

# **Zenith National Insurance Corp. and Subsidiaries**

**Consolidated Financial Statements and  
Supplementary Consolidating Information  
December 31, 2020 and 2019 and for the  
Three Years Ended December 31, 2020**

# Zenith National Insurance Corp. and Subsidiaries

## Consolidated Financial Statements

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## **Report of Independent Auditors**

To the Management of Zenith National Insurance Corp.

We have audited the accompanying consolidated financial statements of Zenith National Insurance Corp. and its subsidiaries, which comprise the consolidated balance sheets as of December 31, 2020 and 2019, and the related consolidated statements of comprehensive income, of stockholders' equity and of cash flows for the each of the three years in the period ended December 31, 2020.

### ***Management's Responsibility for the Consolidated Financial Statements***

Management is responsible for the preparation and fair presentation of the consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

### ***Auditors' Responsibility***

Our responsibility is to express an opinion on the consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the Company's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

### ***Opinion***

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Zenith National Insurance Corp. and its subsidiaries as of December 31, 2020 and 2019, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2020, in accordance with accounting principles generally accepted in the United States of America.



***Other Matter***

Accounting principles generally accepted in the United States of America require that information about incurred and paid claims development that precedes the current reporting period and the historical claims payout percentages included in Note 8 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Financial Accounting Standards Board (FASB) who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

*PricewaterhouseCoopers LLP*

Los Angeles, California  
February 24, 2021

**ZENITH NATIONAL INSURANCE CORP. AND SUBSIDIARIES**  
**CONSOLIDATED BALANCE SHEETS**

(In thousands, except par value)	December 31,	
	2020	2019
<b>Assets:</b>		
Investments:		
Fixed maturity securities, at fair value (amortized cost \$1,011,444 in 2020 and \$1,030,806 in 2019)	\$ 1,015,071	\$ 1,072,560
Equity securities, at fair value (cost \$246,217 in 2020 and \$238,063 in 2019)	222,520	193,753
Short-term investments, at fair value which approximates cost	174,756	158,717
Mortgage loans, at fair value which approximates cost	18,824	
Other investments	114,433	191,363
Derivative assets, at fair value (cost \$22,510 in 2020 and \$46,837 in 2019)	234	4,537
Assets pledged for derivative obligations, at fair value (amortized cost \$6,417 in 2020 and \$10,580 in 2019)	6,418	10,594
<b>Total investments</b>	<b>1,552,256</b>	<b>1,631,524</b>
Cash	62,838	17,918
Accrued investment income	7,105	7,568
Premiums receivable	39,479	41,877
Reinsurance recoverables	39,652	40,156
Deferred policy acquisition costs	12,756	12,788
Deferred tax asset	39,315	47,607
Income tax receivable	1,930	2,431
Operating lease right-of-use assets	26,085	23,164
Goodwill	20,985	20,985
Other assets	61,004	57,794
<b>Total assets</b>	<b>\$ 1,863,405</b>	<b>\$ 1,903,812</b>
<b>Liabilities:</b>		
Unpaid losses and loss adjustment expenses	\$ 1,059,150	\$ 1,085,865
Unearned premiums	88,466	89,861
Policyholders' dividends accrued	32,807	37,857
Long-term debt	38,282	38,253
Operating lease liabilities	27,608	25,044
Derivative liabilities	3,243	1,819
Other liabilities	101,574	67,743
<b>Total liabilities</b>	<b>1,351,130</b>	<b>1,346,442</b>
Commitments and contingencies (see Note 15)		
<b>Stockholders' equity:</b>		
Common stock, \$1 par value, 40 authorized shares; 39 shares issued and outstanding	39	39
Additional paid-in capital	400,264	399,097
Retained earnings	118,659	162,336
Accumulated other comprehensive loss	(6,687)	(4,102)
<b>Total stockholders' equity</b>	<b>512,275</b>	<b>557,370</b>
<b>Total liabilities and stockholders' equity</b>	<b>\$ 1,863,405</b>	<b>\$ 1,903,812</b>

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

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

(In thousands)	Year Ended December 31,		
	2020	2019	2018
<b>Revenues:</b>			
Net premiums earned	\$ 643,837	\$ 734,997	\$ 804,299
Net investment income	(10,735)	15,543	35,819
Net realized gains (losses) on investments	24,538	(12,824)	(96,736)
Change in net unrealized gains/losses on fair value option investments	(19,187)	14,715	6,666
Net losses on derivatives	(31,506)	(26,170)	(1,669)
Service fee income	6,976	8,425	9,210
<b>Total revenues</b>	<b>613,923</b>	<b>734,686</b>	<b>757,589</b>
<b>Expenses:</b>			
Losses and loss adjustment expenses incurred	329,078	343,418	370,424
Underwriting and other operating expenses:			
Policy acquisition costs	128,576	138,953	147,161
Underwriting and other costs	125,824	132,269	131,160
Policyholders' dividends	18,360	21,690	24,963
Interest expense	3,321	3,321	3,321
<b>Total expenses</b>	<b>605,159</b>	<b>639,651</b>	<b>677,029</b>
Income before tax	8,764	95,035	80,560
Current	13,462	19,519	34,754
Deferred	(11,421)	(81)	(22,308)
Increase in valuation allowance	20,400		21,600
Total income tax expense	22,441	19,438	34,046
<b>Net income (loss)</b>	<b>\$ (13,677)</b>	<b>\$ 75,597</b>	<b>\$ 46,514</b>
Net change in unrealized gains/losses on investments, net of tax and reclassification adjustment	(3,627)	(2,653)	(121)
Change in unrealized foreign currency translation adjustment, net of tax and reclassification adjustment	1,042	2,149	(1,926)
<b>Other comprehensive loss</b>	<b>(2,585)</b>	<b>(504)</b>	<b>(2,047)</b>
<b>Total comprehensive income (loss)</b>	<b>\$ (16,262)</b>	<b>\$ 75,093</b>	<b>\$ 44,467</b>

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

**ZENITH NATIONAL INSURANCE CORP. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**

(In thousands)	Year Ended December 31,		
	2020	2019	2018
<b>Cash flows from operating activities:</b>			
Premiums collected	\$ 685,178	\$ 745,808	\$ 814,943
Investment income received	23,951	17,518	32,427
Losses and loss adjustment expenses paid	(353,894)	(396,732)	(409,261)
Underwriting and other operating expenses paid	(274,138)	(298,136)	(288,360)
Interest paid	(3,292)	(3,292)	(3,292)
Income taxes paid	(12,960)	(25,248)	(27,743)
<b>Net cash provided by operating activities</b>	<b>64,845</b>	<b>39,918</b>	<b>118,714</b>
<b>Cash flows from investing activities:</b>			
Purchases of investments:			
Fixed maturity securities – fair value option	(611,222)	(483,450)	(999,692)
Equity securities – fair value option	(3,740)	(2,711)	(30,462)
Corporate loan – affiliate		(12,302)	(6,101)
Mortgage loans	(18,636)		
Other investments	(3,872)	(14,977)	(3,506)
Derivatives		(1,151)	(10,902)
Proceeds from maturities and redemptions of investments:			
Fixed maturities securities – fair value option	561,205	471,378	68,500
Corporate loan – affiliate		2,702	
Other investments			432
Proceeds from sales of investments:			
Fixed maturity securities – fair value option	79,575	76,945	254,489
Equity securities – fair value option	19,542	13,129	42,086
Other investments	20,106	4,409	3,944
Net decrease (increase) in short-term investments	(396)	(30,084)	613,348
Net derivative cash settlements	(25,515)	(34,750)	16,051
Capital expenditures and other	(2,579)	(3,025)	(2,100)
<b>Net cash provided by (used in) investing activities</b>	<b>14,468</b>	<b>(13,887)</b>	<b>(53,913)</b>
<b>Cash flows from financing activities:</b>			
Dividends paid to common stockholders	(30,000)	(32,669)	(42,872)
Purchase of Fairfax shares for restricted stock awards	(4,393)	(5,111)	(5,367)
<b>Net cash used in financing activities</b>	<b>(34,393)</b>	<b>(37,780)</b>	<b>(48,239)</b>
Net increase (decrease) in cash	44,920	(11,749)	16,562
Cash at beginning of year	17,918	29,667	13,105
<b>Cash at end of year</b>	<b>\$ 62,838</b>	<b>\$ 17,918</b>	<b>\$ 29,667</b>

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

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

(In thousands)	Year Ended December 31,		
	2020	2019	2018
<b>Reconciliation of net income (loss) to net cash provided by operating activities:</b>			
Net income (loss)	\$ (13,677)	\$ 75,597	\$ 46,514
Adjustments to reconcile net income (loss) to net cash provided by operating activities:			
Depreciation expense	2,863	3,264	3,781
Net amortization (accretion)	3,542	(14,965)	(13,762)
Net realized losses (gains) on investments	(24,538)	12,824	96,736
Change in net unrealized gains/losses on fair value option investments	19,187	(14,715)	(6,666)
Net losses on derivatives	31,506	26,170	1,669
Equity in losses of investee	31,876	19,760	9,566
Stock-based compensation expense	5,560	5,868	4,886
Decrease (increase) in:			
Accrued investment income	463	(3,716)	1,681
Premiums receivable	27,279	(2,572)	1,190
Reinsurance recoverables	504	7,729	6,546
Deferred policy acquisition costs	32	(641)	17
Net income taxes	9,482	(5,811)	6,302
Increase (decrease) in:			
Unpaid losses and loss adjustment expenses	(26,715)	(62,001)	(43,665)
Unearned premiums	(1,395)	3,151	(1,991)
Policyholders' dividends accrued	(5,050)	(5,380)	1,242
Accrued expenses	7,503	(1,677)	(466)
Other	(3,577)	(2,967)	5,134
<b>Net cash provided by operating activities</b>	<b>\$ 64,845</b>	<b>\$ 39,918</b>	<b>\$ 118,714</b>

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

**ZENITH NATIONAL INSURANCE CORP. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY**

(In thousands)	Year Ended December 31,		
	2020	2019	2018
<b>Common stock:</b>			
Beginning of year	\$ 39	\$ 39	\$ 39
End of year	39	39	39
<b>Additional paid-in capital:</b>			
Beginning of year	399,097	398,340	398,821
Stock-based compensation expense	5,560	5,868	4,886
Purchases of Fairfax shares for restricted stock awards	(4,393)	(5,111)	(5,367)
End of year	400,264	399,097	398,340
<b>Retained earnings:</b>			
Beginning of year	162,336	145,515	180,072
Net income (loss)	(13,677)	75,597	46,514
Reclassification of certain tax effects from accumulated other comprehensive loss at January 1, 2018 (see Note 2)			829
Reclassification of net unrealized losses on available-for-sale investments and cost-method partnerships from other comprehensive loss at January 1, 2019 (see Note 2)		(3,126)	
Dividends to common stockholders	(30,000)	(55,650)	(81,900)
End of year	118,659	162,336	145,515
<b>Accumulated other comprehensive loss:</b>			
Beginning of year	(4,102)	(6,724)	(3,848)
Reclassification of certain tax effects to retained earnings at January 1, 2018 (see Note 2)			(829)
Reclassification of net unrealized losses on available-for-sale investments and cost-method partnerships to retained earnings at January 1, 2019 (see Note 2)		3,126	
Net change in unrealized gains/losses on investments, net of tax and reclassification adjustment	(3,627)	(2,653)	(121)
Change in unrealized foreign currency translation adjustment, net of tax	1,042	2,149	(1,926)
End of year	(6,687)	(4,102)	(6,724)
<b>Total stockholders' equity</b>	<b>\$ 512,275</b>	<b>\$ 557,370</b>	<b>\$ 537,170</b>

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

**ZENITH NATIONAL INSURANCE CORP. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**Note 1. Basis of Presentation and Summary of Operations**

***Basis of Presentation***

The accompanying Consolidated Financial Statements have been prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP") and include Zenith National Insurance Corp. ("Zenith National") and its subsidiaries. All intercompany transactions and balances have been eliminated in consolidation.

***Organization and Operations***

Zenith National is a Delaware holding company, which is an indirect wholly-owned 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 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, differences in accounting by Fairfax for certain investments owned by the Company and accounting adjustments recorded by Fairfax related to the acquisition of the Company.

***Use of Estimates***

GAAP requires the use of assumptions and estimates in reporting certain assets and liabilities and related disclosures. Actual results could differ from those estimates.

***COVID-19 Pandemic***

The rapid spread of the COVID-19 virus, which was declared by the World Health Organization to be a pandemic on March 11, 2020, and actions taken globally in response to COVID-19 have significantly disrupted business activities throughout the world.

Given the ongoing and dynamic nature of the circumstances surrounding COVID-19, it is difficult to predict how significant the impact of COVID-19, including any responses to it, will be on the global economy and the Company's businesses in particular, or for how long any disruptions are likely to continue. The extent of such impact will depend on future developments, which are highly uncertain, rapidly evolving and difficult to predict, including new information which may emerge concerning the severity of COVID-19 and additional actions which may be taken to contain COVID-19, as well as the timing of the re-opening of the economy in various parts of the world. Such further developments could have a material adverse effect on the Company's business, financial condition, results of operations and cash flows.

The Company's workers' compensation business is highly correlated to economic cycles given that premium is based on insureds' payrolls. Also, various government officials, including U.S. state insurance commissioners, have taken actions to protect small businesses from hardship caused by COVID-19 which in the aggregate may adversely impact the Company's results of operations in the near term. Premium earned in the year ended December 31, 2020 decreased compared to the same period in 2019, reflecting adjusted insureds' payrolls at the individual policy level from the impact of COVID-19, as well as a provision for the

**ZENITH NATIONAL INSURANCE CORP. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

estimated reduction in insureds' payrolls that have not yet been reported to us. The economic shut down of businesses and reduced payroll exposure also resulted in reduced frequency of claims starting in the second quarter of 2020, which was offset by the estimated impact of COVID-19-related claims. At December 31, 2020, the Company recorded \$4.0 million of incurred losses reported on COVID-19 claims. In addition, the Company established \$16.1 million of incurred but not reported reserves based principally on the California Workers' Compensation Insurance Rating Bureau's COVID-19 estimation methodology.

***Reclassifications***

Certain prior year amounts in the accompanying consolidated financial statements have been reclassified and amended to conform to the current year presentation.

***Subsequent Events***

The Company evaluated subsequent events through the date that the Consolidated Financial Statements were issued on February 24, 2021.

**Note 2. Summary of Accounting Policies**

**Investments**

At both December 31, 2020 and 2019, \$1.5 billion of investments in fixed maturities, equity securities and short-term investments, as well as mortgage loans and cost-method partnerships at December 31, 2020, were recorded under the fair value option; these investments are carried at fair value, with changes in fair value recorded in the change in net unrealized gains/losses on fair value option investments in the Consolidated Statements of Comprehensive Income. At December 31, 2018, \$16.1 million of investments in equity securities were classified as available-for-sale, and \$22.0 million of investments in cost-method partnerships were included in other investments; these investments were carried at fair value with changes in unrealized gains and losses excluded from net income and reported in a separate component of stockholders' equity, net of tax. Effective January 1, 2019, upon adoption of the updated guidance for financial instruments, all equity securities and cost-method partnerships are recorded using the fair value option (see Adopted Accounting Standards, Recognition and Measurement of Financial Assets and Financial Liabilities section below).

