

ATLANTIC AMERICAN CORP  
Form 10-Q  
November 13, 2018

---

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 or 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2018  
OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

Commission File Number 0-3722

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

Georgia 58-1027114  
(State or other jurisdiction of incorporation or organization) (I.R.S. Employer Identification No.)

4370 Peachtree Road, N.E., 30319  
Atlanta, Georgia  
(Address of principal executive offices) (Zip Code)

(404) 266-5500  
(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

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

Large accelerated filer Accelerated filer Non-accelerated filer (Do not check if a smaller reporting company)  
Smaller reporting company Emerging growth company

Edgar Filing: ATLANTIC AMERICAN CORP - Form 10-Q

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes    No

The total number of shares of the registrant's Common Stock, \$1 par value, outstanding on November 2, 2018 was 20,199,314.

---

---

ATLANTIC AMERICAN CORPORATION

TABLE OF CONTENTS

|  | <u>Page<br/>No.</u> |
|--|---------------------|
| <u>Part I. Financial Information</u>   |                     |
| Item 1. Financial Statements:  |                     |
| <u>Consolidated Balance Sheets at September 30, 2018 and December 31, 2017</u>   | 2                   |
| <u>Consolidated Statements of Operations for the three months and nine months ended September 30, 2018 and 2017</u>                  | 3                   |
| <u>Consolidated Statements of Comprehensive Income (Loss) for the three months and nine months ended September 30, 2018 and 2017</u> | 4                   |
| <u>Consolidated Statements of Shareholders' Equity for the nine months ended September 30, 2018 and 2017</u>                         | 5                   |
| <u>Consolidated Statements of Cash Flows for the nine months ended September 30, 2018 and 2017</u>                                   | 6                   |
| <u>Notes to Consolidated Financial Statements</u>  | 7                   |
| Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>                                 | 21                  |
| Item 4. <u>Controls and Procedures</u>   | 29                  |
| <u>Part II. Other Information</u>  |                     |
| Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>   | 30                  |
| Item 6. <u>Exhibits</u>  | 30                  |
| <u>Signatures</u>  | 31                  |

---

Table of Contents

## PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

## ATLANTIC AMERICAN CORPORATION

## CONSOLIDATED BALANCE SHEETS

(Dollars in thousands, except per share data)

## ASSETS

|   | Unaudited<br>September<br>30,<br>2018 | December<br>31,<br>2017 |
|---|---------------------------------------|-------------------------|
| Cash and cash equivalents   | \$ 10,038                             | \$ 24,547               |
| Investments:  |                                       |                         |
| Fixed maturities, available-for-sale (cost: \$215,698 and \$212,544)  | 207,138                               | 215,108                 |
| Equity securities (cost: \$10,515 and \$10,918)   | 23,705                                | 23,355                  |
| Other invested assets   | 10,817                                | 5,626                   |
| Policy loans  | 2,084                                 | 2,146                   |
| Real estate   | 38                                    | 38                      |
| Investment in unconsolidated trusts   | 1,238                                 | 1,238                   |
| Total investments   | 245,020                               | 247,511                 |
| Receivables:  |                                       |                         |
| Reinsurance   | 24,022                                | 17,613                  |
| Insurance premiums and other (net of allowance for doubtful accounts: \$216 and \$209)  | 14,972                                | 13,241                  |
| Deferred income taxes, net  | 3,077                                 | -                       |
| Deferred acquisition costs  | 34,934                                | 32,694                  |
| Other assets  | 4,942                                 | 5,089                   |
| Intangibles   | 2,544                                 | 2,544                   |
| Total assets  | \$ 339,549                            | \$ 343,239              |
| <b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>   |                                       |                         |
| Insurance reserves and policyholder funds:  |                                       |                         |
| Future policy benefits  | \$ 88,437                             | \$ 82,435               |
| Unearned premiums   | 26,272                                | 23,449                  |
| Losses and claims   | 71,816                                | 65,689                  |
| Other policy liabilities  | 1,288                                 | 2,010                   |
| Total insurance reserves and policyholder funds   | 187,813                               | 173,583                 |
| Accounts payable and accrued expenses   | 15,880                                | 22,342                  |
| Deferred income taxes, net  | -                                     | 593                     |
| Junior subordinated debenture obligations, net  | 33,738                                | 33,738                  |
| Total liabilities   | 237,431                               | 230,256                 |
| Commitments and contingencies (Note 9)  |                                       |                         |
| Shareholders' equity:   |                                       |                         |
| Preferred stock, \$1 par, 4,000,000 shares authorized; Series D preferred, 55,000 shares issued and outstanding; \$5,500 redemption value | 55                                    | 55                      |
| Common stock, \$1 par, 50,000,000 shares authorized; shares issued: 22,400,894; shares outstanding: 20,218,836 and 20,449,531             | 22,401                                | 22,401                  |
| Additional paid-in capital  | 57,419                                | 57,495                  |

Edgar Filing: ATLANTIC AMERICAN CORP - Form 10-Q

|   |            |   |            |   |
|---|------------|---|------------|---|
| Retained earnings                                       | 37,107     |   | 30,993     |   |
| Accumulated other comprehensive income (loss)           | (6,762     | ) | 9,751      |   |
| Unearned stock grant compensation                       | (252       | ) | (579       | ) |
| Treasury stock, at cost: 2,182,058 and 1,951,363 shares | (7,850     | ) | (7,133     | ) |
| Total shareholders' equity                              | 102,118    |   | 112,983    |   |
| Total liabilities and shareholders' equity              | \$ 339,549 |   | \$ 343,239 |   |

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

-2-

---

Table of ContentsATLANTIC AMERICAN CORPORATION  
CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited; Dollars in thousands, except per share data)

|  | Three Months Ended<br>September 30, |           | Nine Months Ended<br>September 30, |            |
|--|-------------------------------------|-----------|------------------------------------|------------|
|  | 2018                                | 2017      | 2018                               | 2017       |
| Revenue:   |                                     |           |                                    |            |
| Insurance premiums                                   | \$ 42,557                           | \$ 42,094 | \$ 127,604                         | \$ 122,996 |
| Net investment income                                | 2,215                               | 2,136     | 7,111                              | 6,380      |
| Realized investment gains, net                       | 484                                 | 539       | 797                                | 2,818      |
| Unrealized gains on equity securities, net           | 1,083                               | -         | 753                                | -          |
| Other income   | 31                                  | 29        | 88                                 | 95         |
| Total revenue  | 46,370                              | 44,798    | 136,353                            | 132,289    |
| Benefits and expenses:                               |                                     |           |                                    |            |
| Insurance benefits and losses incurred               | 33,087                              | 30,417    | 98,478                             | 87,446     |
| Commissions and underwriting expenses                | 8,722                               | 10,176    | 28,456                             | 31,800     |
| Interest expense                                     | 529                                 | 440       | 1,497                              | 1,273      |
| Other expense  | 2,960                               | 3,134     | 9,168                              | 9,301      |
| Total benefits and expenses                          | 45,298                              | 44,167    | 137,599                            | 129,820    |
| Income (loss) before income taxes                    | 1,072                               | 631       | (1,246 )                           | 2,469      |
| Income tax expense (benefit)                         | 138                                 | (116 )    | (341 )                             | 483        |
| Net income (loss)                                    | 934                                 | 747       | (905 )                             | 1,986      |
| Preferred stock dividends                            | (100 )                              | (100 )    | (299 )                             | (299 )     |
| Net income (loss) applicable to common shareholders  | \$ 834                              | \$ 647    | \$(1,204 )                         | \$ 1,687   |
| Earnings (loss) per common share (basic and diluted) | \$.04                               | \$.03     | \$(.06 )                           | \$.08      |
| Dividends per common share                           | \$ -                                | \$ -      | \$.02                              | \$.02      |

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

Table of Contents

## ATLANTIC AMERICAN CORPORATION

## CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

(Unaudited; Dollars in thousands)

|   | Three Months<br>Ended<br>September 30, |          | Nine Months Ended<br>September 30, |          |
|---|--|----------|------------------------------------|----------|
|   | 2018                                   | 2017     | 2018                               | 2017     |
| Net income (loss)   | \$ 934                                 | \$ 747   | \$(905 )                           | \$1,986  |
| Other comprehensive income (loss):  |  |          |                                    |          |
| <u>Available-for-sale securities:</u>   |  |          |                                    |          |
| Gross unrealized holding gain (loss) arising in the period                              | 63                                     | 2,852    | (10,327 )                          | 7,271    |
| Related income tax effect   | (13 )                                  | (997 )   | 2,169                              | (2,544 ) |
| Subtotal  | 50                                     | 1,855    | (8,158 )                           | 4,727    |
| Less: reclassification adjustment for net realized losses included in net income (loss) | (484 )                                 | (539 )   | (797 )                             | (2,818 ) |
| Related income tax effect   | 101                                    | 188      | 167                                | 986      |
| Subtotal  | (383 )                                 | (351 )   | (630 )                             | (1,832 ) |
| Total other comprehensive income (loss), net of tax                                     | (333 )                                 | 1,504    | (8,788 )                           | 2,895    |
| Total comprehensive income (loss)   | \$ 601                                 | \$ 2,251 | \$(9,693 )                         | \$4,881  |

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

Table of Contents

## ATLANTIC AMERICAN CORPORATION

## CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

(Unaudited; Dollars in thousands)

| Nine Months Ended  | Preferred<br>Stock | Common<br>Stock | Additional<br>Paid-In<br>Capital | Retained<br>Earnings | Accumulated<br>Other<br>Comprehensive<br>Income | Unearned<br>Stock<br>Grant<br>Compensation | Treasury<br>Stock | Total      |
|--|--------------------|-----------------|----------------------------------|----------------------|---|--|-------------------|------------|
|  |                    |                 |                                  |                      |   |  |                   |            |
| September 30, 2018   |                    |                 |                                  |                      |   |  |                   |            |
| Balance, December 31, 2017   | \$ 55              | \$ 22,401       | \$ 57,495                        | \$ 30,993            | \$ 9,751  | \$ (579 )                                  | \$(7,133 )        | \$ 112,983 |
| Cumulative effect of adoption of accounting guidance for equity financial instruments at January 1, 2018 | -                  | -               | -                                | 9,825                | (9,825 )  | -  | -                 | -          |
| Reclassification of certain tax effects from accumulated other comprehensive income at January 1, 2018   | -                  | -               | -                                | (2,100 )             | 2,100   | -  | -                 | -          |
| Net loss   | -                  | -               | -                                | (905 )               | -   | -  | -                 | (905 )     |
| Other comprehensive loss, net of tax   | -                  | -               | -                                | -                    | (8,788 )  | -  | -                 | (8,788 )   |
| Dividends on common stock  | -                  | -               | -                                | (407 )               | -   | -  | -                 | (407 )     |
| Dividends accrued on preferred stock   | -                  | -               | -                                | (299 )               | -   | -  | -                 | (299 )     |
| Restricted stock grants, net   | -                  | -               | (88 )                            | -                    | -   | 135  | (47 )             | -          |
| Amortization of unearned compensation  | -                  | -               | -                                | -                    | -   | 192  | -                 | 192        |
| Purchase of shares for treasury  | -                  | -               | -                                | -                    | -   | -  | (463 )            | (463 )     |
| Net shares acquired related to employee share-based compensation plans                                   | -                  | -               | -                                | -                    | -   | -  | (223 )            | (223 )     |
| Issuance of shares under stock plans   | -                  | -               | 12                               | -                    | -   | -  | 16                | 28         |
| Balance, September 30, 2018  | \$ 55              | \$ 22,401       | \$ 57,419                        | \$ 37,107            | \$ (6,762 )                                     | \$ (252 )                                  | \$(7,850 )        | \$ 102,118 |
|  |                    |                 |                                  |                      |   |  |                   |            |
| Nine Months Ended  |                    |                 |                                  |                      |   |  |                   |            |
| September 30, 2017   |                    |                 |                                  |                      |   |  |                   |            |
| Balance, December 31, 2016   | \$ 55              | \$ 22,401       | \$ 57,114                        | \$ 27,272            | \$ 5,830  | \$ (428 )                                  | \$(6,738 )        | \$ 105,506 |
| Net income   | -                  | -               | -                                | 1,986                | -   | -  | -                 | 1,986      |
| Other comprehensive income, net of tax   | -                  | -               | -                                | -                    | 2,895   | -  | -                 | 2,895      |
| Dividends on common stock  | -                  | -               | -                                | (408 )               | -   | -  | -                 | (408 )     |
|  | -                  | -               | -                                | (299 )               | -   | -  | -                 | (299 )     |



