Zenith National Insurance Corp. and Subsidiaries

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

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

(In thousands, except par value)		September 30, 2018		December 31, 2017
Assets:				
Investments:				
Fixed maturity securities, at fair value (amortized cost $950,029 in 2018 and $433,191 in 2017)	$	962,857	$	460,349
Equity securities, at fair value (cost $323,013 in 2018 and $376,920 in 2017)		282,076		326,841
Short-term investments, at fair value which approximates cost		340,937		726,952
Other investments		225,407		220,377
Derivative assets, at fair value (cost $41,531 in 2018 and $43,017 in 2017)		3,714		6,804
Assets pledged for derivative obligations, at fair value (amortized cost $16,331 in 2018 and $11,858 in 2017)		16,329		11,858
Total investments		1,831,320		1,753,181
Cash		24,424		13,105
Accrued investment income		5,322		5,533
Premiums receivable		46,566		41,686
Reinsurance recoverables		48,384		54,431
Deferred policy acquisition costs		14,295		12,164
Deferred tax asset		51,006		46,140
Income tax receivable		6,132		3,711
Goodwill		20,985		20,985
Other assets		55,027		65,145
Total assets	$	2,103,461	$	2,016,081
Liabilities:				
Unpaid losses and loss adjustment expenses	$	1,174,622	$	1,191,531
Unearned premiums		104,217		88,701
Policyholders' dividends accrued		45,619		41,995
Long-term debt		38,217		38,196
Derivative liabilities		3,374		4,280
Other liabilities		73,890		76,294
Total liabilities		1,439,939		1,440,997
Commitments and contingencies (see Note 10)				
Stockholders' equity:				
Common stock, $1 par value, 40 authorized shares; 39 shares issued and outstanding		39		39
Additional paid-in capital		402,337		398,821
Retained earnings		267,342		180,072
Accumulated other comprehensive loss		(6,196)		(3,848)
Total stockholders' equity		663,522		575,084
Total liabilities and stockholders' equity	$	2,103,461	$	2,016,081

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

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
(In thousands)	2018	2017	2018	2017
Revenues:				
Net premiums earned	$ 206,362	$ 211,497	$ 602,067	$ 599,111
Net investment income	4,776	12,770	16,261	26,076
Net realized gains (losses) on investments	(11,808)	(917)	(12,415)	6,504
Change in net unrealized gains/losses on fair value option investments	20,257	5,188	(4,789)	22,882
Net gains (losses) on derivatives	8,983	641	18,379	(10,083)
Service fee income	2,180	2,272	6,786	7,086
Total revenues	230,750	231,451	626,289	651,576
Expenses:				
Losses and loss adjustment expenses incurred	94,361	102,839	292,226	288,451
Underwriting and other operating expenses:				
Policyholder acquisition costs	37,204	36,941	109,505	106,890
Underwriting and other costs	32,201	34,659	98,867	101,271
Policyholders' dividends	4,369	5,798	17,710	18,090
Interest expense	830	830	2,490	2,490
Total expenses	168,965	181,067	520,798	517,192
Income before tax	61,785	50,384	105,491	134,384
Income tax expense	10,428	16,474	19,050	43,393
Net income	$ 51,357	$ 33,910	$ 86,441	$ 90,991
Net change in unrealized gains/losses on available-for-sale and other investments, net of tax and reclassification adjustment	(388)	1,147	(1,612)	268
Change in unrealized foreign currency translation adjustment, net of tax	(875)	1,660	(736)	2,013
Other comprehensive income (loss)	(1,263)	2,807	(2,348)	2,281
Total comprehensive income	$ 50,094	$ 36,717	$ 84,093	$ 93,272

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

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

	Nine Months Ended September 30,	
(In thousands)	2018	2017
Cash flows from operating activities:		
Premiums collected	$ 617,468	$ 626,294
Investment income received	13,185	14,310
Losses and loss adjustment expenses paid	(304,975)	(301,457)
Underwriting and other operating expenses paid	(206,726)	(220,958)
Interest paid	(3,292)	(3,292)
Income taxes paid	(25,932)	(39,432)
Net cash provided by operating activities	89,728	75,465
Cash flows from investing activities:		
Purchases of investments:		
Fixed maturity securities – fair value option	(743,418)	(6,446)
Equity securities – fair value option	(1,082)	(24,102)
Corporate loan – affiliate	(6,101)	
Other investments	(9,744)	(77,174)
Derivatives	(3,383)	(1,960)
Proceeds from maturities and redemptions of investments:		
Fixed maturity securities – fair value option	68,500	41,215
Other investments	432	3,329
Proceeds from sales of investments:		
Fixed maturity securities – fair value option	166,495	79,813
Equity securities – fair value option	43,167	9,985
Other investments	2,894	
Net decrease (increase) in short-term investments	384,308	(32,247)
Net derivative cash settlements	21,484	(17,403)
Capital expenditures and other	(1,803)	(4,728)
Net cash used in by investing activities	(78,251)	(29,718)
Cash flows from financing activities:		
Dividends paid to common stockholders		(14,561)
Purchase of Fairfax shares for restricted stock awards	(158)	(6,574)
Net cash used in financing activities	(158)	(21,135)
Net increase in cash	11,319	24,612
Cash at beginning of period	13,105	21,409
Cash at end of period	$ 24,424	$ 46,021

