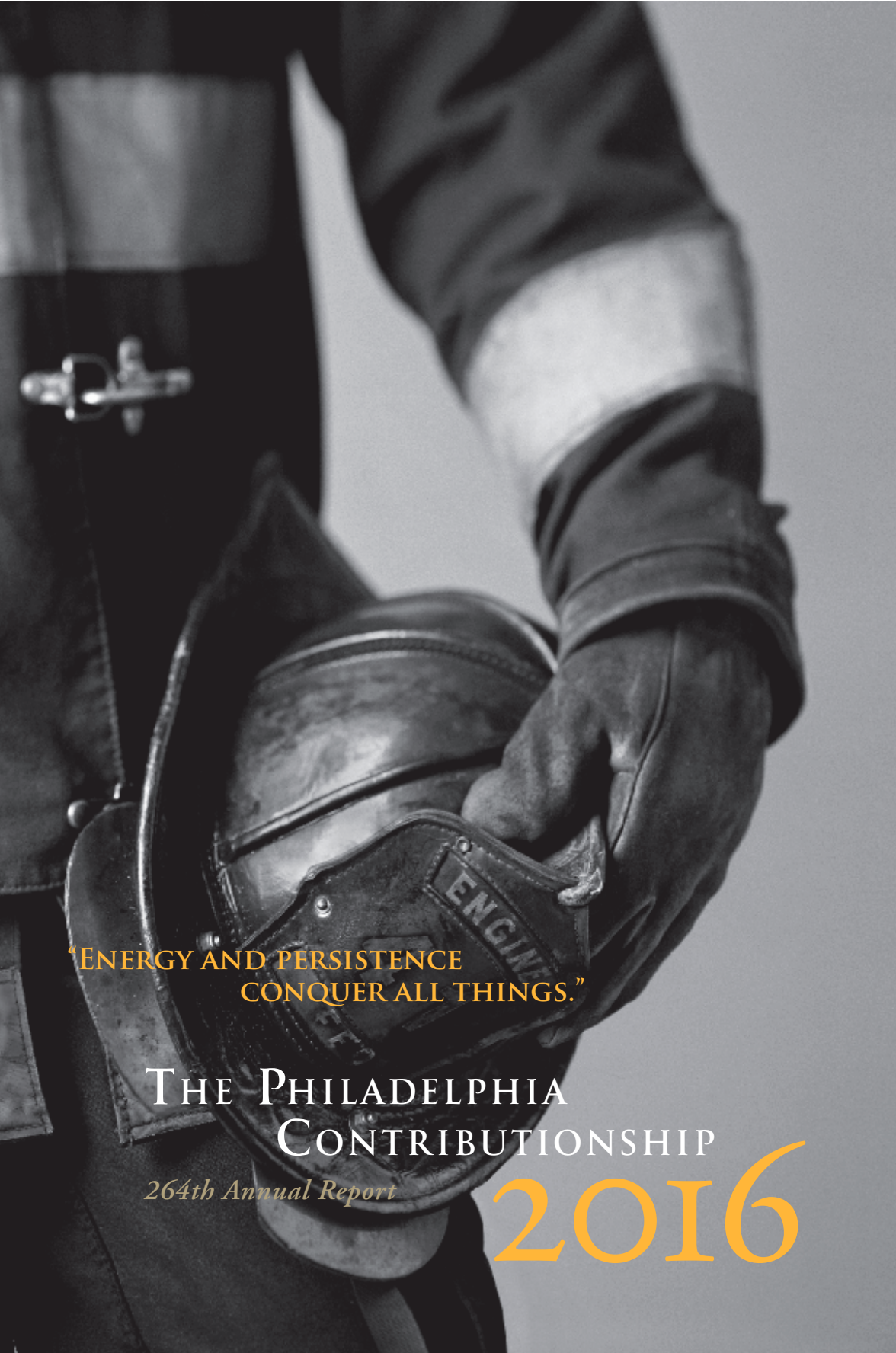


A black and white photograph of a firefighter. The firefighter is wearing a dark uniform with reflective silver stripes on the sleeves. They are holding a dark, worn leather helmet with both hands. The helmet has a patch on the front that says 'ENGINE'. The background is a plain, light-colored wall.

"ENERGY AND PERSISTENCE
CONQUER ALL THINGS."

THE PHILADELPHIA
CONTRIBUTIONSHIP

264th Annual Report

2016



THE PHILADELPHIA CONTRIBUTIONSHIP
MUTUAL HOLDING COMPANY

TPC HOLDINGS, INC.

VECTOR SECURITY HOLDINGS, INC.

THE PHILADELPHIA CONTRIBUTIONSHIP FOR THE INSURANCE OF
HOUSES FROM LOSS BY FIRE, INC.

THE PHILADELPHIA CONTRIBUTIONSHIP INSURANCE COMPANY

GERMANTOWN INSURANCE COMPANY

FIRST INSURANCE COMPANY OF AMERICA

FRANKLIN AGENCY, INC.

At A Glance

The Philadelphia Contributionship Mutual Holding Company is a mutual holding company serving as the ultimate controlling parent in the corporate structure. The principal business of The Philadelphia Contributionship Mutual Holding Company is to hold the stock of TPC Holdings, Inc.

TPC Holdings, Inc. is a stock holding company whose principal business is to hold the stock of The Philadelphia Contributionship for the Insurance of Houses from Loss by Fire, Inc. and Vector Security Holdings, Inc.

The Philadelphia Contributionship for the Insurance of Houses from Loss by Fire, Inc. is the oldest successful property and casualty insurance company in the United States, having been founded in 1752. The company was converted from a mutual company to a stock company in 2009.

The Philadelphia Contributionship is our group of insurance companies writing residential business in predominantly urban communities. Our Company was founded by Benjamin Franklin and his fellow fire-fighters to provide insurance to urban Philadelphia homeowners. We provide homeowners, fire and liability insurance to customers in New Jersey, Pennsylvania, Delaware and Maryland. We have earned the distinction of A rating or higher from A.M. Best Company for over 90 years.

Vector Security Holdings, Inc., our residential and commercial security subsidiary, is one of the top ten security providers in North America. Vector provides electronic security services to commercial and residential markets including fire and burglary detection, video, access control, environmental monitoring, home automation and commercial analytics. Subsidiary Vector Intelligent Solutions provides customized managed network services including broadband and broadband-enabled services, network deployment, network management and mobile applications.

Cover quote by Benjamin Franklin.

OUR MISSION

THE PHILADELPHIA CONTRIBUTIONSHIP

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is committed to providing insurance protection for the urban community and surrounding areas. We are dedicated to producing an underwriting profit by providing responsive insurance services to our members and policyholders as well as maintaining a stable market for our agency partners. We value our employees and are committed to providing them professional development opportunities. We will continue to support the community that we've been a part of since 1752.



LETTER TO POLICY HOLDERS

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Many quotations have been attributed to Benjamin Franklin, one of our founders. The one printed on the cover of this annual report is particularly appropriate for the work and accomplishments at The Philadelphia Contributionship in 2016. In 2013, the insurance operation began a multi-year project to replace our legacy software system with a new system which we branded “The Key”. In 2016, we completed implementation of The Key in all of our states. Over the years, our geographic footprint has become much more diverse. We have broadened our insurance product portfolio with coverage additions and enhancements that keep us competitive in our market. The security operation continued to make good progress increasing recurring revenue, expanded its presence in new geographies and kept pace with the ongoing changes in home automation technologies. In addition, we acquired the remaining portion of Vector Intelligent Solutions and now own 100% of that operation.

None of this would have been possible without the energy and persistence of our employees. The 104 associates in the insurance operation and 1,243 associates in the security operation have worked tirelessly to achieve all that we accomplished in 2016. Their dedication to the success of The Philadelphia Contributionship and Vector Security and their commitment to providing great service to our customers is a vital component of our past, present and future success.

On February 1, 2017, Craig N. Johnson retired from our Board of Directors. Mr. Johnson served the company as a Director since 1992

and was a member of various Board committees including Audit, Executive, Nominating, Investment, Risk Management and Benefits/Compensation. He served as Chair of the Audit, Risk Management and Benefits/Compensation Committees at various points in time. In addition, Craig served as acting President and CEO in 2008-2009 and as a Director of Vector Security, Inc. Craig's contributions to our companies are many and are lasting. We thank him for his dedicated service to The Philadelphia Contributionship.

2016 was a strong year for the company and we can, once again, report that The Philadelphia Contributionship's legacy of financial strength is intact. With 265 years of experience providing insurance and security services to our customers, you can count on us to be there when you need us most.

INSURANCE GROUP OPERATIONS

The insurance operations has a successful year in 2016. We made strides in our ongoing strategy to geographically diversify our exposure – and we did so profitably with favorable results in both underwriting and investments. Policy counts in our expansion territories grew 40% while we continued to decrease our exposure in areas that are more vulnerable to localized weather events.

Direct written premium was \$137.3 million in 2016, up 0.9% from 2015 while policy counts grew 4.5% for the year. Net premiums earned for 2016 were \$121.6 million, down 1.3% from 2015. Gross income from the investment portfolio was \$10.4 million in 2016 compared to \$9.8 million in 2015. Net realized gains on investments were \$2.1

million during 2016 compared to \$3.7 million in 2015. In total, revenues from insurance operations for the year ending December 31, 2016 were \$134.1 million compared to \$136.7 million for 2015.

Losses and loss adjustment expenses were down 10.7% from the prior year due primarily to lower losses from weather catastrophes. In total, 2016 losses and loss adjustment expenses were \$83.6 million compared to \$93.5 million in 2015.

Underwriting expenses were up 1.9% in 2016 to \$36.0 million and investment expenses increased 1.9% to \$2.4 million consistent with the performance of our investment portfolio.

Finally, we continued our consistent record of returning capital to our members with dividend payments totaling \$1.0 million.

Overall, the insurance operation produced income before income taxes of \$11.6 million in 2016 compared to \$4.9 million in 2015.