|                                       |       |           |           |           |          |           |            |            |
|---------------------------------------|-------|-----------|-----------|-----------|----------|-----------|------------|------------|
| Dividends accrued on preferred stock  |       |           |           |           |          |           |            |            |
| Restricted stock grants               | -     | -         | 293       | -         | -        | (522 )    | 229        | -          |
| Amortization of unearned compensation | -     | -         | -         | -         | -        | 363       | -          | 363        |
| Purchase of shares for treasury       | -     | -         | -         | -         | -        | -         | (546 )     | (546 )     |
| Issuance of shares under stock plans  | -     | -         | 13        | -         | -        | -         | 10         | 23         |
| Balance, September 30, 2017           | \$ 55 | \$ 22,401 | \$ 57,420 | \$ 28,551 | \$ 8,725 | \$ (587 ) | \$(7,045 ) | \$ 109,520 |

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

-5-

---

Table of ContentsATLANTIC AMERICAN CORPORATION  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
(Unaudited; Dollars in thousands)

|  | Nine Months Ended<br>September 30, |          |
|--|------------------------------------|----------|
|  | 2018                               | 2017     |
| <b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>   |                                    |          |
| Net (loss) income  | \$(905 )                           | \$1,986  |
| Adjustments to reconcile net (loss) income to net cash used in operating activities: |                                    |          |
| Amortization of deferred acquisition costs   | 8,986                              | 8,696    |
| Acquisition costs deferred   | (11,226)                           | (11,880) |
| Realized investment gains, net   | (797 )                             | (2,818 ) |
| Unrealized losses on equity securities, net  | (753 )                             | -        |
| Distributions received from equity method investees                                  | 725                                | 58       |
| Compensation expense related to share awards   | 192                                | 363      |
| Depreciation and amortization  | 783                                | 1,149    |
| Deferred income tax benefit  | (1,335 )                           | (423 )   |
| Increase in receivables, net   | (7,882 )                           | (8,289 ) |
| Increase in insurance reserves   | 14,230                             | 12,513   |
| Decrease in other liabilities  | (6,760 )                           | (2,096 ) |
| Other, net   | (377 )                             | (344 )   |
| Net cash used in operating activities  | (5,119 )                           | (1,085 ) |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>   |                                    |          |
| Proceeds from investments sold   | 28,177                             | 52,702   |
| Proceeds from investments matured, called or redeemed                                | 4,577                              | 8,982    |
| Investments purchased  | (40,827)                           | (63,346) |
| Additions to property and equipment  | (252 )                             | (101 )   |
| Net cash used in investing activities  | (8,325 )                           | (1,763 ) |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>   |                                    |          |
| Payment of dividends on common stock   | (407 )                             | (408 )   |
| Proceeds from shares issued under stock plans  | 28                                 | 23       |
| Treasury stock acquired — share repurchase authorization                             | (463 )                             | (546 )   |
| Treasury stock acquired — net employee share-based compensation                      | (223 )                             | -        |
| Net cash used in financing activities  | (1,065 )                           | (931 )   |
| Net decrease in cash and cash equivalents  | (14,509)                           | (3,779 ) |
| Cash and cash equivalents at beginning of period                                     | 24,547                             | 13,252   |
| Cash and cash equivalents at end of period   | \$10,038                           | \$9,473  |
| <b>SUPPLEMENTAL CASH FLOW INFORMATION:</b>   |                                    |          |
| Cash paid for interest   | \$1,471                            | \$1,263  |
| Cash paid for income taxes   | \$1,892                            | \$1,400  |

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

Table of Contents

ATLANTIC AMERICAN CORPORATION  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
(Unaudited; Dollars in thousands, except per share amounts)

Note 1. Basis of Presentation

The accompanying unaudited consolidated financial statements include the accounts of Atlantic American Corporation (the “Parent”) and its subsidiaries (collectively with the Parent, the “Company”). The Parent’s primary operating subsidiaries, American Southern Insurance Company and American Safety Insurance Company (together known as “American Southern”) and Bankers Fidelity Life Insurance Company and Bankers Fidelity Assurance Company (together known as “Bankers Fidelity”), operate in two principal business units. American Southern operates in the property and casualty insurance market, while Bankers Fidelity operates in the life and health insurance market. All significant intercompany accounts and transactions have been eliminated in consolidation. The accompanying financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP”) for interim financial information and with the instructions to Form 10-Q and Article 8 of Regulation S-X. Accordingly, they do not include all of the information and notes required by GAAP for audited annual financial statements. In the opinion of management, all adjustments (consisting only of normal recurring adjustments) considered necessary for a fair presentation have been included. The unaudited consolidated financial statements included herein and these related notes should be read in conjunction with the Company’s consolidated financial statements, and the notes thereto, included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2017 (the “2017 Annual Report”). The Company’s financial condition and results of operations and cash flows as of and for the three month and nine month periods ended September 30, 2018 are not necessarily indicative of the financial condition or results of operations and cash flows that may be expected for the year ending December 31, 2018 or for any other future period.

The Company’s significant accounting policies have not changed materially from those set out in the Company’s 2017 Annual Report, except as noted below for the adoption of new accounting standards.

The preparation of financial statements in accordance with GAAP requires management to make estimates and assumptions that affect the reported amount of assets and liabilities, disclosures of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ materially from those estimates.

Note 2. Recently Issued Accounting Standards

Adoption of New Accounting Standards

In February 2018, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) No. 2018-02, Income Statement – Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income (“ASU 2018-02”). The FASB issued this guidance for the effect on deferred tax assets and liabilities related to items recorded in accumulated other comprehensive income (“AOCI”) resulting from legislated tax reform enacted on December 22, 2017. The tax reform reduced the federal tax rate applied to the Company’s deferred tax balances from 35% to 21% on enactment. The Company recorded the total effect of the change in enacted tax rates on deferred tax balances in the income tax expense component of net income. ASU 2018-02 permits the Company to reclassify out of AOCI and into retained earnings the “stranded” tax effects that resulted from recording the tax effects of unrealized investment gains at a 35% tax rate because the 14% reduction in tax rate was recognized in net income instead of other comprehensive income. The Company adopted ASU 2018-02 as of January 1, 2018. As a result, on January 1, 2018, the Company reclassified \$2,100 of stranded tax effects related to continuing operations which increased AOCI and reduced retained earnings.

In August 2016, the FASB issued ASU No. 2016-15, Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments (“ASU 2016-15”). ASU 2016-15 is intended to reduce diversity in practice in how certain transactions are classified in the statement of cash flows. The issues addressed in ASU 2016-15 are: 1) debt prepayment or debt extinguishment costs, 2) settlement of zero-coupon debt instruments, 3) contingent consideration payments made after a business combination, 4) proceeds from the settlement of insurance claims, 5) proceeds from the settlement of corporate-owned life insurance policies, including bank-owned life insurance policies, 6) distributions received from equity method investees, 7) beneficial interests in securitization transactions and 8) separately identifiable cash flows and application of the predominance principle. The Company adopted ASU 2016-15 as of January 1, 2018, which impacted the classification of distributions from equity method investees. The Company made the election to use the nature of distributions approach. For the nine month period ended September 30, 2018, the Company classified distributions from equity method investees of \$725 as cash flows from operating activities and reclassified \$58 as cash flows from investing activities to cash flows from operating activities for the nine month period ended September 30, 2017, in its consolidated statements of cash flows.

-7-

---

### Table of Contents

In January 2016, the FASB issued ASU No. 2016-01, Financial Instruments – Overall (Subtopic 825-10) (“ASU 2016-01”). ASU 2016-01 provides updated guidance for the recognition and measurement of financial instruments. The guidance requires investments in equity securities to be measured at fair value with any changes in valuation reported in net income except for investments that are consolidated or are accounted for under the equity method of accounting. The guidance also requires a deferred tax asset resulting from net unrealized losses on available-for-sale (AFS) fixed maturities that are recognized in AOCI to be evaluated for recoverability in combination with the Company’s other deferred tax assets. Under previous guidance, the Company measured investments in equity securities at fair value with any changes in fair value reported in other comprehensive income. The Company adopted ASU 2016-01 as of January 1, 2018. The adoption of this guidance resulted in the recognition of \$9,825 of net after tax unrealized gains on equity securities as a cumulative effect adjustment that increased retained earnings as of January 1, 2018 and decreased AOCI by the same amount. The Company elected to report changes in the fair value of equity securities in a separate line item on the Company’s consolidated statements of operations. At December 31, 2017, equity securities were classified as AFS in the Company’s consolidated balance sheets. However, upon adoption, the updated guidance eliminated the AFS balance sheet classification for equity securities.

In May 2014, the FASB issued ASU No. 2014-09, Revenue from Contracts with Customers (Topic 606) (“ASU 2014-09”). ASU 2014-09, as modified, provides guidance for recognizing revenue which excludes insurance contracts and financial instruments. Revenue is to be recognized when, or as, goods or services are transferred to customers in an amount that reflects the consideration that an entity is expected to be entitled in exchange for those goods or services. The Company adopted ASU No. 2014-09 as of January 1, 2018. For the nine months ended September 30, 2018, approximately \$88, or less than one-tenth of 1% of the Company's total revenues, were within the scope of this updated guidance. The adoption of this ASU did not have an impact on the Company’s consolidated financial statements.

### Future Adoption of New Accounting Standards

In August 2018, the FASB issued ASU No. 2018-13, Fair Value Measurement (Topic 820): Disclosure Framework – Changes to the Disclosure Requirements for Fair Value Measurement (“ASU 2018-13”). This guidance removes the following disclosure requirements from Topic 820: (1) the amount of and reasons for transfers between Level 1 and Level 2 of the fair value hierarchy, (2) the policy for timing of transfers between levels, and (3) the valuation processes for Level 3 fair value measurements. This disclosure also includes the changes in unrealized gains and losses for the period included in other comprehensive income for recurring Level 3 fair value measurements held at the end of the reporting period and the range and weighted average of significant unobservable inputs used to develop Level 3 fair value measurements. ASU 2018-13 is effective for interim and annual reporting periods beginning after December 15, 2019, although earlier adoption is permitted. The Company does not expect the adoption of this ASU to have a material impact on its consolidated financial statements.