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

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

	Nine Months Ended September 30,	
(In thousands)	2018	2017
Reconciliation of net income to net cash provided by operating activities:		
Net income	$ 86,441	$ 90,991
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation expense	2,909	2,563
Net accretion	(9,656)	(3,739)
Net realized losses (gains) on investments	12,415	(6,504)
Change in net unrealized gains/losses on fair value option investments	4,789	(22,882)
Net losses (gains) on derivatives	(18,379)	10,083
Equity in losses/earnings of investee	7,465	(8,761)
Stock-based compensation expense	3,674	2,979
Decrease (increase) in:		
Accrued investment income	211	1,513
Premiums receivable	(8,767)	(6,430)
Reinsurance recoverables	6,047	6,314
Deferred policy acquisition costs	(2,131)	(3,279)
Net income taxes	(6,882)	3,963
Increase (decrease) in:		
Unpaid losses and loss adjustment expenses	(16,909)	(19,135)
Unearned premiums	15,516	25,148
Policyholders' dividends accrued	3,624	6,192
Accrued expenses	3,795	2,520
Interest payable	(823)	(823)
Other	6,389	(5,248)
Net cash provided by operating activities	$ 89,728	$ 75,465

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

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

	Nine Months Ended September 30,	
(In thousands)	2018	2017
Common stock:	$ 39	$ 39
Additional paid-in capital:		
Beginning of period	398,821	401,249
Stock-based compensation expense	3,674	2,979
Purchases of Fairfax shares for restricted stock awards	(158)	(6,574)
End of period	402,337	397,654
Retained earnings:		
Beginning of period	180,072	173,430
Net income	86,441	90,991
Reclassification of certain tax effects from accumulated other comprehensive loss at January 1, 2018 (see Note 8)	829	
Dividends declared to common stockholders		(35,000)
End of period	267,342	229,421
Accumulated other comprehensive loss:		
Beginning of period	(3,848)	(6,867)
Reclassification of certain tax effects to retained earnings at January 1, 2018 (see Note 8)	(829)	
Net change in unrealized gains/losses on available-for-sale and other investments, net of tax and reclassification adjustment	(1,063)	268
Change in unrealized foreign currency translation adjustment, net of tax	(456)	2,013
End of period	(6,196)	(4,586)
Total stockholders' equity	$ 663,522	$ 622,528

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

Note 1. Basis of Presentation

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

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

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

Subsequent Events

The Company evaluated subsequent events through the date and time that the Consolidated Financial Statements were issued on November 2, 2018.

Note 2. Investments

As of September 30, 2018 and December 31, 2017, $1.6 billion and $1.5 billion, respectively, of investments in fixed maturities and equity securities and short-term investments were recorded under the fair value option and changes in fair value for these investments are recorded in the change in net unrealized gains/losses on fair value option investments in the Consolidated Statements of Comprehensive Income (Loss). As of September 30, 2018 and December 31, 2017, $15.7 million and $16.2 million, respectively, of investments in equity securities were classified as available-for-sale and reported at fair value with changes in unrealized gains/losses excluded from earnings and reported in a separate component of stockholders' equity, net of tax.

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

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

(In thousands)	Cost or Amortized Cost	Gross Unrealized Gains	Gross Unrealized (Losses)	Fair Value
September 30, 2018				
Fair value option investments:				
Fixed maturity securities:				
State and local government debt	$ 163,978	$ 15,612	$ (518)	$ 179,072
U.S. Government debt (a)	739,864		(1,805)	738,059
Corporate debt	47,042	3,156	(3,619)	46,579
Total fixed maturity securities (a)	950,884	18,768	(5,942)	963,710
Equity securities	302,649	47,302	(83,552)	266,399
Short-term investments (b)	356,413			356,413
Other investments - affiliate corporate loans	6,111		(169)	5,942
Total fair value option investments	1,616,057	66,070	(89,663)	1,592,464
Available-for-sale investments:				
Equity securities	20,364	28	(4,715)	15,677
Total available-for-sale investments	20,364	28	(4,715)	15,677
Total fixed maturity, equity securities and short-term investments	**$ 1,636,421**	**$ 66,098**	**$ (94,378)**	**$ 1,608,141**
December 31, 2017				
Fair value option investments:				
Fixed maturity securities:				
State and local government debt	$ 388,034	$ 27,084	$ (46)	$ 415,072
U.S. Government debt	23,159	520	(91)	23,588
Corporate debt	21,998	2,869	(3,178)	21,689
Total fixed maturity securities	433,191	30,473	(3,315)	460,349
Equity securities	356,556	32,175	(78,137)	310,594
Short-term investments (b)	738,810			738,810
Total fair value option investments	1,528,557	62,648	(81,452)	1,509,753
Available-for-sale investments:				
Equity securities	20,364	16	(4,133)	16,247
Total available-for-sale investments	20,364	16	(4,133)	16,247
Total fixed maturity, equity securities and short-term investments	**$ 1,548,921**	**$ 62,664**	**$ (85,585)**	**$ 1,526,000**

(a) Includes investments with an amortized cost and fair value of $0.9 million pledged for derivative obligations at September 30, 2018.

(b) Includes investments of $15.5 million and $11.9 million pledged for derivative obligations at September 30, 2018 and December 31, 2017, respectively.