The Philadelphia Contributionship's financial strength rating from AM Best Company was affirmed in 2016 as A (Excellent), once again confirming the strength and stability of America's oldest successful fire insurance company.

SECURITY GROUP OPERATIONS

Vector Security, Inc. again exceeded \$300 million in revenue for 2016. Overall, revenue for the year was \$301.1 million, The Central Station and Managed Network Services segments again realized growth year over year. Gross margins for the year were 37.4%, better than prior year of 35.8%. On a year over year basis, gross margin improved across all segments with the majority of the improvement coming from the Branch and National Accounts business units. A

non-recurring \$1.1 million accrual due to sales and use tax audits negatively impacted year-to-year earnings. We have contested the audits' findings and are optimistic that this will be resolved in our favor and positively impact earnings going forward.

Performance was in line with our goal of increasing our recurring revenue base, while controlling expenses. Our security operation saw revenue growth of \$1.8 million in recurring services over 2015. The managed network services division improved their recurring revenue by \$3.2 million, a 7% improvement over the previous year. Installation revenue in 2016 declined, as we sought to eliminate revenue that did not meet margin expectations. This resulted in an improvement in the installation gross margin of 1.5%.

During October 2016, Vector Intelligent Solutions (VIS) redeemed, from MGJ Enterprises, the remaining 28% of VIS that it did not previously own for a value of \$19.1 million. VIS now owns 100% of the entity. This payment was financed through the Vector Security, Inc. credit facility. Efforts to consolidate this acquisition with our National Accounts business unit are now proceeding with pace. The combined entity will enable us to provide a unified solution for our retail and multi-site commercial customers seeking to move to IP security products. Combined, these two divisions added 14 new retail brands to their portfolio in 2016.

Vector Security continues to experience increased interest in home automation products within its residential offerings. An increase in locks and camera components drove sales in 2016, as homeowners continued to embrace home automation products in

combination with their security systems. We have also begun to capitalize on the new geographic markets accessible to us through the Pelican acquisition in late 2015. Commercially, video is the largest growth market. As cameras become more sophisticated, price points drop, and edge analytics become increasingly more available, we anticipate this will continue to be a driver in the coming years.

CONSOLIDATED BALANCE SHEET

Total assets as of December 31, 2016 are \$762.2 million, a 0.3% decline from 2015. The decline was primarily due to a decrease in intangible assets in the security operation. Liabilities increased 1.2% to \$425.3 million. Additionally, there was an elimination of the \$22.2 million redeemable noncontrolling interest related to Vector Intelligent Solutions. Total equity as of December 31, 2016 is \$336.8 million – up 4.7% from the end of 2015.

On behalf of the Board of Directors, our officers and employees, thank you for remaining loyal customers of The Philadelphia Contributionship. We are committed to meeting your insurance and security needs now and into the future.



Scott M. Jenkins
Chairman of the Board



Robert G. Whitlock, Jr., FCAS, MAAA
President and Chief Executive Officer

CONSOLIDATED FINANCIAL STATEMENTS

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CONSOLIDATED BALANCE SHEET
DECEMBER 31, 2016 AND 2015

(IN THOUSANDS, UNLESS OTHERWISE NOTED)

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ASSETS	2016	2015
INSURANCE GROUP ASSETS		
Investments:		
Fixed income securities	\$ 143,575	\$ 141,218
Convertible bonds	11,672	10,457
Preferred stocks	2,566	2,197
Convertible preferred stocks	2,261	1,835
Common stocks	228,515	216,194
Other invested assets	36,695	28,604
	425,284	400,505
Cash and cash equivalents	14,076	14,672
Reinsurance recoverable and receivable	12,982	14,253
Prepaid reinsurance premiums	1,880	1,913
Premiums receivable	9,095	8,448
Accrued income from investments	1,575	1,523
Income tax recoverable	27	256
Deferred acquisition costs	14,892	13,686
Property and equipment, net	5,573	6,499
Other assets	551	1,634
Total Insurance Group assets	485,935	463,389
SECURITY GROUP ASSETS		
Current assets:		
Cash and cash equivalents	193	2,360
Trade accounts receivable, less allowance for doubtful accounts of \$1,800 in 2016 and \$1,811 in 2015	21,820	23,137
Unbilled revenue	10,550	13,028
Inventories	5,175	5,746
Prepaid expenses and other current assets	6,716	6,361
Deferred income taxes	617	1,029
Income taxes receivable	1,625	1,998
Total current assets	46,696	53,659
Property and equipment, net	27,877	25,837
Intangible assets, net	139,565	159,321
Goodwill, net	30,438	35,080
Deferred income taxes	23,738	22,188
Other noncurrent assets	1,594	1,076
Deferred charges	6,323	3,895
Total Security Group assets	276,231	301,056
Total assets	\$ 762,166	\$ 764,445

SEE NOTES TO CONSOLIDATED FINANCIAL STATEMENTS.

CONSOLIDATED BALANCE SHEET
DECEMBER 31, 2016 AND 2015

(IN THOUSANDS, UNLESS OTHERWISE NOTED)

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LIABILITIES AND EQUITY	2016	2015
INSURANCE GROUP LIABILITIES		
Unpaid losses and loss adjustment expenses	\$ 91,527	\$ 94,361
Unearned premiums	72,703	71,500
Advance premiums	2,192	2,306
Deposit premiums	15,602	15,966
Deferred income taxes	25,319	19,316
Ceded premium payable	165	208
Other liabilities	9,163	8,417
Total Insurance Group liabilities	216,671	212,074
SECURITY GROUP LIABILITIES		
Current liabilities:		
Current maturities of long-term debt	1,700	5,367
Accounts payable and accrued expenses	29,987	24,234
Customer deposits	726	887
Unearned revenue	10,204	10,016
Purchase holdbacks	1,491	4,336
Interest rate swap payable	—	184
Total current liabilities	44,108	45,024
Long-term debt, less current maturities	157,049	157,917
Unearned revenue	3,849	2,206
Other long-term liabilities	3,663	3,263
Total Security Group liabilities	208,669	208,410
Total liabilities	425,340	420,484
REDEEMABLE NONCONTROLLING INTEREST (NOTE 8)	—	22,244
EQUITY		
Unassigned equity	285,830	279,791
Accumulated other comprehensive income	50,996	41,926
Total equity	336,826	321,717
Total liabilities and equity	\$762,166	\$764,445

SEE NOTES TO CONSOLIDATED FINANCIAL STATEMENTS.

CONSOLIDATED STATEMENT OF OPERATIONS
YEARS ENDED DECEMBER 31, 2016 AND 2015

(IN THOUSANDS, UNLESS OTHERWISE NOTED)

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	2016	2015
INSURANCE GROUP		
Revenue:		
Net premiums earned	\$121,649	\$123,218
Gross investment income	10,353	9,836
Net realized gains on investments	2,067	3,666
Total revenue	134,069	136,720
Losses and expenses:		
Losses and loss adjustment expenses	83,551	93,535
Underwriting expenses	35,990	35,313
Investment expenses	2,402	2,357
Total losses and expenses	121,943	131,205
Income before other income, dividends to policyholders, and income tax expense	12,126	5,515
Other income, net	471	400
Dividends to policyholders	(950)	(991)
Insurance Group income before income tax expense (benefit)	11,647	4,924
SECURITY GROUP		
Revenue	301,116	300,184
Cost of sales	188,553	192,765
Gross profit	112,563	107,419
Operating expenses:		
Selling, general, and administrative	67,881	63,729
Acquisition-related costs	—	310
Depreciation	11,095	8,872
Amortization and impairment of intangible assets and goodwill	35,847	40,419
Total operating expenses	114,823	113,330
Operating (loss)	(2,260)	(5,911)
Other:		
Interest expense	(5,158)	(4,953)
Other income, net	249	542
Gain on business divestiture	1,199	—
Security Group loss before income tax expense (benefit)	(5,970)	(10,322)
Income (loss) income before income tax expense (benefit)	5,677	(5,398)
Income tax expense (benefit)	823	(2,311)
Net income (loss)	4,854	(3,087)
Less: Net loss attributable to redeemable noncontrolling interest	(633)	(235)
Net income (loss) income attributable to the Company	\$ 5,487	\$ (2,852)

SEE NOTES TO CONSOLIDATED FINANCIAL STATEMENTS.

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME (LOSS)
YEARS ENDED DECEMBER 31, 2016 AND 2015

(IN THOUSANDS, UNLESS OTHERWISE NOTED)

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	2016	2015
Net income (loss)	<u>\$ 4,854</u>	<u>\$ (3,087)</u>
Other comprehensive income (loss) net of tax:		
Unrealized gains (losses) on securities available-for-sale:		
Unrealized net holding gains (losses) arising during the year (net of tax of \$5,086 in 2016 and (\$7,767) in 2015)	9,444	(14,424)
Less: reclassification adjustment for net realized gains included in net income (net of tax of \$326 in 2016 and \$1,954 in 2015)	<u>606</u>	<u>3,629</u>
	<u>8,838</u>	<u>(18,053)</u>
Cash flow hedge:		
Change in fair value of cash flow hedge (net of tax of \$3 in 2016 and \$(114) in 2015)	5	(212)
Less: reclassification adjustment for settlement of cash flow hedge included in net income (net of tax of \$(60) in 2016 and \$(207) in 2015)	<u>(112)</u>	<u>(385)</u>
	<u>117</u>	<u>173</u>
Defined benefit pension plan:		
Change in actuarial assumptions	(9)	308
Asset gain and amortization of net loss	77	(415)
Experience gain (loss)	<u>47</u>	<u>(36)</u>
Defined benefit pension plan, net actuarial gain (loss) arising during the year (net of tax of \$61 in 2016 and \$(78) in 2015)	<u>115</u>	<u>(143)</u>
Other comprehensive income (loss)	<u>9,070</u>	<u>(18,023)</u>
Comprehensive income (loss)	13,924	(21,110)
Less: Comprehensive loss attributable to redeemable noncontrolling interest	<u>(633)</u>	<u>(235)</u>
Comprehensive income (loss) attributable to the Company	<u>\$14,557</u>	<u>\$(20,875)</u>

SEE NOTES TO CONSOLIDATED FINANCIAL STATEMENTS.