In August 2018, the FASB issued ASU No. 2018-12, Financial Services —Insurance (Topic 944): Targeted Improvements to the Accounting for Long-Duration Contracts (“ASU 2018-12”). This guidance (1) improves the timeliness of recognizing changes in the liability for future policy benefits and modifies the rate used to discount future cash flows, (2) simplifies and improves the accounting for certain market-based options or guarantees associated with deposit (or account balance) contracts, (3) simplifies the amortization of deferred acquisition costs, and (4) improves the effectiveness of the required disclosures. ASU 2018-12 is effective for interim and annual reporting periods beginning after December 15, 2020, although earlier adoption is permitted. The Company has not yet determined the method or timing for adoption or estimated the impact on the Company’s consolidated financial statements.

In July 2018, the FASB issued ASU No. 2018-11, Leases (Topic 842): Targeted Improvements (“ASU 2018-11”). This guidance was issued to clarify the comparative reporting requirements for initial adoption and to provide an additional and optional transition method to adopt the new lease standard. The Company has not yet made an election on the

optional transition method. See Note 1 – Summary of Significant Accounting Policies of Notes to Consolidated Financial Statements included in the Company's 2017 Annual Report for more information on the future adoption of the new lease accounting standard. The Company does not expect the adoption of the new lease standard to have a material impact on its consolidated financial statements; however, it is expected that assets and liabilities will increase based on the present value of remaining lease payments for the minor number of leases which will be in place at the adoption date.

-8-

---

Table of ContentsNote 3. Investments

The following tables set forth the estimated fair value, gross unrealized gains, gross unrealized losses and cost or amortized cost of the Company's investments in fixed maturities and equity securities, aggregated by type and industry, as of September 30, 2018 and December 31, 2017.

Fixed maturities were comprised of the following:

|  | September 30, 2018         |                              |                               |                              |
|--|----------------------------|------------------------------|-------------------------------|------------------------------|
|  | Estimated<br>Fair<br>Value | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Cost or<br>Amortized<br>Cost |
| Fixed maturities:  |                            |                              |                               |                              |
| Bonds:   |                            |                              |                               |                              |
| U.S. Treasury securities and obligations of U.S. Government agencies and authorities | \$26,240                   | \$ 7                         | \$ 1,449                      | \$ 27,682                    |
| Obligations of states and political subdivisions                                     | 8,224                      | 259                          | 135                           | 8,100                        |
| Corporate securities:  |                            |                              |                               |                              |
| Utilities and telecom  | 18,891                     | 855                          | 756                           | 18,792                       |
| Financial services   | 51,517                     | 1,031                        | 2,142                         | 52,628                       |
| Other business – diversified   | 47,267                     | 240                          | 2,668                         | 49,695                       |
| Other consumer – diversified   | 54,807                     | 87                           | 3,889                         | 58,609                       |
| Total corporate securities   | 172,482                    | 2,213                        | 9,455                         | 179,724                      |
| Redeemable preferred stocks:   |                            |                              |                               |                              |
| Other consumer – diversified   | 192                        | -                            | -                             | 192                          |
| Total redeemable preferred stocks  | 192                        | -                            | -                             | 192                          |
| Total fixed maturities   | \$207,138                  | \$ 2,479                     | \$ 11,039                     | \$ 215,698                   |
|  |                            |                              |                               |                              |
|  | December 31, 2017          |                              |                               |                              |
|  | Estimated<br>Fair<br>Value | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Cost or<br>Amortized<br>Cost |
| Fixed maturities:  |                            |                              |                               |                              |
| Bonds:   |                            |                              |                               |                              |
| U.S. Treasury securities and obligations of U.S. Government agencies and authorities | \$31,155                   | \$ 149                       | \$ 511                        | \$ 31,517                    |
| Obligations of states and political subdivisions                                     | 10,809                     | 630                          | 1                             | 10,180                       |
| Corporate securities:  |                            |                              |                               |                              |
| Utilities and telecom  | 21,882                     | 1,709                        | 130                           | 20,303                       |
| Financial services   | 53,686                     | 2,049                        | 453                           | 52,090                       |
| Other business – diversified   | 44,184                     | 1,024                        | 1,349                         | 44,509                       |
| Other consumer – diversified   | 53,200                     | 924                          | 1,477                         | 53,753                       |
| Total corporate securities   | 172,952                    | 5,706                        | 3,409                         | 170,655                      |
| Redeemable preferred stocks:   |                            |                              |                               |                              |
| Other consumer – diversified   | 192                        | -                            | -                             | 192                          |
| Total redeemable preferred stocks  | 192                        | -                            | -                             | 192                          |
| Total fixed maturities   | \$215,108                  | \$ 6,485                     | \$ 3,921                      | \$ 212,544                   |

Bonds having an amortized cost of \$9,896 and \$11,178 and included in the tables above were on deposit with insurance regulatory authorities as of September 30, 2018 and December 31, 2017, respectively, in accordance with

statutory requirements.

-9-

---



Table of Contents

Equity securities were comprised of the following:

|   | September 30, 2018 |            |            |           |
|---|--------------------|------------|------------|-----------|
|   | Estimated Gross    |            | Gross      |           |
|   | Fair               | Unrealized | Unrealized | Cost      |
|   | Value              | Gains      | Losses     |           |
| Equity securities:                          |                    |            |            |           |
| Common and non-redeemable preferred stocks: |                    |            |            |           |
| Utilities and telecom                       | \$ 1,602           | \$ 637     | \$ -       | \$ 965    |
| Financial services                          | 4,770              | 390        | -          | 4,380     |
| Other business – diversified                | 320                | 273        | -          | 47        |
| Other consumer – diversified                | 17,013             | 11,890     | -          | 5,123     |
| Total equity securities                     | \$23,705           | \$ 13,190  | \$ -       | \$ 10,515 |

|   | December 31, 2017 |            |            |           |
|---|-------------------|------------|------------|-----------|
|   | Estimated Gross   |            | Gross      |           |
|   | Fair              | Unrealized | Unrealized | Cost      |
|   | Value             | Gains      | Losses     |           |
| Equity securities:                          |                   |            |            |           |
| Common and non-redeemable preferred stocks: |                   |            |            |           |
| Utilities and telecom                       | \$ 1,588          | \$ 624     | \$ -       | \$ 964    |
| Financial services                          | 5,634             | 851        | -          | 4,783     |
| Other business – diversified                | 297               | 250        | -          | 47        |
| Other consumer – diversified                | 15,836            | 10,712     | -          | 5,124     |
| Total equity securities                     | \$23,355          | \$ 12,437  | \$ -       | \$ 10,918 |

The carrying value and amortized cost of the Company's investments in fixed maturities at September 30, 2018 and December 31, 2017 by contractual maturity were as follows. Actual maturities may differ from contractual maturities because issuers may call or prepay obligations with or without call or prepayment penalties.

|  | September 30, 2018 |                | December 31, 2017 |                |
|--|--------------------|----------------|-------------------|----------------|
|  | Carrying Value     | Amortized Cost | Carrying Value    | Amortized Cost |
| Due in one year or less                | \$3,148            | \$ 3,150       | \$ 1,653          | \$ 1,655       |
| Due after one year through five years  | 19,055             | 19,408         | 13,738            | 14,056         |
| Due after five years through ten years | 126,581            | 131,961        | 112,847           | 112,116        |
| Due after ten years                    | 42,251             | 43,970         | 67,328            | 64,928         |
| Varying maturities                     | 16,103             | 17,209         | 19,542            | 19,789         |
| Totals                                 | \$207,138          | \$ 215,698     | \$ 215,108        | \$ 212,544     |

Table of Contents

The following tables present the Company's unrealized loss aging for securities by type and length of time the security was in a continuous unrealized loss position as of September 30, 2018 and December 31, 2017.

|  | September 30, 2018  |                   |                     |                   |            |                   |
|--|---------------------|-------------------|---------------------|-------------------|------------|-------------------|
|  | Less than 12 months |                   | 12 months or longer |                   | Total      |                   |
|  | Fair Value          | Unrealized Losses | Fair Value          | Unrealized Losses | Fair Value | Unrealized Losses |
| U.S. Treasury securities and obligations of U.S. Government agencies and authorities | \$3,923             | \$ 178            | \$ 20,812           | \$ 1,271          | \$24,735   | \$ 1,449          |
| Obligations of states and political subdivisions                                     | 4,402               | 135               | -                   | -                 | 4,402      | 135               |
| Corporate securities   | 90,396              | 4,116             | 50,934              | 5,339             | 141,330    | 9,455             |
| Total temporarily impaired securities  | \$98,721            | \$ 4,429          | \$ 71,746           | \$ 6,610          | \$170,467  | \$ 11,039         |

|  | December 31, 2017   |                   |                     |                   |            |                   |
|--|---------------------|-------------------|---------------------|-------------------|------------|-------------------|
|  | Less than 12 months |                   | 12 months or longer |                   | Total      |                   |
|  | Fair Value          | Unrealized Losses | Fair Value          | Unrealized Losses | Fair Value | Unrealized Losses |
| U.S. Treasury securities and obligations of U.S. Government agencies and authorities | \$12,175            | \$ 162            | \$ 12,737           | \$ 349            | \$24,912   | \$ 511            |
| Obligations of states and political subdivisions                                     | 999                 | 1                 | -                   | -                 | 999        | 1                 |
| Corporate securities   | 40,108              | 653               | 32,667              | 2,756             | 72,775     | 3,409             |
| Total temporarily impaired securities  | \$53,282            | \$ 816            | \$ 45,404           | \$ 3,105          | \$98,686   | \$ 3,921          |

The evaluation for an other than temporary impairment is a quantitative and qualitative process, which is subject to risks and uncertainties in the determination of whether declines in the fair value of investments are other than temporary. Potential risks and uncertainties include, among other things, changes in general economic conditions, an issuer's financial condition or near term recovery prospects and the effects of changes in interest rates. In evaluating a potential impairment, the Company considers, among other factors, management's intent and ability to hold the securities until price recovery, the nature of the investment and the expectation of prospects for the issuer and its industry, the status of an issuer's continued satisfaction of its obligations in accordance with their contractual terms, and management's expectation as to the issuer's ability and intent to continue to do so, as well as ratings actions that may affect the issuer's credit status.

Table of Contents

As of September 30, 2018 and December 31, 2017, there were one hundred thirty-three and sixty-nine securities, respectively, in an unrealized loss position which primarily included certain of the Company's investments in fixed maturities within the financial services, other diversified business and other diversified consumer sectors. The increase in the number and value of securities in an unrealized loss position during the nine month period ended September 30, 2018, was primarily attributable to the rising interest rate environment. The Company does not currently intend to sell nor does it expect to be required to sell any of the securities in an unrealized loss position. Based upon the Company's expected continuation of receipt of contractually required principal and interest payments and its intent and ability to retain the securities until price recovery, as well as the Company's evaluation of other relevant factors, including those described above, the Company has deemed these securities to be temporarily impaired as of September 30, 2018.

The following describes the fair value hierarchy and provides information as to the extent to which the Company uses fair value to measure the value of its financial instruments and information about the inputs used to value those financial instruments. The fair value hierarchy prioritizes the inputs in the valuation techniques used to measure fair value into three broad levels.

Level 1 Observable inputs that reflect quoted prices for identical assets or liabilities in active markets that the Company has the ability to access at the measurement date. The Company's financial instruments valued using Level 1 criteria include cash equivalents and exchange traded common stocks.

