classified as Level 2 within the fair value hierarchy due to variations in trading volumes and the lack of quoted market prices. Fair value for senior long-term debt and other debt is generally derived through recent reported trades for identical securities, making adjustments through the reporting date, if necessary, based upon available market observable data including U.S. Treasury securities and implied credit spreads. Significant inputs used to determine the fair value of senior long-term debt and other debt include reported trades, benchmark yields, issuer spreads, bids and offers.

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The following tables present the balances of assets measured at fair value on a recurring basis by level within the fair value hierarchy.

(dollars in thousands)	June 30, 2018			
	Level 1	Level 2	Level 3	Total
Assets:				
Investments:				
Fixed maturities, available-for-sale:				
U.S. Treasury securities	\$—	\$182,198	\$—	\$182,198
U.S. government-sponsored enterprises	—	360,367	—	360,367
Obligations of states, municipalities and political subdivisions	—	4,452,976	—	4,452,976
Foreign governments	—	1,556,110	—	1,556,110
Commercial mortgage-backed securities	—	1,610,896	—	1,610,896
Residential mortgage-backed securities	—	892,155	—	892,155
Asset-backed securities	—	29,775	—	29,775
Corporate bonds	—	1,049,596	—	1,049,596
Total fixed maturities, available-for-sale	—	10,134,073	—	10,134,073
Equity securities:				
Insurance, banks and other financial institutions	1,981,481	—	119,675	2,101,156
Industrial, consumer and all other	3,968,089	—	—	3,968,089
Total equity securities	5,949,570	—	119,675	6,069,245
Short-term investments, available-for-sale	1,853,387	94,198	—	1,947,585
Total investments	\$7,802,957	\$10,228,271	\$119,675	\$18,150,903

(dollars in thousands)	December 31, 2017			
	Level 1	Level 2	Level 3	Total
Assets:				
Investments available-for-sale:				
Fixed maturities:				
U.S. Treasury securities	\$—	\$160,613	\$—	\$160,613
U.S. government-sponsored enterprises	—	363,520	—	363,520
Obligations of states, municipalities and political subdivisions	—	4,566,562	—	4,566,562
Foreign governments	—	1,489,228	—	1,489,228
Commercial mortgage-backed securities	—	1,234,326	—	1,234,326
Residential mortgage-backed securities	—	856,168	—	856,168
Asset-backed securities	—	34,728	—	34,728
Corporate bonds	—	1,235,525	—	1,235,525
Total fixed maturities	—	9,940,670	—	9,940,670
Equity securities: ⁽¹⁾				
Insurance, banks and other financial institutions	1,934,224	—	168,809	2,103,033
Industrial, consumer and all other	3,864,814	—	—	3,864,814
Total equity securities	5,799,038	—	168,809	5,967,847
Short-term investments	2,065,749	95,225	—	2,160,974
Total investments available-for-sale ⁽¹⁾	\$7,864,787	\$10,035,895	\$168,809	\$18,069,491

⁽¹⁾ Effective January 1, 2018, the Company adopted ASU No. 2016-01 and equity securities are no longer classified as available-for-sale. Prior periods have not been restated to conform to the current presentation. See note 2.

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The following table summarizes changes in Level 3 investments measured at fair value on a recurring basis.

(dollars in thousands)	Quarter Ended June		Six Months Ended	
	30, 2018	2017	June 30, 2018	2017
Equity securities, beginning of period	\$151,398	\$178,043	\$168,809	\$191,203
Purchases	—	1,250	28,900	7,250
Sales	(6,401)	(1,303)	(34,653)	(26,674)
Total gains (losses) included in net income	(25,322)	5,923	(43,381)	12,134
Transfers into Level 3	—	—	—	—
Transfers out of Level 3	—	—	—	—
Equity securities, end of period	\$119,675	\$183,913	\$119,675	\$183,913
Change in fair value of equity securities included in net income relating to assets held at June 30, 2018 and 2017	\$(25,322)	\$5,923	\$(43,381)	\$12,134

There were no transfers into or out of Level 1 and Level 2 during the quarter and six months ended June 30, 2018 and 2017.

The Company did not have any assets or liabilities measured at fair value on a non-recurring basis during the six months ended June 30, 2018 and 2017.