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

(In thousands)		Amortized Cost		Fair Value
Due in one year or less	$	458,539	$	458,105
Due after one year through five years		670,547		666,125
Due after five years through ten years		11,435		13,497
Due after ten years		166,776		182,396
Total	$	1,307,297	$	1,320,123

Expected maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

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

Other investments consist of the following:

(In thousands)		September 30, 2018		December 31, 2017
Equity-method common stock (a)	$	184,782	$	169,788
Cost-method partnerships, at fair value (cost $21,309 in 2018 and $22,985 in 2017) (b)		20,925		24,220
Equity-method partnerships (a)		13,758		26,369
Affiliate corporate loans, at fair value (cost $6,111)		5,942		
Total other investments	$	225,407	$	220,377

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

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

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

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
(In thousands)	2018	2017	2018	2017
Sales of fixed maturity securities, including short-term investments and other (a)	$ 172	$ 10	$ 382	$ 11,783
Sale of equity securities (b)	(13,004)		(11,820)	(10,553)
Gains (losses) from other investments	1,024	(927)	(977)	5,274
Net realized gains (losses) on investments	$ (11,808)	$ (917)	$ (12,415)	$ 6,504

(a) Net realized gains on sales of fixed maturity securities, including short-term investments in the nine months ended September 30, 2017 included $12.8 million of gross realized gains and $1.1 million of gross realized losses on sales of fair value option securities. These gross realized gains included $4.5 million of realized gains for a fixed maturity security transferred to an affiliate of Fairfax as part of a dividend payment.

(b) Net realized losses on sales of equity securities in the three and nine months ended September 30, 2018 include $13.0 million of gross realized losses on sale of one fair option security in the third quarter 2018 and $1.2 million of gross realized gains on sale of one fair value option security in the second quarter 2018. Net realized losses on sales of equity securities in the nine months ended September 30, 2017 included $4.9 million of gross realized gains and $15.5 million of gross realized losses on sales of fair value option securities. These gross realized losses included $15.3 million of losses on Exco Resources, Inc. ("Exco") that were reclassified from unrealized losses when the Company commenced applying the equity method of accounting upon increase in ownership interest in Exco during the second quarter of 2017. This reclassification had no impact on net income or total comprehensive income.

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
(In thousands)	2018	2017	2018	2017
Equity securities	$ (188)	$ 1,336	$ (570)	$ 2,052
Investments in equity-method partnerships	(230)		916	396
Investments in equity-method common stocks	30	(64)	(73)	(1,394)
Investments in cost-method partnerships	(103)	492	(1,619)	(642)
Total before tax	$ (491)	$ 1,764	$ (1,346)	$ 412
After tax (see Note 8)	$ (388)	$ 1,147	$ (1,612)	$ 268

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
(In thousands)	2018	2017	2018	2017
Change in net unrealized gains/losses recognized on fair value option investments	$ 20,257	$ 5,188	$ (4,789)	$ 22,882
Less: Net losses (gains) recognized on fair value option investments sold	14,198	(67)	9,689	4,343
Change in net unrealized gains/losses recognized on fair value option investments still held at the reporting date	$ 6,059	$ 5,255	$ (14,478)	$ 18,539

Net investment income was as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
(In thousands)	2018	2017	2018	2017
Fixed maturity securities (a)	$ 6,049	$ 5,046	$ 15,118	$ 15,919
Short-term and other investments (a)	2,068	1,436	7,344	3,720
Derivatives	1,321	46	4,193	193
Equity securities	880	950	2,799	2,832
Income (loss) from equity-method investments (b)	(3,636)	7,134	(7,465)	8,761
Subtotal	6,682	14,612	21,989	31,425
Investment expenses	1,906	1,842	5,728	5,349
Net investment income	$ 4,776	$ 12,770	$ 16,261	$ 26,076

(a) In 2017 and early part of 2018, a large portion of the long-dated taxable and tax-exempt municipal bonds was sold and redeemed, with the proceeds primarily reinvested in short-term U.S. treasury bonds and corporate bonds in later part of 2018.

(b) Loss from equity-method investments in the three months ended September 30, 2018 primarily includes the Company’s share of the net losses of $3.1 million from Fairfax Africa Holdings Corp. and $1.2 million from Farmers Edge, Inc. (“Farmers Edge”), partially offset by the Company’s share in the net income of $0.8 million from Apple Bidco Ltd (“Apple Bidco”). Loss from equity-method investments in the nine months ended September 30, 2018 includes the Company’s share of the net losses of $4.0 million from Farmers Edge, $1.6 million from Peak Achievement Athletics (“PPA”), $1.2 million from Astarta Holdings NV (“Astarta”), and $0.8 million from Davos Brands LLC (“Davos”), partially offset by the Company’s share of the net income of $0.9 million from Grivalia Properties S.A.

Income from equity-method investments in the three months ended September 30, 2017 primarily includes the Company’s share of the net earnings of $2.6 million from Fairfax India Holdings Corp. (“FIH”), $1.6 million from Apple Bidco, $1.6 million from Boat Rocker Media Inc. (“Boat Rocker”) and $1.5 million from Astarta, partially offset by the Company’s share of the net losses of $0.9 million from Farmers Edge. Income from equity-method investments in the nine months ended September 30, 2017 primarily includes the Company’s share of the net earnings of $4.2 million from Apple Bidco, $4.0 million from FIH, $1.7 million from Astarta and $1.4 million from Boat Rocker, partially offset by the Company’s share of the net losses of $1.3 million from Davos, $1.2 million from Agrigroupe LP and $1.2 million from Farmers Edge.

At both September 30, 2018 and December 31, 2017, investments with a fair value of approximately $1.1 billion were on deposit with regulatory authorities in compliance with insurance company regulations.

At September 30, 2018, the Company had additional qualifying securities with a fair value of $151.4 million available for deposit.