Level 2 Observable inputs, other than quoted prices included in Level 1, for an asset or liability or prices for similar assets or liabilities. The Company's financial instruments valued using Level 2 criteria include significantly all of its fixed maturities, which consist of U.S. Treasury securities and U.S. Government securities, obligations of states and political subdivisions, and certain corporate fixed maturities, as well as its non-redeemable preferred stocks. In determining fair value measurements of its fixed maturities and non-redeemable preferred stocks using Level 2 criteria, the Company utilizes data from outside sources, including nationally recognized pricing services and broker/dealers. Prices for the majority of the Company's Level 2 fixed maturities and non-redeemable preferred stocks were determined using unadjusted prices received from pricing services that utilize a matrix pricing concept, which is a mathematical technique used widely in the industry to value debt securities based on various relationships to other benchmark quoted prices.

Level 3 Valuations that are derived from techniques in which one or more of the significant inputs are unobservable (including assumptions about risk). Fair value is based on criteria that use assumptions or other data that are not readily observable from objective sources. The Company's financial instruments valued using Level 3 criteria consist of a limited number of fixed maturities. As of September 30, 2018 and December 31, 2017, the value of the Company's fixed maturities valued using Level 3 criteria was \$1,018 and \$1,369, respectively. The use of different criteria or assumptions regarding data may have yielded materially different valuations.

Table of Contents

As of September 30, 2018, financial instruments carried at fair value were measured on a recurring basis as summarized below:

|                   | Quoted Prices<br>in Active<br>Markets<br>for Identical<br>Assets<br>(Level 1) | Significant<br>Other<br>Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) | Total          |
|-------------------|---|---|--|----------------|
| <u>Assets:</u>    |   |   |  |                |
| Fixed maturities  | \$ -  | \$ 206,120  | \$ 1,018   | (1) \$ 207,138 |
| Equity securities | 19,155  | 4,550   | (1) -  | 23,705         |
| Cash equivalents  | 8,653   | -   | -  | 8,653          |
| Total             | \$ 27,808   | \$ 210,670  | \$ 1,018   | \$ 239,496     |

(1) All underlying securities are financial service industry related.

As of December 31, 2017, financial instruments carried at fair value were measured on a recurring basis as summarized below:

|                   | Quoted Prices<br>in Active<br>Markets<br>for Identical<br>Assets<br>(Level 1) | Significant<br>Other<br>Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) | Total          |
|-------------------|---|---|--|----------------|
| <u>Assets:</u>    |   |   |  |                |
| Fixed maturities  | \$ -  | \$ 213,739  | \$ 1,369   | (1) \$ 215,108 |
| Equity securities | 17,973  | 5,382   | (1) -  | 23,355         |
| Cash equivalents  | 13,855  | -   | -  | 13,855         |
| Total             | \$ 31,828   | \$ 219,121  | \$ 1,369   | \$ 252,318     |

(1) All underlying securities are financial service industry related.

The following tables provide a roll-forward of the Company's financial instruments measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the three month and nine month periods ended September 30, 2018 and 2017.

|  |                     |
|--|---------------------|
|  | Fixed<br>Maturities |
| Balance, December 31, 2017                                   | \$ 1,369            |
| Total unrealized losses included in other comprehensive loss | (30 )               |
| Balance, March 31, 2018                                      | 1,339               |
| Total unrealized gains included in other comprehensive loss  | 7                   |
| Balance, June 30, 2018                                       | 1,346               |
| Total realized gains included in earnings                    | 208                 |
| Total unrealized losses included in other comprehensive loss | (53 )               |
| Settlements  | (483 )              |
| Balance, September 30, 2018                                  | \$ 1,018            |

Edgar Filing: ATLANTIC AMERICAN CORP - Form 10-Q

|   | Fixed<br>Maturities |
|---|---------------------|
| Balance, December 31, 2016                                    | \$ 1,264            |
| Total unrealized gains included in other comprehensive income | 38                  |
| Balance, March 31, 2017                                       | 1,302               |
| Total unrealized gains included in other comprehensive income | 30                  |
| Balance, June 30, 2017  | 1,332               |
| Total unrealized gains included in other comprehensive income | 19                  |
| Balance, September 30, 2017                                   | \$ 1,351            |

-13-

---

Table of Contents

The Company's fixed maturities valued using Level 3 inputs consist solely of issuances of pooled debt obligations of multiple, smaller financial services companies that are not actively traded. There are no assumed prepayments and/or default probability assumptions as a majority of these instruments contain certain U.S. government agency strips to support repayment of the principal. Other qualitative and quantitative information received from the original underwriter of the pooled offerings is also considered, as applicable.

The following table is a summary of realized investment gains (losses) for the three month and nine month periods ended September 30, 2018 and 2017.

|                                | Three Months Ended |        | Nine Months Ended |          |
|--------------------------------|--------------------|--------|-------------------|----------|
|                                | September 30,      |        | September 30,     |          |
|                                | 2018               | 2017   | 2018              | 2017     |
| Gross gains                    | \$ 484             | \$ 539 | \$ 1,101          | \$ 2,879 |
| Gross losses                   | -                  | -      | (304 )            | (61 )    |
| Realized investment gains, net | \$ 484             | \$ 539 | \$ 797            | \$ 2,818 |

The following table presents the portion of unrealized gains (losses) related to equity securities still held for the three month and nine month periods ended September 30, 2018 and 2017.

|   | Three Months Ended |      | Nine Months Ended |      |
|---|--------------------|------|-------------------|------|
|   | September 30,      |      | September 30,     |      |
|   | 2018               | 2017 | 2018              | 2017 |
| Net gains recognized during the period on equity securities   | \$ 1,355           | \$ - | \$ 1,025          | \$ - |
| Less: Net losses recognized during the period on equity securities sold during the period                         | (272 )             | -    | (272 )            | -    |
| Net unrealized gains recognized during the reporting period on equity securities still held at the reporting date | \$ 1,083           | \$ - | \$ 753            | \$ - |

Note 4. Fair Values of Financial Instruments

The estimated fair values have been determined by the Company using available market information from various market sources and appropriate valuation methodologies as of the respective dates. However, considerable judgment is necessary to interpret market data and to develop the estimates of fair value. Although management is not aware of any factors that would significantly affect the estimated fair value amounts, the estimates presented herein are not necessarily indicative of the amounts which the Company could realize in a current market exchange. The use of different market assumptions and/or estimation methodologies may have a material effect on the estimated fair value amounts.

Table of Contents

The following table sets forth the carrying amount, estimated fair value and level within the fair value hierarchy of the Company's financial instruments as of September 30, 2018 and December 31, 2017.

|                                     | Level in Fair Value Hierarchy <sup>(1)</sup> | September 30, 2018 |                      | December 31, 2017 |                      |
|-------------------------------------|--|--------------------|----------------------|-------------------|----------------------|
|                                     |  | Carrying Amount    | Estimated Fair Value | Carrying Amount   | Estimated Fair Value |
| <u>Assets:</u>                      |  |                    |                      |                   |                      |
| Cash and cash equivalents           | Level 1                                      | \$ 10,038          | \$ 10,038            | \$ 24,547         | \$ 24,547            |
| Fixed maturities                    | (1)  | 207,138            | 207,138              | 215,108           | 215,108              |
| Equity securities                   | (1)  | 23,705             | 23,705               | 23,355            | 23,355               |
| Other invested assets               | Level 3                                      | 10,817             | 10,817               | 5,626             | 5,626                |
| Policy loans                        | Level 2                                      | 2,084              | 2,084                | 2,146             | 2,146                |
| Real estate                         | Level 2                                      | 38                 | 38                   | 38                | 38                   |
| Investment in unconsolidated trusts | Level 2                                      | 1,238              | 1,238                | 1,238             | 1,238                |
| <u>Liabilities:</u>                 |  |                    |                      |                   |                      |
| Junior subordinated debentures, net | Level 2                                      | 33,738             | 33,738               | 33,738            | 33,738               |

<sup>(1)</sup> See Note 3 for a description of the fair value hierarchy as well as a disclosure of levels for classes of these financial assets.

There have not been any transfers between Level 1, Level 2 and Level 3 during the periods presented in these consolidated financial statements.

Note 5. Liabilities for Unpaid Losses, Claims and Loss Adjustment Expenses

The roll-forward of liabilities for unpaid losses, claims and loss adjustment expenses, by major product, is as follows:

| <u>Property and Casualty Insurance Products</u>                                     | Nine Months Ended  |           |
|---|--------------------|-----------|
|   | September 30, 2018 | 2017      |
| Beginning liabilities for unpaid losses, claims and loss adjustment expenses, gross | \$ 47,997          | \$ 49,556 |
| Less: Reinsurance recoverable on unpaid losses                                      | (7,220 )           | (9,806 )  |
| Beginning liabilities for unpaid losses, claims and loss adjustment expenses, net   | 40,777             | 39,750    |
| Incurred related to:  |                    |           |
| Current accident year   | 30,339             | 27,359    |
| Prior accident year development <sup>(1)</sup>                                      | (1,795 )           | (1,480 )  |
| Total incurred  | 28,544             | 25,879    |
| Paid related to:  |                    |           |
| Current accident year   | 10,716             | 9,858     |
| Prior accident years  | 15,693             | 13,720    |
| Total paid  | 26,409             | 23,578    |
| Ending liabilities for unpaid losses, claims and loss adjustment expenses, net      | 42,912             | 42,051    |
| Plus: Reinsurance recoverable on unpaid losses                                      | 6,928              | 9,455     |
| Ending liabilities for unpaid losses, claims and loss adjustment expenses, gross    | \$ 49,840          | \$ 51,506 |

<sup>(1)</sup>

In establishing property and casualty reserves, the Company initially reserves for losses at the higher end of the reasonable range if no other value within the range is determined to be more probable. Selection of such an initial loss estimate is an attempt by management to give recognition that initial claims information received generally is not conclusive with respect to legal liability, is generally not comprehensive with respect to magnitude of loss and generally, based on historical experience, will develop more adversely as time passes and more information becomes available. Accordingly, the Company generally experiences reserve redundancies when analyzing the development of prior year losses in a current period.