CONSOLIDATED STATEMENT OF EQUITY
YEARS ENDED DECEMBER 31, 2016 AND 2015

(IN THOUSANDS, UNLESS OTHERWISE NOTED)

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	Unassigned Equity	Accumulated Other Comprehensive Income	Total
BALANCE, JANUARY 1, 2015	\$282,643	\$59,949	\$342,592
Net (loss) attributable to the Company (1)	(2,852)	—	(2,852)
Other comprehensive (loss), net of tax	—	(18,023)	(18,023)
BALANCE, DECEMBER 31, 2015	279,791	41,926	321,717
Net income attributable to the Company (1)	5,487	—	5,487
Redemption of noncontrolling interest, net of purchase price and distributions	552	—	552
Other comprehensive income, net of tax	—	9,070	9,070
BALANCE, DECEMBER 31, 2016	\$285,830	\$50,996	\$336,826

(1) Net (loss) for the years December 31, 2016 and 2015 excludes \$(633) and \$(235), respectively, allocable to the redeemable noncontrolling interest, which, is reported in the mezzanine section of the consolidated balance sheets at December 31, 2016 and 2015. See Note 8 to the consolidated financial statements for further detail.

CONSOLIDATED STATEMENT OF CASH FLOWS
YEARS ENDED DECEMBER 31, 2016 AND 2015

(IN THOUSANDS, UNLESS OTHERWISE NOTED)

	2016	2015
CASH FLOW FROM OPERATING ACTIVITIES		
Net income (loss)	\$ 4,854	\$(3,087)
Adjustments to reconcile net income to net cash provided by operating activities:		
Net realized gains on investments	(2,067)	(3,666)
Depreciation and amortization	49,651	52,158
Deferred income taxes	(1,144)	(6,348)
Gains on disposals of property and equipment	(94)	(69)
Gains on divestiture of business	(1,199)	—
Change in assets and liabilities, net of effects of acquisitions:		
Reinsurance recoverable and receivable	1,271	4,175
Prepaid reinsurance premiums	33	44
Premiums receivable	(647)	653
Accrued income from investments	(52)	68
Deferred acquisition costs	(1,206)	42
Unpaid losses and loss adjustment expenses	(2,834)	825
Unearned premiums	1,203	(1,086)
Advance premiums	(114)	(565)
Deposit premiums	(364)	(386)
Other liabilities	877	(839)
Income taxes and other receivables	1,633	(761)
Prepaid expenses and other assets	(328)	(218)
Trade accounts receivable, unbilled revenue, and inventories	3,619	(397)
Accounts payable, accrued expenses and purchase holdbacks	6,180	(89)
Unearned revenue and customer deposits	1,670	1,070
Deferred charges	(2,428)	(3,895)
Net cash provided by operating activities	\$58,514	\$37,629

CONSOLIDATED STATEMENT OF CASH FLOWS (CONTINUED)
YEARS ENDED DECEMBER 31, 2016 AND 2015

(IN THOUSANDS, UNLESS OTHERWISE NOTED)

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	2016	2015
CASH FLOW FROM INVESTING ACTIVITIES		
Cash paid for acquisitions, net of cash received	\$ (14,336)	\$ (27,212)
Purchases of property, plant and equipment	(11,605)	(10,290)
Proceeds from disposals of property and equipment	213	85
Proceeds from divestiture of business, net	3,198	—
Purchases of fixed income securities	(37,586)	(24,860)
Purchases of convertible bonds	(4,397)	(6,735)
Purchases of common stocks	(60,844)	(45,445)
Purchases of convertible preferred stocks	(399)	(1,285)
Purchases of other invested assets	(3,450)	(10,000)
Proceeds from sales of fixed income securities	14,547	16,468
Proceeds from sales of convertible bonds	4,041	6,379
Proceeds from maturities/calls of fixed income securities	18,174	11,950
Proceeds from the sales of common stocks	59,802	50,041
Proceeds from the sales of convertible preferred stocks	137	936
Net cash used in investing activities	(32,505)	(39,968)
CASH FLOW FROM FINANCING ACTIVITIES		
Proceeds from revolving credit agreements	59,440	72,374
Payments on revolving credit agreements	(64,454)	(63,273)
Cash paid for debt issuance costs	(840)	—
Payment for redemption of noncontrolling interest, including distributions	(19,938)	—
Principal payments on capital leases	(1,794)	(1,856)
Payments of contingent consideration	(1,186)	(1,779)
Net cash (used in) provided by financing activities	(28,772)	5,466
Net (decrease) increase in cash and cash equivalents	(2,763)	3,127
CASH AND CASH EQUIVALENTS, BEGINNING	17,032	13,905
CASH AND CASH EQUIVALENTS, ENDING	\$ 14,269	\$ 17,032
SUPPLEMENTARY CASH FLOWS INFORMATION		
Interest paid	\$ 5,337	\$ 5,316
Income taxes paid	\$ 5,151	\$ 5,253
SUPPLEMENTARY SCHEDULE OF NONCASH INVESTING AND FINANCING ACTIVITIES		
In conjunction with acquisitions, the Security Group:		
Recorded purchase holdbacks	\$ 1,252	\$ 2,867
Capital leases	\$ 2,273	\$ 1,815

SEE NOTES TO CONSOLIDATED FINANCIAL STATEMENTS.

Note 1: Summary of Significant Accounting Policies

Basis of Presentation

The accompanying consolidated financial statements include the accounts of The Philadelphia Contributionship Mutual Holding Company (the Company), a mutual holding company, and its wholly-owned subsidiaries: TPC Holdings, Inc., The Philadelphia Contributionship for the Insurance of Houses from Loss by Fire, Inc. (The Contributionship), and Vector Security Holdings, Inc. (Vector).

The consolidated financial statements include the accounts of The Contributionship, a stock company, and its wholly-owned subsidiaries, The Philadelphia Contributionship Insurance Company, Germantown Insurance Company, First Insurance Company of America, and Franklin Agency, Inc. (collectively, the Insurance Group), and Vector. Vector is the parent company of the following wholly-owned subsidiaries: Vector Security, Inc., Vector International Holdings, Inc., Vector Security Canada, Inc., and Vector Security de Mexico, S.A. de C.V., and Vector Intelligent Solutions, LLC (VIS) (collectively, the Security Group). The consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America (GAAP), which differ in some regard from those followed in reports to insurance regulatory authorities. All significant intercompany transactions and balances have been eliminated.

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect amounts reported in the financial statements and accompanying notes. Such estimates and assumptions could change in the future as more information becomes known which could impact the amounts reported and disclosed herein.

The Insurance Group writes property and casualty insurance for homeowners and multi-family dwellings principally in urban communities in Pennsylvania, New Jersey, Delaware and Maryland. The Insurance Group had approximately 127,000 policyholders at December 31, 2016.

Vector sells, installs, services, and manages intelligent security and home automation products and solutions and provides security monitoring services as well as network services through advanced electronic systems designed to detect intrusion, as well as fire, water, temperature, and medical emergencies. Vector also does business with large national commercial accounts to which it provides equipment and installation, monitoring, and managed network services. Vector's customers are located throughout North America. Vector has approximately 282,000 residential and commercial customers as of December 31, 2016. No such customer accounted for more than 10% of the December 31, 2016 and 2015 trade accounts receivable balance or revenue for the years then ended.

Premiums

The Contributionship issues perpetual fire and homeowners insurance policies. When a perpetual policy is issued, a deposit premium is received, which is reflected as a liability. The deposit premium is returned if coverage terminates.

The Insurance Group also issues term policies for property and casualty coverage. Premiums on such policies are reflected in income over the effective period of the policies. Unearned premiums are computed on either a monthly pro rata basis or a daily basis over the term of the policy.

Reinsurance

Prospective reinsurance premiums, losses, and loss adjustment expenses are accounted for on bases consistent with those used in accounting for the original policies issued and the terms of the reinsurance contracts.

The Contributionship cedes reinsurance to other insurance companies to minimize the net loss potential arising from large losses and as well as from an aggregation of losses. An allowance is established for amounts deemed uncollectible and losses are charged against the allowance when the uncollectibility of amounts recoverable from reinsurers is confirmed. There was no such allowance recorded as of December 31, 2016, or 2015, respectively.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2016 AND 2015

(DOLLARS IN THOUSANDS, UNLESS OTHERWISE NOTED)

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Acquisition Costs

Acquisition costs, such as commissions, premium taxes, and certain other underwriting and agency expenses that vary with and are directly related to the successful acquisition of new and renewal business, are deferred and amortized over the effective period of the related insurance policies. The Insurance Group determines whether acquisition costs are recoverable considering future losses and loss adjustment expenses, policy maintenance costs and anticipated investment income. To the extent that acquisition costs are determined not to be recoverable, the difference is charged to income in the period identified. All deferred acquisition costs at December 31, 2016 and 2015 were determined to be recoverable.

Liability for Unpaid Losses and Loss Adjustment Expenses

The liability for unpaid losses and loss adjustment expenses includes management's best estimate for the ultimate net cost of all reported and unreported losses and loss adjustment expenses incurred through December 31.

The Insurance Group believes that the liability for losses and loss adjustment expenses is adequate to provide for the ultimate cost of losses and loss adjustment expenses, but this liability is necessarily based on estimates, and the amount ultimately paid may vary significantly from such estimates. Those estimates are subject to the effects of trends in loss severity and frequency. This liability is continually reviewed and changes in estimates are reflected in earnings currently.

Fixed Income Securities and Preferred & Common stocks

All fixed income securities, preferred and common stocks are classified as available-for-sale and are carried at fair value. Management reviews the securities in its investment portfolio on a periodic basis to specifically identify individual securities that have incurred an other-than-temporary decline in fair value below cost or amortized cost. As part of its periodic review process, management utilizes information received from its outside professional asset manager to assess each issuer's current credit situation. When management's review identifies an other-than-temporary impairment in the valuation of a fixed income security, it compares its projected discounted cash flows to the amortized cost in order to determine the credit related portion and the non-credit related portion of the loss. The credit related portion is recorded as a charge in the consolidated statement of operations while the non-credit related portion is recorded through other comprehensive income and included as a component of accumulated other comprehensive income (loss) in the consolidated balance sheet. For preferred and common stocks, the cost of the security is adjusted and recognized as a realized loss in the statement of operations.