Other investments at December 31, 2020 and 2019 are comprised of investments in partnerships and limited liability companies, investments in equity-method common stock and loans to affiliates. Partnerships and limited liability company investments where the Company's ownership is minor and the Company does not have significant operating or financial influence ("cost-method partnerships") are carried at fair value. Effective January 1, 2019, changes in fair value for these investments are recorded in the change in net unrealized gain/losses on fair value option investments in the Consolidated Statements of Comprehensive Income. Investments in partnerships and limited liability companies where the Company's ownership share is more than minor as well as investments in common stock of an entity over which the Company is deemed to have significant influence are recorded under the equity-method of accounting, unless the fair value option is elected. The carrying value of the Company's investments in equity-method partnerships and common stock represents the initial cost, adjusted for any additional purchases/distributions, other-than-temporary impairments, if any (as discussed below), and the Company's share of the changes in the investee's net asset value ("NAV") since the initial acquisition. Loans to affiliates are carried at fair value, with changes in fair value recorded in the change in net unrealized gain/losses on fair value option investments in the Company's Consolidated Statements of Comprehensive Income.

Investments could be subject to default by the issuer or declines in fair value that become other-than-temporary. The Company continually assesses the prospects for its investments, other than fair value option investments, as part of its ongoing portfolio management, including the identification of other-than-temporary

**ZENITH NATIONAL INSURANCE CORP. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

declines in fair value. The Company's other-than-temporary assessment includes reviewing the extent and duration of declines in fair value of such investments below the cost or amortized cost basis or carrying value, the seniority and duration of the securities, historical and projected company financial performance, company-specific news and other developments, the outlook for industry sectors, credit ratings, and macro-economic changes, including government policy initiatives. An other-than-temporary impairment is recognized in net income and reflected as a reduction in the cost basis or carrying value of the security based on the extent and duration that its fair value is below cost or carrying value, in addition to issuer specific events. The Company recorded other-than-temporary impairments of \$16.7 million and \$11.6 million on equity-method common stock investments in the years ended December 31, 2020 and 2019, respectively. The Company recorded other-than-temporary impairments of \$1.3 million on cost-method partnerships for the year ended December 31, 2018.

Investment income is recorded when earned. Realized capital gains and losses are determined under the "average cost" method.

### **Derivative Contracts**

Derivative contracts may include interest rate and total return swaps, consumer price index linked ("CPI-linked"), currency options and forwards, warrants and option contracts, all of which derive their value mainly from changes in underlying interest rates, foreign exchange rates, inflation indexes or equity instruments. A derivative contract may be traded on an exchange or over-the-counter ("OTC"). OTC derivative contracts are individually negotiated between contracting parties and may include the Company's forwards and foreign currency option contracts, CPI-linked derivatives and total return swaps.

The Company uses derivatives principally to mitigate financial risks arising from its investment holdings, and monitors the derivatives for effectiveness in achieving their risk management objectives. Derivative contracts entered into by the company are considered investments or economic hedges and are not designated as hedges for financial reporting.

Derivatives are carried at fair value. The fair value of derivative contracts in a gain position is presented as derivative assets in the Consolidated Balance Sheets. The fair value of derivative contracts in a loss position is presented as derivative liabilities in 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 fair value of the contract at each balance sheet date. Changes in fair value of derivatives are recorded in the Consolidated Statements of Comprehensive Income as net gains (losses) on derivatives, with a corresponding adjustment to the carrying value of the derivative asset or liability. Cash settlements related to fair value changes on derivative contracts are also recorded in the Consolidated Statements of Comprehensive Income as net gains (losses) on derivatives, and are recorded as an investing activity in the Consolidated Statements of Cash Flows.

Cash received from counterparties as collateral for derivative contracts is recorded as other assets in the Consolidated Balance Sheets, and a corresponding liability is recognized as other liabilities. Securities pledged by counterparties as collateral for derivatives in a gain position are not recorded as assets of the Company. Securities pledged to counterparties by the Company as collateral for derivative contracts in a loss position, as well as contractually required independent collateral, are reflected in the Consolidated Balance Sheets as assets pledged for derivative obligations.

See Note 4 for additional information related to derivative contracts.

### **Cash**

Cash includes demand deposits with financial institutions.

**ZENITH NATIONAL INSURANCE CORP. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**Recognition of Property-Casualty Revenue and Expense**

*Revenue Recognition*

The consideration paid for an insurance policy is generally known as a “premium.” Premiums billed to the Company’s policyholders are recorded as revenues in the Consolidated Statements of Comprehensive Income. Premiums are billed and collected according to policy terms, predominantly in the form of installments during the policy period. Premiums are earned pro-rata over the terms of the policies. Billed premiums applicable to the unexpired terms of policies in-force are recorded in the accompanying Consolidated Balance Sheets as a liability for unearned premiums.

Certain states in which the Company conducts business require that the Company bill additional amounts, or assessments, to policyholders in accordance with state statutes. In some cases, the Company is required to pay in advance estimated amounts of these assessments to the relevant regulatory agency. Premiums do not include these assessments and their collection does not have any impact on the Company’s results of operations.

Any amounts receivable for billed premiums are charged-off upon initiating the legal collection process. An estimate of amounts that are likely to be charged-off is established as an allowance for doubtful accounts as of the balance sheet date. The estimate is comprised of any specific accounts that are past due and are considered probable to be charged-off and a provision against remaining accounts receivable based on historical bad debt expense. Premiums receivable is reported net of an allowance for estimated uncollectible amounts which was \$0.3 million at both December 31, 2020 and 2019.

Workers’ compensation premiums are determined based upon the payroll of the insured, the applicable premium rates and, where applicable, an experience-based modification factor and a debit or credit applied by the Company’s underwriters based upon individual risk characteristics. Audits of policyholders’ records are conducted after policy expiration to make a final determination of applicable premiums. Included with premiums earned is an estimate of the impact of final audit premiums. The Company can estimate this adjustment because it monitors, by policy, how much additional premium will be billed or refunded in final audit invoices as a percentage of the original estimated amount that was billed. The Company uses the historical percentage and current trends to estimate the probable amount to be billed or refunded as of the balance sheet date. When payrolls decline during policy periods (such as during a recession), the Company may bill more premium than is actually owed and will establish a liability for the estimated amount to be refunded to its policyholders. When payrolls increase during policy periods, the Company may bill less premium than is actually owed and will establish a receivable for the estimated amount due from its policyholders. At December 31, 2020, the Company recorded a liability of \$24.1 million in Other Liabilities for estimated additional amounts of premiums net of commissions owed to the Company’s policyholders. This estimated liability is primarily due to the provision for the estimated reduction in insureds’ payrolls that have not yet been reported to the Company as a result of the impact of COVID-19. Included in premiums receivable was \$5.4 million at December 31, 2019, for estimated additional amounts of premiums net of commissions to be billed to the Company’s policyholders.

The Company has written a relatively small number of workers’ compensation policies that are retrospectively rated. Under this type of policy, subsequent to policy expiration, the policyholder may be entitled to a refund or owe additional premium based on the amount of losses sustained under the policy. These retrospective premium adjustments are limited in the amount by which they increase or decrease the standard amount of premium applicable to the policy. The Company can estimate these retrospective premium adjustments because it knows the underlying loss experience of the policies involved. At December 31, 2020 and 2019, the net premiums payable under retrospectively rated workers’ compensation policies reflected in unearned premiums was \$2.0 million and \$1.6 million, respectively.

**ZENITH NATIONAL INSURANCE CORP. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

*Losses and Loss Adjustment Expenses Incurred*

Losses and loss adjustment expenses incurred in the accompanying Consolidated Statements of Comprehensive Income include provisions for the amount the Company expects to ultimately pay for all reported and unreported claims for the applicable periods. Loss adjustment expenses are the expenses applicable to the process of administering, settling and investigating claims, including related legal expenses.

Estimates of losses from environmental and asbestos related claims are included in overall loss reserves and to date have not been material.

*Unpaid Losses and Loss Adjustment Expenses*

The liabilities for unpaid losses and loss adjustment expenses (“loss reserves”) in the accompanying Consolidated Balance Sheets are estimates of the unpaid amounts that the Company expects to pay for the ultimate cost of reported and unreported claims as of the balance sheet date. Loss reserves are estimates and are inherently uncertain; they do not and cannot represent an exact measure of ultimate liability. The Company’s actuaries perform a comprehensive review of loss reserves at the end of every quarter, from which a point estimate of loss reserves is determined. The loss reserve estimates recorded in the financial statements reflect management’s best estimate of loss reserves based on the actuarial point estimate as well as judgment regarding the inherent uncertainties of ultimate loss costs. There is no material difference between the actuarial point estimate and the loss reserve estimate recorded in the financial statements at December 31, 2020 and 2019. At December 31, 2020, workers’ compensation, the Company’s principle line of insurance, accounts for 88.0% of the net earned premium in 2020 and 93.1% of the outstanding liabilities for unpaid losses and loss adjustment expenses, net of reinsurance recoverable. Given the long-tail nature of workers’ compensation liabilities, the ultimate losses will not be known for many years and estimating loss reserves is a complex process which involves a combination of actuarial techniques and management judgment including the consideration of all relevant data.

The Company’s actuaries produce a point estimate for workers’ compensation loss reserves using the results of various methods of estimation. The actuaries prepare reserve estimates for all accident years using the Company’s historical claims data and many of the common actuarial methodologies for estimating loss reserves, such as paid loss development methods, incurred loss development methods, the Bornhuetter-Ferguson methods and methods that utilize claim counts and average severity. The actuarial point estimate is based on a selection of the results of these various methods depending upon both the age of the accident year and the geographic state of the injury. For mature accident years, all of the methods produce very similar loss estimates; the actuarial point selections are primarily based upon incurred loss development methods because the actuaries believe this most accurately reflects the required reserves for the relatively few claims that remain open. For recent accident years, the Bornhuetter-Ferguson methods and methods that utilize claim counts and average severity are weighted with paid and incurred loss development methods.

When losses are reported to the Company, it establishes individual estimates of the ultimate cost of the claims, known as “case reserves.” These case reserves are continually monitored and revised in response to new information and for amounts paid. The Company’s actuaries use this information about reported claims in some of their estimation techniques. In estimating the Company’s total loss reserves, the Company makes provision for two types of loss development. At the end of any calendar period, there are a number of claims that have not yet been reported but will arise out of accidents that have already occurred. These are referred to in the insurance industry as incurred but not reported (“IBNR”) claims and the Company’s loss reserves contain an estimate for IBNR claims. In addition to this provision for late reported claims, the Company also has to estimate, and make provision for, the extent to which the case reserves on known claims may also develop. These types of reserves are referred to in the insurance industry as “bulk” reserves. The Company’s loss reserves make provision for both IBNR and bulk reserves in total, but not separately. The large majority

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of claims are reported promptly and therefore, as of the balance sheet date, the number of IBNR claims is relatively insignificant.

The principal uncertainty in the Company's workers' compensation loss reserve estimates is the risk of increasing claim costs, particularly medical. In estimating loss reserves, the Company's actuaries consider medical costs by evaluating long-term trends. The additional uncertainties considered in estimating ultimate loss costs include the ultimate number of expensive cases and the length of time required to settle long-term expensive cases. Expensive claims are those involving permanent disability of an injured worker and are paid over many years. The ultimate costs of expensive claims are difficult to estimate because of such factors as the on-going and possibly increasing need for medical care, complications from comorbidity, the duration of disability, life expectancy and benefits for dependents, as well as increased costs associated with obtaining settlement approval from Medicare.

The greater part of the challenge in estimating the loss reserves is associated with estimating the year-over-year increase (or decrease) in average claim severity for each accident year. Year-over-year rates of change of workers' compensation average claim severity (severity trends/inflation) vary considerably. The Company's initial workers' compensation loss reserve estimates for recent accident years provide for claim severity trends that contemplate the long-term trend observed in the Company's business. As loss experience emerges, actuarial estimates of ultimate losses and severity trends converge with those of the traditional dollar based loss development methods, resulting in net favorable or unfavorable development of the total loss reserve estimate.

Different assumptions about the claim severity inflation rates would change the workers' compensation loss reserve estimates; a material change is reasonably possible although management cannot predict if, when and to what extent such a change will occur. If the average annual inflation rate for each of the accident years 2018 through 2020 were increased or decreased by one percentage point in each year, the loss reserve estimates at December 31, 2020 would change accordingly by approximately \$17.5 million.

The Company believes its loss reserve estimates are adequate. However, the ultimate losses will not be known with any certainty for several years. The Company evaluates its loss reserve estimates every quarter to reflect the most current data and judgments. Any resulting adjustments to loss reserves are reflected in the Company's Consolidated Statements of Comprehensive Income in the period in which the change is made.

*Deferred Policy Acquisition Costs*

Policy acquisition costs, consisting of agent commissions and premium taxes that vary with, and are primarily related to, the production of new or renewal business are deferred and amortized as the related premiums are earned.

A premium deficiency is recognized if the sum of expected losses and loss adjustment expenses, expected dividends to policyholders, unamortized acquisition costs and policy maintenance costs exceeds the remaining unearned premiums. A premium deficiency would first be recognized by charging any unamortized acquisition costs to expense to the extent required to eliminate the deficiency. If the premium deficiency were greater than unamortized acquisition costs, a liability would be accrued for the excess deficiency. The Company does not consider anticipated investment income when determining if a premium deficiency exists. There was no premium deficiency at December 31, 2020 or 2019.

*Policyholders' Dividends*

The Company issues certain policies in which the policyholder may qualify to receive a dividend. An estimated provision for workers' compensation policyholders' dividends is accrued as the related premiums are earned. Such dividends do not become a fixed liability unless and until declared by the respective Board of Directors of Zenith National's insurance subsidiaries. The dividend to which a policyholder may be entitled

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is set forth in the policy. Dividends are calculated after policy expiration. The Company is able to estimate any liability it may have because it knows the underlying loss experience of the policies it has written with dividend provisions and can estimate the future liability from the policy terms. Approximately 48% of the Company's workers' compensation net premiums were earned from participating policies with dividend provisions.

#### *State Guaranty Fund Assessments*

Guaranty funds ("Guaranty Funds") exist in several states to ensure that policyholders (holders of direct insurance policies but not of reinsurance policies) receive payment of their claims if insurance companies become insolvent. A Guaranty Fund is funded primarily by statutorily required assessments on insurance companies doing business in the state. Various mechanisms exist in some of these states for assessed insurance companies to recover these assessments. Upon the insolvency of an insurance company, the Guaranty Funds become primarily liable for the payment of the insolvent company's liabilities to policyholders. The declaration of an insolvency establishes the presumption that assessments by the Guaranty Funds are probable. The Company writes workers' compensation insurance in many states in which unpaid workers' compensation liabilities are the responsibility of the Guaranty Funds and has received, and expects to continue to receive, Guaranty Fund assessments, some of which may be based on a certain amount of the premiums it has already earned as of December 31, 2020.