Note 3. Derivative Contracts

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

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

(In thousands)	Notional Amount	Cost	Fair Value of Derivative Assets	Fair Value of Derivative Liabilities
September 30, 2018				
CPI-linked derivatives	$ 7,959,138	$ 41,058	$ 991	
Foreign exchange forwards	55,171		299 (a)	
U.S. government bond forwards	94,000			$ 322 (a)
Long equity total return swaps	80,323		2,424	3,052 (a)
Equity rights/warrants	4,928	473		
Total		$ 41,531	$ 3,714	$ 3,374
December 31, 2017				
CPI-linked derivatives	$ 8,041,674	$ 41,058	$ 3,445	
Foreign exchange forwards	57,638			$ 677 (a)
U.S. government bond forwards	98,000			1,686 (a)
Long equity total return swaps	58,265		2,077	1,917 (a)
Equity rights/warrants	16,774	1,959	1,282	
Total		$ 43,017	$ 6,804	$ 4,280

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

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

(In thousands)	Three Months Ended September 30, 2018	Three Months Ended September 30, 2017	Nine Months Ended September 30, 2018	Nine Months Ended September 30, 2017
Gains (losses) on settlements				
Equity derivatives:				
Equity total return swaps – long positions (a)	$ 7,562	$ (1,754)	$ 12,008	$ (1,855)
Equity warrants	(359)		(762)	
Equity call options				1,357
U.S. government bond forward contracts	230	119	5,202	(9,508)
Foreign exchange forward contracts	1,695	(4,024)	2,629	(6,040)
Total	9,128	(5,659)	19,077	(16,046)
Change in fair value (b)				
Equity derivatives:				
Equity total return swaps – long positions (a)	(1,612)	5,602	(788)	3,974
Equity warrants	(8)	(266)	204	(567)
CPI-linked derivative contracts	(447)	(880)	(2,454)	(1,985)
U.S. government bond forward contracts	2,854	(112)	1,364	3,901
Foreign exchange forward contracts	(932)	1,956	976	640
Total	(145)	6,300	(698)	5,963
Net gains (losses) on derivatives				
Equity derivatives:				
Equity total return swaps – long positions (a)	5,950	3,848	11,220	2,119
Equity call options and warrants	(367)	(266)	(558)	790
CPI-linked derivative contracts	(447)	(880)	(2,454)	(1,985)
U.S. government bond forward contracts	3,084	7	6,566	(5,607)
Foreign exchange forward contracts	763	(2,068)	3,605	(5,400)
Total net gains (losses) on derivatives	$ 8,983	$ 641	$ 18,379	$ (10,083)

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

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

Equity Derivative Contracts

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

CPI-linked Derivative Contracts

The Company has purchased derivative contracts referenced to consumer price indexes (''CPI'') in the United States and Europe to serve as an economic hedge against the potential adverse financial impact on the Company of decreasing price levels. In the event of a sale, expiration or early settlement of any of these contracts, the Company would receive the fair value of that contract on the date of the transaction. The Company's maximum potential loss on any contract is limited to the original cost of that contract. Net unrealized gains (losses) on CPI-linked derivative contracts typically reflect the market's expectation of decreases (increases) in the values of the CPI indexes underlying these contracts at their respective maturities during the periods presented (these contracts are structured to benefit the Company during periods of decreasing CPI index values). At September 30, 2018, these contracts had a remaining weighted average life of 3 years.

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

	Notional Amount		Weighted Average Strike Price	
(Notional amount in thousands)	Original Currency	US Dollars	In Original Currency	Index Value
Underlying CPI Index:				
September 30, 2018				
United States	5,520,000	$ 5,520,000	232.81	252.44
European Union	2,100,000	2,439,138	97.66	104.05
		$ 7,959,138		
December 31, 2017				
United States	5,520,000	$ 5,520,000	232.81	246.52
European Union	2,100,000	2,521,674	97.66	102.57
		$ 8,041,674		

U.S. Government Bond Forward Contracts

To reduce its exposure to interest rate risk (specifically exposure to state and local government bonds and long dated U.S. treasury bonds held in its fixed income portfolio), the Company entered into forward contracts to sell long dated U.S. treasury bonds with a notional amount of $94.0 million and $98.0 million at September 30, 2018 and December 31, 2017, respectively. These contracts have an average term to maturity of less than one year and may be renewed at market rates.

Foreign Exchange Forward Contracts

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

Counterparty Risk

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

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

(In thousands)	September 30, 2018	December 31, 2017
Total derivative assets (a)	$ 3,714	$ 5,522
Impact of net settlement arrangements	(1,653)	(3,603)
Fair value of collateral deposited for the benefit of the Company	(1,762)	(1,919)
Excess of collateral pledged by the Company in favor of counterparties	65	
Net derivative counterparty exposure after net settlement and collateral arrangements	$ 364	$

(a) Excludes equity warrants with a fair value of $1.3 million at December 31, 2017, which are not subject to counterparty risk.

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

At September 30, 2018 and December 31, 2017, the Company pledged to its counterparties securities with a fair value of $16.3 million and $11.9 million, respectively, as independent and mark-to-market collateral for CPI-linked, U.S. Government bond forward and equity long total return swap derivative contracts and recorded these amounts as assets pledged for derivative obligations in the Company’s Consolidated Balance Sheets.

At September 30, 2018, the counterparties pledged $0.3 million of cash and $2.6 million of securities, at fair value for the Company’s benefit, compared to $0.8 million of cash and $2.9 million of securities, at fair value, at December 31, 2017. The Company recorded the cash collateral as other assets and recognized a corresponding liability in its Consolidated Balance Sheets. The Company does not record in its Consolidated Balance Sheets securities pledged by counterparties as collateral for derivatives in a gain position.