For structured securities, management projects cash flows using loss adjusted cash flows that contemplate current market factors such as prepayment assumptions, expected default assumptions, and the current condition of the guarantor of the security. For structured securities, the discount rate used in the present value calculation is the security's current effective interest rate. The discount rate used for other fixed income securities is the security's effective interest rate at the date of acquisition.

In addition to issuer-specific financial information, general economic data and management's projections of discounted cash flows, management also assesses whether it has the intent to sell a particular security or whether it is more-likely-than-not it will be required to sell the security before its anticipated recovery. When management determines that it either intends to sell or is no longer more likely than not to hold the security until its anticipated recovery, a realized loss is recorded in the consolidated statement of operations for the full amount of the difference between fair value and amortized cost.

Dividends and interest income are recognized when earned. Premiums and discounts on fixed income securities are amortized or accreted based upon the effective-interest method. Realized gains and losses on investments are determined by the specific identification method.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2016 AND 2015

(DOLLARS IN THOUSANDS, UNLESS OTHERWISE NOTED)

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Other Invested Assets

Other invested assets consist of investments in limited partnerships that invest in oil and gas interests, equity and debt securities of public and privately held companies. These investments are classified as available-for-sale investments and are carried at fair value. Net unrealized gains (losses) are reported as a component of accumulated other comprehensive income. See Note 3 for more information on the determination of fair value.

The Company reviews other invested assets in its investment portfolio on a periodic basis to specifically identify individual securities that have incurred an other-than-temporary decline in fair value below cost. This review encompasses, among other things, recent issuer activities, such as defaults, quarterly earnings announcements, and other pertinent financial news for the issuer, recent developments and economic outlooks for particular industries, rating agency actions, and the length of time and extent to which fair value has been less than cost. When management's review identifies an other-than-temporary impairment in the valuation of a security, a realized loss is recognized in the consolidated statement of operations.

Convertible Bonds and Preferred Stocks

The Company's investments in convertible bonds and convertible preferred stocks are considered hybrid financial instruments and are carried at estimated fair value, with changes in estimated fair value reported in net realized gains on investments in the consolidated statements of operations and comprehensive income.

Property and Equipment - Insurance Group

Property and equipment, which primarily consist of the Insurance Group's home office, electronic data processing equipment, furniture and fixtures, a software license and related implementation costs, are stated at cost, less accumulated depreciation of \$11,591 and \$10,091 at December 31, 2016 and 2015, respectively. Depreciation is provided using the straight-line method over the estimated useful lives of depreciable assets. Land is not subject to depreciation.

Property and Equipment - Security Group

Property and equipment are stated at cost less accumulated depreciation. Equipment under capital leases is stated at the present value of minimum lease payments. Vector provides for depreciation over the estimated useful lives of the related assets utilizing the straight-line method. Estimated useful lives range from 3 to 12 years, with the exception of buildings, which are depreciated over approximately 25 years.

Vector installs certain home security package systems in residences if the customer commits to a monitoring arrangement for a minimum period of time. These security systems remain the property of Vector. The costs of the security systems, including costs of installation, are capitalized and depreciated over their estimated useful life of 7 years.

Balances consist of the following as of December 31:

	2016	2015
Land	\$ 200	\$ 200
Buildings and improvements	4,287	4,225
Home security package systems	40,303	36,869
Furniture and fixtures	4,120	4,538
Vehicles and equipment	20,951	19,757
Construction-in-progress	122	242
	69,983	65,831
Less accumulated depreciation	(42,106)	(39,994)
Total Property and Equipment	\$ 27,877	\$25,837

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Revenue Recognition

Vector's major sources of revenue are equipment sales, installation, monitoring and managed network services as described above. While Vector frequently sells these elements in a bundled arrangement, it also sells each element individually, with no discounts given for the elements included in a bundled arrangement. Accordingly, when elements are included in a bundled arrangement, each element is treated as a separate unit of accounting. The revenue recognition policy with respect to each of the three major elements is as follows:

- Installation and equipment revenue - Recognized as services are performed on a percentage-of-completion basis calculated on a cost-to-cost comparison.
- Service revenue - Recognized as services are performed for time and material agreements and recognized ratably over the service period for those agreements entered into under a fixed fee arrangement.
- Monitoring and managed network revenue - Recognized ratably over the service period with amounts billed in advance of service delivery deferred and amortized over the applicable period of service.

In accordance with Accounting Standards Update (ASU) 2009 13, *Revenue Recognition (Topic 605): Multiple Deliverable Revenue Arrangements* (EITF Issue No. 08 1, *Revenue Arrangements with Multiple Deliverables*), the overall arrangement fee for bundled arrangements is allocated to each element (both delivered and undelivered items) based on their relative selling prices, regardless of whether those selling prices are evidenced by vendor specific objective evidence or third party evidence or are based on the entity's estimated selling price. Application of the "residual method" of allocating an overall arrangement fee between delivered and undelivered elements is not permitted.

In connection with our Home Security System (HSS) package offering Vector bundles a free or low cost equipment package with a long term monitoring contract, which is generally three to five years. Vector retains ownership of the system for the duration of the monitoring contract. The equipment costs, including related direct costs, are capitalized and amortized to cost of sales over the expected life of the customer relationship, which is generally seven years. Such direct costs are recorded as deferred charges on the consolidated balance sheet. Upfront fees charged in connection with the HSS packages are recorded as unearned revenue on the consolidated balance sheet. The HSS packages are priced so that the additional monitoring and other fees generated over the life of the contract will exceed the cost of the equipment and related direct costs.

Inventories

Inventories, consisting primarily of security equipment, are stated at the lower of average cost or market.

Intangible Assets

In accordance with ASC Topic 350, *Intangibles – Goodwill and Other*, as of January 1, 2013, goodwill is amortized over 10 years and tested when a triggering event occurs. A triggering event draws into question whether the fair value of the entity may be below its carrying amount.

In accordance with Impairment or Disposal of Long Lived Assets subsections of ASC Subtopic 360-10, *Property, Plant, and Equipment – Overall*, long lived assets, such as property, plant, and equipment, and purchased intangible assets subject to amortization are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. If circumstances require a long lived asset or asset group be tested for possible impairment, Vector first compares the undiscounted future cash flows of that asset or asset group to its carrying value. If the carrying value of the long lived asset or asset group is greater than the undiscounted future cash flows, an impairment is recognized to the extent that the carrying value exceeds its estimated fair value. Vector recorded impairment expense, through amortization expense, on their customer service agreements of \$1,680 and \$6,891 during 2016 and 2015, respectively.

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Newly acquired customer service agreements, that have been purchased through Vector's authorized dealer program, are being amortized on a straight-line basis over a seven year period, which reflects the historical attrition rate on Vector's customer service agreements acquired through the authorized dealer program.

Customer relationships, which were recorded in connection with acquisitions, are amortized on a straight-line basis over a period of 13 years.

Covenants not-to-compete are generally amortized on a straight-line basis over periods ranging from 3 to 5 years, depending upon the length of the agreement. All intangible assets have been recorded in connection with acquisitions.

Covenants not to solicit, which were recorded in connection with acquisitions, are amortized on a straight-line basis over a period of 8 years.

Trade names, which were recorded in connection with acquisitions, are amortized on a straight-line basis over a period of 5 years.

Technology, which was recorded in connection with acquisitions, is amortized on a straight-line basis over a period of 5 years.

All fully amortized intangible assets are removed from Vector's asset system in the year following full amortization.

Redeemable Noncontrolling Interest

On August 15, 2013, Vector issued membership interest units to Industry Retail Group, LLC (IRG), the former noncontrolling interest holder of VIS, that is redeemable either at the option of the holder or upon the occurrence of an event that is not solely within Vector's control. Under the terms of an agreement related to the IRG acquisition, the noncontrolling interest holder had the right to require Vector to purchase its 28% interest in Vector's subsidiary for an amount equal to a specified multiple of trailing twelve-month gross margin multiplied by the noncontrolling interest holder's percentage interest in Vector's subsidiary at the time of redemption. The noncontrolling interest becomes redeemable within 10 days after the earliest of the third anniversary of the date of the acquisition and every anniversary thereafter or the date on which certain principals of IRG no longer control IRG. During 2016, the conditions for redemption of the noncontrolling interest were met, and effective October 21, 2016, Vector redeemed the remaining 28% interest from the noncontrolling interest holder for \$19,124 funded primarily through cash on hand and drawings from Vectors revolving credit facility.

Income Taxes

Deferred income taxes are recognized in the consolidated financial statements for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective income tax bases. Deferred income tax expense is the result of changes in deferred tax assets and liabilities. Deferred tax assets are reduced by a valuation allowance when, in the opinion of management, it is more likely than not that some portion of the deferred income tax asset will not be realized.

A tax position is recognized as a benefit at the largest amount that is more likely than not to be sustained in a tax examination solely on its merits. An uncertain tax position will not be recognized if it has a less than 50% likelihood of being sustained. The Company recognizes interest and penalties accrued related to uncertain tax positions as a component of income tax expense. The Company has no such uncertain tax positions as of December 31, 2016 or 2015.

Cash Equivalents

Cash equivalents consist of highly liquid short-term investments with an expected maturity at date of purchase of three months or less.

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Credit Risk

The Company maintains cash balances in major financial institutions in excess of the federally insured limit of \$250 by the Federal Deposit Insurance Corporation (FDIC). The Company has not experienced any losses and believes it is not exposed to any significant credit risk on cash and cash equivalents.