The Company recorded an estimate of \$1.9 million and \$1.6 million for the expected net liability at December 31, 2020 and 2019, respectively, for Guaranty Fund assessments. The ultimate impact of such assessments will depend upon the amount and timing of actual assessments and of any recoveries to which the Company may be entitled.

#### **Reinsurance Ceded**

In the ordinary course of business and in accordance with general insurance industry practices, the Company purchases excess of loss reinsurance to protect it against the impact of large, irregularly occurring losses in the workers' compensation business. Such reinsurance reduces the magnitude of such losses on net income and the capital of the Company. Reinsurance makes the assuming reinsurer liable to the ceding company to the extent of the reinsurance. It does not, however, discharge the ceding company from its primary liability to its policyholders in the event the reinsurer is unable to meet its obligations under such reinsurance agreement. The Company monitors the financial condition of its reinsurers and does not believe that it is currently exposed to any material credit risk through its ceded reinsurance arrangements because most of its reinsurance is recoverable from large, well-capitalized reinsurance companies. As such, the Company did not record an allowance for uncollectible recoverables from its reinsurers. Historical write-offs have been infrequent and insignificant.

Premiums earned and losses and loss adjustment expenses incurred are stated in the accompanying Consolidated Statements of Comprehensive Income after deduction of amounts ceded to reinsurers. Balances due from reinsurers on unpaid losses, including an estimate of such recoverables related to reserves for IBNR losses, are reported as assets and are included in reinsurance recoverables even though amounts due on unpaid losses and loss adjustment expenses are not recoverable from the reinsurer until such losses are paid.

In 1998, Zenith Insurance acquired substantially all of the assets and certain liabilities of RISCORP, Inc. and certain of its subsidiaries (collectively, "RISCORP") related to its workers' compensation business. Also, in 1998, the Company entered into an aggregate excess of loss reinsurance agreement which provided ceded reinsurance for unpaid losses assumed by Zenith Insurance from RISCORP up to \$50.0 million in excess of \$182.0 million. In May 2018, the Company commuted this retroactive reinsurance agreement, received \$3.0 million in cash, eliminated a deferred gain of \$0.4 million and recorded a total gain of \$0.6 million.

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**Properties and Equipment**

Properties and equipment used in operations, including certain costs incurred to develop and obtain computer software, are capitalized and carried at cost less accumulated depreciation. Depreciation is calculated on a straight-line basis using the following useful lives: buildings — up to 40 years; and other property and equipment — 3 to 10 years. Expenditures for maintenance and repairs are charged to operations as incurred. Additions and improvements to buildings and other fixed assets are capitalized and depreciated over the useful lives of the properties and equipment. Upon disposition, the asset cost and related depreciation are removed from the accounts and the resulting gain or loss is included in the Company's results of operations.

**Intangible Assets**

At December 31, 2020 and 2019, goodwill from acquisitions was \$21.0 million, of which \$19.0 million is included in the assets of Zenith Insurance with the remaining \$2.0 million included in Zenith National's assets. Other than goodwill, the Company had no intangible assets at December 31, 2020 or 2019. The Company tests goodwill for impairment annually and more frequently if an event occurs or circumstances change that management determines would more likely than not reduce the fair value of a reporting unit below its carrying amount. A reporting unit is an operating segment or a unit one level below the operating segment. The impairment tests include a comparison of the carrying amount of goodwill to the present value of future cash flows of both the Company's total workers' compensation business and the Southeast region workers' compensation business operation, a reporting unit. The fair value, estimated based on the present value of future cash flows of the reporting unit, exceeded its carrying amount as of December 31, 2020. Therefore, goodwill of the reporting unit is not considered impaired.

**Restricted Stock**

Under a restricted stock plan adopted by Fairfax in September 2010 ("Restricted Stock Plan"), certain Company officers are awarded shares of Fairfax Subordinate Voting Shares, no par value, with restricted ownership rights ("Restricted Stock"). Under the terms of the original Restricted Stock Plan agreement, 200,000 Fairfax Subordinate Voting Shares were authorized for purchase. In April 2020, the Restricted Stock Plan was amended and restated to provide for an additional 300,000 Fairfax Subordinate Voting Shares. Vesting of shares awarded in 2012 through November 2014 were conditioned upon the Company meeting a performance criterion in either the third, fourth or fifth year following the award date, with vesting to occur in three equal consecutive annual installments following the first year in which the condition was met. The Restricted Stock awarded after 2014 vests on the fifth anniversary of the award date and contains no performance conditions. The Restricted Stock vests in full upon the death or disability of the recipient of Restricted Stock. Restricted Stock is generally forfeited by employees who terminate employment prior to vesting. During the vesting period, the Restricted Stock Plan participants are entitled to voting rights and ordinary cash dividends paid by Fairfax from the date of the award. Restricted Stock awards under the Restricted Stock Plan are accounted for as equity awards based on the amount paid by the Company for the open market purchase of Fairfax Subordinate Voting Shares prior to each award. Compensation expense is recognized over the vesting period based on the grant date fair value with an offsetting entry to the initial charge to the Company's stockholders' equity.

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***Adopted Accounting Standards***

*Callable Debt Securities – Accounting for Premium Amortization*

Effective January 1, 2020, the Company adopted the updated guidance 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 adoption of this guidance did not have a material impact on the Company's consolidated financial position, results of operations or cash flows.

*Changes to the Disclosure Requirements for Fair Value Measurements*

Effective January 1, 2020, the Company adopted the updated guidance which changes the fair value measurement disclosure requirements. The updated guidance removes certain disclosure requirements regarding the amounts and reasons for transfers between Level 1 and Level 2 of the fair value hierarchy and the policy for timing of transfers between the levels. The updated guidance also adds disclosure requirements regarding unrealized gains and losses included in Other comprehensive income (loss) for recurring Level 3 fair value measurements and the range and weighted average of unobservable inputs used in Level 3 fair value measurements. The adoption of this guidance did not have a material impact on the Company's financial statements.

*Accounting for Cloud Computing Implementation Costs*

Effective January 1, 2020, the Company early adopted the 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 adoption of this guidance did not have a material impact on the Company's consolidated financial position, results of operations or cash flows.

*Accounting for Variable Interest Entities*

Effective January 1, 2020, the Company early adopted the updated guidance that expands the application of a specific private company accounting alternative related to variable interest entities and changes how entities evaluate decision-making fees under the variable interest guidance. Entities will consider indirect interests held through related parties under common control on a proportionate basis rather than in their entirety. Entities are required to apply the amendments retrospectively. The adoption of this guidance did not have a material impact on the Company's consolidated financial position, results of operations or cash flows.

*Recognition and Measurement of Financial Assets and Financial Liabilities*

Effective January 1, 2019, the Company adopted the updated guidance for 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 any changes in fair value recognized in net income. Equity securities that do not have readily determinable fair values may be measured at estimated fair value or cost less impairment, if any, adjusted for subsequent observable price changes, with changes in the carrying value recognized in net income. 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. Upon adoption of this guidance on January 1, 2019, \$4.2 million of pre-tax net unrealized losses on equity investments previously classified as available-for-sale and \$0.3 million of pre-tax net unrealized gains on cost-method partnership investments were reclassified from accumulated

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other comprehensive loss (“AOCL”) to retained earnings. The change in accounting for equity securities and cost-method partnership investments did not affect the Company’s total shareholders’ equity and the after-tax net unrealized losses of \$3.1 million reclassified to retained earnings will never be recognized in net income.

#### *Reclassification of the Stranded Tax Effects Related to The Tax Cuts and Jobs Act of 2017 (“Act”)*

In February 2018, the Financial Accounting Standards Board (“FASB”) issued updated guidance that allows a reclassification from AOCL to retained earnings for the stranded tax effects resulting from the enactment of the Act. The Company early adopted this amended guidance as of January 1, 2018, and as a result, elected to reclassify a total of \$0.8 million in stranded tax effects from AOCL to retained earnings as of January 1, 2018.

#### **Recent Accounting Standards Not Yet Adopted**

##### *Measurement of Credit Losses on Financial Instruments*

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 shall 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 changes accounting for available-for-sale debt securities that were previously recorded at fair value with changes in fair value recorded in Other comprehensive income (loss). The new guidance requires an estimate of credit losses to be recorded through an allowance for credit losses, with changes in the allowance recorded in current period net income (loss). In May 2019, the FASB issued updated guidance that provides transition relief by providing entities with an alternative to irrevocably elect the fair value option for eligible financial assets measured at amortized cost upon the adoption of the credit losses standard. To be eligible for the transition election, the existing financial asset must otherwise be both within the scope of the new credit losses standards and eligible for applying the fair value option standard (effectively can be elected for available-for-sale debt securities). The election must be applied on an instrument-by-instrument basis and is not available for held-to-maturity debt securities. 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.

##### *Goodwill Impairment*

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 is 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.

##### *Reference Rate Reform*

In January 2021, the FASB issued updated guidance which refines and clarifies reference rate reform guidance as part of the FASB’s monitoring of global reference rate reform activities. The update permits

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entities to elect certain optional expedients and exceptions when accounting for derivative contracts and certain hedging relationships affected by changes in the interest rates used for discounting cash flows, for computing variation margin settlements, and for calculating price alignment interest in connection with reference rate reform activities under way in global financial markets. For contract modifications, entities should use either a retrospective transition approach as of any date from the beginning of an interim period that includes March 12, 2020, or a prospective transition approach from any date within an interim period that includes or is after January 7, 2021, up to the date that the financial statements are available to be issued. For hedging relationships, entities should apply the amendments to eligible hedging relationships existing as of the beginning of the interim period that includes March 12, 2020, or for hedging relationships entered into after the beginning of the interim period that includes March 12, 2020. The amendments do not apply to contract modifications made or new hedging relationships entered into after December 31, 2022, or to existing hedging relationships evaluated for periods after December 31, 2022, unless an entity elects to apply certain optional expedients that permit the accounting effects to be retained through the end of the hedging relationships that extend beyond December 31, 2022. The guidance is not expected to have a material impact on the Company's consolidated financial position, results of operations or cash flows.

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**Note 3. Investments**

The cost or amortized cost and fair value of investments recorded at fair value at December 31, 2020 and 2019 were as follows:

(In thousands)	Cost or Amortized Cost	Gross Unrealized		Fair Value
		Gains	(Losses)	
<b>December 31, 2020</b>				
<b>Fair value option investments:</b>				
Fixed maturity securities:				
State and local government debt	\$ 10,353	\$ 616		\$ 10,969
U.S. Government debt (a)	969,969	2,509	\$ (4)	972,474
Corporate debt	36,414	1,451	(944)	36,921
<b>Total fixed maturity securities</b>	<b>1,016,736</b>	<b>4,576</b>	<b>(948)</b>	<b>1,020,364</b>
Short-term investments (b)	175,881			175,881
Equity securities	246,217	13,726	(37,423)	222,520
Other investments – affiliate corporate loans	16,697	1,368		18,065
Other investments – cost-method partnerships	32,020	3,130	(4,995)	30,155
Mortgage loans	18,824			18,824
<b>Total fair value option investments</b>	<b>\$ 1,506,375</b>	<b>\$ 22,800</b>	<b>\$ (43,366)</b>	<b>\$ 1,485,809</b>

<b>December 31, 2019</b>				
<b>Fair value option investments:</b>				
Fixed maturity securities:				
State and local government debt	\$ 55,655	\$ 38,741		\$ 94,396
U.S. Government debt (a)	962,622	2,071	\$ (20)	964,673
Corporate debt	22,167	1,394	(420)	23,141
<b>Total fixed maturity securities</b>	<b>1,040,444</b>	<b>42,206</b>	<b>(440)</b>	<b>1,082,210</b>
Short-term investments (b)	159,531	133	(3)	159,661
Equity securities	238,063	26,055	(70,365)	193,753
Other investments – affiliate corporate loans	15,712	811		16,523
Other investments – cost-method partnerships	29,649	2,794	(2,570)	29,873
<b>Total fair value option investments</b>	<b>\$ 1,483,399</b>	<b>\$ 71,999</b>	<b>\$ (73,378)</b>	<b>\$ 1,482,020</b>

(a) Includes investments of \$5.3 million and \$9.6 million pledged for derivative obligations at December 31, 2020 and 2019, respectively.

(b) Includes investments of \$1.1 million and \$0.9 million pledged for derivative obligations at December 31, 2020 and 2019, respectively.

Fixed maturity securities, including short-term investment, by contractual maturity at December 31, 2020 were as follows:

(In thousands)	Amortized Cost	Fair Value
Due in one year or less	\$ 1,147,730	\$ 1,150,251
Due after one year through five years	27,570	28,001
Due after five years through ten years	14,519	14,887
Due after ten years	2,798	3,106
<b>Total</b>	<b>\$ 1,192,617</b>	<b>\$ 1,196,245</b>

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 December 31, 2020 also include other investments detailed below and derivative contracts described in Note 4.

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Other investments consist of the following:

(In thousands)	December 31,	
	2020	2019
Equity-method common stock (a)	\$ 66,213	\$ 132,860
Equity-method partnerships (b)		12,107
Cost-method partnerships, at fair value (cost \$32,020 in 2020 and \$29,649 in 2019) (c)	30,155	29,873
Affiliate corporate loans, at fair value (amortized cost \$16,697 in 2020 and \$15,712 in 2019)	18,065	16,523
Total other investments	\$ 114,433	\$ 191,363

- (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. The decrease in the carrying value of equity-method common stock from December 31, 2019 to December 31, 2020 was primarily due to the sale of Apple Bidco in the first quarter of 2020, the Company's share of investee losses recognized, mostly on a one-quarter lag, from the economic effects of COVID-19 and an other-than-temporary impairment write-down recorded for Fairfax Africa Holdings Corp. in the third quarter of 2020 (see Note 12).
- (b) The decrease in equity-method partnerships was due to the sale of Davos Brands LLC on September 30, 2020 (see Note 12).
- (c) 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. Effective January 1, 2019, upon adoption of the updated guidance for financial instruments (see Note 2), changes in fair value of cost-method partnerships are recorded in the change in net unrealized gains/losses on fair value option investments in net income. Prior to the adoption of this updated accounting guidance, changes in fair value of cost-method partnerships were recorded in Other comprehensive income (loss).

At December 31, 2020, the Company had commitments to invest an additional \$18.9 million in partnerships and limited liability companies.

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

(In thousands)	Year Ended December 31,		
	2020	2019	2018
Sales of fixed maturity securities, including short-term investments and other (a)	\$ 26,691	\$ (2,451)	\$ 1,799
Sales of equity securities (b)	2,808	(3,256)	(97,838)
Losses from other investments (c)	(4,961)	(7,117)	(697)
<b>Net realized gains (losses) on investments</b>	<b>\$ 24,538</b>	<b>\$ (12,824)</b>	<b>\$ (96,736)</b>

- (a) Net realized gains on sales of fixed maturity securities, including short-term investments and other for the year ended December 31, 2020 include \$26.8 million of gross realized gains on sales of fair value option fixed maturity securities to affiliates of Fairfax and the Company (see Note 12).

Net realized losses on sales of fixed maturity securities, including short-term investments and other for the year ended December 31, 2019 included \$4.6 million losses on bonds issued by Exco Resources, Inc. (see Note 12), partially offset by realized gains of \$5.5 million, primarily \$4.9 million realized gains recognized upon transfer of certain fair value option fixed maturity securities to pay dividends to Fairfax affiliates in December 2019 (see Note 12).