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6. Segment Reporting Disclosures

In conjunction with the Company's continued growth and diversification, beginning in the first quarter of 2018 the Company's chief operating decision maker changed the way it reviews the Company's ongoing underwriting results. Effective January 1, 2018, the Company's chief operating decision maker reviews the Company's ongoing underwriting operations on a global basis in the following two segments: Insurance and Reinsurance. In determining how to allocate resources and assess the performance of its underwriting results, management considers many factors, including the nature of the insurance product sold, the type of account written and the type of customer served. The Insurance segment includes all direct business and facultative placements written across the Company. The Reinsurance segment includes all treaty reinsurance written across the Company. All investing activities related to the Company's underwriting operations are included in the Investing segment.

Also during the first quarter of 2018, the Company's chief operating decision maker changed the way it assesses the performance of and allocates resources to its Markel Ventures operations. Historically, the Company's chief operating decision maker reviewed and assessed the performance of each Markel Ventures business separately with no single business being individually significant. Following the continued growth in the Company's Markel Ventures operations, effective in the first quarter of 2018, the chief operating decision maker reviews and assesses Markel Ventures' performance in the aggregate, as a single operating segment. The Markel Ventures segment primarily consists of controlling interests in a diverse portfolio of businesses that operate in various industries.

The following table summarizes revenue from the Markel Ventures segment by major product grouping.

	Quarter Ended June		Six Months Ended	
	30,		June 30,	
(dollars in thousands)	2018	2017	2018	2017
Markel Ventures:				
Products	\$472,323	\$217,175	\$766,459	\$414,239
Services	106,433	96,422	204,354	186,293
Total Markel Ventures	\$578,756	\$313,597	\$970,813	\$600,532

The Company's other operations include the results of the Company's legal and professional consulting services and the results of the Company's investment management services attributable to Markel CATCo Investment Management Ltd. Also included in the Company's other operations are results attributable to the run-off of acquired managing general agent operations and underwriting results for lines of business discontinued prior to, or in conjunction with, acquisitions, including run-off of life and annuity reinsurance business, which are monitored separately from the Company's ongoing underwriting operations. Effective November 17, 2017, the Company's other operations also include the results of the program services business acquired as part of the State National transaction. For purposes of segment reporting, none of the Company's other operations are considered to be reportable segments.

Segment profit for each of the Company's underwriting segments is measured by underwriting profit. The property and casualty insurance industry commonly defines underwriting profit as earned premiums net of losses and loss adjustment expenses and underwriting, acquisition and insurance expenses. Underwriting profit does not replace operating income or net income computed in accordance with U.S. GAAP as a measure of profitability. Underwriting profit or loss provides a basis for management to evaluate the Company's underwriting performance. Segment profit for the Investing segment is measured by net investment income and net investment gains. Segment profit for the Markel Ventures segment is measured by operating income.

For management reporting purposes, the Company allocates assets to its underwriting, investing, Markel Ventures, and other operations. Underwriting assets are all assets not specifically allocated to the Investing or Markel Ventures segments, or to the Company's other operations. Underwriting and investing assets are not allocated to the Insurance

and Reinsurance segments since the Company does not manage its assets by underwriting segment. The Company does not allocate capital expenditures for long-lived assets to either of its underwriting segments for management reporting purposes.

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a)The following tables summarize the Company's segment disclosures. Prior year amounts have been recast for consistency with the current year presentation.

(dollars in thousands)	Quarter Ended June 30, 2018					
	Insurance	Reinsurance	Investing	Markel Ventures	Other ⁽¹⁾	Consolidated
Gross premium volume	\$1,233,828	\$208,805	\$—	\$—	\$554,800	\$1,997,433
Net written premiums	1,001,126	178,729	—	—	751	1,180,606
Earned premiums	918,194	229,613	—	—	377	1,148,184
Losses and loss adjustment expenses:						
Current accident year	(610,634)	(145,992)	—	—	(48)	(756,674)
Prior accident years	139,485	18,525	—	—	(514)	157,496
Amortization of policy acquisition costs	(191,843)	(57,407)	—	—	—	(249,250)
Other operating expenses	(180,928)	(21,178)	—	—	(214)	(202,320)
Underwriting profit (loss)	74,274	23,561	—	—	(399)	97,436
Net investment income	—	—	105,195	192	—	105,387
Net investment gains	—	—	105,249	—	—	105,249
Other revenues	—	—	—	578,756	49,437	628,193
Other expenses ⁽²⁾	—	—	—	(555,833)	(39,510)	(595,343)
Amortization of intangible assets ⁽³⁾	—	—	—	(10,096)	(19,545)	(29,641)
Segment profit (loss)	\$74,274	\$23,561	\$210,444	\$13,019	\$(10,017)	\$311,281
Interest expense						(36,702)
Net foreign exchange gains						86,158
Income before income taxes						\$360,737
U.S. GAAP combined ratio ⁽⁴⁾	92	% 90	%		NM	⁽⁵⁾ 92 %