-15-

---



Table of Contents

|   | Nine Months Ended<br>September 30, |           |
|---|------------------------------------|-----------|
|   | 2018                               | 2017      |
| <u>Medicare Supplement Insurance Products</u>                                       |                                    |           |
| Beginning liabilities for unpaid losses, claims and loss adjustment expenses, gross | \$ 15,859                          | \$ 11,263 |
| Less: Reinsurance recoverable on unpaid losses                                      | (4,748 )                           | (990 )    |
| Beginning liabilities for unpaid losses, claims and loss adjustment expenses, net   | 11,111                             | 10,273    |
| Incurred related to:  |                                    |           |
| Current accident year   | 59,356                             | 50,733    |
| Prior accident year development   | 817                                | 720       |
| Total incurred  | 60,173                             | 51,453    |
| Paid related to:  |                                    |           |
| Current accident year   | 46,734                             | 40,801    |
| Prior accident years  | 11,594                             | 10,445    |
| Total paid  | 58,328                             | 51,246    |
| Ending liabilities for unpaid losses, claims and loss adjustment expenses, net      | 12,956                             | 10,480    |
| Plus: Reinsurance recoverable on unpaid losses                                      | 7,340                              | 3,640     |
| Ending liabilities for unpaid losses, claims and loss adjustment expenses, gross    | \$ 20,296                          | \$ 14,120 |

|   | Nine Months Ended<br>September 30, |          |
|---|------------------------------------|----------|
|   | 2018                               | 2017     |
| <u>Other Life and Health Insurance Products</u>                                     |                                    |          |
| Beginning liabilities for unpaid losses, claims and loss adjustment expenses, gross | \$ 1,833                           | \$ 1,743 |
| Less: Reinsurance recoverable on unpaid losses                                      | -                                  | -        |
| Beginning liabilities for unpaid losses, claims and loss adjustment expenses, net   | 1,833                              | 1,743    |
| Incurred related to:  |                                    |          |
| Current accident year   | 6,729                              | 6,226    |
| Prior accident year development   | (71 )                              | (104 )   |
| Total incurred  | 6,658                              | 6,122    |
| Paid related to:  |                                    |          |
| Current accident year   | 5,148                              | 4,807    |
| Prior accident years  | 1,663                              | 1,500    |
| Total paid  | 6,811                              | 6,307    |
| Ending liabilities for unpaid losses, claims and loss adjustment expenses, net      | 1,680                              | 1,558    |
| Plus: Reinsurance recoverable on unpaid losses                                      | -                                  | -        |
| Ending liabilities for unpaid losses, claims and loss adjustment expenses, gross    | \$ 1,680                           | \$ 1,558 |

Following is a reconciliation of total incurred losses to total insurance benefits and losses incurred:

|  | Nine Months Ended<br>September 30, |           |
|--|------------------------------------|-----------|
|  | 2018                               | 2017      |
| Total incurred losses                        | \$ 95,375                          | \$ 83,454 |
| Cash surrender value and matured endowments  | 1,057                              | 1,167     |
| Benefit reserve changes                      | 2,046                              | 2,825     |
| Total insurance benefits and losses incurred | \$ 98,478                          | \$ 87,446 |



Table of ContentsNote 6. Junior Subordinated Debentures

The Company has two unconsolidated Connecticut statutory business trusts, which exist for the exclusive purposes of: (i) issuing trust preferred securities (“Trust Preferred Securities”) representing undivided beneficial interests in the assets of the trusts; (ii) investing the gross proceeds of the Trust Preferred Securities in junior subordinated deferrable interest debentures (“Junior Subordinated Debentures”) of Atlantic American; and (iii) engaging in those activities necessary or incidental thereto.

The financial structure of each of Atlantic American Statutory Trust I and II as of September 30, 2018 was as follows:

|  | Atlantic American<br>Statutory Trust I | Atlantic American<br>Statutory Trust II |
|--|--|---|
| <b>JUNIOR SUBORDINATED DEBENTURES</b> <sup>(1) (2)</sup> |  |   |
| Principal amount owed September 30, 2018                 | \$ 18,042                              | \$ 23,196                               |
| Less: Treasury debt <sup>(3)</sup>                       | -                                      | (7,500)                                 |
| Net balance September 30, 2018                           | \$ 18,042                              | \$ 15,696                               |
| Net balance December 31, 2017                            | \$ 18,042                              | \$ 15,696                               |
| Coupon rate  | LIBOR + 4.00%                          | LIBOR + 4.10%                           |
| Interest payable   | Quarterly                              | Quarterly                               |
| Maturity date  | December 4, 2032                       | May 15, 2033                            |
| Redeemable by issuer                                     | Yes                                    | Yes                                     |
| <b>TRUST PREFERRED SECURITIES</b>                        |  |   |
| Issuance date  | December 4, 2002                       | May 15, 2003                            |
| Securities issued  | 17,500                                 | 22,500                                  |
| Liquidation preference per security                      | \$ 1                                   | \$ 1                                    |
| Liquidation value  | \$ 17,500                              | \$ 22,500                               |
| Coupon rate  | LIBOR + 4.00%                          | LIBOR + 4.10%                           |
| Distribution payable                                     | Quarterly                              | Quarterly                               |
| Distribution guaranteed by <sup>(4)</sup>                | Atlantic American Corporation          | Atlantic American Corporation           |

For each of the respective debentures, the Company has the right at any time, and from time to time, to defer payments of interest on the Junior Subordinated Debentures for a period not exceeding 20 consecutive quarters up to the debentures’ respective maturity dates. During any such period, interest will continue to accrue and the

(1) Company may not declare or pay any cash dividends or distributions on, or purchase, the Company’s common stock nor make any principal, interest or premium payments on or repurchase any debt securities that rank equally with or junior to the Junior Subordinated Debentures. The Company has the right at any time to dissolve each of the trusts and cause the Junior Subordinated Debentures to be distributed to the holders of the Trust Preferred Securities.

(2) The Junior Subordinated Debentures are unsecured and rank junior and subordinate in right of payment to all senior debt of the Parent and are effectively subordinated to all existing and future liabilities of its subsidiaries.

(3) On August 4, 2014, the Company acquired \$7,500 of the Junior Subordinated Debentures.

The Parent has guaranteed, on a subordinated basis, all of the obligations under the Trust Preferred Securities,

(4) including payment of the redemption price and any accumulated and unpaid distributions to the extent of available funds and upon dissolution, winding up or liquidation.

Table of ContentsNote 7. Earnings (Loss) Per Common Share

A reconciliation of the numerator and denominator used in the earnings (loss) per common share calculations is as follows:

|  | Three Months Ended<br>September 30, 2018 |   |                     |
|--|--|---|---------------------|
|  | Income                                   | Weighted<br>Average<br>Shares<br>(In thousands) | Per Share<br>Amount |
| Basic and Diluted Earnings Per Common Share: |  |   |                     |
| Net income                                   | \$934                                    | 20,420  |                     |
| Less: preferred stock dividends              | (100)                                    | -   |                     |
| Net income applicable to common shareholders | \$834                                    | 20,420  | \$ .04              |

|  | Three Months Ended<br>September 30, 2017 |   |                        |
|--|--|---|------------------------|
|  | Income                                   | Weighted<br>Average<br>Shares<br>(In thousands) | Per<br>Share<br>Amount |
| Basic and Diluted Earnings Per Common Share: |  |   |                        |
| Net income                                   | \$747                                    | 20,440  |                        |
| Less: preferred stock dividends              | (100)                                    | -   |                        |
| Net income applicable to common shareholders | \$647                                    | 20,440  | \$ .03                 |

|  | Nine Months Ended<br>September 30, 2018 |   |                        |
|--|---|---|------------------------|
|  | Income                                  | Weighted<br>Average<br>Shares<br>(In thousands) | Per<br>Share<br>Amount |
| Basic and Diluted Loss Per Common Share:   |   |   |                        |
| Net loss                                   | \$(905 )                                | 20,314  |                        |
| Less: preferred stock dividends            | (299 )                                  | -   |                        |
| Net loss applicable to common shareholders | \$(1,204)                               | 20,314  | \$ (.06)               |

|  | Nine Months Ended<br>September 30, 2017 |   |                        |
|--|---|---|------------------------|
|  | Income                                  | Weighted<br>Average<br>Shares<br>(In thousands) | Per<br>Share<br>Amount |
| Basic and Diluted Earnings Per Common Share: |   |   |                        |
| Net income                                   | \$1,986                                 | 20,428  |                        |
| Less: preferred stock dividends              | (299 )                                  | -   |                        |
| Net income applicable to common shareholders | \$1,687                                 | 20,428  | \$ .08                 |

The assumed conversion of the Company's Series D preferred stock was excluded from the earnings per common share calculation for all periods presented since its impact would have been antidilutive.

-18-

---

Table of ContentsNote 8. Income Taxes

A reconciliation of the differences between income taxes computed at the federal statutory income tax rate and income tax expense (benefit) is as follows:

|   | Three Months<br>Ended<br>September 30,<br>2018 |           | Nine Months<br>Ended<br>September 30,<br>2018 |        |
|---|--|-----------|---|--------|
| Federal income tax provision at statutory rate of 21% and 35% for 2018 and 2017, respectively | \$ 225   | \$ 221    | \$ (262 )                                     | \$ 864 |
| Dividends-received deduction  | (10 )  | (23 )     | (30 )   | (71 )  |
| Small life insurance company deduction  | -  | (313 )    | -   | (343 ) |
| Other permanent differences   | 22   | 18        | 50  | 52     |
| Adjustment for prior years' estimates to actual   | (99 )  | (19 )     | (99 )   | (19 )  |
| Income tax expense (benefit)  | \$ 138   | \$ (116 ) | \$ (341 )                                     | \$ 483 |

The components of income tax expense (benefit) were:

|                    | Three Months Ended<br>September 30,<br>2018 |           | Nine Months Ended<br>September 30,<br>2018 |        |
|--------------------|---|-----------|--|--------|
| Current - Federal  | \$ 255                                      | \$ (157 ) | \$ 994                                     | \$ 906 |
| Deferred - Federal | (117 )                                      | 41        | (1,335 )                                   | (423 ) |
| Total              | \$ 138                                      | \$ (116 ) | \$ (341 )                                  | \$ 483 |

The primary difference between the effective tax rate and the federal statutory income tax rate for the three month and nine month periods ended September 30, 2018 resulted from provision-to-filed return adjustments, as described below, and the dividends-received deduction ("DRD"). The current estimated DRD is adjusted as underlying factors change and can vary from estimates based on, but not limited to, actual distributions from investments as well as the amount of the Company's taxable income.

The primary differences between the effective tax rate and the federal statutory income tax rate for the three month and nine month periods ended September 30, 2017 resulted from the DRD and the small life insurance company deduction ("SLD"), which was subsequently repealed by tax reform enacted on December 22, 2017. Under the then-applicable tax rules, the SLD varied in amount and was determined at a rate of 60 percent of the tentative life insurance company taxable income ("LICTI"). The SLD for any taxable year was reduced (but not below zero) by 15 percent of the tentative LICTI for such taxable year as it exceeded \$3,000 and was ultimately phased out at \$15,000.

The provision-to-filed return adjustments are generally updated at the completion of the third quarter of each fiscal year and were \$99 and \$19 in the three month and nine month periods ended September 30, 2018 and 2017, respectively.

Note 9. Commitments and Contingencies

From time to time, the Company is, and expects to continue to be, involved in various claims and lawsuits incidental to and in the ordinary course of its businesses. In the opinion of management, any such known claims are not expected to have a material effect on the financial condition or results of operations of the Company.