Net realized gains on sales of fixed maturity securities, including short-term investments and other for the year ended December 31, 2018 include \$1.9 million of gross realized gains and \$0.1 million of gross realized losses on sales of fair value option fixed maturity securities.

- (b) Net realized gains on sales of equity securities for the year ended December 31, 2020 include realized gains of \$2.8 million on sale of Eurobank Ergasias S.A. common stock to an affiliate of Fairfax and the Company (see Note 12).

Net realized losses on sales of equity securities for the year ended December 31, 2019 include realized foreign exchange losses of \$2.7 million on the return of capital distribution from a privately held common stock investment and realized losses of \$1.7 million on the conversion of AGT Food and Ingredients Inc. ("AGT") preferred stock to common stock as a result of AGT's privatization (see Note 12). Realized losses on equity securities for the year ended December 31, 2019 were partially offset by realized gains of \$1.3 million on the sale of two fair value option common stock investments.

Net realized losses on sales of equity securities for the year ended December 31, 2018 include \$1.2 million of gross realized gains and \$99.0 million of gross realized losses on sales of fair value option equity securities, including \$86.0 million of realized losses recognized upon transfer of certain equity securities to pay dividends to Fairfax affiliates in December 2018.

- (c) Net realized gains from other investments for the year ended December 31, 2020 include other-than-temporary impairments charges of \$12.7 million and \$4.0 million for Fairfax Africa Holdings Corp. and Astarta Holding NV ("Astarta"), respectively; offset by \$8.0 million realized gain on sale of Davos Brands LLC, \$2.7 million dilution gain for Boat Rocker Media Inc. and \$1.0 million of gains on cost-method partnership distributions (see Note 12).

Net losses from other investments for the year ended December 31, 2019 include a \$11.6 million other-than-temporary impairment for Astarta, partially offset by \$2.7 million gain on sale for Grivalia Properties; \$0.8 million gain on dilution for Farmer's Edge, Inc. and a \$0.8 million gain on cost-method partnership distributions (see Note 12).

The changes in net unrealized gains/losses on investments recognized as a separate component of stockholders' equity were as follows:

(In thousands)	Year Ended December 31,		
	2020	2019	2018
Equity-method common stock	\$ (2,920)	\$ (3,626)	\$ (85)
Equity-method partnerships	(1,670)	268	1,006
Cost-method partnerships (a)			(942)
Available-for-sale equity securities (a)			(132)
<b>Total before tax</b>	<b>\$ (4,590)</b>	<b>\$ (3,358)</b>	<b>\$ (153)</b>
<b>After tax (see Note 13)</b>	<b>\$ (3,627)</b>	<b>\$ (2,653)</b>	<b>\$ (121)</b>

- (a) Effective January 1, 2019, upon adoption of the updated guidance for financial instruments (see Note 2) changes in fair value of available-for-sale equity securities and cost-method partnerships are recorded in the change in net unrealized gains/losses on fair value option investments in net income.

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

(In thousands)	Year Ended December 31,		
	2020	2019	2018
Change in net unrealized gains/losses recognized on fair value option investments	\$ (19,187)	\$ 14,715	\$ 6,666
Less: Net losses (gains) recognized on fair value option investments sold (a)	(45,625)	5,077	51,606
Change in net unrealized gains/losses recognized on fair value option investments still held at the reporting date	\$ 26,438	\$ 9,638	\$ (44,940)

(a) Net gains recognized during the year ended December 31, 2020 are primarily related to the sale of municipal bonds to affiliates of Fairfax (see Note 12).

Net investment income (loss) was as follows:

(In thousands)	Year Ended December 31,		
	2020	2019	2018
Fixed maturity securities (a)	\$ 20,143	\$ 30,122	\$ 23,022
Equity securities (b)	2,558	5,829	16,511
Short-term and other investments (a)	2,385	4,840	8,373
Derivatives	2,764	2,151	5,473
Mortgage loans	400		
Loss from equity-method investments (c)	(31,876)	(19,760)	(9,566)
Subtotal	(3,626)	23,182	43,813
Investment expenses	(7,109)	(7,639)	(7,994)
Net investment income (loss)	\$ (10,735)	\$ 15,543	\$ 35,819

(a) Income from fixed maturity securities in the year ended December 31, 2020 decreased compared to the corresponding periods of 2019, primarily due to maturities of higher yielding municipal bonds and short-dated U.S. treasury bonds and notes, and the reinvestment of the proceeds into lower yielding U.S. treasury bonds. Income from fixed maturity securities in the year ended December 31, 2019 increased compared to the corresponding period of 2018, primarily as a result of the reinvestment of the short-term investments into short-dated U.S. Government bonds and high quality corporate bonds in the later part of 2018 and first quarter of 2019

(b) Income from equity securities in the year ended December 31, 2018 includes \$12.4 million special dividend received from common stock investment.

(c) Losses from equity-method investments for each period presented is detailed below:

(In thousands)	Year Ended December 31,		
	2020	2019	2018
Helios Fairfax Partners Corp. (fka Fairfax Africa Holdings Corp.)	\$ (12,964)	\$ (8,751)	\$ (1,489)
Toys R Us Canada (1)	(11,312)	1,891	
Boat Rocker Media Inc.	(6,469)	(180)	(233)
Farmers Edge Inc.	(4,765)	(4,931)	(5,121)
Apple Bidco	(1,232)	(5,957)	(1,014)
Davos Brands LLC	(883)	(1,664)	(1,228)
AGT Food and Ingredients Inc.	(702)	(625)	
Fairfax India Holdings Corp.	3,822	221	1,330
Peak Achievement Athletics	2,274	(339)	
Astarta Holdings NV	651	949	(1,958)
Other	(296)	(374)	147
Losses from equity-method investments	\$ (31,876)	\$ (19,760)	\$ (9,566)

(1) The Company received GAAP financial statements of Toys "R" Us (Canada) Ltd. ("TRU") as of December 28, 2019 (audited) in the second quarter 2020 and most recently as of November 28, 2020 (unaudited). Based on this information, the Company's additional share of TRU's cumulative losses through November 28, 2020 was \$21.3 million. The Company recorded equity in losses of TRU of \$7.6 million in the second quarter 2020 that reduced the carrying value of its investment in TRU to zero. The remaining share of the TRU's losses not yet recognized in the Company's results as of December 31, 2020 was approximately \$13.7 million.

At December 31, 2020 and 2019, investments with a fair value of \$926 million and \$1.1 billion, respectively, were on deposit with regulatory authorities in compliance with insurance company regulations. At December

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31, 2020, the Company had additional qualifying securities with a fair value of approximately \$222 million available for deposit.

**Note 4. Derivative Contracts**

See Note 2 for a description of the Company's accounting policies related to derivative contracts.

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

(In thousands)	Notional Amount	Cost	Fair Value of Derivative	
			Assets	Liabilities
<b>December 31, 2020</b>				
CPI-linked derivatives	\$ 4,692,978	\$ 22,510	\$ 234	
Long equity total return swaps	48,067			\$ 1,607
Foreign exchange forwards	36,342			1,636
<b>Total</b>		<b>\$ 22,510</b>	<b>\$ 234</b>	<b>\$ 3,243</b>
<b>December 31, 2019</b>				
CPI-linked derivatives	\$ 7,477,246	\$ 39,318	\$ 671	
Foreign currency options	437,500	7,519	820	
U.S. Government bond forwards	97,000			\$ 659
Long equity total return swaps	52,591		3,046	121
Foreign exchange forwards	60,613			1,039
<b>Total</b>		<b>\$ 46,837</b>	<b>\$ 4,537</b>	<b>\$ 1,819</b>

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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)	Year Ended December 31,		
	2020	2019	2018
<b>Gains (losses) on settlements</b>			
Equity derivatives:			
Equity total return swaps – long positions	\$ (4,525)	\$ (18,840)	\$ 3,115
Equity index put options		(640)	
Equity warrants			(1,234)
CPI-linked derivatives (a)	(16,808)	(1,740)	
U.S. Government bond forwards	(24,531)	(16,954)	7,135
Foreign exchange forwards	2,860	796	4,149
Foreign currency options	(7,102)		
<b>Total</b>	<b>(50,106)</b>	<b>(37,378)</b>	<b>13,165</b>
<b>Change in fair value</b>			
Equity derivatives:			
Equity total return swaps – long positions	(4,532)	13,883	(11,118)
Equity warrants		(20)	697
CPI-linked derivatives (a)	16,371	108	(1,142)
U.S. Government bond forwards	659	4,871	(3,844)
Foreign exchange forwards	(597)	(1,023)	661
Foreign currency options	6,699	(6,611)	(88)
<b>Total</b>	<b>18,600</b>	<b>11,208</b>	<b>(14,834)</b>
<b>Net gains (losses) on derivatives</b>			
Equity derivatives:			
Equity total return swaps – long positions	(9,057)	(4,957)	(8,003)
Equity index put options		(640)	
Equity warrants		(20)	(537)
CPI-linked derivative contracts (a)	(437)	(1,632)	(1,142)
U.S. Government bond forwards	(23,872)	(12,083)	3,291
Foreign exchange forwards	2,263	(227)	4,810
Foreign currency options	(403)	(6,611)	(88)
<b>Total net losses on derivatives</b>	<b>\$ (31,506)</b>	<b>\$ (26,170)</b>	<b>\$ (1,669)</b>

- (a) Eight CPI-linked derivative contracts with a total notional amount of \$2.9 billion matured in the year ended December 31, 2020 with a fair value of zero at maturity, and \$16.8 million of losses previously recognized in the change in fair value component of net gains (losses) on derivatives were reclassified to gains (losses) on settlements component of net gains (losses) on derivatives.

**Equity contracts**

The Company holds long equity total return swaps on individual equities or equity index for investment purposes. These contracts provide the total return on a notional amount (including dividends and capital gains or losses) that is directly correlated to changes in fair value of the underlying individual equities or equity indexes in exchange for the payment of a floating rate of interest on the notional amount. The Company classifies dividends and interest paid or received related to its long equity total return swaps on a net basis as investment income in the Consolidated Statements of Comprehensive Income.

Total return swaps require no initial net cash investment; and at inception the fair value is zero. The Company's long equity total return swaps may contain reset provisions requiring counterparties to cash-settle on a monthly or quarterly basis any fair value movements arising subsequent to the prior settlement date. Any cash amounts paid to settle unfavorable fair value changes and conversely, any cash amounts received in settlement of favorable fair value changes, are recorded as net gains (losses) on derivatives recorded in the Consolidated Statements of Comprehensive Income (included in the Gains (losses) on settlements section in the table above). To the extent that a contractual reset date does not correspond to the balance sheet date, the Company records net gains (losses) on derivatives in the Consolidated Statements of Comprehensive Income to adjust the carrying value of the corresponding derivative asset or liability associated with each total return swap to reflect its fair value at the balance sheet date (included in the Change in fair value section in the table above). Final cash settlements on total return swaps are recognized

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as net gains (losses) on derivatives net of any previously recorded unrealized fair value changes since the last reset date (also included in the Gains (losses) on settlements section in the table above). At December 31, 2020 and 2019, the Company pledged securities with a fair value of \$5.3 million and \$5.0 million, respectively, as collateral to the counterparties to its long equity total return swaps derivative contracts.

In the years ended December 31, 2020, 2019 and 2018, the Company recognized \$2.8 million, \$2.2 million and \$5.5 million, respectively, of net dividend and interest income earned recorded in net investment income on its total return swaps.

*CPI-linked derivative contracts*

The Company's derivative contracts referenced to the consumer price index in the United States and Europe ("CPI-linked derivatives") serve as an economic hedge against the potential adverse financial impact on the Company of decreasing price levels. The initial premium paid for each contract is recorded as a derivative asset and is subsequently adjusted for changes in fair value of the contract at each balance sheet date with a corresponding offset to net gains (losses) on derivatives in the Consolidated Statements of Comprehensive Income. In the event of a sale, expiration or early settlement of any of these contracts, the Company would receive a cash settlement equal to 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. The Company's CPI-linked derivatives have a remaining weighted average life of 3 years as of December 31, 2020. At December 31, 2020 and 2019, the Company pledged securities with a fair value of \$1.1 million and \$1.6 million, respectively, as contractually required independent collateral to a counterparty for the CPI-linked derivatives.

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 December 31, 2020 and December 31, 2019:

(Notional amount in thousands)	Notional Amount		Weighted Average Strike Price In Original Currency	Index Value
	Original Currency	US Dollars		
<b>Underlying CPI Index:</b>				
<b>December 31, 2020</b>				
United States	2,980,000	\$ 2,980,000	235.47	260.47
European Union	1,400,000	1,712,978	100.07	104.70
		\$ 4,692,978		
<b>December 31, 2019</b>				
United States	5,120,000	\$ 5,120,000	233.02	256.97
European Union	2,100,000	2,357,246	97.66	105.13
		\$ 7,477,246		

*U.S. Government bond forward contracts*

The Company held forward contracts to sell long dated U. S. government bonds ("Treasury locks") to reduce its exposure to interest rate risk. Treasury locks derive their value primarily from changes in fair value of the underlying U.S. Treasury bond between the contract inception and expiration dates, 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. To the extent that the expiration date does not correspond to the balance sheet date, the Company adjusts the carrying value of the corresponding derivative asset or liability associated with each Treasury lock to reflect its fair value at the balance sheet date with the corresponding

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net gains (losses) on derivatives recorded in the Consolidated Statements of Comprehensive Income. At December 31, 2019, the Company pledged securities with a fair value of \$4.0 million as contractually required independent and mark-to-market collateral to the counterparty for the Treasury locks. In April 2020, the Company terminated all of the outstanding U.S. government bond forward contracts with a notional amount of \$97.0 million and recognized a loss of \$21.3 million on this termination.

*Foreign exchange forward contracts*

Foreign exchange forward contracts (“foreign exchange forwards”), primarily denominated in the Canadian dollar (in 2020 and 2019) and the euro (in 2019 and prior), are used to manage certain foreign currency exposures arising from foreign currency denominated investments. These foreign exchange forwards 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. To the extent that the expiration date does not correspond to the balance sheet date, the Company adjusts the carrying value of the corresponding derivative asset or liability associated with each foreign exchange forward to reflect its fair value at the balance sheet date with the corresponding net gains (losses) on derivatives recorded in the Consolidated Statements of Comprehensive Income. At both December 31, 2020 and 2019, the Company had no pledged securities as collateral for any foreign exchange forwards.

*Counterparty collateral and exposure*

The Company endeavors to limit counterparty risk through the terms of master netting agreements negotiated with the counterparties to its derivative contracts. These agreements 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”). Pursuant to these agreements, the counterparties to the derivative contracts are also 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. The Company had not exercised its right to sell or repledge collateral at December 31, 2020.

At December 31, 2020 and 2019, the Company pledged to its counterparties securities with a fair value of \$6.4 million and \$10.6 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 December 31, 2020, the counterparties pledged \$0.3 million of cash and \$0.6 million of U.S. Treasury notes, compared to \$0.3 million of cash and \$3.1 million of U.S. Treasury notes at December 31, 2019. 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.