Offsetting of Derivative Assets/Liabilities

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

		Gross amounts not offset in the Consolidated Balance Sheets		
(In thousands)	Gross and net amounts reflected in the Consolidated Balance Sheets	Derivative asset (liability)	Collateral provided (held) - financial instruments (a)	Net amount of exposure
September 30, 2018				
Derivative assets:				
Citibank, N.A.	$ 3,188	$ (1,653)	$ (1,535)	
Deutsche Bank AG London	227		(227)	
Bank of New York Mellon (b)	299			$ 299
Total derivative assets	$ 3,714	$ (1,653)	$ (1,762)	$ 299
Derivative liabilities:				
Citibank, N.A.	$ (1,653)	$ 1,653		
Bank of America	(1,721)		$ 1,721	
Total derivative liabilities	$ (3,374)	$ 1,653	$ 1,721	
December 31, 2017				
Derivative assets:				
Citibank, N.A.	$ 2,814	$ (2,303)	$ (511)	
Deutsche Bank AG London	631		(631)	
Bank of America	2,077	(1,300)	(777)	
Total derivative assets (c)	$ 5,522	$ (3,603)	$ (1,919)	
Derivative liabilities:				
Citibank, N.A.	$ (2,303)	$ 2,303		
Bank of America	(1,300)	1,300		
Bank of New York Mellon (b)	(677)			$ (677)
Total derivative liabilities	$ (4,280)	$ 3,603		$ (677)

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

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

(c) Excludes equity warrants with a fair value of $1.3 million at December 31, 2017, which are not subject to counterparty risk.

Note 4. Fair Value Measurements

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

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

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

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

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

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

		Fair Value Measurement Using		
(In thousands)	Total	Level 1	Level 2	Level 3
September 30, 2018				
Fair value option securities:				
Fixed maturity securities:				
State and local government debt	$ 179,072		$ 179,072	
U.S. government debt	738,059		738,059	
Corporate debt	46,579		20,521	$ 26,058
Total fixed maturity securities	963,710		937,652	26,058
Equity securities (a)	266,399	$ 212,569		11,183
Short-term investments	356,413	351,514	4,899	
Other investments - affiliate corporate loans	5,942			5,942
Total fair value option investments	$ 1,592,464	$ 564,083	$ 942,551	$ 43,183
Available-for-sale investments:				
Equity securities	$ 15,677		$ 61	$ 15,616
Total available-for-sale investments	$ 15,677		$ 61	$ 15,616
Derivatives:				
Equity total return swaps – long positions	$ 2,424		$ 2,424	
CPI-linked derivative contracts	991			$ 991
Foreign exchange forward contracts	299		299	
Total derivative assets	3,714		2,723	991
Equity total return swaps – long positions	(3,052)		(3,052)	
U.S. Government bond forward contracts	(322)		(322)	
Total derivative liabilities	(3,374)		(3,374)	
Net derivatives	$ 340		$ (651)	$ 991

		Fair Value Measurement Using		
(In thousands)	Total	Level 1	Level 2	Level 3
December 31, 2017				
Fair value option securities:				
Fixed maturity securities:				
State and local government debt	$ 415,072		$ 415,072	
U.S. government debt	23,588		23,588	
Corporate debt	21,689			$ 21,689
Total fixed maturity securities	460,349		438,660	21,689
Equity securities (a)	310,594	$ 250,317		12,106
Short-term investments	738,810	738,810		
Total fair value option investments	$ 1,509,753	$ 989,127	$ 438,660	$ 33,795
Available-for-sale investments:				
Equity securities	$ 16,247		$ 48	$ 16,199
Total available-for-sale investments	$ 16,247		$ 48	$ 16,199
Derivatives:				
Equity total return swaps – long positions	$ 2,077		$ 2,077	
CPI-linked derivative contracts	3,445			$ 3,445
Equity warrants	1,282		18	1,264
Total derivative assets	6,804		2,095	4,709
Equity total return swaps – long positions	(1,917)		(1,917)	
U.S. Government bond forward contracts	(1,686)		(1,686)	
Foreign exchange forward contracts	(677)		(677)	
Total derivative liabilities	(4,280)		(4,280)	
Net derivatives	$ 2,524		$ (2,185)	$ 4,709

(a) In accordance with recent accounting guidance, certain common stock investments with a fair value of $42.6 million and $48.2 million that are measured using the NAV practical expedient have not been classified in the fair value hierarchy at September 30, 2018 and December 31, 2017, respectively. The fair value amounts presented in the "Total" column are intended to permit reconciliation of the fair value hierarchy to the amounts presented in the Consolidated Balance Sheets.

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

(In thousands)	Corporate Debt	Equity Securities	Derivatives	Affiliate Corporate Loans
Balance at June 30, 2018	$ 29,822	$ 26,592	$ 1,438	$ 5,886
Realized and unrealized gains/losses included in:				
Other comprehensive loss (a)		(194)		
Change in net unrealized gains/losses on fair value option investments	1,069	401		56
Accretion of discounts	20			
Net losses on derivatives			(447)	
Transfers out of Level 3	(4,853)			
Balance at September 30, 2018	$ 26,058	$ 26,799	$ 991	$ 5,942
Balance at December 31, 2017	$ 21,689	$ 28,305	$ 4,709	
Purchases	9,395		563	$ 6,111
Sales			(1,645)	
Realized and unrealized gains/losses included in:				
Other comprehensive loss (a)		(583)		
Change in net unrealized gains/losses on fair value option investments	(232)	(923)		(169)
Accretion of discounts	59			
Net realized loss on investments			(403)	
Net losses on derivatives			(2,233)	
Transfers out of Level 3	(4,853)			
Balance at September 30, 2018	$ 26,058	$ 26,799	$ 991	$ 5,942

(a) Change in unrealized gain/losses for equity securities include changes in fair value and foreign currency fluctuation.