Table of ContentsNote 10. Segment Information

The Parent's primary insurance subsidiaries, American Southern and Bankers Fidelity, operate in two principal business units, each focusing on specific products. American Southern operates in the property and casualty insurance market, while Bankers Fidelity operates in the life and health insurance market. Each business unit is managed independently and is evaluated on its individual performance. The following sets forth the revenue and income (loss) before income taxes for each business unit for the three month and nine month periods ended September 30, 2018 and 2017.

| Revenues            | Three Months Ended |           | Nine Months Ended |            |
|---------------------|--------------------|-----------|-------------------|------------|
|                     | September 30,      |           | September 30,     |            |
|                     | 2018               | 2017      | 2018              | 2017       |
| American Southern   | \$ 13,998          | \$ 15,047 | \$ 42,174         | \$ 43,402  |
| Bankers Fidelity    | 31,196             | 29,661    | 92,950            | 87,757     |
| Corporate and Other | 1,176              | 90        | 1,229             | 1,130      |
| Total revenue       | \$ 46,370          | \$ 44,798 | \$ 136,353        | \$ 132,289 |

| Income (Loss) Before Income Taxes | Three Months Ended |          | Nine Months Ended |          |
|-----------------------------------|--------------------|----------|-------------------|----------|
|                                   | September 30,      |          | September 30,     |          |
|                                   | 2018               | 2017     | 2018              | 2017     |
| American Southern                 | \$ 995             | \$ 1,860 | \$ 3,892          | \$ 5,941 |
| Bankers Fidelity                  | 512                | 402      | (1,762 )          | 190      |
| Corporate and Other               | (435 )             | (1,631 ) | (3,376 )          | (3,662 ) |
| Income (loss) before income taxes | \$ 1,072           | \$ 631   | \$ (1,246 )       | \$ 2,469 |

Note 11. Accumulated Other Comprehensive Income (Loss)

The following table sets forth the balance of the only component of accumulated other comprehensive income (loss) as of September 30, 2018 and December 31, 2017, and the changes in the balance of that component thereof during the nine month period ended September 30, 2018, net of taxes.

|  |   |             |
|--|---|-------------|
| Balance, December 31, 2017   | Unrealized Gains on Available-for-Sale Securities | \$ 9,751    |
| Cumulative effect of adoption of updated accounting guidance for equity financial instruments at January 1, 2018 |   | (9,825 )    |
| Reclassification of certain tax effects from accumulated other comprehensive income at January 1, 2018           |   | 2,100       |
| Total effect of adoption of updated accounting guidance at January 1, 2018                                       |   | (7,725 )    |
| Other comprehensive loss before reclassifications  |   | (8,158 )    |
| Amounts reclassified from accumulated other comprehensive loss   |   | (630 )      |
| Net current period other comprehensive loss  |   | (8,788 )    |
| Balance, September 30, 2018  |   | \$ (6,762 ) |

Note 12. Related Party Transactions



For the nine month periods ended September 30, 2018 and 2017, Gray Television, Inc., a related party, paid the Company approximately \$306 and \$448, respectively, in employer paid insurance premiums related to a group accident plan.

-20-

---

Table of ContentsItem 2.MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION  
AND RESULTS OF OPERATIONS

The following is management's discussion and analysis of the financial condition and results of operations of Atlantic American Corporation ("Atlantic American" or the "Parent") and its subsidiaries (collectively with the Parent, the "Company") as of and for the three month and nine month periods ended September 30, 2018. This discussion should be read in conjunction with the unaudited consolidated financial statements and notes thereto included elsewhere herein, as well as with the audited consolidated financial statements and notes included in the Company's Annual Report on Form 10-K for the year ended December 31, 2017 (the "2017 Annual Report").

Atlantic American is an insurance holding company whose operations are conducted primarily through its insurance subsidiaries: American Southern Insurance Company and American Safety Insurance Company (together known as "American Southern") and Bankers Fidelity Life Insurance Company and Bankers Fidelity Assurance Company (together known as "Bankers Fidelity"). Each operating company is managed separately, offers different products and is evaluated on its individual performance.

## Critical Accounting Policies

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America ("GAAP") requires management to make estimates and assumptions that affect reported amounts and related disclosures. Actual results could differ significantly from those estimates. The Company has identified certain estimates that involve a higher degree of judgment and are subject to a significant degree of variability. The Company's critical accounting policies and the resultant estimates considered most significant by management are disclosed in the Company's 2017 Annual Report. Except as disclosed in Note 2 of the Consolidated Financial Statements, the Company's critical accounting policies are consistent with those disclosed in the Company's 2017 Annual Report.

## Overall Corporate Results

The following presents the Company's revenue, expenses and net income (loss) for the three month and nine month periods ended September 30, 2018 and the comparable periods in 2017:

|  | Three Months<br>Ended<br>September 30, |          | Nine Months Ended<br>September 30, |           |
|--|--|----------|------------------------------------|-----------|
|  | 2018                                   | 2017     | 2018                               | 2017      |
|  | (In thousands)                         |          |                                    |           |
| Insurance premiums                         | \$42,557                               | \$42,094 | \$127,604                          | \$122,996 |
| Net investment income                      | 2,215                                  | 2,136    | 7,111                              | 6,380     |
| Realized investment gains, net             | 484                                    | 539      | 797                                | 2,818     |
| Unrealized gains on equity securities, net | 1,083                                  | -        | 753                                | -         |
| Other income                               | 31                                     | 29       | 88                                 | 95        |
| Total revenue                              | 46,370                                 | 44,798   | 136,353                            | 132,289   |
| Insurance benefits and losses incurred     | 33,087                                 | 30,417   | 98,478                             | 87,446    |
| Commissions and underwriting expenses      | 8,722                                  | 10,176   | 28,456                             | 31,800    |
| Interest expense                           | 529                                    | 440      | 1,497                              | 1,273     |
| Other expense                              | 2,960                                  | 3,134    | 9,168                              | 9,301     |
| Total benefits and expenses                | 45,298                                 | 44,167   | 137,599                            | 129,820   |

Edgar Filing: ATLANTIC AMERICAN CORP - Form 10-Q

|                                   |         |       |           |           |
|-----------------------------------|---------|-------|-----------|-----------|
| Income (loss) before income taxes | \$1,072 | \$631 | \$(1,246) | ) \$2,469 |
| Net income (loss)                 | \$934   | \$747 | \$(905)   | ) \$1,986 |

-21-

---

Table of Contents

Management also considers and evaluates performance by analyzing the non-GAAP measure operating income (loss), and believes it is a useful metric for investors, potential investors, securities analysts and others because it isolates the “core” operating results of the Company before considering certain items that are either beyond the control of management (such as taxes, which are subject to timing, regulatory and rate changes depending on the timing of the associated revenues and expenses) or are not expected to regularly impact the Company’s operational results (such as any realized investment gains, which are not a part of the Company’s primary operations and are, to a limited extent, subject to discretion in terms of timing of realization).

A reconciliation of net income (loss) to operating income (loss) for the three month and nine month periods ended September 30, 2018 and the comparable period in 2017 is as follows:

| Reconciliation of Non-GAAP Financial Measure | Three Months                   |       | Nine Months Ended |          |
|--|--------------------------------|-------|-------------------|----------|
|  | Ended<br>September 30,<br>2018 | 2017  | 2018              | 2017     |
|  | (In thousands)                 |       |                   |          |
| Net income (loss)                            | \$934                          | \$747 | \$ (905 )         | \$ 1,986 |
| Income tax expense (benefit)                 | 138                            | (116) | (341 )            | 483      |
| Realized investment gains, net               | (484 )                         | (539) | (797 )            | (2,818 ) |
| Unrealized gains on equity securities, net   | (1,083)                        | -     | (753 )            | -        |
| Operating income (loss)                      | \$(495 )                       | \$92  | \$(2,796 )        | \$(349 ) |

On a consolidated basis, the Company had net income of \$0.9 million, or \$0.04 per diluted share, for the three month period ended September 30, 2018, compared to net income of \$0.7 million, or \$0.03 per diluted share, for the three month period ended September 30, 2017. The Company had a net loss of \$0.9 million, or \$0.06 per diluted share, for the nine month period ended September 30, 2018, compared to net income of \$2.0 million, or \$0.08 per diluted share, for the nine month period ended September 30, 2017. Premium revenue for the three month period ended September 30, 2018 increased \$0.5 million, or 1.1%, to \$42.6 million from \$42.1 million in the three month period ended September 30, 2017. For the nine month period ended September 30, 2018, premium revenue increased \$4.6 million, or 3.7%, to \$127.6 million from \$123.0 million in the comparable 2017 period. The increase in premium revenue for the three month and nine month periods ended September 30, 2018 was primarily attributable to an increase in Medicare supplement business in the life and health operations. Operating income decreased \$0.6 million in the three month period ended September 30, 2018 from the three month period ended September 30, 2017. For the nine month period ended September 30, 2018, the operating loss increased \$2.4 million over the comparable period in 2017. The change in operating income (loss) during the three month and nine month periods ended September 30, 2018 was primarily due to unfavorable loss experience in both the property and casualty and the life and health operations. Partially offsetting the unfavorable loss experience for the three month and nine month periods ended September 30, 2018 was a lower ratio of underwriting expenses incurred relative to earned premiums.

A more detailed analysis of the individual operating companies and other corporate activities follows.

Table of Contents

## American Southern

The following summarizes American Southern's premiums, losses, expenses and underwriting ratios for the three month and nine month periods ended September 30, 2018 and the comparable periods in 2017:

|                                       | Three Months                   |          | Nine Months Ended     |          |
|---------------------------------------|--------------------------------|----------|-----------------------|----------|
|                                       | Ended<br>September 30,<br>2018 | 2017     | September 30,<br>2018 | 2017     |
|                                       | (Dollars in thousands)         |          |                       |          |
| Gross written premiums                | \$9,250                        | \$9,520  | \$44,592              | \$46,505 |
| Ceded premiums                        | (1,238 )                       | (1,238 ) | (3,669 )              | (3,592 ) |
| Net written premiums                  | \$8,012                        | \$8,282  | \$40,923              | \$42,913 |
| Net earned premiums                   | \$13,050                       | \$14,046 | \$39,299              | \$40,268 |
| Net loss and loss adjustment expenses | 10,672                         | 9,663    | 28,544                | 25,879   |
| Underwriting expenses                 | 2,331                          | 3,525    | 9,737                 | 11,583   |
| Underwriting income                   | \$47                           | \$858    | \$1,018               | \$2,806  |
| Loss ratio                            | 81.8 %                         | 68.8 %   | 72.6 %                | 64.3 %   |
| Expense ratio                         | 17.9                           | 25.1     | 24.8                  | 28.7     |
| Combined ratio                        | 99.7 %                         | 93.9 %   | 97.4 %                | 93.0 %   |

Gross written premiums at American Southern decreased \$0.3 million, or 2.8%, during the three month period ended September 30, 2018, and \$1.9 million, or 4.1%, during the nine month period ended September 30, 2018, from the comparable periods in 2017. The decrease in gross written premiums for the three month and nine month periods ended September 30, 2018 was primarily attributable to a decline in premiums written in the surety line of business as a result of increased competition. Also contributing to the decrease in gross written premiums for the nine month period ended September 30, 2018 was the non-renewal of one agency during the first half of the year. Partially offsetting the decrease was an increase in premiums written in the automobile physical damage line of business due to increased writings from certain agencies.

Ceded premiums did not vary during the three month period ended September 30, 2018 and increased \$0.1 million, or 2.1%, during the nine month period ended September 30, 2018, over the comparable periods in 2017 due primarily to an increase in earned premiums in certain accounts within the automobile physical damage line of business, which is subject to reinsurance. Also contributing to the increase was a slight reinsurance rate increase in the automobile liability line of business.

The following presents American Southern's net earned premiums by line of business for the three month and nine month periods ended September 30, 2018 and the comparable periods in 2017 (in thousands):

|                            | Three Months                   |          | Nine Months Ended     |          |
|----------------------------|--------------------------------|----------|-----------------------|----------|
|                            | Ended<br>September 30,<br>2018 | 2017     | September 30,<br>2018 | 2017     |
|                            | (In thousands)                 |          |                       |          |
| Automobile liability       | \$6,878                        | \$7,971  | \$21,123              | \$22,103 |
| Automobile physical damage | 3,013                          | 2,424    | 8,365                 | 7,297    |
| General liability          | 678                            | 745      | 2,131                 | 2,211    |
| Surety                     | 1,729                          | 2,091    | 5,441                 | 6,418    |
| Other lines                | 752                            | 815      | 2,239                 | 2,239    |
| Total                      | \$13,050                       | \$14,046 | \$39,299              | \$40,268 |

Net earned premiums decreased \$1.0 million, or 7.1%, during the three month period ended September 30, 2018, and \$1.0 million, or 2.4% during the nine month period ended September 30, 2018, over the comparable periods in 2017. The decrease in net earned premiums for the three month and nine month periods ended September 30, 2018 was primarily attributable to decreases in the automobile liability and surety lines of businesses. Partially offsetting this variance was an increase in premiums written in the automobile physical damage line of business, as discussed above. Premiums are earned ratably over their respective policy terms, and therefore premiums earned in the current year are related to policies written during both the current year and immediately preceding year.