Other segment profit (loss) represents the total profit (loss) attributable to the Company's operations that are not

⁽¹⁾ included in a reportable segment as well as any amortization of intangible assets that is not allocated to a reportable segment.

⁽²⁾ Other expenses for the Markel Ventures segment include depreciation expense of \$12.8 million for the quarter ended June 30, 2018.

⁽³⁾ Segment profit for the Markel Ventures segment includes amortization of intangible assets attributable to Markel Ventures. Amortization of intangible assets is not allocated to any other reportable segments.

The U.S. GAAP combined ratio is a measure of underwriting performance and represents the relationship of

⁽⁴⁾ incurred losses, loss adjustment expenses and underwriting, acquisition and insurance expenses to earned premiums.

⁽⁵⁾ NM - Ratio is not meaningful

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(dollars in thousands)	Quarter Ended June 30, 2017					Consolidated
	Insurance	Reinsurance	Investing	Markel Ventures	Other ⁽¹⁾	
Gross premium volume	\$ 1,109,278	\$ 247,902	\$—	\$—	\$(16)	\$ 1,357,164
Net written premiums	917,286	220,466	—	—	(95)	1,137,657
Earned premiums	804,189	229,480	—	—	(95)	1,033,574
Losses and loss adjustment expenses:						
Current accident year	(538,399)	(146,186)	—	—	—	(684,585)
Prior accident years	132,528	28,151	—	—	928	161,607
Amortization of policy acquisition costs	(160,388)	(53,086)	—	—	—	(213,474)
Other operating expenses	(163,480)	(24,181)	—	—	(135)	(187,796)
Underwriting profit	74,450	34,178	—	—	698	109,326
Net investment income	—	—	99,239	60	—	99,299
Net realized investment gains	—	—	17,627	—	—	17,627
Other revenues	—	—	—	313,597	17,396	330,993
Other expenses ⁽²⁾	—	—	—	(271,045)	(27,711)	(298,756)
Amortization of intangible assets ⁽³⁾	—	—	—	(6,956)	(11,070)	(18,026)
Segment profit (loss)	\$ 74,450	\$ 34,178	\$ 116,866	\$ 35,656	\$(20,687)	\$ 240,463
Interest expense						(31,797)
Net foreign exchange gains						879
Income before income taxes						\$ 209,545
U.S. GAAP combined ratio ⁽⁴⁾	91	% 85	%		NM ⁽⁵⁾	89 %

Other segment profit (loss) represents the total profit (loss) attributable to the Company's operations that are not

(1) included in a reportable segment as well as any amortization of intangible assets that is not allocated to a reportable segment.

(2) Other expenses for the Markel Ventures segment include depreciation expense of \$9.6 million for the quarter ended June 30, 2017.

(3) Segment profit for the Markel Ventures segment includes amortization of intangible assets attributable to Markel Ventures. Amortization of intangible assets is not allocated to any other reportable segments.

The U.S. GAAP combined ratio is a measure of underwriting performance and represents the relationship of (4) incurred losses, loss adjustment expenses and underwriting, acquisition and insurance expenses to earned premiums.