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

Note 5. Related Party Transactions

Investments

Management of all of the Company's investments is centralized at Fairfax through investment management agreements entered into in 2010. The parties to these agreements are Zenith National's insurance subsidiaries, Fairfax and Hamblin Watsa Investment Counsel, Ltd. ("HWIC"), a Fairfax affiliate. Investment management expenses incurred under these agreements for the three and nine months ended September 30, 2018 were $1.3 million and $3.9 million, respectively, and $1.3 million and $3.7 million, respectively, for the comparable periods of 2017.

The Company owns common shares in various mutual fund classes of HWIC Asia which is a wholly-owned subsidiary of Fairfax. At September 30, 2018 and December 31, 2017, the aggregate fair value of these investments was $42.6 million and $48.2 million, respectively. Changes in fair value for these investments are recorded in the change in net unrealized gains/losses on fair value option investments in the Consolidated Statements of Comprehensive Income (Loss). During the nine months ended September 30, 2018, the Company recorded a net decrease in unrealized gains/losses of $5.5 million and dividend income of $0.4 million on these investments, compared to a net increase in unrealized gains/losses of $3.0 million and no dividend income during the nine months ended September 30, 2017.

The Company owns common stock in publicly-traded and private companies and invests in limited partnerships which are affiliates of Fairfax (including but not limited to investments described in the following paragraphs). These investments are recorded under the equity method of accounting. At September 30, 2018 and December 31, 2017, the aggregate value of its equity-method investments in Fairfax affiliates recorded in the Consolidated Balance Sheets was $198.5 million and $196.2 million, respectively. The Company's share of net income/loss of the equity-method investees was recorded in net investment income. Net realized gains/losses on sales and on dilution resulting from additional shares issued or bought back by equity-method investees are recorded in net realized gains/losses on investments. The Company's share of other changes in investees' equity was recorded in net change in net unrealized gain/losses in Other Comprehensive Income (Loss). Net unrealized gains/losses on foreign currency translation adjustment related to the Company's equity-method investments are recorded in the change in unrealized foreign currency translation adjustment Other Comprehensive Income (Loss). The following table summarizes impact from the Company's investments in equity-method common stocks and partnerships on various components of Comprehensive Income:

	Three Months Ended September 30,		Nine Months Ended September 30,	
(In thousands)	2018	2017	2018	2017
Equity-method common stocks and partnerships:				
Net investment income/loss	$ (3,636)	$ 7,134	$ (7,465)	$ 8,761
Net realized gains/losses on sales and dilution	932	(34)	(585)	1,564
Change in unrealized gains/losses, before tax	(200)	(64)	843	(998)
Change in unrealized foreign currency translation adjustment, before tax	(1,107)	2,555	(577)	3,097

In January 2018, Fairfax and the Company entered into an agreement with Exco, an affiliate of Fairfax and the Company, to extend a private debtor-in-possession loan to Exco ("Exco DIP Loan") who is in the process of bankruptcy restructuring. Investment in this affiliated corporate loan, at fair value, was $2.7 million at September 30, 2018.

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

In February 2018, Fairfax and the Company invested in private placement non-rated debt securities issued by Seaspan Corporation ("Seaspan"), a publicly traded company domiciled in the Marshal Islands. Fairfax and The Company received warrants to purchase Seaspan common stock in connection with this investment ("Seaspan Warrants"). Seaspan became an affiliate of Fairfax and the Company simultaneously with this investment. The Company's share of this investment was $5.0 million, allocated between $4.4 million ($5.0 million par value) in Seaspan corporate bonds and $0.6 million in Seaspan Warrants. The Company sold the Seaspan Warrants to Wentworth in April 2018, substantially at cost.

In July 2018, the Company purchased 796,813 of Seaspan Warrants from Wentworth for $2.8 million and subsequently converted these warrants to purchase an equivalent number of Seaspan common stock for $5.2 million in cash paid to Seaspan. The Company recorded the acquisition of Seaspan affiliated common stock at a cost of $7.6 million and recognized a loss of $0.4 million on the conversion of Seaspan Warrants. Fairfax and the Company account for this investment in Seaspan affiliated common stock using the equity-method, on a quarter lag. The carrying value of this investment at September 30, 2018 equaled its cost. The carrying value of the Company's affiliated investment in Seaspan fixed maturity securities was $4.9 million at September 30, 2018.

In February 2018, Fairfax completed the sale of its 51.0% ownership interest in Keg Restaurants Ltd. ("The Keg") to Cara Operations Limited ("Cara"), a subsidiary of Fairfax domiciled in Canada, for consideration that comprised of cash and Cara common stock. In 2014, the Company invested in FFHL LP, a wholly-owned limited partnership subsidiary of Fairfax formed to hold The Keg common stock. As a result of the sale of The Keg to Cara, the Company received a $0.6 million cash dividend distribution from FFHL LP, and the Company's remaining equity interest in the FFHL LP was redeemed in full in the form of $11.7 million of Cara common stock. The Company recorded its share of the FFHL LP realized loss on the sale of The Keg to Cara of $0.3 million as part of equity in losses of FFHL LP in investment income. The Company recognized realized losses on foreign exchange of $1.2 million upon final redemption of its investment in FFHL LP that was reclassified from unrealized foreign currency translation adjustment previously recorded in accumulated other comprehensive loss component of Stockholders' Equity. Cara was subsequently renamed Recipe Unlimited Corp. In April and June 2018, the Company received $0.1 million in dividend distributions that the Company recorded as return of capital. The Company's share of this equity-method common stock investment was $11.5 million at September 30, 2018.