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

(In thousands)	December 31,	
	2020	2019
Total derivative assets	\$ 234	\$ 4,537
Impact of net settlement arrangements	(157)	(779)
Fair value of collateral deposited for the benefit of the Company	(77)	(3,126)
Net derivative counterparty exposure after net settlement and collateral arrangements	\$	\$ 632

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

*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 warrants) and liabilities in the Consolidated Balance Sheets; (2) the gross amounts of the derivative instruments eligible for netting but not offset in the Consolidated Balance Sheets; and (3) financial collateral received and pledged which is contractually permitted to be offset upon an event of default, but is not allowed to be presented net under GAAP (net amount of exposure).

(In thousands)	Gross and net amounts reflected in the Consolidated Balance Sheets	Gross amounts not offset in the Consolidated Balance Sheets		Net amount of exposure
		Derivative asset (liability)	Collateral provided (held) - financial instruments (a)	
<b>December 31, 2020</b>				
<b>Derivative assets:</b>				
Citibank, N.A.	\$ 157	\$ (157)		\$
Deutsche Bank AG London	77		(77)	
Bank of America				
<b>Total derivative assets</b>	<b>\$ 234</b>	<b>\$ (157)</b>	<b>\$ (77)</b>	<b>\$</b>
<b>Derivative liabilities:</b>				
Citibank, N.A.	\$ (372)	\$ 157		\$ (215)
Bank of New York Mellon (b)	(1,636)			(1,636)
Bank of America	(1,235)		1,125	(110)
<b>Total derivative liabilities</b>	<b>\$ (3,243)</b>	<b>\$ 157</b>	<b>1,125</b>	<b>\$ (1,961)</b>
<b>December 31, 2019</b>				
<b>Derivative assets:</b>				
Citibank, N.A.	\$ 3,973	\$ (762)	\$ (2,579)	\$ 632
Deutsche Bank AG London	80		(80)	
Bank of America	484	(17)	(467)	
<b>Total derivative assets</b>	<b>\$ 4,537</b>	<b>\$ (779)</b>	<b>\$ (3,126)</b>	<b>\$ 632</b>
<b>Derivative liabilities:</b>				
Citibank, N.A.	\$ (762)	\$ 762		
Bank of New York Mellon (b)	(1,040)			\$ (1,040)
Bank of America	(17)	17		
<b>Total derivative liabilities</b>	<b>\$ (1,819)</b>	<b>\$ 779</b>		<b>\$ (1,040)</b>

(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 exchange forward contracts that are not subject to a master netting arrangement.

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**Note 5. 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.

Considerable judgment may be required particularly in developing estimates of fair value for financial instruments classified as Level 3 in the fair value hierarchy as such estimates incorporate market unobservable inputs that require management to use its own assumptions. While the Company's valuation techniques for Level 3 financial instruments remained unchanged during the 2020, the development of market unobservable inputs included added estimation uncertainty due to the global economic and social disruption caused by the ongoing and developing COVID-19 pandemic. Estimates of the amount and timing of future cash flows, discount rates, growth rates and other inputs incorporated into fair value measurements of Level 3 financial instruments are inherently more difficult to determine due to the unpredictable duration and impacts of the COVID-19 pandemic, including further actions that may be taken by governments to contain it and the timing of the re-opening of the economy in various parts of the world. The Company has assumed that the economic impacts of COVID-19 will remain for the duration of government mandated restrictions by jurisdiction as currently known, with gradual lifting of those restrictions. The uncertainty in those assumptions have been incorporated into the company's valuations of Level 3 financial instruments primarily through wider credit spreads and higher discount rates, as applicable. Additional volatility in the fair values of Level 3 financial instruments may arise in future periods if actual results differ materially from the Company's estimates.

There were no other significant changes to the valuation techniques and processes used at December 31, 2020 compared to those described in the Company's Consolidated Financial Statements at December 31, 2019.

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

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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 forwards, options 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.

**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. 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 December 31, 2020 and December 31, 2019 classified by the valuation hierarchy discussed previously:

(In thousands)	Total	Fair Value Measurement Using		
		Level 1	Level 2	Level 3
<b>December 31, 2020</b>				
<b>Fair value option securities:</b>				
Fixed maturity securities:				
State and local government debt	\$ 10,969		\$ 10,969	
U.S. Government debt	972,474		972,474	
Corporate debt	36,921		29,947	\$ 6,974
Total fixed maturity securities	1,020,364		1,013,390	6,974
Equity securities (a)	222,520	\$ 157,124	7,708	17,639
Short-term investments	175,881	175,881		
Mortgage loans	18,824			18,824
Other investments - affiliate corporate loans	18,065			18,065
Other investments – cost-method partnerships (a)	30,155			
<b>Total fair value option investments</b>	<b>\$ 1,485,809</b>	<b>\$ 333,005</b>	<b>\$ 1,021,098</b>	<b>\$ 61,502</b>
<b>Derivatives:</b>				
CPI-linked derivative contracts	\$ 234			\$ 234
Total derivative assets	234			234
Equity total return swaps – long positions	(1,607)		(1,607)	
Foreign exchange forward contracts	(1,636)		(1,636)	
Total derivative liabilities	(3,243)		(3,243)	
<b>Net derivatives</b>	<b>\$ (3,009)</b>		<b>\$ (3,243)</b>	<b>\$ 234</b>

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(In thousands)	Total	Fair Value Measurement Using		
		Level 1	Level 2	Level 3
<b>December 31, 2019</b>				
<b>Fair value option securities:</b>				
Fixed maturity securities:				
State and local government debt	\$ 94,396		\$ 94,396	
U.S. Government debt	964,673		964,673	
Corporate debt	23,141		15,299	\$ 7,842
Total fixed maturity securities	1,082,210		1,074,368	7,842
Equity securities (a)	193,753	\$ 143,467		17,038
Short-term investments	159,661	153,650	6,011	
Other investments – affiliate corporate loans	16,523			16,523
Other investments – cost-method partnerships (a)	29,873			
<b>Total fair value option investments</b>	<b>\$ 1,482,020</b>	<b>\$ 297,117</b>	<b>\$ 1,080,379</b>	<b>\$ 41,403</b>
<b>Derivatives:</b>				
Equity total return swaps – long positions	\$ 3,046		\$ 3,046	
Foreign currency options	820		820	
CPI-linked derivative contracts	671			\$ 671
Total derivative assets	4,537		3,866	671
Equity total return swaps – long positions	(121)		(121)	
U.S. Government bond forward contracts	(659)		(659)	
Foreign exchange forward contracts	(1,039)		(1,039)	
Total derivative liabilities	(1,819)		(1,819)	
<b>Net derivatives</b>	<b>\$ 2,718</b>		<b>\$ 2,047</b>	<b>\$ 671</b>

(a) Certain common stock investments with a fair value of \$40.0 million and \$33.2 million at December 31, 2020 and 2019, respectively, and cost-method partnership investments are measured using the NAV practical expedient and have not been classified in the fair value hierarchy. 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 (a)	Derivatives	Affiliate Corporate Loans	Mortgage Loans
<b>Balance at December 31, 2018</b>	\$ 17,862	\$ 24,815	\$ 2,303	\$ 6,365	
Purchases		5,727		12,302	
Sales and maturities	(5,914)	(11,484)		(2,702)	
Realized and unrealized gains/losses included in:					
Change in net unrealized gains/losses on fair value option investments	3,664	8,089		558	
Net investments income – accretion of discounts	41				
Net realized losses on investments	(7,811)	(4,382)			
Net losses on derivatives			(1,632)		
Transfers from Level 3 (b)		(5,727)			
<b>Balance at December 31, 2019</b>	<b>\$ 7,842</b>	<b>\$ 17,038</b>	<b>\$ 671</b>	<b>\$ 16,523</b>	
Purchases				985	\$ 18,636
Realized and unrealized gains/losses included in:					
Change in net unrealized gains/losses on fair value option investments	(868)	601		557	
Net investments income – accretion of discounts					188
Net losses on derivatives			(437)		
<b>Balance at December 31, 2020</b>	<b>\$ 6,974</b>	<b>\$ 17,639</b>	<b>\$ 234</b>	<b>\$ 18,065</b>	<b>\$ 18,824</b>

- (a) Change in unrealized gains/losses for equity securities include change in fair value and foreign currency fluctuation.
- (b) Transfer out of Level 3 represents AGT common stock for which equity-method accounting commenced in the third quarter of 2019 (see Note 12).

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The following table provides information on the valuation techniques, significant unobservable inputs and ranges for each major category of Level 3 assets measured at fair value on a recurring basis at December 31, 2020:

(In thousands)	Balance at December 31, 2020	Valuation Techniques	Significant Unobservable Inputs
Mortgage loans (a)	\$ 18,824	Market approach	Recent transaction price
Affiliate corporate loans (b)	\$ 18,065	Market approach	Credit spread of issuer
Equity securities, fair value option (c)	\$ 17,639	Market approach	Credit spread of issuer Estimated NAV multiple
Corporate debt (b)	\$ 6,974	Market approach	Credit spread of issuer
Derivatives (d)	\$ 234	Market approach	Broker quotes

- (a) The Level 3 mortgage loans consist of two loans recently purchased and valued at amortized cost, which approximates fair value.
- (b) The Level 3 affiliate corporate loans consist of four loans (see Note 12) and the Level 3 corporate debt consist of two private placement fixed maturity securities with the fair value determined using a Black-Scholes Model. Prices for identical instruments are not available and significant subjectivity may be involved when fair value is determined using pricing data available for comparable instruments.
- (c) The Level 3 equity securities, fair value option consist primarily of a common stock of a company based in the United Kingdom and a preferred stock. The common stock's fair value was estimated as a multiple of NAV because a significant portion of its NAV, excluding cash balances, was comprised of real estate holdings supported by appraisals, and adjusted based on observable economic and market conditions, and also included foreign currency fluctuations. The preferred stock's fair value is determined using a Black-Scholes Model. Prices for identical instruments are not available and significant subjectivity may be involved when fair value is determined using pricing data available for comparable instruments.
- (d) The Level 3 derivatives consist primarily of CPI-linked derivatives that were valued using broker-dealer quotes which management has determined use market observable inputs except for the inflation volatility input which is not market observable.

**Note 6. Properties and Equipment**

Properties and equipment, included in other assets, consist of the following:

(In thousands)	December 31,	
	2020	2019
Land	15,208	15,208
Buildings	\$ 42,156	\$ 42,007
Other property and equipment	86,892	83,934
Subtotal	144,256	141,149
Accumulated depreciation	(111,165)	(108,647)
Total	\$ 33,091	\$ 32,502

Depreciation expense for the years ended December 31, 2020, 2019, and 2018 was \$2.9 million, \$3.3 million and \$3.8 million, respectively.

**Note 7. Income Tax**

The Company is included in the consolidated federal income tax return of Fairfax (US) Inc. and its eligible subsidiaries and in various state combined or consolidated income tax returns. Zenith National and Fairfax (US) Inc. are parties to a tax allocation agreement whereby, in general, federal income taxes are allocated by Fairfax (US) Inc. to Zenith National equal to the taxes that would have been payable/refunded between the Company and the Internal Revenue Service ("IRS") if it had filed a stand-alone consolidated federal income tax return. The insurance subsidiaries pay premium taxes on direct premiums written in lieu of most state income or franchise taxes.

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The difference between the statutory income tax rate and the Company's effective tax rate on income, as reflected in the Consolidated Statements of Comprehensive Income, was as follows:

(In thousands)	Year Ended December 31,		
	2020	2019	2018
Statutory tax rate at 21%			
Statutory income tax expense	\$ 1,840	\$ 19,957	\$ 16,918
Increase (reduction) in tax:			
Tax-exempt interest and other investments	(468)	(1,165)	(2,778)
Foreign taxes paid	164	534	350
Non-deductible expenses and other	505	112	(2,044)
Income tax expense before valuation allowance	2,041	19,438	12,446
Valuation allowance	20,400		21,600
Income tax expense	\$ 22,441	\$ 19,438	\$ 34,046

Deferred tax is provided based upon temporary differences between the tax and book basis of assets and liabilities. The components of the deferred tax assets and liabilities were as follows:

(In thousands)	December 31,			
	2020		2019	
	Deferred Tax Assets	Deferred Tax Liabilities	Deferred Tax Assets	Deferred Tax Liabilities
Unpaid losses and loss adjustment expenses discount	\$ 16,163	\$	\$ 14,664	
Limitation on deduction for unearned premiums	6,253		6,377	
Investments	50,159		37,535	
Policyholders' dividends accrued	6,890		7,950	
Compensation and benefits	4,743		5,190	
Deferred policy acquisition costs		2,678		\$ 2,684
Properties and equipment		560		151
Other	345		326	
Total before valuation allowance	\$ 84,553	\$ 3,238	\$ 72,042	\$ 2,835
Valuation allowance	(42,000)		(21,600)	
Net deferred tax asset	\$ 39,315		\$ 47,607	

GAAP requires the Company to evaluate the recoverability of its deferred tax assets ("DTAs") and establish a valuation allowance, if necessary, to reduce the DTA to an amount that is more likely than not to be realized (a likelihood of more than 50%). In making this evaluation, the Company is required to consider all available evidence, both positive and negative, including objectively verifiable evidence of taxable income in the immediate ensuing years. The discounting of loss reserves for tax purposes reverse over 10 to 25 years; and the limitation on deductions for unearned premiums reverse in the following year. Investments-related DTAs at December 31, 2020 are primarily attributable to deferred and unrealized tax losses on the Company's equity securities.

In assessing the recoverability of the Company's DTAs, management evaluates whether it is more likely than not that some portion or all of the deferred tax assets will not be realized by generating sufficient taxable income of the appropriate character. Management considers the reversal of deferred tax liabilities, carryback potential of an appropriate nature, and tax-planning strategies in making this assessment. The Company established a valuation allowance of \$42.0 million and \$21.6 million, recorded as a non-cash reduction of its investment-related DTAs, at December 31, 2020 and 2019 respectively. The valuation allowance does not adversely affect the Company's ability to use these tax deductions to reduce taxable income in the future.

At December 31, 2020 and 2019, there were no material unrecognized tax benefits.

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The Company recognizes any interest and penalties related to uncertain tax positions in income tax expense; however, there were none during the years ended December 31, 2020, 2019 and 2018.

The IRS is examining taxable year 2019. Taxable years 2016 through 2019 are subject to examination by state taxing authorities.

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**Note 8. Unpaid Losses and Loss Adjustment Expenses**

See Note 2 for a description of the Company's accounting policies related to unpaid losses and loss adjustment expenses.

The Company's workers' compensation incurred and paid losses and allocated loss adjustment expenses, net of reinsurance, are presented in the following tables.