(5) NM - Ratio is not meaningful

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(dollars in thousands)	Six Months Ended June 30, 2018					Consolidated
	Insurance	Reinsurance	Investing	Markel Ventures	Other ⁽¹⁾	
Gross premium volume	\$2,327,190	\$701,138	\$—	\$—	\$1,015,989	\$4,044,317
Net written premiums	1,914,105	599,787	—	—	1,516	2,515,408
Earned premiums	1,821,045	477,577	—	—	583	2,299,205
Losses and loss adjustment expenses:						
Current accident year	(1,180,661)	(299,173)	—	—	(48)	(1,479,882)
Prior accident years	258,658	5,454	—	—	1,474	265,586
Amortization of policy acquisition costs	(371,328)	(119,827)	—	—	—	(491,155)
Other operating expenses	(350,899)	(33,308)	—	—	(598)	(384,805)
Underwriting profit	176,815	30,723	—	—	1,411	208,949
Net investment income	—	—	213,089	314	—	213,403
Net investment losses	—	—	(17,749)	—	—	(17,749)
Other revenues	—	—	—	970,813	96,812	1,067,625
Other expenses ⁽²⁾	—	—	—	(914,138)	(83,335)	(997,473)
Amortization of intangible assets ⁽³⁾	—	—	—	(20,193)	(38,271)	(58,464)
Segment profit (loss)	\$176,815	\$30,723	\$195,340	\$36,796	\$(23,383)	\$416,291
Interest expense						(76,761)
Net foreign exchange gains						64,044
Income before income taxes						\$403,574
U.S. GAAP combined ratio ⁽⁴⁾	90	% 94	%		NM	⁽⁵⁾ 91 %

Other segment profit (loss) represents the total profit (loss) attributable to the Company's operations that are not included in a reportable segment as well as any amortization of intangible assets that is not allocated to a reportable segment.

(2) Other expenses for the Markel Ventures segment include depreciation expense of \$25.5 million for the six months ended June 30, 2018.

(3) Segment profit for the Markel Ventures segment includes amortization of intangible assets attributable to Markel Ventures. Amortization of intangible assets is not allocated to any other reportable segments.

The U.S. GAAP combined ratio is a measure of underwriting performance and represents the relationship of incurred losses, loss adjustment expenses and underwriting, acquisition and insurance expenses to earned premiums.

(5) NM - Ratio is not meaningful

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	Six Months Ended June 30, 2017					
(dollars in thousands)	Insurance	Reinsurance	Investing	Markel Ventures	Other ⁽¹⁾	Consolidated
Gross premium volume	\$2,022,275	\$795,639	\$—	\$—	\$1	\$2,817,915
Net written premiums	1,687,803	710,062	—	—	21	2,397,886
Earned premiums	1,561,038	455,117	—	—	21	2,016,176
Losses and loss adjustment expenses:						
Current accident year	(1,031,135)	(291,796)	—	—	—	(1,322,931)
Prior accident years	225,414	(43,412)	—	—	6,232	188,234
Amortization of policy acquisition costs	(308,077)	(109,945)	—	—	—	(418,022)
Other operating expenses	(309,877)	(46,350)	—	—	(299)	(356,526)
Underwriting profit (loss)	137,363	(36,386)	—	—	5,954	106,931
Net investment income	—	—	199,564	103	—	199,667
Net investment gains	—	—	38,492	—	—	38,492
Other revenues	—	—	—	600,532	38,377	638,909
Other expenses ⁽²⁾	—	—	—	(522,357)	(59,032)	(581,389)
Amortization of intangible assets ⁽³⁾	—	—	—	(13,860)	(20,936)	(34,796)
Segment profit (loss)	\$137,363	\$(36,386)	\$238,056	\$64,418	\$(35,637)	\$367,814
Interest expense						(65,199)
Net foreign exchange gains						974
Income before income taxes						\$303,589
U.S. GAAP combined ratio ⁽⁴⁾	91	% 108	%		NM ⁽⁵⁾	95 %

Other segment profit (loss) represents the total profit (loss) attributable to the Company's operations that are not

(1) included in a reportable segment as well as any amortization of intangible assets that is not allocated to a reportable segment.

(2) Other expenses for the Markel Ventures segment include depreciation expense of \$19.0 million for the six months ended June 30, 2017.

(3) Segment profit for the Markel Ventures segment includes amortization of intangible assets attributable to Markel Ventures. Amortization of intangible assets is not allocated to any other reportable segments.

The U.S. GAAP combined ratio is a measure of underwriting performance and represents the relationship of

(4) incurred losses, loss adjustment expenses and underwriting, acquisition and insurance expenses to earned premiums.

(5) NM - Ratio is not meaningful

b)The following table reconciles segment assets to the Company's consolidated balance sheets.