Derivative Instruments and Hedging Activities

Vector accounts for derivatives and hedging activities in accordance with ASC Topic 815, *Derivatives and Hedging*, which requires entities to recognize all derivative instruments as either assets or liabilities in the balance sheet at their respective fair values.

Vector only enters into derivative contracts that it intends to designate as a hedge of a forecasted transaction or the variability of cash flows to be received or paid related to a recognized asset or liability (cash flow hedge). For all hedging relationships, Vector formally documents the hedging relationship and its risk-management objective and strategy for undertaking the hedge, the hedging instrument, the hedged item, the nature of the risk being hedged, how the hedging instrument's effectiveness in offsetting the hedged risk will be assessed prospectively and retrospectively, and a description of the method of measuring ineffectiveness. Vector also formally assesses, both at the hedge's inception and on an ongoing basis, whether the derivatives that are used in hedging transactions are highly effective in offsetting cash flows of hedged items. For derivative instruments that are designated and qualify as a cash-flow hedge, the effective portion of the gain or loss on the derivative is reported as a component of other comprehensive income and reclassified into earnings in the same period or periods during which the hedged transaction affects earnings. Gains and losses on the derivative representing either hedge ineffectiveness or hedge components excluded from the assessment of effectiveness are recognized in current earnings.

Vector discontinues hedge accounting prospectively when it determines that the derivative is no longer effective in offsetting cash flows of the hedged item, the derivative expires or is sold, terminated, or exercised, the derivative is designated as a hedging instrument because it is unlikely that a forecasted transaction will occur, or management determines that designation of the derivative as a hedging instrument is no longer appropriate.

In all situations in which hedge accounting is discontinued and the derivative is retained, Vector continues to carry the derivative at its fair value on the balance sheet and recognizes any subsequent changes in its fair value in earnings. When it is probable that a forecasted transaction will not occur, Vector discontinues hedge accounting and recognizes immediately in earnings gains and losses that were accumulated in other comprehensive income.

Deferred Financing Costs

Deferred financing costs represent loan fees and other related costs incurred in obtaining the debt financing currently in place, which are being amortized over the term of the related debts.

Comprehensive Income

Certain changes in assets and liabilities, such as unrealized gains and losses on available-for-sale investments, changes in fair value of certain hedges, defined benefit pension plans, and unrealized losses related to factors other than credit on fixed income securities are reported as a separate component on the equity section of the consolidated balance sheet. Such items, along with net income, are components of comprehensive income and are reflected in the consolidated statement of comprehensive income (loss).

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Changes in the balances of each component of accumulated other comprehensive income, net of tax, at December 31 are as follows:

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	UNREALIZED GAINS ON AVAILABLE-FOR-SALE SECURITIES	CASH FLOW HEDGE	DEFINED BENEFIT PENSION PLAN	ACCUMULATED OTHER COMPREHENSIVE INCOME
Balance, January 1, 2015	\$62,108	\$ (290)	\$(1,869)	\$59,949
Other comprehensive income (loss) before reclassifications	(14,424)	558	(196)	(14,062)
Amounts reclassified from accumulated other comprehensive income (loss)	(3,629)	(385)	53	(3,961)
Balance, December 31, 2015	44,055	(117)	(2,012)	41,926
Other comprehensive income before reclassifications	9,444	229	55	9,728
Amounts reclassified from accumulated other comprehensive income (loss)	(606)	(112)	60	(658)
Balance, December 31, 2016	\$52,893	\$ —	\$(1,897)	\$50,996

The following table presents the effect of the reclassification of significant items out of accumulated other comprehensive income on the respective line items in the consolidated statement of operations for year ended December 31.

	AMOUNT RECLASSIFIED FROM ACCUMULATED OTHER COMPREHENSIVE INCOME		AFFECTED LINE ITEM IN THE CONSOLIDATED STATEMENT OF OPERATIONS
	2016	2015	
Unrealized gain on securities available for sale			
Realized gains on sale of securities	\$932	\$5,583	NET REALIZED GAINS ON INVESTMENTS
Gains on cash flow hedges			
Interest rate derivative contracts	172	592	INTEREST EXPENSE
Change in retirement plan liabilities adjustment			
Amortization of actuarial losses	(92)	(81)	(a)
Total reclassifications before income tax expense	1,012	6,094	
Less: Income tax expense	354	2,133	
Total reclassifications net of income tax expense	\$658	\$3,961	

(a) These accumulated other comprehensive income components are included in the computation of net periodic pension cost. See Note 12 to the consolidated financial statements for further detail.

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Legal Matters

The Company is involved in various claims and legal actions arising in the ordinary course of business. In the opinion of management, the ultimate disposition of these matters will not have a material adverse effect on the Company's consolidated financial position, results of operations, or liquidity.

Recently Issued Accounting Pronouncements

In January 2017, the FASB issued ASU No. 2017-01, Clarifying the Definition of a Business, which provides a new framework for determining whether transactions should be accounted for as acquisitions (or disposals) of assets or businesses. The ASU creates an initial screening test (step one) that reduces the population of transactions that an entity needs to analyze to determine whether there is an input and a substantive process in the set (step two). During step one, an entity must first determine if substantially all of the fair value of the gross assets acquired concentrated in a single (group of similar) identifiable asset(s) and if so, the set is not a business. If not, an entity must evaluate during step two whether the set is a business if it includes input(s) and an organized workforce, a process that cannot be replaced or a process that is considered unique or scarce. This ASU is expected to result in fewer transactions being defined as acquiring or selling a business and is effective for the Company beginning in fiscal year 2019, with early adoption permitted. The Company is in the process of assessing the effect that the new standard will have on future acquisitions and divestitures.

In August 2016, the FASB issued ASU No. 2016-15, Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments (a consensus of the Emerging Issues Task Force), which provides new guidance intended to clarify the presentation of certain cash flow items including debt prepayments, debt extinguishment costs, contingent considerations payments, and insurance proceeds, among other things. This ASU is effective for the Company beginning in fiscal year 2019, and early adoption is permitted. The Company is in the process of assessing the impact this ASU will have on its consolidated financial statements.

In June 2016, the FASB issued ASU No. 2016-13, Measurement of Credit Losses on Financial Instruments (Topic 326), which requires financial assets measured at amortized cost to be presented at the net amount expected to be collected, through an allowance for credit losses that is deducted from the amortized cost basis. The measurement of expected credit losses is based on relevant information about past events, including historical experience, current conditions, and reasonable and supportable forecasts that affect the collectability of the reported amount. This ASU is effective for annual periods beginning after December 15, 2020, and interim periods within fiscal years beginning after December 15, 2021. Early adoption is permitted for annual and interim periods beginning after December 15, 2018. The company is currently assessing the effect that this ASU will have on its results of operations, financial position and cash flows

In March 2016, the FASB issued ASU No. 2016-08, Revenue from Contracts with Customers (Topic 606): Principle versus Agent Considerations (Reporting Revenue Gross versus Net), which coincides with ASU 2014-09, Revenue from Contracts with Customers (Topic 606), and provides additional guidance in the determination of principles versus agents. ASU 2014-09 provides guidance to all entities in order to establish a common revenue standard for companies entering into contracts with customers for the transfer of goods or services or entering into contracts for the transfer of nonfinancial assets. This ASU requires an entity to recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The standard prescribes a five step model for recognizing revenue, the application of which will require significant judgment. An entity should disclose sufficient quantitative and qualitative information to enable users of financial statements to understand the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. These ASUs are effective for the Company beginning in fiscal year 2019. The Company has not yet determined the effect of the new standard on its current policies for revenue recognition.

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In February 2016, the FASB issued ASU No. 2016-02, Leases (Topic 842), which provides new guidance on how an entity should account for leases and recognize associated lease assets and liabilities. This ASU requires lessees to recognize assets and liabilities that arise from financing and operating leases on the consolidated balance sheet. The implementation of this standard will require application of the new guidance at the beginning of the earliest comparative period presented, once adopted. This ASU is effective for the Company beginning in fiscal year 2020, and does allow for early adoption. The Company has not yet determined the effect that the new standard will have on its consolidated financial statements.

In January 2016, the FASB issued ASU No. 2016-01, Recognition and Measurement of Financial Assets and Financial Liabilities (Subtopic 825-10), which requires equity investments (except those accounted for under the equity method of accounting or those that result in consolidation of the investee) to be measured at fair value with changes in fair value recognized in net income; (b) simplifies the impairment assessment of equity investments without readily determinable fair values by requiring a qualitative assessment to identify impairment; (c) eliminates the requirement to disclose the fair value of financial instruments measured at amortized cost for entities that are not public business entities; (d) eliminates the requirement for public business entities to disclose the method(s) and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured at amortized cost on the balance sheet; (e) requires public business entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes; (f) requires an entity to present separately in other comprehensive income the portion of the total change in the fair value of a liability resulting from a change in the instrument-specific credit risk when the entity has elected to measure the liability at fair value in accordance with the fair value option for financial instruments; (g) requires separate presentation of financial assets and financial liabilities by measurement category and form of financial asset (that is, securities or loans and receivables) on the balance sheet or the accompanying notes to the financial statements; and (h) clarifies that an entity should evaluate the need for a valuation allowance on a deferred tax asset related to available-for-sale securities in combination with the entity's other deferred tax assets. This ASU is effective for annual periods beginning after December 15, 2018, and interim periods within fiscal years beginning after December 15, 2019. Early adoption is permitted as of the fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. The Company is currently assessing the effect that this ASU will have on our consolidated financial statements.

In November 2015, the FASB issued ASU No. 2015-17, Balance Sheet Classification of Deferred Taxes (Income Taxes – Topic 740), which requires all deferred tax assets and liabilities, and related valuation allowances, to be classified as noncurrent on the Company's consolidated balance sheets. The new standard will be effective for the Company's fiscal year 2018 and the adoption of this ASU is not expected to have a material impact on the Company's consolidated financial statements.