Workers' Compensation												As of December 31, 2020	
Incurred Losses and Allocated Loss Adjustment Expenses, Net of Reinsurance													
Years Ended December 31,													
(In thousands)													
Accident Year	2011 <sup>(1)</sup>	2012 <sup>(1)</sup>	2013 <sup>(1)</sup>	2014 <sup>(1)</sup>	2015 <sup>(1)</sup>	2016 <sup>(1)</sup>	2017 <sup>(1)</sup>	2018 <sup>(1)</sup>	2019 <sup>(1)</sup>	2020	Net IBNR Reserves	Cumulative Number of Reported Claims <sup>(2)</sup>	
2011	\$ 322,367	\$ 311,367	\$ 311,367	\$ 300,665	\$ 293,127	\$ 287,565	\$ 286,064	\$ 283,977	\$ 282,462	\$ 280,395	\$ 11,906	\$ 26,534	
2012		385,899	350,993	332,441	321,499	312,301	309,930	307,331	305,814	302,925	14,318	30,092	
2013			370,296	341,735	323,545	309,959	302,556	297,707	293,888	290,411	13,592	30,671	
2014				358,819	331,551	307,190	294,755	286,855	282,139	278,267	14,081	30,431	
2015					354,155	329,034	315,023	299,935	290,627	284,453	16,698	30,883	
2016						360,638	340,182	323,750	311,498	305,082	16,516	31,539	
2017							354,148	328,410	312,606	306,378	21,814	31,423	
2018								337,529	312,395	302,111	22,831	31,523	
2019									310,160	293,573	27,433	30,345	
2020										285,156	58,880	22,642	
									Total	\$ 2,928,751			

(1) Data presented for these calendar years is required supplementary information, which is unaudited.

(2) The amounts reported for the cumulative number of reported claims include direct and assumed open and closed claims by accident year at the claimant level. The amounts do not include claim counts for business assumed through pools and associations. Claims reported are counted even if they eventually close with no loss or loss adjustment payment or if they are within a policy deductible where the insured is responsible for payment of losses in the deductible layer.

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**Workers' Compensation**

**Cumulative Paid Losses and Allocated Loss Adjustment Expenses, Net of Reinsurance**

Years Ended December 31,

(In thousands)

Accident Year	2011 <sup>(1)</sup>	2012 <sup>(1)</sup>	2013 <sup>(1)</sup>	2014 <sup>(1)</sup>	2015 <sup>(1)</sup>	2016 <sup>(1)</sup>	2017 <sup>(1)</sup>	2018 <sup>(1)</sup>	2019 <sup>(1)</sup>	2020
2011	\$ 67,805	\$ 152,550	\$ 201,241	\$ 242,278	\$ 240,048	\$ 247,932	\$ 254,485	\$ 257,343	\$ 259,685	\$ 261,112
2012		77,738	168,162	212,470	241,385	256,922	266,111	272,125	276,218	278,959
2013			70,631	166,783	211,947	237,852	251,613	258,546	262,315	264,362
2014				73,323	160,065	203,881	229,189	240,337	246,592	250,333
2015					74,561	166,502	214,635	236,628	247,394	252,161
2016						81,103	177,908	225,456	247,851	259,036
2017							85,204	183,532	230,039	248,840
2018								85,641	178,957	219,585
2019									81,641	166,594
2020										63,482
									Total	\$ 2,264,464
										\$ 664,287
										191,096
										\$ 855,383

All outstanding liabilities for unpaid losses and allocated loss adjustment expenses beginning 2011, net of reinsurance

All outstanding liabilities for unpaid losses and allocated loss adjustment expenses prior to 2011, net of reinsurance

Total outstanding liabilities for unpaid losses and allocated loss adjustment expenses, net of reinsurance

(1) Data presented for these calendar years is required supplementary information, which is unaudited.

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The reconciliation of the net incurred and paid loss development tables to the liability for unpaid losses and loss adjustment expenses is as follows:

(In thousands)	December 31, 2020
Workers' compensation	\$ 855,383
Other insurance operations	67,313
Liabilities for unpaid losses and allocated loss adjustment expenses, net of reinsurance	922,696
Liabilities for unpaid unallocated loss adjustment expenses	98,633
Liabilities for unpaid losses and loss adjustment expenses, net of reinsurance	1,021,329
Receivable from reinsurers for unpaid losses	37,821
Total gross liabilities for unpaid losses and loss adjustment expenses	\$ 1,059,150

The following table presents the average annual percentage payout of losses and loss adjustment expenses incurred by age, net of reinsurance, for an accident year as of December 31, 2020. The percentages show the average portion of the net losses and loss adjustment expenses paid in each succeeding year.

Average Annual Percentage Payout of Incurred Losses and Loss Adjustment Expenses by Age, Net of Reinsurance (unaudited)										
Years	1	2	3	4	5	6	7	8	9	10
	29.3%	31.9%	15.3%	7.6%	4.1%	2.3%	1.5%	1.0%	0.8%	0.6%

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

(In thousands)	Year Ended December 31,		
	2020	2019	2018
Beginning of year, net of reinsurance	\$ 1,046,248	1,100,917	\$ 1,139,373
Incurred claims:			
Current accident year	403,169	425,553	455,714
Prior accident years	(74,091)	(82,135)	(85,290)
Total incurred claims	329,078	343,418	370,424
Payments:			
Current accident year	(115,514)	(137,727)	(137,616)
Prior accident years	(238,483)	(260,360)	(271,264)
Total payments	(353,997)	(398,087)	(408,880)
End of year, net of reinsurance	1,021,329	1,046,248	1,100,917
Receivable from reinsurers for unpaid losses	37,821	39,617	46,949
End of year, gross of reinsurance	\$ 1,059,150	1,085,865	\$ 1,147,866

The net favorable development of \$74.1 million in 2020 was principally attributable to workers' compensation favorable loss development trends for 2015 through 2019 accident years. The net favorable development of \$82.1 million in 2019 was principally attributable to workers' compensation favorable loss development trends for 2016 through 2018 accident years. The net favorable development of \$85.3 million in 2018 was principally attributable to workers' compensation favorable loss development trends for 2015 through 2017 accident years.

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**Note 9. Long-Term Debt**

At December 31, 2020 and 2019, the outstanding principal amount and fair value of the Company's Subordinated Deferrable Interest Debentures ("long-term debt") was \$38.5 million. The long-term debt is due in 2028 and bears interest at the rate of 8.55% per annum.

The semi-annual interest payments on the long-term debt may be deferred by Zenith National for up to ten consecutive semi-annual periods. This debt is redeemable by Zenith National at 100% of the principal amount plus a "make-whole premium," if any, together with accrued and unpaid interest. The make-whole premium is the excess of the sum of the present value of the principal amount at maturity and the present value of the remaining scheduled payments of interest over 100% of the principal amount. The original issue costs and discount on the long-term debt of \$1.7 million are being amortized over the term of the long-term debt. Interest, issue costs and discount expense were \$3.3 million for each of the years ended December 31, 2020, 2019 and 2018.

**Note 10. Reinsurance Ceded**

*2021 Reinsurance Ceded Workers' Compensation Coverage*

The Company maintains excess of loss catastrophe reinsurance that provides protection for losses up to \$150 million for losses including catastrophe losses arising out of earthquakes and acts of terrorism including nuclear, biological and chemical attacks. For the agriculture business, the Company retains the first \$10 million of each loss arising from industrial accidents and the first \$20 million of each loss arising out of earthquakes and acts of terrorism. For all other business classes, the Company retains the first \$20 million of each loss.

*2020 Reinsurance Ceded Workers' Compensation Coverage*

For January 1, 2020 through April 14, 2020 loss occurrences, the Company maintains excess of loss catastrophe reinsurance that provides protection up to \$150 million for losses including catastrophe losses arising out of earthquakes and acts of terrorism including nuclear, biological and chemical attacks. For the agriculture business, the Company retains the first \$10 million and the layer from \$20 million to \$50 million of each loss arising from industrial accidents and the first \$50 million of each loss arising out of earthquakes and acts of terrorism. For all other business classes, the Company retains the first \$50 million of each loss.

For April 15, 2020 through December 31, 2020 loss occurrences, the Company maintains excess of loss catastrophe reinsurance that provides protection for losses up to \$150 million for losses including catastrophe losses arising out of earthquakes and acts of terrorism including nuclear, biological and chemical attacks. For the agriculture business, the Company retains the first \$10 million of each loss arising from industrial accidents and the first \$20 million of each loss arising out of earthquakes and acts of terrorism. For all other business classes, the Company retains the first \$20 million of each loss.

*2019 Reinsurance Ceded Workers' Compensation Coverage*

The Company maintains excess of loss catastrophe reinsurance that provides protection up to \$150 million for losses including catastrophe losses arising out of earthquakes and acts of terrorism including nuclear, biological and chemical attacks. For the agriculture business, the Company retains the first \$10 million and the layer from \$20 million to \$50 million of each loss arising from industrial accidents and the first \$50 million of each loss arising out of earthquakes and acts of terrorism. For all other business classes, the Company retains the first \$50 million of each loss.

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Reinsurance transactions reflected in the accompanying Consolidated Statements of Comprehensive Income were as follows:

(In thousands)	Year Ended December 31,		
	2020	2019	2018
Direct premiums earned	\$ 651,913	\$ 739,670	\$ 807,953
Assumed premiums earned	6,900	7,067	7,412
Ceded premiums earned	(14,976)	(11,740)	(11,066)
Net premiums earned	\$ 643,837	\$ 734,997	\$ 804,299
Ceded losses and loss adjustment expenses incurred	\$ 54	\$ 2,285	\$ (970)

Amounts recoverable for paid and unpaid losses from reinsurers at December 31, 2019 and 2018 and their respective A.M. Best ratings were as follows:

(In thousands)	December 31,		A.M. Best Rating (b)	A.M. Best Rating Date
	2020 (a)	2019 (a)		
General Reinsurance Corp.	\$ 33,016	\$ 33,718	A++	3/2020
Factory Mutual Insurance Company		853	A+	1/2021
All others (c)	6,636	5,585		
Total	\$ 39,652	\$ 40,156		

- (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) No individual reinsurer in excess of \$1.2 million and \$0.8 million at December 31, 2020 and 2019, respectively.

**Note 11. Stockholders' Equity and Statutory Financial Information**

***Dividend Restrictions***

The California Insurance Holding Company System Regulatory Act limits the ability of Zenith Insurance to pay dividends to Zenith National and for Zenith Insurance to receive dividends from its insurance subsidiary by providing that the appropriate insurance regulatory authorities in the state of California must approve any dividend that, together with all other such dividends paid during the preceding twelve months, exceeds the greater of: (a) 10% of the paying company's statutory surplus as regards policyholders at the preceding December 31; or (b) 100% of the net income for the preceding year. In addition, any such dividend must be paid from policyholders' surplus attributable to accumulated earnings. Such restrictions on dividends are not cumulative. Dividend payments from Zenith Insurance to Zenith National must also be in compliance with the California Corporations Code that permit dividends to be paid only out of retained earnings and only if specified ratios between assets and liabilities and between current assets and current liabilities exist after payment.

In 2020, Zenith National paid ordinary dividends of \$30.0 million in cash to Fairfax affiliates. In 2019, Zenith National paid ordinary dividends of \$55.7 million (\$23.0 million in fixed maturity securities, at fair value including accrued interest, and \$32.7 million in cash) to Fairfax affiliates. In 2018, Zenith National paid ordinary dividends of \$81.9 million (\$39.0 million in equity securities, at fair value, and \$42.9 million in cash) to Fairfax affiliates.

In 2020, Zenith Insurance paid ordinary dividends of \$35.0 million in cash to Zenith National. In 2019, Zenith Insurance paid ordinary dividends of \$60.7 million (\$23.0 million in fixed maturity securities, at fair value

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including accrued interest, and \$37.7 million in cash) to Zenith National. In 2018, Zenith Insurance paid ordinary dividends of \$85.9 million (\$39.0 million in equity securities, at fair value, and \$46.9 million in cash) to Zenith National. Zenith Insurance has the ability to pay up to \$52.2 million of dividends to Zenith National without prior approval of the California Department of Insurance (“California DOI”) during 2021.

In 2020, 2019 and 2018, ZNAT Insurance Company (“ZNAT”), a wholly-owned insurance subsidiary of Zenith Insurance, paid dividends of \$2.5 million, \$2.8 million and \$2.5 million, respectively, to Zenith Insurance to reduce ZNAT’s excess capital. ZNAT Insurance has the ability to pay up to \$2.5 million to Zenith Insurance without prior approval of the California DOI during 2021.

**Statutory Financial Data**

The capital stock and surplus and net income of the Company’s insurance subsidiaries, prepared in accordance with the statutory accounting practices of the National Association of Insurance Commissioners, were as follows:

(In thousands)	As of and for the Year Ended December 31,		
	2020	2019	2018
Capital stock and surplus	\$ 522,329	\$ 531,836	\$ 541,085
Net income (loss)	\$ (65,924)	\$ 66,650	\$ 134,018

Statutory accounting net income/loss differs from GAAP primarily due to the timing of the recognition of changes in fair value of investment securities.

The insurance business is subject to state-by-state regulation and legislation focused on solvency, pricing, market conduct, claims practices, underwriting, accounting, investment criteria, and other areas. Such regulation and legislation changes frequently. Compliance is essential and is an inherent risk and cost of the business. The Company believes it is in compliance with all material regulations.

**Note 12. 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 were \$4.5 million, \$4.8 million and \$5.2 million for the years ended December 31, 2020, 2019 and 2018, respectively.

In March 2020, the Company sold a portion of its investment in certain municipal bonds, at fair value, to various subsidiaries of Allied World Assurance Holdings, Ltd., an affiliate of Fairfax and the Company, and received \$21.6 million in U.S. treasury notes and \$13.2 million in cash, and recognized realized gains of \$12.1 million on these transactions. In April 2020, the Company sold the remaining portion of its investment in these municipal bonds, at fair value, to various subsidiaries of Allied World Assurance Holdings, Ltd., for \$31.3 million in cash and \$17.1 million in commercial paper and recognized realized gains of \$14.7 million on these transactions.

In September 2019, the Company sold six corporate bond securities, at fair value including accrued interest, to U.S. Fire Insurance Company, an affiliate of Fairfax and the Company, for \$12.9 million in cash. The Company recognized realized gains of \$0.2 million on the sale.

The Company owns common stock, fixed maturity securities and corporate loans issued by publicly-traded and private companies and invests in limited partnerships which are affiliates of Fairfax (including but not

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limited to investments described in the following paragraphs). Affiliated common stock investments are recorded using the equity-method of accounting, unless a fair value option is elected for such securities. The Company's share of net income/loss of the equity-method investees is recorded in net investment income in the Consolidated Statements of Comprehensive 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 in the Consolidated Statements of Comprehensive Income. The Company's share of other changes in investees' equity is recorded in the net change in unrealized gain/losses on investments 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 in Other comprehensive income (loss).