The Company owns an investment in common stock of Boat Rocker, a majority-owned subsidiary of Fairfax. In July 2018, the Company received a capital distribution of $0.4 million from Boat Rocker as a result of a sale of its real estate property. The Company's share of this equity-method common stock investment was $14.9 million at September 30, 2018.

In September 2018, the Company paid $4.3 million to purchase 5.6 million common stock shares of Toys "R" Us (Canada) Ltd. ("Toys R Us"), a wholly-owned subsidiary of Fairfax, from Allied World Assurance Company, Ltd. ("AWAC"), a wholly-owned subsidiary of Fairfax. The Company accounts for this investment in affiliated common stock of Toys R Us using the equity-method, on a one quarter lag. The carrying amount of this investment at September 30, 2018 equaled its cost.

Other

The Company continues to be a party to various reinsurance treaties with affiliates of Fairfax that were entered into in the ordinary course of business, primarily excess of loss reinsurance agreements with Odyssey Re for 2010 through 2018. At September 30, 2018 and December 31, 2017, the Company recorded net reinsurance recoverables of $1.0 million and $0.7 million, respectively, related to the reinsurance transactions with the affiliates of Fairfax.

Zenith National paid Fairfax $0.1 million and $6.6 million in the nine months ended September 30, 2018 and 2017, respectively, for the cost of the open market purchase made by Fairfax on Zenith National's behalf of Fairfax Subordinate Voting Shares granted to certain officers under the Restricted Stock Plan.

In April 2015, Zenith National entered into an agreement with MFXchange US, Inc., an indirect, wholly-owned subsidiary of Fairfax, to provide information technology services to Zenith National. The Company recorded expenses of $22,000 and $67,000 in the three and nine months ended September 30, 2018, and 2017, respectively.

In November 2014, the Company entered into a Master Administrative Services Agreement with various affiliates of Fairfax. Under the agreement, the affiliated parties provide and receive administration services such as accounting, underwriting, claims, reinsurance, preparation of regulatory reports, and actuarial services. The Company began providing claims processing services for Seneca Insurance Company, Inc. ("Seneca") under this agreement in March 2016 and recorded service fee income of $0.1 million and $0.3 million and $0.1 million and $0.4 million in the three and nine months ended September 30, 2018 and 2017, respectively, in the Consolidated Statements of Comprehensive Income (Loss) which was substantially offset by costs of dedicated staff and allocated shared services. Other liabilities at both September 30, 2018 and December 31, 2017 include a loss fund of $0.6 million maintained by the Company to process future workers' compensation claim payments on behalf of Seneca.

In March 2013, the Company entered into an agreement with TIG Insurance Company ("TIG") to become their primary workers' compensation claims service provider. The Company recorded service fee income of $2.1 million and $6.4 million and $2.2 million and $6.7 million, in the three and nine months ended September 30, 2018 and 2017, respectively, in the Consolidated Statements of Comprehensive Income (Loss) which is substantially offset by costs of dedicated staff and allocated shared services. Other liabilities at September 30, 2018 include a net liability of $2.9 million which includes net loss fund liability of $3.6 million reduced by a service fee income receivable of $0.7 million. Other liabilities at December 31, 2017 include a net liability of $2.3 million which includes net loss fund liability of $3.3 million reduced by a service fee income receivable of $1.0 million.

Note 6. Reinsurance Recoverable

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

(In thousands)	September 30, 2018 (a)	December 31, 2017 (a)	A.M. Best Rating (b)	A.M. Best Rating Date
General Reinsurance Corp.	$ 38,607	$ 43,567	A++	1/2018
Lloyds Underwriters	1,521	1,025	A	7/2018
Factory Mutual Insurance Company	1,225	492	A+	2/2018
Inter-Ocean Re Ins Co. Ltd. (c)		2,799	NR	
All others (d)	7,031	6,548		
Total	$ 48,384	$ 54,431		

(a) Under insurance regulations in California, reinsurers placed securities on deposit equal to the California component of the Company's ceded workers' compensation loss reserves.

(b) A.M. Best, in assigning ratings, is primarily concerned with the ability of insurance and reinsurance companies to pay the claims of policyholders. In the A.M. Best ratings scheme, ratings of B+ to A++ are considered "Secure" and ratings of B and below are considered "Vulnerable." NR means A.M. Best does not rate the reinsurer.

(c) Reinsurance recoverable from the Inter-Ocean Re Ins Co. Ltd. at December 31, 2017 was fully secured by an investment grade security held in a bank trust account on the Company's behalf. In May 2018, the Company commuted this retroactive reinsurance agreement, received $3.0 million, eliminated a deferred gain of $0.4 million and recorded a total gain of $0.6 million.

(d) No individual reinsurer in excess of $1.0 million at September 30, 2018 and December 31, 2017, respectively.

Note 7. Unpaid Losses and Loss Adjustment Expenses

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

(In thousands)		September 30, 2018		September 30, 2017
Beginning of year, net of reinsurance	$	1,139,373	$	1,144,409
Incurred claims:				
Current accident year		351,537		350,122
Prior accident years		(59,311)		(61,671)
Total incurred claims		292,226		288,451
Payments:				
Current accident year		(85,768)		(84,513)
Prior accident years		(219,071)		(217,928)
Total payments		(304,839)		(302,441)
End of year, net of reinsurance		1,126,760		1,130,419
Receivable from reinsurers for unpaid losses		47,862		59,018
End of year, gross of reinsurance	$	1,174,622	$	1,189,437

Note 8. Other Comprehensive Income (Loss)