-23-

---

Table of Contents

The performance of an insurance company is often measured by its combined ratio. The combined ratio represents the percentage of losses, loss adjustment expenses and other expenses that are incurred for each dollar of premium earned by the company. A combined ratio of under 100% represents an underwriting profit while a combined ratio of over 100% indicates an underwriting loss. The combined ratio is divided into two components, the loss ratio (the ratio of losses and loss adjustment expenses incurred to premiums earned) and the expense ratio (the ratio of expenses incurred to premiums earned).

Net loss and loss adjustment expenses at American Southern increased \$1.0 million, or 10.4%, during the three month period ended September 30, 2018, and \$2.7 million, or 10.3%, during the nine month period ended September 30, 2018, over the comparable periods in 2017. As a percentage of earned premiums, net loss and loss adjustment expenses were 81.8% in the three month period ended September 30, 2018, compared to 68.8% in the three month period ended September 30, 2017. For the nine month period ended September 30, 2018, this ratio increased to 72.6% from 64.3% in the comparable period of 2017. The increase in the loss ratio was primarily due to an increase in the frequency and severity of claims in the automobile liability and automobile physical damage lines of business during the three month and nine month periods ended September 30, 2018. Partially offsetting the increase in the loss ratio during the three month and nine month periods ended September 30, 2018 was more favorable loss experience in the general liability line of business.

Underwriting expenses decreased \$1.2 million, or 33.9%, during the three month period ended September 30, 2018 from the three month period ended September 30, 2017, and \$1.8 million, or 15.9%, during the nine month period ended September 30, 2018, from the comparable period in 2017. As a percentage of earned premiums, underwriting expenses were 17.9% in the three month period ended September 30, 2018, compared to 25.1% in the three month period ended September 30, 2017. For the nine month period ended September 30, 2018, this ratio decreased to 24.8% from 28.7% in the comparable period of 2017. The change in the expense ratio for the three month and nine month periods ended September 30, 2018 was primarily due to American Southern's use of a variable commission structure with certain agents, which compensates the participating agents in relation to the loss ratios of the business they write. During periods in which the loss ratio decreases, commissions and underwriting expenses will generally increase, and conversely, during periods in which the loss ratio increases, commissions and underwriting expenses will generally decrease. During the three month and nine month periods ended September 30, 2018, variable commissions at American Southern decreased \$0.8 million and \$1.2 million, respectively, from the comparable periods in 2017 due to less favorable loss experience from accounts subject to variable commissions. Also contributing to the decrease in variable commissions was a decline in premiums written in the surety line of business during the three month period ended September 30, 2018.

Table of Contents

## Bankers Fidelity

The following summarizes Bankers Fidelity's earned premiums, losses, expenses and underwriting ratios for the three month and nine month periods ended September 30, 2018 and the comparable periods in 2017:

|                               | Three Months Ended<br>September 30,<br>2018 |           | September 30,<br>2017 |           | Nine Months Ended<br>September 30,<br>2018 |   | September 30,<br>2017 |   |
|-------------------------------|---|-----------|-----------------------|-----------|--|---|-----------------------|---|
|                               | (Dollars in thousands)                      |           |                       |           |  |   |                       |   |
| Medicare supplement           | \$41,123                                    | \$32,617  | \$120,550             | \$90,369  |  |   |                       |   |
| Other health products         | 2,139                                       | 1,641     | 5,729                 | 4,749     |  |   |                       |   |
| Life insurance                | 2,306                                       | 2,413     | 6,879                 | 7,384     |  |   |                       |   |
| Gross earned premiums         | 45,568                                      | 36,671    | 133,158               | 102,502   |  |   |                       |   |
| Ceded premiums                | (16,061)                                    | (8,623)   | (44,853)              | (19,774)  |  |   |                       |   |
| Net earned Premiums           | 29,507                                      | 28,048    | 88,305                | 82,728    |  |   |                       |   |
| Insurance benefits and losses | 22,415                                      | 20,754    | 69,934                | 61,567    |  |   |                       |   |
| Underwriting expenses         | 8,270                                       | 8,505     | 24,779                | 26,000    |  |   |                       |   |
| Total expenses                | 30,685                                      | 29,259    | 94,713                | 87,567    |  |   |                       |   |
| Underwriting loss             | \$(1,178)                                   | \$(1,211) | \$(6,408)             | \$(4,839) |  |   |                       |   |
| Loss ratio                    | 76.0  | %         | 74.0                  | %         | 79.2                                       | % | 74.4                  | % |
| Expense ratio                 | 28.0  |           | 30.3                  |           | 28.1                                       |   | 31.4                  |   |
| Combined ratio                | 104.0                                       | %         | 104.3                 | %         | 107.3                                      | % | 105.8                 | % |

Net earned premium revenue at Bankers Fidelity increased \$1.5 million, or 5.2%, during the three month period ended September 30, 2018, and \$5.6 million, or 6.7%, during the nine month period ended September 30, 2018, over the comparable periods in 2017. Gross earned premiums from the Medicare supplement line of business increased \$8.5 million, or 26.1%, during the three month period ended September 30, 2018, and \$30.2 million, or 33.4%, during the nine month period ended September 30, 2018, due primarily to successful execution of new business generating strategies with both new and existing agents. Other health product premiums increased \$0.5 million and \$1.0 million, respectively, during the same comparable periods, primarily as a result of new sales of the company's hospital indemnity, disability income and group health products. Gross earned premiums from the life insurance line of business decreased \$0.1 million, or 4.4%, during the three month period ended September 30, 2018, and \$0.5 million, or 6.8%, during the nine month period ended September 30, 2018 from the comparable 2017 periods due to the redemption and settlement of existing policy obligations exceeding the level of new sales activity. Premiums ceded increased \$7.4 million, or 86.3%, during the three month period ended September 30, 2018 and \$25.1 million, or 126.8%, during the nine month period ended September 30, 2018, over the comparable periods in 2017. The increase in ceded premiums for the three month and nine month periods ended September 30, 2018 was due to a significant increase in Medicare supplement premiums subject to the reinsurance agreement.

Benefits and losses increased \$1.7 million, or 8.0%, during the three month period ended September 30, 2018, and \$8.4 million, or 13.6%, during the nine month period ended September 30, 2018, over the comparable periods in 2017. As a percentage of earned premiums, benefits and losses were 76.0% in the three month period ended September 30, 2018, compared to 74.0% in the three month period ended September 30, 2017. For the nine month period ended September 30, 2018, this ratio increased to 79.2% from 74.4% in the comparable period of 2017. The increase in the loss ratio for the three month and nine month periods ended September 30, 2018 was primarily attributable to unfavorable loss experience in the Medicare supplement line of business. Throughout 2017 and continuing into the nine month period ended September 30, 2018, Bankers Fidelity experienced a higher than expected level of claims in the Medicare supplement line of business which had an unfavorable effect on the company's loss patterns and increased the resultant loss ratio.



Underwriting expenses decreased \$0.2 million, or 2.8%, during the three month period ended September 30, 2018 and \$1.2 million, or 4.7%, during the nine month period ended September 30, 2018, from the comparable periods in 2017. As a percentage of earned premiums, underwriting expenses were 28.0% in the three month period ended September 30, 2018, compared to 30.3% in the three month period ended September 30, 2017. For the nine month period ended September 30, 2018, this ratio decreased to 28.1% from 31.4% in the comparable period of 2017. The decrease in the expense ratio for the three month and nine month periods ended September 30, 2018 was primarily due to the increase in earned premiums coupled with a relatively consistent level of fixed general and administrative expenses. Also contributing to the decrease in the expense ratio was a reinsurance expense-reimbursement allowance associated with the reinsurance agreement, which reimbursed the company for a portion of its indirect underwriting expenses.

Table of Contents

NET INVESTMENT INCOME AND REALIZED GAINS

Net investment income increased \$0.1 million, or 3.7%, during the three month period ended September 30, 2018, and \$0.7 million, or 11.5%, during the nine month period ended September 30, 2018, over the comparable periods in 2017. The increase in net investment income was primarily attributable to an increase in the equity in earnings from investments in real estate partnerships during the three month and nine month periods ended September 30, 2018 of \$0.1 million and \$0.7 million, respectively, over the comparable periods of 2017.

The Company had net realized investment gains of \$0.5 million during each of the three month periods ended September 30, 2018 and 2017. The Company had net realized investment gains of \$0.8 million during the nine month period ended September 30, 2018, compared to net realized investment gains of \$2.8 million in the nine month period ended September 30, 2017. The net realized investment gains in the three month and nine month periods ended September 30, 2018 resulted from the disposition of several of the Company's investments in fixed maturities and an equity security. The net realized investment gains in the three month and nine month periods ended September 30, 2017 were primarily attributable to gains from the sale of certain equity securities and a number of the Company's investments in fixed maturities. Management continually evaluates the Company's investment portfolio and, as may be determined to be appropriate, makes adjustments for impairments and/or will divest investments.

UNREALIZED LOSSES ON EQUITY SECURITIES

As described in Note 2 of the Consolidated Financial Statements, on January 1, 2018 the Company adopted ASU No. 2016-01, which requires, among other things, investments in equity securities to be measured at fair value at the end of the reporting period, with any changes in fair value reported in net income during the period, with certain exceptions. As a result of the adoption of ASU No. 2016-01, the Company recognized net unrealized gains on equity securities still held of \$1.1 million during the three month period ended September 30, 2018 and unrealized gains on equity securities still held of \$0.8 million during the nine month period ended September 30, 2018. In accordance with then-applicable accounting guidance, the Company recognized changes in the fair value of equity securities then held through other comprehensive income during the three month and nine month periods ended September 30, 2017.

INTEREST EXPENSE

Interest expense increased \$0.1 million, or 20.2%, during the three month period ended September 30, 2018, and \$0.2 million, or 17.6%, during the nine month period ended September 30, 2018, over the comparable periods in 2017. The increase in interest expense for the three month and nine month periods ended September 30, 2018 was due to an increase in the London Interbank Offered Rate ("LIBOR"), as the interest rates on the Company's outstanding junior subordinated deferrable interest debentures ("Junior Subordinated Debentures") are directly related to LIBOR.

OTHER EXPENSES

Other expenses (commissions, underwriting expenses, and other expenses) decreased \$1.6 million, or 12.2%, during the three month period ended September 30, 2018, and \$3.5 million, or 8.5%, during the nine month period ended September 30, 2018, from the comparable periods in 2017. The decrease in other expenses for the three month and nine month periods ended September 30, 2018 was primarily attributable to a reinsurance expense-reimbursement allowance associated with the reinsurance agreement in the life and health operations, which reimbursed a portion of the Company's indirect underwriting expenses. Also contributing to the decrease in other expenses for the three month and nine month periods ended September 30, 2018 was a decrease of \$0.8 million and \$1.2 million, respectively, in the variable commission accrual in the property and casualty operations. On a consolidated basis, as a percentage of earned premiums, other expenses decreased to 27.5% in the three month period ended September 30, 2018 from 31.6% in the three month period ended September 30, 2017. For the nine month period ended September 30, 2018, this ratio decreased to 29.5% from 33.4% in the comparable period of 2017. The decrease in the expense ratio for the

three month and nine month periods ended September 30, 2018 was primarily attributable to the increase in earned premiums coupled with a lower level of general and administrative expenses and the decrease in the variable commission accrual.