The aggregate value of the Company's affiliated investments at December 31, 2020 and December 31, 2019 was as follows:

(In thousands)	December 31,	
	2020	2019
Equity securities, at fair value option	\$ 79,040	\$ 53,484
Fixed maturity securities, at fair value option	15,049	5,080
Other invested assets:		
Equity-method common stock	66,213	132,860
Equity-method partnerships		12,107
Affiliate corporate loans	18,065	16,523
<b>Total</b>	<b>\$ 178,367</b>	<b>\$ 220,054</b>

The following table summarizes the impact from the Company's affiliated investments on various components of total comprehensive income:

(In thousands)	Year Ended December 31,		
	2020	2019	2018
<b>Included in Net income (loss):</b>			
Net investment loss	\$ (28,249)	\$ (15,718)	\$ (6,937)
Net realized losses on investments	(5,978)	(17,247)	(1,369)
Change in net unrealized gains/losses on fair value option investments	4,862	2,099	(8,867)
<b>Included in Other comprehensive income (loss):</b>			
Net change in unrealized gains/losses on investments, before tax	(4,590)	(3,358)	921
Change in unrealized foreign currency translation adjustment, before tax	1,318	2,720	(2,438)
<b>Total</b>	<b>\$ (32,637)</b>	<b>\$ (31,504)</b>	<b>\$ (18,690)</b>

The Company owns common stock shares in various mutual fund classes of HWIC Asia, which is a wholly-owned subsidiary of Fairfax. The Company elected the fair value option of accounting for its investment in HWIC Asia common stock. The Company recorded changes in unrealized gains/losses related to its investments in HWIC Asia of \$6.8 million increase, \$7.0 million decrease and \$8.0 million decrease during the years ended December 31, 2020, 2019 and 2018, respectively. The Company recorded dividend income related to its investments in HWIC Asia of \$1.6 million and \$1.0 million for the years ended December 31, 2019 and 2018, respectively. No dividend income was recorded in 2020. At December 31, 2020 and 2019, the aggregate fair value of the Company's investment in HWIC Asia affiliated common stock was \$40.0 million and \$33.2 million, respectively.

The Company owned common stock of Fairfax Africa Holdings Corp. ("FAH"), a majority-owned subsidiary of Fairfax and an affiliate of the Company. The Company recorded its investment in FAH using equity-method of accounting. As of September 30, 2020, the fair value of this investment had been significantly below its

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carrying value for an extended period of time. Therefore, due to the extent and duration of the impairment, the Company recorded an other-than-temporary impairment realized loss on its investment in FAH of \$12.7 million during 2020. On December 8, 2020, FAH completed its transaction with Helios Holdings Limited (“Helios”), pursuant to which Helios contributed certain fee streams to FAH in exchange for a 45.9% equity and voting interest in the share capital of FAH upon closing. FAH was renamed Helios Fairfax Partners Corp. (“HFP”). HFP common stock is publicly traded on the Toronto stock exchange; and the Company continues to record its investment in HFP using the equity- method of accounting. The carrying value of HFP was \$13.7 million and \$39.2 million at December 31, 2020 and 2019, respectively.

The Company owns an investment in the common stock of Boat Rocker Media Inc. (“Boat Rocker”), a majority-owned subsidiary of Fairfax and an affiliate of the Company. The Company records this investment in affiliated common stock of Boat Rocker using the equity-method of accounting. In March 2019, the Company sold a portion of its investment to a third party for \$0.4 million and recognized a realized gain on the sale of \$0.3 million. In November 2020, Boat Rocker issued additional shares in exchange for a receivable from original shareholders. The Company’s share of this transaction was recorded as additional investment in Boat Rocker of \$1.1 million, with a corresponding payable for securities (netted with the other unsettled trades balances as of December 31, 2020 and included as part of Short-term investments on the Balance Sheet). On January 1, 2021, the payable for securities balance was settled when Boat Rocker distributed back the capital contributed by the shareholders in November 2020, recorded as a return of capital by the Company. The carrying value of the Company’s investment in Boat Rocker equity-method common stock was \$7.2 million and \$10.9 million at December 31, 2020 and 2019, respectively.

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”), an affiliate of Fairfax and the Company. The Company records this investment in affiliated common stock of Toys R Us using the equity-method of accounting. In November 2019, the Company invested an additional \$5.0 million for 4.7 million shares of common stock of Toys R Us. The Company received GAAP financial statements of TRU as of February 1, 2020 (audited) in the second quarter 2020 and most recently as of November 28, 2020 (unaudited). Based on this information, the Company’s additional share of TRU’s cumulative losses through November 28, 2020 was \$21.3 million. The Company recorded equity in losses of TRU of \$7.6 million in the second quarter 2020 that reduced the carrying value of its investment in TRU to zero. The remaining share of the TRU’s losses not yet recognized in the Company’s results as of December 31, 2020 was approximately \$13.7 million. The carrying value of this equity-method common stock investment was zero and \$11.1 million at December 31, 2020 and 2019, respectively.

The Company owned an investment in Davos Brands LLC (“Davos”), an affiliate of Fairfax and the Company, and recorded this investment in an affiliated partnership using the equity-method of accounting. On September 30, 2020, the Company, along with the affiliates of Fairfax, sold its investment in Davos for cash proceeds of \$17.6 million and recorded a net realized gain of \$8.0 million. The Company and other former shareholders of Davos are eligible to receive additional consideration contingent on the brand performance over the next ten years of Aviation American Gin, which is majority owned by Davos.

The Company owns 0.8 million common stock shares of Astarta Holding NV (“Astarta”), an affiliate of Fairfax and the Company. Astarta is a Netherlands company whose common stock is publicly traded on the Polish stock exchange. The Company records this investment in affiliated common stock of Astarta using the equity-method of accounting. As of December 31, 2019, the fair value of this investment had been significantly below its carrying value for an extended period of time. Therefore, the Company recorded an other-than-temporary impairment realized loss of \$11.6 million in the fourth quarter of 2019 due to the extent and duration of the impairment. As the fair value of Astarta continued to decline, the Company recorded additional other-than-temporary impairment realized loss of \$4.0 million in 2020. The Company’s share of Astarta’s changes in equity was \$2.8 million increase, \$1.4 million increase and \$2.9 million decrease recorded in the year ended December 31, 2020, 2019 and 2018, respectively. The carrying value of Astarta was \$2.2 million and \$3.4 million at December 31, 2020 and 2019, respectively.

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In February 2018, Fairfax completed the sale of its 51.0% ownership interest in the Keg Restaurants Ltd. (“Keg”) to Cara Operations Limited (“Cara”), a publicly traded majority-owned subsidiary of Fairfax domiciled in Canada, for consideration comprised of cash and Cara common stock. The Company previously 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 Keg to Cara, in the first quarter 2018 the Company received a \$0.6 million cash dividend distribution from FFHL LP, recorded its share of the FFHL LP realized loss on the sale of Keg to Cara of \$0.3 million as part of equity in losses of FFHL LP in investment income and recorded the final redemption of its interest in the FFHL LP in exchange for Cara common stock valued at \$11.7 million on the day of the transaction. The Company also recognized a realized loss 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 equity. Cara was subsequently renamed Recipe Unlimited Corp. (“Recipe”). The Company elected the fair value option of accounting for its investment in Recipe affiliated common stock. On March 30, 2020, the Company exchanged its investment in subordinate voting shares of Recipe for the same number of multiple voting shares of Recipe at the same price with RiverStone Insurance (UK) Limited and TIG Insurance (Barbados) Limited, both affiliates of Fairfax and the Company. The Company did not recognize any realized gain or loss on this exchange transaction. The Company recorded changes in unrealized gains/losses on this investment of \$1.2 million decrease, \$2.3 million decrease and \$0.5 million decrease during the years ended December 31, 2020, 2019 and 2018, respectively. The Company recorded dividend income from this investment of \$50,000, \$0.2 million and \$0.2 million for the years ended December 31, 2020, 2019, and 2018, respectively. At December 31, 2020 and 2019, the carrying value of the Company’s investment in Recipe affiliated common stock was \$7.7 million and \$8.9 million, respectively.

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 Marshall Islands. Fairfax and the Company received warrants (“Seaspan Warrants”) to purchase Seaspan common stock in connection with this investment. 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 its Seaspan Warrants, at fair value, to Wentworth Insurance Company Ltd. (“Wentworth”), an affiliate of Zenith and Fairfax, in April 2018 for \$0.6 million. In July 2018, the Company purchased 0.8 million shares of Seaspan Warrants from Wentworth for \$2.8 million and subsequently converted these warrants to purchase an equivalent number of Seaspan common stock shares 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. On February 27, 2020, Seaspan completed a reorganization pursuant to which Atlas Corp. (“Atlas”), a newly created holding company, became its parent. Shareholders of Seaspan, including the Company, exchanged their Seaspan shares for Atlas shares with no change in ownership percentage. On February 28, 2020, Atlas acquired all issued and outstanding shares of Apple Bidco Limited (“AB”), an affiliate of Fairfax and the Company, from the Company and AB shareholders in an all-stock transaction at a deemed value of \$21.1 million. Accordingly, the Company derecognized its investment in equity-accounted AB common stock, recorded a net pre-tax loss of \$31,000 and increased its carrying value of Atlas by the fair value of the AB common stock exchanged (considered to be equal to the fair value of the newly issued Atlas common shares received of \$21.1 million). The Company elected the fair value option of accounting for its investment in Atlas affiliated common stock. The Company recorded changes in unrealized gains/losses on this investment of \$1.2 million decrease, \$5.1 million increase and \$1.4 million decrease during the years ended December 31, 2020, 2019 and 2018, respectively. The Company recorded dividend income from this investment of \$1.2 million, \$0.4 million and \$0.1 million for the years ended December 31, 2020, 2019, and 2018, respectively. At December 31, 2020 and 2019, the carrying value of the Company’s investment in Atlas affiliated common stock was \$31.3 million and \$11.3 million, respectively. In February 2020, in connection with the Atlas reorganization, the Company invested \$10.0 million in Atlas 5.50% unsecured debentures due March 1, 2027. At December 31, 2020 and

## ZENITH NATIONAL INSURANCE CORP. AND SUBSIDIARIES

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

2019, the total carrying value of the Company's investment in Atlas affiliated fixed maturity securities was \$15.0 million and \$5.1 million, respectively.

At December 31, 2018, the Company owned an investment in the common stock of Grivalia Properties REIC ("Grivalia"), a majority-owned publicly traded subsidiary of Fairfax. The Company recorded this affiliated common stock investment using the equity-method of accounting. In May 2019, Grivalia merged into Eurobank Ergasias S.A. ("Eurobank"), as a result of which shareholders of Grivalia, including the Company, received 20.9 million newly issued shares of Eurobank common stock in exchange for Grivalia shares, with a fair value of \$16.7 million. Accordingly, the Company derecognized its investment in Grivalia common stock and recorded a net realized gain of \$2.7 million on this transaction (\$5.2 million realized gain on sale, partially offset by a \$2.5 million realized loss as a result of the reclassification of the cumulative translation adjustment). In connection with the merger, in February 2019 Grivalia paid a pre-merger capital dividend. The Company recorded cash received of \$0.6 million as a reduction of the carrying value of its investment in Grivalia common stock prior to the merger. The Company elected the fair value option of accounting for its investment in Eurobank common stock. In January 2020, the Company sold its investment in Eurobank to Odyssey Group Holdings, Inc., an affiliate of Fairfax and the Company, and recognized realized gain of \$2.8 million on this transaction.

The Company owns 13.5 million shares of common stock of Peak Achievements Athletics ("PAA"), a private Canadian company that is an affiliate of Fairfax and the Company. The Company records this investment in affiliated common stock of PAA using the equity-method of accounting. In December 2019, the Company recorded a cash distribution received from PAA of \$1.3 million as a return of capital. The carrying value of PAA was \$9.3 million and \$7.0 million at December 31, 2020 and 2019, respectively.

At December 31, 2018, the Company owned the following investments in Exco Resources, Inc. ("Exco"), an affiliate of Fairfax and the Company: Exco equity-method common stock ("Old Exco Stock"), carried at zero value as of December 31, 2018, 1.75 and 1.5 Exco Lien Bonds ("Exco Bonds") and private debtor-in-possession loans to Exco ("Exco DIP Loans") classified as Other Investments – Affiliate Corporate Loans in the Consolidated Balance Sheets. Exco filed for bankruptcy restructuring in January 2018. In June 2019, Exco emerged from bankruptcy protection and settled the Company's investments in Exco DIP Loans and Exco bonds with \$2.8 million in cash and newly issued Exco common stock ("Exco Stock") with a fair value of \$5.9 million. The impact of the derecognition of the Exco Bonds on the Company's investment results in the year ended December 31, 2019 was as follows: realized loss recognized of \$7.8 million, partially offset by the change in net unrealized gains/losses on investments of \$3.2 million (from the reclassification of previously recognized unrealized losses), and investment income reduction of \$0.3 million, primarily for the write-off of the remaining accrued interest. The derecognition of the previously owned Old Exco Stock did not have an impact on the current year investment results as this investment was valued at zero as of December 31, 2018. The Company records its investment in the affiliated Exco Stock using the equity-method of accounting. At December 31, 2020 and 2019, the carrying value of this affiliated Exco Stock was \$5.9 million and \$6.1 million, respectively.

The Company owned an investment in the preferred stock of AGT Food and Ingredients Inc. ("AGT") as of December 31, 2018. In April 2019, AGT completed its previously announced management led privatization, resulting in the conversion of the outstanding preferred stock into new AGT Class A common stock ("AGT Stock"). In connection with the privatization, Fairfax, including Zenith, as a member of the buying group, extended loans to AGT ("AGT Loans") in order to, among other things, acquire all of the outstanding AGT old common stock shares not already owned by the buying group. As a result, in the second quarter of 2019, the Company recognized a realized loss of \$1.7 million on the conversion of the AGT preferred stock, and commenced equity-method accounting for AGT Stock. In connection with the AGT Loans, Fairfax, including Zenith, received warrants ("AGT Warrants"). The Company immediately sold the AGT Warrants to Wentworth at cost. The Company classifies its investment in the AGT Loans as Affiliated Corporate Loans in Other Invested Assets. As of December 31, 2020 and 2019, the carrying value of the Company's investment in its

**ZENITH NATIONAL INSURANCE CORP. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

AGT Loans was \$10.0 million and \$9.6 million, respectively; and investment in AGT Stock was \$2.1 million and \$4.9 million, respectively.

The Company owns 5.3 million shares of common stock of Farmers Edge, Inc. ("Farmers Edge"), a private Canadian company that is an affiliate of Fairfax and the Company. The Company records this investment in affiliated common stock of Farmers Edge using the equity-method of accounting. In February 2018, Fairfax and the Company entered into a private loan agreement ("Farmers Edge Loan") with Farmers Edge. Fairfax and the Company also received warrants ("Farmers Edge Warrants") to purchase Farmers Edge common stock in connection with this loan. The Company's additional investment in Farmers Edge was \$4.1 million, allocated between \$3.4 million (Canadian \$5.0 million par value) in Farmers Edge Loan and \$0.7 million in Farmers Edge Warrants. The Company sold the Farmers Edge Warrants at cost to Wentworth on the day of acquisition. In February 2019, the Company invested an additional Canadian \$4.0 million in Farmers Edge Loans. Farmers Edge Loans are included in Other Investments – Affiliate Corporate Loans in the Consolidated Balance Sheets. At December 31, 2020 and December 31, 2019, the total carrying value of the Company's investment in Farmers Edge Loans was \$8.1 million and \$6.9 million, respectively; and investment in Farmers Edge common stock was \$0.8 million and \$5.6 million, respectively.

*Other*

In December 2020, Zenith National paid a \$30.0 million ordinary dividend in cash to Fairfax affiliates.