In July 2015, the FASB issued ASU No. 2015-11, Simplifying the Measurement of Inventory, which changes the measurement principle for inventory from the lower of cost or market to the lower of cost and net realizable value. Net realizable value is the estimated selling price in the ordinary course of business, less reasonably predictable costs of completion, disposal, and transportation. The new inventory measurement requirements are effective for the Company's fiscal year 2017, and will replace the current inventory valuation guidance that requires the use of a lower of cost or market framework. The Company does not expect ASU 2015-11 to have a material effect on the Company's consolidated financial statements.

In May of 2015 the Financial Accounting Standards Board "FASB" issued ASU 2015-09 Financial Services Insurance (Topic 944): Disclosures about Short-Duration Contracts, which requires additional disclosures in annual and interim reporting periods by insurance entities regarding liabilities for unpaid claims and claim adjustment expense and any changes in assumption or methodologies for calculations for such liabilities. The guidance is effective for periods beginning after December 15, 2016. The Company is evaluating the effect that the adoption of ASU 2015-09 will have on our consolidated financial statements.

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In May of 2015 the FASB issued ASU 2015-07 Fair Value Measurement (Topic 820) which eliminated the requirement for investments measured at fair value using net asset value as a practice expedient to be categorized within the fair value hierarchy. The Company adopted this guidance which requires a change in disclosure only and adoption did not have an impact on our financial condition or results of operations.

In April and August 2015, the Financial Accounting Standards Board (FASB) issued ASU Nos. 2015-3, Interest – Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs, and 2015-15, Interest – Imputation of Interest (Subtopic 835 30): Presentation and Subsequent Measurement of Debt Issuance Costs Associated with Lines of Credit Arrangements, respectively. The new guidance requires that debt issuance costs related to a recognized debt liability be presented on the balance sheet as a direct deduction from the carrying amount of debt, consistent with debt discounts. The guidance also allows for debt issuance costs related to line of credit arrangements to be presented as an asset, regardless of whether there are any outstanding borrowings on the line of credit arrangements. The adoption of this guidance has no material impact on the Company's consolidated financial statements due to Vectors revolving credit facility.

Subsequent Events

In preparing these consolidated financial statements, management has evaluated events and transactions for potential recognition or disclosure through February 28, 2017, the date the consolidated financial statements were available to be issued.

Note 2: Investments

The cost or amortized cost and estimated fair values of investments at December 31 are as follows:

	2016			
	COST OR AMORTIZED COST	GROSS UNREALIZED GAINS	GROSS UNREALIZED LOSSES	ESTIMATED FAIR VALUE
Fixed income securities:				
U.S. Treasury securities and obligations of U.S. government corporations and agencies	\$ 5,766	\$ 29	\$ (99)	\$ 5,696
Obligations of states and political subdivisions	62,067	3,017	(244)	64,840
Corporate securities	28,140	1,066	(61)	29,145
Mortgage-backed and asset- backed securities	43,523	938	(567)	43,894
Total fixed income securities	139,496	5,050	(971)	143,575
Preferred stocks	2,277	575	(286)	2,566
Common stocks	153,124	79,016	(3,625)	228,515
Total	\$294,897	\$84,641	\$(4,882)	\$374,656

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	2015			
	COST OR AMORTIZED COST	GROSS UNREALIZED GAINS	GROSS UNREALIZED LOSSES	ESTIMATED FAIR VALUE
Fixed income securities:				
U.S. Treasury securities and obligations of U.S. government corporations and agencies	\$ 5,471	\$ 273	\$ (18)	\$ 5,726
Obligations of states and political subdivisions	65,239	4,546	(5)	69,780
Corporate securities	28,757	1,090	(123)	29,724
Mortgage-backed and asset- backed securities	35,189	1,161	(362)	35,988
Total fixed income securities	134,656	7,070	(508)	141,218
Preferred stocks	2,277	210	(290)	2,197
Common stocks	151,354	72,878	(8,038)	216,194
Total	\$288,287	\$80,158	\$(8,836)	\$359,609

Other investments in limited partnerships are classified as available for sale and carried at fair value in the consolidated balance sheet as follows:

	COST		ESTIMATED FAIR VALUE	
	2016	2015	2016	2015
Other Invested Assets	\$35,081	\$32,150	\$36,695	\$28,604

The amortized cost and estimated fair value of fixed income securities and convertible bonds at December 31, 2016, by contractual maturity, are shown below. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or repayment penalties.

	AMORTIZED COST	ESTIMATED FAIR VALUE
Due in one year or less	\$ 1,104	\$ 1,165
Due after one year through five years	27,261	28,903
Due after five years through ten years	41,211	42,289
Due after ten years	37,033	38,996
	106,609	111,353
Mortgage-backed and asset-backed securities	43,523	43,894
Total	\$150,132	\$155,247

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Net realized gains on investments consisted of the following:

	2016	2015
Realized gains on investments	\$ 11,113	\$ 12,180
Realized losses on investments	(9,523)	(4,728)
Change in fair value of convertible securities	996	(1,286)
Other-than-temporary impairment charges	(519)	(2,500)
	<u>\$ 2,067</u>	<u>\$ 3,666</u>

The 2016 and 2015 other-than-temporary impairment charges noted above related to an investment in an oil and gas related limited partnership. This charge resulted from a reduction in the GAAP book value of the limited partnership caused by impairment charges to partnership assets.

The Company had on deposit, as required by various state regulatory agencies, fixed income securities with a fair value of \$3,222 and \$3,129 and cash equivalents of \$821 and \$341 at December 31, 2016 and 2015, respectively.

As of December 31, 2016 and 2015, the Company's investment portfolio had gross unrealized losses of \$4,882 and \$8,836, respectively. For securities that were in an unrealized loss position as of December 31, the lengths of time that such securities have been in an unrealized loss position, as measured by their year-end fair values, are as follows:

	LESS THAN 12 MONTHS		12 MONTHS OR MORE		TOTAL	
	FAIR VALUE	UNREALIZED LOSSES	FAIR VALUE	UNREALIZED LOSSES	FAIR VALUE	UNREALIZED LOSSES
December 31, 2016:						
Fixed income securities:						
U.S. Treasury securities and obligations of U.S. government corporations and agencies	\$ 4,325	\$ (87)	\$ 635	\$ (12)	\$ 4,960	\$ (99)
Obligations of states and political subdivisions	7,113	(240)	499	(4)	7,612	(244)
Corporate securities	4,141	(35)	1,261	(26)	5,402	(61)
Mortgage-backed and asset-backed securities	15,084	(293)	10,849	(274)	25,933	(567)
Total fixed income securities	30,663	(655)	13,244	(316)	43,907	(971)
Preferred stocks	—	—	1,914	(286)	1,914	(286)
Common stocks	23,843	(2,282)	12,085	(1,343)	35,928	(3,625)
Total	<u>\$54,506</u>	<u>\$ (2,937)</u>	<u>\$27,243</u>	<u>\$ (1,945)</u>	<u>\$81,749</u>	<u>\$ (4,882)</u>

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	LESS THAN 12 MONTHS		12 MONTHS OR MORE		TOTAL	
	FAIR VALUE	UNREALIZED LOSSES	FAIR VALUE	UNREALIZED LOSSES	FAIR VALUE	UNREALIZED LOSSES
December 31, 2015:						
Fixed income securities:						
U.S. Treasury securities and obligations of U.S. government corporations and agencies	\$ 2,585	\$ (12)	\$ 694	\$ (6)	\$ 3,279	\$ (18)
Obligations of states and political subdivisions	1,441	(5)	518	—	1,959	(5)
Corporate securities	4,128	(123)	—	—	4,128	(123)
Mortgage-backed and asset-backed securities	8,578	(129)	10,272	(233)	18,850	(362)
Total fixed income securities	16,732	(269)	11,484	(239)	28,216	(508)
Preferred stocks	—	—	1,914	(290)	1,914	(290)
Common stocks	29,288	(6,221)	4,523	(1,817)	33,811	(8,038)
Total	\$46,020	\$(6,490)	\$17,921	\$(2,346)	\$63,941	\$(8,836)

There were 81 fixed income securities in an unrealized loss position as of December 31, 2016 and 2015. In management's opinion, the unrealized losses on fixed income securities reflect general market conditions. Management believes that the unrealized losses are temporary. The Company does not intend to sell these securities prior to maturity or market recovery, and it is more likely than not the Company has the ability to hold these securities until maturity or market recovery. Management performed cash flow testing on its mortgage-backed and asset-backed securities and based on this cash flow testing all principal of these securities was deemed to be recoverable at December 31, 2016. There were 78 and 85 common and preferred stocks in an unrealized loss position as of December 31, 2016 and 2015, respectively. Management believes that the unrealized losses on common and preferred stocks reflect general market conditions and has the intent and ability to hold these common and preferred stocks to market price recovery of original cost.

Note 3: Fair Value Measurements

The Company measures fair value by categorizing assets and liabilities based upon the level of judgment associated with the inputs to measure their fair value. These levels are:

- Level 1 - Inputs that are unadjusted, quoted prices for identical assets or liabilities in active markets at the measurement date.
- Level 2 - Inputs other than quoted process included in Level 1 that are observable for the asset or liability through corroboration with market data at the measurement date.
- Level 3 - Unobservable inputs that reflect management's best estimate of what market participants would use in pricing the asset or liability at the measurement date.

The fair values for securities included in Level 1 are based on observable inputs either directly or indirectly, such as quoted prices in markets that are active, quoted prices for similar securities at the measurement date; quoted prices in markets that are not active; or other inputs

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that are observable. The Company classifies its investment in U.S. Treasury securities and common stocks as Level 1 assets.

The fair values for securities included in Level 2 are based upon fair values generated by external pricing models that vary by asset class and incorporate available trade, bid and other market information, as well as price quotes from other independent market participants which reflect fair value of that particular security. The Company considers its investments in U.S. government agency bonds, municipal bonds, corporate bonds, mortgage-backed and asset-backed securities, and one convertible bond as Level 2 assets.

In classifying the mortgage-backed and asset-backed securities owned as Level 2 securities, the Company considers the inputs as follows:

- a. Quoted prices for similar assets or liabilities in active markets.
- b. Quoted prices for identical or similar assets or liabilities in markets that are not active, that is, markets in which there are few transactions for the assets or liabilities, the prices are not current, or price quotations vary substantially either over time or among market makers (for example, some brokered markets) or in which little information is released publicly (for example, a principal-to-principal market).