-26-

---

Table of Contents  
INCOME TAXES

The primary difference between the effective tax rate and the federal statutory income tax rate for the three month and nine month periods ended September 30, 2018 resulted from provision-to-filed return adjustments, as described below, and the dividends-received deduction (“DRD”). The current estimated DRD is adjusted as underlying factors change and can vary from estimates based on, but not limited to, actual distributions from investments as well as the amount of the Company’s taxable income.

The primary differences between the effective tax rate and the federal statutory income tax rate for the three month and nine month periods ended September 30, 2017 resulted from the DRD and the small life insurance company deduction (“SLD”), which was subsequently repealed by tax reform enacted on December 22, 2017. Under the then-applicable tax rules, the SLD varied in amount and was determined at a rate of 60 percent of the tentative life insurance company taxable income (“LICTI”). The SLD for any taxable year was reduced (but not below zero) by 15 percent of the tentative LICTI for such taxable year as it exceeded \$3.0 million and was ultimately phased out at \$15.0 million.

The provision-to-filed return adjustments are generally updated at the completion of the third quarter of each fiscal year and were \$99 and \$19 in the three month and nine month periods ended September 30, 2018 and 2017, respectively.

LIQUIDITY AND CAPITAL RESOURCES

The primary cash needs of the Company are for the payment of claims and operating expenses, maintaining adequate statutory capital and surplus levels, and meeting debt service requirements. Current and expected patterns of claim frequency and severity may change from period to period but generally are expected to continue within historical ranges. The Company’s primary sources of cash are written premiums, investment income and proceeds from the sale and maturity of its invested assets. The Company believes that, within each operating company, total invested assets will be sufficient to satisfy all policy liabilities and that cash inflows from investment earnings, future premium receipts and reinsurance collections will be adequate to fund the payment of claims and operating expenses as needed.

Cash flows at the Parent are derived from dividends, management fees, and tax-sharing payments, as described below, from the subsidiaries. The principal cash needs of the Parent are for the payment of operating expenses, the acquisition of capital assets and debt service requirements, as well as the repurchase of shares and payments of any dividends as may be authorized and approved by the Company’s board of directors from time to time. At September 30, 2018, the Parent had approximately \$18.9 million of unrestricted cash and investments.

The Parent’s insurance subsidiaries reported statutory net loss of \$1.0 million for the nine month period ended September 30, 2018 compared to statutory net income of \$2.0 million for the nine month period ended September 30, 2017. Statutory results are impacted by the recognition of all costs of acquiring business. In periods in which the Company’s first year premiums increase, statutory results are generally lower than results determined under GAAP. Statutory results for the Company’s property and casualty operations may differ from the Company’s results of operations under GAAP due to the deferral of acquisition costs for financial reporting purposes. The Company’s life and health operations’ statutory results may differ from GAAP results primarily due to the deferral of acquisition costs for financial reporting purposes, as well as the use of different reserving methods.

Over 90% of the invested assets of the Parent’s insurance subsidiaries are invested in marketable securities that can be converted into cash, if required; however, the use of such assets by the Company is limited by state insurance regulations. Dividend payments to a parent corporation by its wholly owned insurance subsidiaries are subject to annual limitations and are restricted to 10% of statutory surplus or statutory earnings before recognizing realized investment gains of the individual insurance subsidiaries. At September 30, 2018, American Southern had \$40.9

million of statutory surplus and Bankers Fidelity had \$28.3 million of statutory surplus. In 2018, dividend payments by the Parent's insurance subsidiaries in excess of \$4.8 million would require prior approval. Through September 30, 2018, the Parent received dividends of \$3.6 million from its subsidiaries.

The Parent provides certain administrative and other services to each of its insurance subsidiaries. The amounts charged to and paid by the subsidiaries include reimbursements for various shared services and other expenses incurred directly on behalf of the subsidiaries by the Parent. In addition, there is in place a formal tax-sharing agreement between the Parent and its insurance subsidiaries. As a result of the Parent's tax loss, it is anticipated that the tax-sharing agreement will continue to provide the Parent with additional funds from profitable subsidiaries to assist in meeting its cash flow obligations.

-27-

---

Table of Contents

The Company has two statutory trusts which exist for the exclusive purpose of issuing trust preferred securities representing undivided beneficial interests in the assets of the trusts and investing the gross proceeds of the trust preferred securities in Junior Subordinated Debentures. The outstanding \$18.0 million and \$15.7 million of Junior Subordinated Debentures mature on December 4, 2032 and May 15, 2033, respectively, are callable quarterly, in whole or in part, only at the option of the Company, and have an interest rate of three-month LIBOR plus an applicable margin. The margin ranges from 4.00% to 4.10%. At September 30, 2018, the effective interest rate was 6.37%. The obligations of the Company with respect to the issuances of the trust preferred securities represent a full and unconditional guarantee by the Parent of each trust's obligations with respect to the trust preferred securities. Subject to certain exceptions and limitations, the Company may elect from time to time to defer Junior Subordinated Debenture interest payments, which would result in a deferral of distribution payments on the related trust preferred securities. The Company has not made such an election.

The Company intends to pay its obligations under the Junior Subordinated Debentures using existing cash balances, dividend and tax-sharing payments from the operating subsidiaries, or from potential future financing arrangements.

At September 30, 2018, the Company had 55,000 shares of Series D preferred stock ("Series D Preferred Stock") outstanding. All of the shares of Series D Preferred Stock are held by an affiliate of the Company's controlling shareholder. The outstanding shares of Series D Preferred Stock have a stated value of \$100 per share; accrue annual dividends at a rate of \$7.25 per share (payable in cash or shares of the Company's common stock at the option of the board of directors of the Company) and are cumulative. In certain circumstances, the shares of the Series D Preferred Stock may be convertible into an aggregate of approximately 1,378,000 shares of the Company's common stock, subject to certain adjustments and provided that such adjustments do not result in the Company issuing more than approximately 2,703,000 shares of common stock without obtaining prior shareholder approval; and are redeemable solely at the Company's option. The Series D Preferred Stock is not currently convertible. At September 30, 2018, the Company had accrued but unpaid dividends on the Series D Preferred Stock totaling \$0.3 million.

Cash and cash equivalents decreased from \$24.5 million at December 31, 2017 to \$10.0 million at September 30, 2018. The decrease in cash and cash equivalents during the nine month period ended September 30, 2018 was primarily attributable to net cash used in operating activities of \$5.1 million, a \$8.1 million decrease resulting from investment purchases exceeding the sale and maturity of securities and the purchase of shares for treasury for \$0.5 million.

The Company believes that existing cash balances as well as the dividends, fees, and tax-sharing payments it expects to receive from its subsidiaries and, if needed, additional borrowings from financial institutions, will enable the Company to meet its liquidity requirements for the foreseeable future. Management is not aware of any current recommendations by regulatory authorities, which, if implemented, would have a material adverse effect on the Company's liquidity, capital resources or operations.

Table of Contents

Item 4. Controls and Procedures

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in our Securities Exchange Act of 1934 (the “Exchange Act”) reports is recorded, processed, summarized and reported within the time periods specified in the SEC’s rules and forms, and that such information is accumulated and communicated to management, including the Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. Management necessarily applies its judgment in assessing the costs and benefits of such controls and procedures, which, by their nature, can provide only reasonable assurance regarding management’s control objectives. The Company’s management, including the Chief Executive Officer and Chief Financial Officer, does not expect that our disclosure controls and procedures can prevent all possible errors or fraud. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. There are inherent limitations in all control systems, including the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of simple errors or mistakes. Additionally, controls can be circumvented by the intentional acts of one or more persons. The design of any system of controls is based in part upon certain assumptions about the likelihood of future events, and, while our disclosure controls and procedures are designed to be effective under circumstances where they should reasonably be expected to operate effectively, there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Because of the inherent limitations in any control system, misstatements due to possible errors or fraud may occur and may not be detected. An evaluation was performed under the supervision and with the participation of our management, including the Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) of the Exchange Act) as of the end of the period covered by this report. Based on that evaluation, our management, including the Chief Executive Officer and Chief Financial Officer, concluded that our disclosure controls and procedures were effective as of the end of the period covered by this report.

There have been no changes in our internal control over financial reporting that occurred during the period covered by this report that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

**CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS**

This report contains and references certain information that constitutes forward-looking statements as that term is defined in the federal securities laws. Statements, to the extent they are not statements of historical facts, should be considered forward-looking statements, and are subject to various risks and uncertainties. Such forward-looking statements are made based upon management’s current assessments of various risks and uncertainties, as well as assumptions made in accordance with the “safe harbor” provisions of the federal securities laws. The Company’s actual results could differ materially from the results anticipated in these forward-looking statements as a result of such risks and uncertainties, including those identified in filings made by the Company from time to time with the Securities and Exchange Commission. In addition, other risks and uncertainties not known by us, or that we currently determine to not be material, may materially adversely affect our financial condition, results of operations or cash flows. The Company undertakes no obligation to update any forward-looking statement as a result of subsequent developments, changes in underlying assumptions or facts, or otherwise.

Table of Contents

## PART II. OTHER INFORMATION

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

On October 31, 2016, the Board of Directors of the Company approved a plan that allows for the repurchase of up to 750,000 shares of the Company's common stock (the "Repurchase Plan") on the open market or in privately negotiated transactions, as determined by an authorized officer of the Company. Any such repurchases can be made from time to time in accordance with applicable securities laws and other requirements.

The table below sets forth information regarding repurchases by the Company of shares of its common stock on a monthly basis during the three month period ended September 30, 2018.

| Period                           | Total Number of Shares Purchased | Average Price Paid per Share | Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs | Maximum Number of Shares that May Yet be Purchased Under the Plans or Programs |
|----------------------------------|----------------------------------|------------------------------|--|--|
| July 1 – July 31, 2018           | 13,287                           | \$ 2.63                      | 13,287   | 423,342  |
| August 1 – August 31, 2018       | 10,196                           | 2.66                         | 10,196   | 413,146  |
| September 1 – September 30, 2018 | 14,115                           | 2.82                         | 14,115   | 399,031  |
| Total                            | 37,598                           | \$ 2.71                      | 37,598   |  |

The Company acquired 10,150 shares for a total cost of \$26,390 during the three months ended September 30, 2018 that were not part of the publicly announced share repurchase authorization. These shares consisted of shares retained to cover payroll withholding taxes in connection with the vesting of restricted stock awards.

Item 6. Exhibits

31.1 Certification of the Principal Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

31.2 Certification of the Principal Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

32.1 Certifications pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

101.INS XBRL Instance Document.

101.SCH XBRL Taxonomy Extension Schema.

101.CALXBRL Taxonomy Extension Calculation Linkbase.

101.DEF XBRL Taxonomy Extension Definition Linkbase.

101.LABXBRL Taxonomy Extension Label Linkbase.

101.PRE XBRL Taxonomy Extension Presentation Linkbase.





Table of Contents

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

ATLANTIC AMERICAN CORPORATION

(Registrant)

Date: November 13, 2018 By: /s/ J. Ross Franklin

J. Ross Franklin

Vice President and Chief Financial Officer

(Principal Financial and Accounting Officer)