(dollars in thousands)	June 30, 2018	December 31, 2017
Segment assets:		
Investing	\$20,303,090	\$20,317,160
Underwriting	6,955,342	6,828,048
Markel Ventures	1,936,966	1,900,728
Total segment assets	29,195,398	29,045,936
Other operations	4,051,633	3,759,080
Total assets	\$33,247,031	\$32,805,016

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7. Unpaid Losses and Loss Adjustment Expenses

The following table presents a reconciliation of consolidated beginning and ending reserves for losses and loss adjustment expenses.

(dollars in thousands)	Six Months Ended June 30,	
	2018	2017
Net reserves for losses and loss adjustment expenses, beginning of year	\$8,964,945	\$8,108,717
Foreign currency movements	(20,554	) 57,991
Adjusted net reserves for losses and loss adjustment expenses, beginning of year	8,944,391	8,166,708
Incurred losses and loss adjustment expenses:		
Current accident year	1,479,882	1,322,931
Prior accident years	(265,613	) (184,367
Total incurred losses and loss adjustment expenses	1,214,269	1,138,564
Payments:		
Current accident year	195,873	186,138
Prior accident years	1,073,004	829,126
Total payments	1,268,877	1,015,264
Effect of foreign currency rate changes	(101	) 2,333
Net reserves for losses and loss adjustment expenses of acquired insurance companies	—	12,702
Net reserves for losses and loss adjustment expenses, end of period	8,889,682	8,305,043
Reinsurance recoverable on unpaid losses	4,739,259	2,007,652
Gross reserves for losses and loss adjustment expenses, end of period	\$13,628,941	\$10,312,695

Effective March 31, 2017, reserves of \$69.1 million, were formally transferred to a third party by way of a Part VII transfer pursuant to the Financial Services and Markets Act 2000 of the United Kingdom. Upon completion of the transfer in the first quarter of 2017, the Company recognized a previously deferred gain of \$3.9 million, which is included in losses and loss adjustment expenses on the consolidated statement of income (loss) and comprehensive income (loss) for the six months ended June 30, 2017. This amount is excluded from the prior years' incurred losses and loss adjustment expenses for the six months ended June 30, 2017 in the above table as the deferred gain was included in other liabilities on the consolidated balance sheet as of December 31, 2016, rather than unpaid losses and loss adjustment expenses.

For the six months ended June 30, 2018, incurred losses and loss adjustment expenses included \$265.6 million of favorable development on prior years' loss reserves, which included \$211.9 million of favorable development on the Company's general liability, professional liability, worker's compensation and marine and energy product lines within the Insurance segment, and surety and marine and energy product lines within the Reinsurance segment.

For the six months ended June 30, 2017, incurred losses and loss adjustment expenses included \$184.4 million of favorable development on prior years' loss reserves, which included \$195.7 million of loss reserve redundancies on the Company's general liability, professional liability, marine and energy, personal lines business and worker's compensation product lines within the Insurance segment and property and whole account product lines within the Reinsurance segment. Redundancies for the six months ended June 30, 2017 were partially offset by \$85.0 million of adverse development resulting from a decrease in the discount rate, known as the Ogden Rate, used to calculate lump sum awards in United Kingdom bodily injury cases.

During the six months ended June 30, 2017, the Company recorded net reserves for losses and loss adjustment expenses of \$12.7 million as a result of the acquisition of SureTec.

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8. Other Revenues

The amount of revenues from contracts with customers included in other revenues on the consolidated statements of income and comprehensive income (loss) is \$581.4 million and \$307.1 million for the quarters ended June 30, 2018 and 2017, respectively, and \$978.6 million and \$592.0 million for the six months ended June 30, 2018 and 2017, respectively.

The following tables disaggregate revenues from contracts with customers by type.

(dollars in thousands)	Quarter Ended June 30,			2017		
	2018			2017		
	Markel Ventures	Other	Total	Markel Ventures	Other	Total
Products	\$461,007	\$—	\$461,007	\$204,839	\$—	\$204,839
Services	94,035	8,972	103,007	85,617	7,348	92,965
Investment management	—	17,418	17,418	—	9,277	9,277
Total revenues from contracts with customers	555,042	26,390	581,432	290,456	16,625	307,081
Program services	—	22,635	22,635	—	—	—
Other	23,714	412	24,126	23,141	771	23,912
Total Other Revenues	\$578,756	\$49,437	\$628,193	\$313,597	\$17,396	\$330,993