The Company's determination of the fair value of its interest rate swap as Level 2 is calculated using a discounted cash flow analysis based on the terms of the swap contract and the observable interest rate curve.

Securities included in Level 3 are securities where inputs are based solely on a broker price or unobservable market data. The Company classifies its investments in certain convertible bonds, convertible preferred stocks, and a closely held equity security as Level 3 assets.

The fair value of the other invested assets (limited partnership interests) is determined by the investment company and is based upon fair value policies established by management of the underlying fund. Fair value policies at the underlying fund generally require the fund to utilize pricing/valuation information; however, in some instances current valuation information, for illiquid securities or securities in markets that are not active, may not be available from any third party source, or fund management may conclude that the valuations available from third party sources are not reliable. In these instances fund management may perform model-based analytical valuations that may be used to value these investments. The Company uses net asset value (NAV) per share (or its equivalent), as a practical expedient to estimate the fair value of its other invested assets, if NAV is calculated consistent with accounting principles generally accepted in the United States of America and sale of the investment at an amount different than NAV is not probable. The Company considered the nature, risk, and probability for the sale of the investment (at amounts different from NAV). The Company's considerations included (but were not limited to):

- Unfunded commitments (for additional investment)
- Redemption eligibility and frequency
- Required redemption notice

Based upon these considerations, the Company concluded that NAV for the other invested assets is calculated consistent with accounting principles generally accepted in the United States of America.

Investments carried at NAV may be adjusted based upon management's assumptions; therefore, any withdrawal, transfer, or sale of the limited partnership interest is subject to the general partner's discretion. At December 31, 2016 and 2015, the fair value using net asset value for the Company's other invested assets were \$36,695 and \$28,604, respectively.

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One investment in a limited partnership included in other invested assets comprising 60% of other invested assets is subject to certain lock up provisions. This investment provides that the Company may not withdraw a capital contribution for 12 months following the date of its initial investment. Following this one year lock up period, the Company, in order to make a withdrawal, must provide 90 days' prior notice as of the last date of each calendar quarter to the general partner. Withdrawals made by the Company less than 36 months from initial contribution are subject to a 3% early withdrawal charge. These restrictions may be waived by the general partner in the case of certain events or at the discretion of the general partner. This partnership does not have a finite life.

One investment in a master limited partnership included in other invested assets comprising 36% of other invested assets contains a stipulation that redemptions by the Company within 12 months following its initial investment are subject to a 1% early withdrawal charge. This restriction may be waived by the managing member. The Company can make a withdrawal as of the last business day of the month by providing notice to the managing member at least 30 days in advance of the withdrawal. This partnership does not have a finite life.

One investment in a limited partnership included in other invested assets comprising 3% of other invested assets has a term of 10 years from the initial closing, with an option for up to two consecutive one year extensions at the general partner's election. A 90% in interest of the limited partners may elect to terminate the fund at any time. This limited partnership is not subject to lock up provisions.

One investment in a limited partnership included in other invested assets comprising 1% of other invested assets has a term of 10 years from the initial closing. This limited partnership is not subject to lock up provisions.

The following table summarizes fair value measurements by level within the fair value hierarchy at December 31, 2016 and 2015 for assets and liabilities measured at fair value on a recurring basis:

2016				
FAIR VALUE MEASUREMENTS USING:				
DESCRIPTION	TOTAL	QUOTED PRICES IN ACTIVE MARKETS FOR IDENTICAL ASSETS (LEVEL 1)	SIGNIFICANT OTHER OBSERVABLE INPUTS (LEVEL 2)	SIGNIFICANT UNOBSERVABLE INPUTS (LEVEL 3)
Assets				
Fixed income securities:				
U.S. Treasury securities and obligations of U.S. government corporations and agencies	\$ 5,696	\$ 5,696	\$ —	\$ —
Obligations of states and political subdivisions	64,840	—	64,840	—
Corporate securities	29,145	—	29,145	—
Mortgage-backed and asset-backed securities	43,894	—	43,894	—
Total fixed income securities	143,575	5,696	137,879	—
Convertible bonds	11,672	—	7,010	4,662
Preferred stocks	2,566	—	2,038	528
Convertible preferred stocks	2,261	—	—	2,261
Common stocks	228,515	228,415	—	100
Total bonds and stocks	\$388,589	\$234,111	\$146,927	\$7,551

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DESCRIPTION	TOTAL	2015		
		FAIR VALUE MEASUREMENTS USING:		
		QUOTED PRICES IN ACTIVE MARKETS FOR IDENTICAL ASSETS (LEVEL 1)	SIGNIFICANT OTHER OBSERVABLE INPUTS (LEVEL 2)	SIGNIFICANT UNOBSERVABLE INPUTS (LEVEL 3)
Assets				
Fixed income securities:				
U.S. Treasury securities and obligations of U.S. government corporations and agencies	\$ 5,726	\$ 5,726	\$ —	\$ —
Obligations of states and political subdivisions	69,780	—	69,780	—
Corporate securities	29,724	—	29,724	—
Mortgage-backed and asset-backed securities	35,988	—	35,988	—
Total fixed income securities	141,218	5,726	135,492	—
Convertible bonds	10,457	—	2,394	8,063
Preferred stocks	2,197	—	1,649	548
Convertible preferred stocks	1,835	—	—	1,835
Common stocks	216,194	216,095	—	99
Total bonds and stocks	371,901	221,821	139,535	10,545
Liabilities				
Interest rate swap payable	\$ 184	\$ —	\$ 184	\$ —

For fair value measurements using Level 3 inputs, a reconciliation of the beginning and ending balances is as follows at December 31:

	2016				
	FIXED INCOME SECURITIES	CONVERTIBLE BONDS	PREFERRED STOCKS	CONVERTIBLE PREFERRED STOCKS	COMMON STOCKS
Balance, January 1, 2016	\$—	\$8,063	\$548	\$1,835	\$ 99
Purchases	—	1,091	—	265	—
Sales	—	(1,351)	—	—	—
Distributions:					
Transfers in from Level 2	—	—	—	62	1
Transfers out to Level 2	—	(3,526)	—	—	—
Total gains (losses):					
Included in earnings (reported in net realized gains on investments)	—	—	—	4	—
Included in other comprehensive income	—	385	(20)	95	—
Balance, December 31, 2016	\$—	\$ 4,662	\$528	\$2,261	\$100

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	2015				
	FIXED INCOME SECURITIES	CONVERTIBLE BONDS	PREFERRED STOCKS	CONVERTIBLE PREFERRED STOCKS	COMMON STOCKS
Balance, January 1, 2015	\$—	\$ 7,709	\$558	\$1,665	\$95
Purchases	—	3,981	—	938	—
Sales	—	(61)	—	(517)	—
Distributions:					
Transfers in from Level 2	—	606	—	—	—
Transfers out to Level 2	—	(3,179)	—	—	—
Total gains (losses):					
Included in earnings (reported in net realized gains on investments)	—	(993)	—	(251)	—
Included in other comprehensive (loss)	—	—	(10)	—	4
Balance, December 31, 2015	<u>\$—</u>	<u>\$ 8,063</u>	<u>\$548</u>	<u>\$1,835</u>	<u>\$99</u>
					<u>\$10,027</u>
					<u>4,919</u>
					<u>(578)</u>
					<u>606</u>
					<u>(3,179)</u>
					<u>(1,244)</u>
					<u>(6)</u>

The Company's policy is to transfer assets and liabilities into and out of Level 3 at the beginning of the reporting period when the circumstance is such that significant inputs can or cannot be corroborated with market observable data.

The following table presents the carrying amounts and estimated fair values of the Company's financial instruments at December 31, 2016 and 2015. The fair value of a financial instrument is the amount that would be paid to transfer an asset or a liability in an orderly transaction between market participants at the measurement date.

	2016		2015	
	CARRYING VALUE	FAIR VALUE	CARRYING VALUE	FAIR VALUE
Financial assets:				
Insurance Group				
Investments:				
Fixed income securities	\$143,575	\$143,575	\$141,218	\$141,218
Convertible bonds	11,672	11,672	10,457	10,457
Preferred stocks	2,566	2,566	2,197	2,197
Convertible preferred stocks	2,261	2,261	1,835	1,835
Common stocks	228,515	228,515	216,194	216,194
Other invested assets	36,695	36,695	28,604	28,604
Cash and cash equivalents	14,076	14,076	14,672	14,672
Accrued income from investments	1,575	1,575	1,523	1,523
Security Group:				
Cash and cash equivalents	193	193	2,360	2,360
Trade accounts receivable	21,820	21,820	23,137	23,137
Prepaid expenses and other current assets	6,716	6,716	6,361	6,361

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	2016		2015	
	CARRYING VALUE	FAIR VALUE	CARRYING VALUE	FAIR VALUE
Financial liabilities:				
Security Group:				
Accounts payable and accrued expenses	29,987	29,987	24,234	24,234
Customer deposits	726	726	887	887
Interest rate swap payable	—	—	184	184
Long-term debt and current maturities thereof	\$158,749	\$158,749	\$163,284	\$163,284

The carrying amounts shown in the table are included in the consolidated balance sheet under the indicated captions.

Cash and cash equivalents, other receivables, trade accounts receivable, accrued income from investments, accounts payable, and accrued expenses - the carrying amounts at face value approximate fair value because of the short maturity of these instruments.

Interest rate swap payable – The Company's determination of the fair value of its interest rate swap is calculated using a discounted cash flow analysis based on the terms of the swap contract and the observable interest rate curve (Level 2 inputs).

The fair values of the financial instruments shown in the above table as of December 31, 2016 and 2015 represent management's best estimates of the amounts that would be received to sell those assets or that would be paid to transfer those liabilities in an orderly transaction between market participants at that date. Those fair value measurements maximize the use of observable inputs. However, in situations where there is little, if any, market activity for the asset or liability at the measurement date, the fair value measurement reflects the Company's own judgments about the assumptions that market participants would use in pricing the asset or liability. Those judgments are developed by the Company based on the best information available in the circumstances.