In December 2019, Zenith National paid a \$25.0 million ordinary dividend to Fairfax affiliates in the form of a fixed maturity security and cash. The Company transferred a portion of its investment in certain tax exempt fixed maturity securities with a fair value of \$23.0 million, including accrued interest, to Fairfax (US) Inc. and recognized a realized gain of \$4.9 million.

In December 2018, Zenith National paid an \$81.9 million ordinary dividend to Fairfax affiliates in the form of two equity securities and cash. As a result, the Company transferred its entire positions in Eurobank Ergasias S.A. ("Eurobank") and Blackberry Limited ("BBRY") common stock with a fair value of \$25.0 million and \$14.0 million, respectively, to Fairfax (US) Inc. and recognized realized losses of \$63.0 million and \$23.0 million, respectively.

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 2019. At December 31, 2020 and 2019, the Company recorded net reinsurance recoverables of \$0.1 million and \$0.5 million, respectively, related to the reinsurance transactions with the affiliates of Fairfax.

Zenith National paid Fairfax \$4.4 million, \$5.1 million and \$5.4 million for the years ended December 31, 2020, 2019 and 2018, 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.

The Company is party to 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 provides claims administrative services to Seneca Insurance Company, Inc. ("Seneca"), an affiliate of Fairfax and the Company, under this agreement. The Company is also party to a claims administration services agreement with TIG Insurance Company ("TIG"), an affiliate of Fairfax and the Company. Service fee income recorded in the Consolidated Statements of Comprehensive Income (Loss) in the years ended December 31, 2020, 2019 and 2018 for TIG was \$6.2 million, \$8.0 million, and \$8.8 million, respectively, and for Seneca was \$0.3 million, \$0.4 million and \$0.4 million, respectively. Service fee receivable from TIG as of December

**ZENITH NATIONAL INSURANCE CORP. AND SUBSIDIARIES**  
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31, 2020 and 2019 was \$0.9 million and \$1.5 million, respectively. Net liability for loss fund held as of December 31, 2020 and 2019 for TIG claims was \$2.7 million, and for Seneca claims was \$0.6 million.

**Note 13. Other Comprehensive Loss**

Other comprehensive loss is comprised of changes in unrealized gains/losses on investments and foreign currency translation adjustments. The following table summarizes the components of the Company's other comprehensive loss:

(In thousands)	Pre-Tax	Income Tax Effect	After-Tax
<b>Year ended December 31, 2020</b>			
Net unrealized losses arising during the year	\$ (2,920)	(613)	(2,307)
Less: reclassification adjustment for net realized gains included in net income	(1,670)	(350)	(1,320)
Net changes in unrealized gains/losses on investments	(4,590)	(963)	(3,627)
Change in unrealized foreign currency translation adjustment	1,319	277	1,042
Total other comprehensive loss	\$ (3,271)	(686)	(2,585)
<b>Year ended December 31, 2019</b>			
Net unrealized losses arising during the year	\$ (3,287)	\$ (690)	\$ (2,597)
Less: reclassification adjustment for net realized gains included in net income	(71)	(15)	(56)
Net changes in unrealized gains/losses on investments	(3,358)	(705)	(2,653)
Net unrealized foreign currency translation adjustment arising during the year	609	128	481
Less: reclassification adjustment for net realized foreign exchange losses included in net income	2,111	443	1,668
Change in unrealized foreign currency translation adjustment	2,720	571	2,149
Total other comprehensive loss	\$ (638)	\$ (134)	\$ (504)
<b>Year ended December 31, 2018</b>			
Net unrealized gains arising during the year	\$ 629	\$ 131	\$ 498
Less: reclassification adjustment for net realized gains included in net income	(782)	(163)	(619)
Net changes in unrealized gains/losses on investments	(153)	(32)	(121)
Net unrealized foreign currency translation adjustment arising during the year	(3,593)	(755)	(2,838)
Less: reclassification adjustment for net realized foreign exchange losses included in net income	1,155	243	912
Change in unrealized foreign currency translation adjustment	(2,438)	(512)	(1,926)
Total other comprehensive loss	\$ (2,591)	\$ (544)	\$ (2,047)

The following table summarizes the net unrealized gains (losses) on investments and foreign currency translation adjustment recognized in accumulated other comprehensive loss:

(In thousands)	December 31,	
	2020	2019
Equity-method common stock	\$ (8,065)	\$ (5,145)
Equity-method partnerships		1,670
Net unrealized loss on investments, before tax	(8,065)	(3,475)
Deferred tax benefit	(1,693)	(730)
Net unrealized loss on investments, after tax	(6,372)	(2,745)
Net unrealized loss on foreign currency translation adjustment, before tax	(399)	(1,718)
Deferred tax benefit	(84)	(361)
Net unrealized loss on foreign currency translation adjustment, after tax	(315)	(1,357)
Total accumulated other comprehensive loss	\$ (6,687)	\$ (4,102)

**ZENITH NATIONAL INSURANCE CORP. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**Note 14. Employee Benefit and Retirement Plans**

The Company offers a tax deferred savings plan created under Section 401(k) of the Internal Revenue Code for all eligible employees. In the years ended December 31, 2020, 2019 and 2018, the Company matched 66.7%, 58.3% and 50%, respectively, of the first 6% of compensation (subject to certain limits) that employees contributed to the plan and was not liable for any future payments under the plan. The Company contributed \$4.7 million, \$4.1 million and \$3.4 million under the plan for the years ended December 31, 2020, 2019 and 2018, respectively.

In June 2010, an employee stock purchase plan was approved by Zenith National's Board of Directors providing for the purchase of up to 100,000 Fairfax Subordinate Voting Shares. In April 2020, the plan was amended and restated to provide for an additional 200,000 Fairfax Subordinate Voting Shares. The plan limits employee contributions to 10% of base salary or wages before tax for each payroll period. Under this stock purchase plan, the Company matches 30% of employee contributions and purchases Fairfax Subordinate Voting Shares at market value. If the Company achieves certain annual profitability conditions, it will provide an additional 20% match on the total contributions made during the year to employees who are employed on the date the additional match is made. The Company contributed \$2.2 million, \$2.1 million and \$2.1 million in matching contributions under the plan for the years ended December 31, 2020, 2019 and 2018, respectively. The Company is not liable for any future payments under the plan.

**Note 15. Commitments and Contingencies**

***Litigation***

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.

***Leases***

The Company has operating leases for offices and automobiles. The automobile leases have remaining lease terms of 1 month to 3 years. The office leases have remaining lease terms of 5 months to 8 years, some of which include options to extend the leases for up to 5 years, and some of which include options to terminate the leases within 3 years. The exercise of the renewal option is at the Company's discretion. The operating lease liability includes lease payments related to options to extend or renew the lease term if the Company is reasonably certain of exercising those options. The Company utilizes a risk-free interest rate for periods comparable to the term of the underlying lease to determine the present value of lease payments.

Lease expense for the years ended December 31, 2020, 2019 and 2018 was \$9.2 million, \$9.1 million and \$8.6 million, respectively.

**ZENITH NATIONAL INSURANCE CORP. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

Additional information related to the operating leases is provided below:

(In thousands)	As of and for the year ended December 31, 2020	
	Offices	Automobile
Cash payments included in the measurement of lease liabilities reported in operating cash flows	\$ 7,218	\$ 1,013
Weighted average discount rate	2.27%	2.02%
Weighted average remaining lease term (in years)	5.2	1.9

The following table presents the contractual maturities of the Company's lease liabilities as of December 31, 2020:

(In thousands)	Offices	Auto Fleet	Total
2021	\$ 7,241	\$ 798	\$ 8,039
2022	5,358	447	5,805
2023	3,975	114	4,089
2024	3,404		3,404
2025	2,866		2,866
Thereafter	4,490		4,490
Total undiscounted lease payments	\$ 27,334	\$ 1,359	\$ 28,693
Less: present value adjustment	1,035	50	1,085
Operating lease liability	\$ 26,299	\$ 1,309	\$ 27,608

**Note 16. 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
Additional authorization in 2020	300,000
Total authorized for purchases and grants	500,000
Purchased and restricted	(57,601)
Vested	(62,064)
Purchased and available for future grants	(10,205)
Available for future purchases at December 31, 2020	370,130

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, 2017	95,510	\$ 437.24	\$ 41,762
Purchased in 2018	11,315	474.36	5,367
Purchased in 2019	11,527	443.41	5,111
Purchased in 2020	11,518	381.37	4,393
Total purchased since plan inception	129,870	436.07	\$ 56,633

Changes in the restricted shares outstanding were as follows:

**ZENITH NATIONAL INSURANCE CORP. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

(Dollars in thousands, except share data)	Number of Shares	Weighted Average Grant Date Fair Value Per Share	Grant Date Fair Value
<b>Restricted Shares at December 31, 2017</b>	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)
<b>Restricted Shares at December 31, 2018</b>	56,243	472.13	26,554
Granted during 2019	12,426	473.36	5,882
Forfeited during 2019	(1,080)	469.56	(507)
Vested during 2019	(6,156)	412.44	(2,539)
<b>Restricted Shares at December 31, 2019</b>	61,433	478.40	29,390
Granted during 2020	12,844	440.82	5,662
Forfeited during 2020	(200)	465.67	(93)
Vested during 2020	(16,476)	501.91	(8,269)
<b>Restricted Shares at December 31, 2020</b>	57,601	463.34	\$ 26,690

Stock-based compensation expense before tax was \$5.6 million, \$5.9 million and \$4.9 million for the years ended December 31, 2020, 2019 and 2018, respectively.

Unrecognized compensation expense before tax under the Restricted Stock Plan was \$15.1 million and \$13.9 million at December 31, 2020 and 2019, respectively.

## **Supplementary Consolidating Information**



## Report of Independent Auditors

To the Management of Zenith National Insurance Corp.

We have audited the consolidated financial statements of Zenith National Insurance Corp. and its subsidiaries (collectively, the “Company”) as of December 31, 2020 and for the year then ended and our report thereon appears on pages 2 and 3 of this document. That audit was conducted for the purpose of forming an opinion on the consolidated financial statements taken as a whole. The consolidating information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the consolidated financial statements. The consolidating information has been subjected to the auditing procedures applied in the audit of the consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the consolidated financial statements themselves and other additional procedures, in accordance with auditing standards generally accepted in the United States of America. In our opinion, the consolidating information is fairly stated, in all material respects, in relation to the consolidated financial statements taken as a whole. The consolidating information is presented for purposes of additional analysis of the consolidated financial statements rather than to present the financial position, results of operations and cash flows of the individual companies and is not a required part of the consolidated financial statements. Accordingly, we do not express an opinion on the financial position, results of operations and cash flows of the individual companies.

*PricewaterhouseCoopers LLP*

Los Angeles, California  
February 24, 2021

**ZENITH NATIONAL INSURANCE CORP. AND SUBSIDIARIES**  
**SUPPLEMENTARY CONSOLIDATING BALANCE SHEET**  
**DECEMBER 31, 2020**

(In thousands)	Zenith Insurance Company	ZNAT Insurance Company	1390 Main Street LLC	Zenith of Nevada, Inc.	Zenith Captive Insurance	Zenith Insurance Company Eliminations	Note	Zenith Insurance Company & Subsidiaries	Zenith National Insurance Corp.	Zenith National Insurance Corp. Eliminations	Note	Zenith National Insurance Corp. & Subsidiaries
<b>Assets:</b>												
Investments	\$ 1,487,950	\$ 53,065						\$ 1,541,015	\$ 11,241			\$ 1,552,256
Cash	55,009	4,624		\$ 1	\$ 344			59,978	2,860			62,838
Accrued investment income	7,016	89						7,105				7,105
Premiums receivable	38,553	926						39,479				39,479
Reinsurance recoverables	61,176	155,350				\$ (176,874)	(2a)	39,652				39,652
Deferred policy acquisition costs	11,033	1,723						12,756				12,756
Deferred tax asset	37,911	1,005	\$ (28)					38,888	427			39,315
Income tax receivable	1,878	86			3			1,967	(37)			1,930
Investment in subsidiaries	32,638					(32,638)	(2b)		536,870	\$ (536,870)	(2c)	
Operating lease right-of- use assets	26,085							26,085				26,085
Goodwill	18,976							18,976	2,009			20,985
Other assets	51,160	519	9,219					60,898	106			61,004
Intercompany	10,415	(10,970)						(555)	555			
<b>Total assets</b>	<b>\$ 1,839,800</b>	<b>\$ 206,417</b>	<b>\$ 9,191</b>	<b>\$ 1</b>	<b>\$ 347</b>	<b>\$ (209,512)</b>		<b>\$ 1,846,244</b>	<b>\$ 554,031</b>	<b>\$ (536,870)</b>		<b>\$ 1,863,405</b>
<b>Liabilities:</b>												
Unpaid losses and loss adjustment expenses	\$ 1,058,463	\$ 163,174				\$ (162,487)	(2a)	\$ 1,059,150				\$ 1,059,150
Unearned premiums	88,466	14,387				(14,387)	(2a)	88,466				88,466
Policyholders' dividends accrued	28,997	3,810						32,807				32,807
Long-term debt									\$ 38,282			38,282
Operating lease liabilities	27,608							27,608				27,608
Derivative liabilities	3,243							3,243				3,243
Other liabilities	96,153	1,939			\$ 8			98,100	3,474			101,574
<b>Total liabilities</b>	<b>1,302,930</b>	<b>183,310</b>			<b>8</b>	<b>(176,874)</b>		<b>1,309,374</b>	<b>41,756</b>			<b>1,351,130</b>
<b>Total stockholders' equity</b>	<b>536,870</b>	<b>23,107</b>	<b>\$ 9,191</b>	<b>\$ 1</b>	<b>339</b>	<b>(32,638)</b>	<b>(2b)</b>	<b>536,870</b>	<b>512,275</b>	<b>\$ (536,870)</b>	<b>(2c)</b>	<b>512,275</b>
<b>Total liabilities and stockholders' equity</b>	<b>\$ 1,839,800</b>	<b>\$ 206,417</b>	<b>\$ 9,191</b>	<b>\$ 1</b>	<b>\$ 347</b>	<b>\$ (209,512)</b>		<b>\$ 1,846,244</b>	<b>\$ 554,031</b>	<b>\$ (536,870)</b>		<b>\$ 1,863,405</b>

This supplementary consolidating balance sheet should be read in connection with the accompanying notes to supplementary consolidating balance sheet, the consolidated financial statements and notes to the consolidated financial statements.

**ZENITH NATIONAL INSURANCE CORP. AND SUBSIDIARIES**  
**NOTES TO SUPPLEMENTARY CONSOLIDATING BALANCE SHEET**

**1. Basis of Presentation**

The accompanying supplementary consolidating Balance Sheet has been prepared in accordance with GAAP and includes the accounts of Zenith Insurance, ZNAT, 1390 Main Street LLC, Zenith of Nevada, Inc. and Zenith National.

**2. Consolidating Eliminations**

The following eliminations are reflected in the accompanying supplementary consolidating Balance Sheet as of December 31, 2020:

- (a) To eliminate intercompany reinsurance balances;
- (b) To eliminate Zenith Insurance's investment in ZNAT, 1390 Main Street LLC and Zenith of Nevada, Inc.; and
- (c) To eliminate Zenith National's investment in Zenith Insurance.