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

(In thousands)		Pre-Tax		Income Tax Effect		After-Tax
Three months ended September 30, 2018						
Net unrealized losses arising during the period	$	(491)	$	(103)	$	(388)
Change in unrealized foreign currency translation adjustment		(1,107)		(232)		(875)
Total other comprehensive loss	$	(1,598)	$	(335)	$	(1,263)
Nine months ended September 30, 2018						
Net unrealized losses arising during the period	$	(713)	$	(150)	$	(563)
Less: reclassification adjustment for net realized gains included in net income		(633)		(133)		(500)
Reclassification of certain tax effects to retained earnings at January 1, 2018 (a)				549		(549)
Net changes in unrealized gains/losses on available-for-sale and other investments		(1,346)		266		(1,612)
Unrealized foreign currency translation adjustment arising during the period		(1,732)		(364)		(1,368)
Less: reclassification adjustment for net realized foreign exchange losses included in net income		1,155		243		912
Reclassification of certain tax effects to retained earnings at January 1, 2018 (a)				280		(280)
Change in unrealized foreign currency translation adjustment		(577)		159		(736)
Total other comprehensive loss	$	(1,923)	$	425	$	(2,348)
Three months ended September 30, 2017						
Net unrealized gains arising during the period	$	1,764	$	617	$	1,147
Change in unrealized foreign currency translation adjustment		2,555		895		1,660
Total other comprehensive income	$	4,319	$	1,512	$	2,807
Nine months ended September 30, 2017						
Net unrealized gains arising during the period	$	3,154	$	1,104	$	2,050
Less: reclassification adjustment for net realized gains included in net income		(2,742)		(960)		(1,782)
Net changes in unrealized gains/losses on available-for-sale and other investments		412		144		268
Change in unrealized foreign currency translation adjustment		3,097		1,084		2,013
Total other comprehensive income	$	3,509	$	1,228	$	2,281

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

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

(In thousands)		September 30, 2018		December 31, 2017
Equity securities	$	(4,687)	$	(4,117)
Other investments in equity-method common stocks		(1,507)		(1,434)
Other investments in cost-method partnerships		(384)		1,235
Other investments in equity-method partnerships		1,312		396
Net unrealized loss on investments, before tax		(5,266)		(3,920)
Deferred tax benefit		(1,106)		(1,372)
Net unrealized loss on investments, after tax		(4,160)		(2,548)
Net unrealized loss on foreign currency translation adjustment, before tax		(2,577)		(2,000)
Deferred tax benefit		(541)		(700)
Net unrealized loss on foreign currency translation adjustment, after tax		(2,036)		(1,300)
Total accumulated other comprehensive loss	$	(6,196)	$	(3,848)

Note 9. Stock-Based Compensation

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

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

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

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

Changes in the restricted shares outstanding were as follows:

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

Stock-based compensation expense before tax was $1.2 million and $3.7 million for the three and nine months ended September 30, 2018, respectively, compared to $1.2 million and $3.0 million in the corresponding periods of 2017, respectively.

Unrecognized compensation expense before tax under the Restricted Stock Plan was $15.6 million and $13.5 million at September 30, 2018 and December 31, 2017, respectively.

Note 10. Commitments and Contingencies

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

Note 11. Recent Accounting Guidance Not Yet Adopted

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

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

In February 2016, the FASB issued updated guidance to require lessees to recognize a right-to-use asset and a lease liability for leases with terms of more than 12 months. The updated guidance retains the two classifications of a lease as either an operating or finance lease (previously referred to as a capital lease). Both lease classifications require the lessee to record the right-to-use asset and the lease liability based upon the present value of cash flows. Finance leases will reflect the financial arrangement by recognizing interest expense on the lease liability separately from the amortization expense of the right-to-use asset. Operating leases will recognize lease expense (with no separate recognition of interest expense) on a straight-line basis over the term of the lease. The accounting by lessors is not significantly changed by the updated guidance. The updated guidance requires expanded qualitative and quantitative disclosures, including additional information about the amounts recorded in the financial statements. In July 2018, the FASB amended the updated guidance and provided an additional transition method with which to adopt the updated guidance. Under the additional transition method, entities may elect to recognize a cumulative-effect adjustment to the opening balance of retained earnings in the year of adoption. Consequently, if this transition method is elected, an entity's reporting for the comparative periods prior to adoption presented in the financial statements would continue to be in accordance with current lease guidance. This guidance is effective for annual periods beginning after December 15, 2019 and interim periods thereafter, and will require that the earliest comparative period presented include the measurement and recognition of existing leases with an adjustment to equity as if the updated guidance had always been applied. Early adoption is permitted. The adoption of this guidance is not expected to have a material impact on the Company's consolidated financial position, results of operations or cash flows.

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

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

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

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

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

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

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

In August 2018, the FASB issued updated guidance that modifies disclosure requirements related to fair value measurement. The amendments are effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019. Implementation on a prospective or retrospective basis varies by specific disclosure requirement. Early adoption is permitted. The guidance also allows for early adoption of any removed or modified disclosures upon issuance of this guidance while delaying adoption of the additional disclosures until their effective date. The guidance is not expected to have a material impact on the Company's consolidated financial position, results of operations or cash flows.

In August 2018, the FASB issued updated guidance to reduce complexity for the accounting for costs of implementing a cloud computing service arrangement. The new guidance aligns the requirements for capitalizing implementation costs incurred in a hosting arrangement that is a service contract with the requirements for capitalizing implementation costs incurred to develop or obtain internal-use software. The updated guidance is effective for reporting periods beginning after December 15, 2020. Early adoption is permitted. The guidance is not expected to have a material impact on the Company's consolidated financial position, results of operations or cash flows.