The fair value of long-term debt is estimated by discounting the future cash flows of each issuance at rates that the Company could obtain similar debt instruments of comparable maturities.

The Security Group has assets and liabilities that are required to be recorded at fair value on a nonrecurring basis when certain circumstances occur. In the case of intangible assets, upon the occurrence of an event or change in circumstance that may indicate that the fair value of a customer service agreement is less than its carrying value, the Company determines the fair value of the specific customer service agreement and records an impairment for the amount by which the carrying value exceeds the customer service agreement's fair value. The estimate of fair value of a customer service agreement is determined using Level 3 inputs, primarily an analysis of future expected cash flows. The Company recorded impairment expense, through amortization expense, on their customer service agreements of \$1,680 and \$6,891 during 2016 and 2015, respectively.

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Note 4: Liability for Unpaid Losses and Loss Adjustment Expenses

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Activity in the liability for unpaid losses and loss adjustment expenses is summarized as follows:

	2016	2015
Balance as of January 1	\$ 94,361	\$ 93,536
Less reinsurance recoverable	(13,318)	(17,836)
Net balance at January 1	81,043	75,700
Incurred related to:		
Current year	87,747	94,438
Prior years	(4,196)	(903)
Total incurred	83,551	93,535
Paid related to:		
Current year	56,902	60,949
Prior years	28,472	27,243
Total paid	85,374	88,192
Net balance as of December 31	79,220	81,043
Plus reinsurance recoverable	12,307	13,318
Balance at December 31	\$ 91,527	\$ 94,361

Due to changes in estimates of insured events in prior years, the Insurance Group decreased the liability for unpaid losses and loss adjustment expenses relative to prior accident years in 2016 and 2015 by \$4,196 and \$903, respectively. The decrease in 2016 is due to better than expected development of losses incurred, primarily in the homeowners property and special property lines of business, and primarily related to accident year 2015. Additionally, the decrease in 2016 was partially offset by adverse development in accident years 2012, 2013, and 2014 relating to homeowners liability and other liability lines of business. The decrease in 2015 is due to better than expected development of losses incurred, primarily in the homeowners and specialty property lines of business, and primarily related to accident years 2012 and 2014.

Note 5: Reinsurance

The Insurance Group purchases quota share and per risk and catastrophic excess of loss reinsurance. The Insurance Group remains contingently liable in the event that the reinsurer is unable to meet its obligations under the reinsurance agreements.

The Insurance Group had no assumed premiums earned in 2016 and 2015 and ceded premiums earned in 2016 and 2015 of \$14,477 and \$14,016, respectively. Losses and loss adjustment expenses are net of reinsurance recoveries of \$5,121 and \$3,456 in 2016 and 2015, respectively. Amounts paid to reinsurers related to the unexpired portion of reinsured contracts were \$1,880 and \$1,913 as of December 31, 2016 and 2015, respectively.

The Insurance Group had no significant concentration in risk from any one unaffiliated reinsurer as of December 31, 2016 and 2015.

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Note 6: Dividends from Subsidiaries and Statutory Financial Information

The Contributionship and its subsidiaries prepare statutory financial statements in accordance with accounting practices prescribed or permitted by the Pennsylvania Insurance Department. The Commonwealth of Pennsylvania requires that insurance companies domiciled in the Commonwealth of Pennsylvania prepare their statutory financial statements in accordance with the National Association of Insurance Commissioners *Accounting Practices and Procedures* manual, subject to any deviations prescribed or permitted by the Commonwealth of Pennsylvania Insurance Commissioner. Permitted statutory accounting practices encompass all accounting practices that are not prescribed; such practices differ from state to state, may differ from company to company within a state, and may change in the future.

The Contributionship and its subsidiaries are restricted by law as to the amount of dividends they may pay without the approval of regulatory authorities. During 2017, the maximum amount of dividends that can be paid by the Contributionship without such approval is \$25,190. The Contributionship paid no ordinary dividends during 2016 and 2015.

The surplus of the Contributionship and its subsidiaries, as determined in accordance with statutory accounting practices, is \$251,900 and \$233,126 at December 31, 2016 and 2015, respectively. The net income of the Contributionship and its subsidiaries, as determined in accordance with statutory accounting practices, is \$7,983 and \$3,826 for the years ended December 31, 2016 and 2015, respectively.

Risk-based capital is designed to measure the acceptable amount of capital an insurer should have based on the inherent risks of the insurer's business. Insurers failing to meet adequate capital levels may be subject to insurance department scrutiny and ultimately rehabilitation or liquidation. As of December 31, 2016 and 2015, the Contributionship and its subsidiaries maintained statutory-basis surplus in excess of the minimum prescribed risk-based capital requirements. As of December 31, 2016 and 2015, the Contributionship and its subsidiaries were in compliance with the minimum capital requirements under Commonwealth of Pennsylvania regulations.

Note 7: Goodwill and Other Intangible Assets

The changes in the carrying amount of goodwill for the years ended December 31 are as follows:

	2016	2015
Balance as of January 1	\$35,080	\$39,722
Amortization	(4,642)	(4,642)
Balance as of December 31	\$30,438	\$35,080

The following summarizes the gross carrying amount and accumulated amortization of intangible assets as of December 31:

	2016		2015	
	GROSS CARRYING AMOUNT	ACCUMULATED AMORTIZATION	GROSS CARRYING AMOUNT	ACCUMULATED AMORTIZATION
Customer service agreements	\$277,263	\$ 147,986	\$284,175	\$ 137,021
Customer relationships	10,460	2,716	10,460	1,911
Covenants not to compete	698	467	793	430
Covenants not to solicit	2,084	879	2,084	619
Technology	2,740	1,849	2,740	1,301
Trade Names	669	452	669	318
Total	\$293,914	\$154,349	\$300,921	\$141,600

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Amortization expense, excluding impairment charges, for other intangible assets was \$29,525 and \$28,886 for the years ended December 31, 2016 and 2015, respectively.

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The estimated amortization expense for goodwill and other intangible assets for each of the five succeeding fiscal years is as follows:

2017	\$ 34,425
2018	32,707
2019	29,584
2020	26,267
2021	22,426
Thereafter	24,594
Total	<u>\$170,003</u>

Note 8: Acquisitions

Industry Retail Group

On August 15, 2013, Vector, through its VIS subsidiary, acquired selected assets and assumed certain liabilities of IRG. IRG provides virtual managed network services. As a result of the acquisition, Vector began cross-selling virtual managed network services to existing customers. Goodwill arising from the acquisition consisted largely of Vector's specific synergies related to cross-selling. The results of the IRG acquisition have been included in the consolidated financial statements since the acquisition date. The acquisition was accounted for as a business combination.

The following table summarizes the consideration paid for the IRG acquisition and the amounts of estimated fair value of the assets acquired and liabilities assumed at the acquisition date.

Consideration:

Cash	\$27,737
Contingent consideration	3,227
Redeemable noncontrolling interest	25,710
Fair value of total consideration transferred	<u>\$56,674</u>

Recognized amounts of identifiable assets acquired and liabilities assumed:

Current assets	\$ 853
Intangible assets	16,561
Current liabilities	(2,116)
Total identifiable net assets assumed	15,298
Goodwill	41,376
Total	<u>\$56,674</u>

Of the acquired intangible assets, \$10,460 was assigned to customer relationships, which are amortized over 13 years, \$2,740 was assigned to technology, which is amortized over 5 years, \$2,084 was assigned to covenants not to solicit, which are amortized over 8 years, \$669 was assigned to trade names, which are amortized over 5 years, and \$608 was assigned to covenants not to compete, which are amortized over 5 years.

Funding for the acquisition consisted primarily of \$27,737 in borrowings on Vector's existing revolving credit facility, contingent consideration with a fair value at the acquisition date of \$3,227, and issuance of 30% of the outstanding membership units of VIS to IRG (redeemable noncontrolling interest) with a fair value at the acquisition date of \$25,710. In August 2014, the contingent consideration was adjusted to \$3,558 based upon average monthly recurring charges billed to customers during the 12 months subsequent to the acquisition date. The payment of the contingent consideration is being made in 24 monthly installments of \$148, which began in September 2014.

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In November 2014, IRG's membership units in VIS were decreased by 27,052 units based upon average monthly recurring charges billed to and collected from customers during the 12 months subsequent to the acquisition date, which resulted in an adjustment of \$2,285 to the redeemable noncontrolling interest with an offset to the unassigned equity.

Included within Vector's membership units in VIS is a call option to purchase IRG's membership units based on a multiple of trailing twelve-month gross margin at the exercise date. Included within IRG's membership units in VIS is a put option to sell IRG's membership units based on a multiple of trailing twelve-month gross margin at the exercise date. The noncontrolling interest becomes redeemable within 10 days after the earliest of (i) the third anniversary of the date of the acquisition and every anniversary thereafter or (ii) the date on which certain principals of IRG no longer control IRG. Vector determined that the put/call option is embedded within the redeemable noncontrolling interest shares that are subject to the put/call option. Therefore, the put option is accounted for within redeemable noncontrolling interest in the consolidated balance sheet.

In accordance with ASC Topic 815, Vector initially measured the redeemable noncontrolling interest at fair value. The acquisition date fair value of IRG's redeemable noncontrolling interest in VIS was estimated by applying an income approach. This fair value measurement is based on significant inputs that are not observable in the market and thus represents a Level 3 measurement. Key assumptions included a discount rate of 22.3% and the projected 12 month trailing gross margin on the third anniversary of the acquisition date.

Subsequent measurement of the redeemable noncontrolling interest is the greater of the amount determined under ASC Subtopic 810-10 (adjusted carrying value) or ASC Section 480-10-S99 (redemption value). The noncontrolling interest was \$22,244 at December 31, 2015 as the adjusted carrying value exceeded the redemption value. During 2015, the carrying value of the redeemable noncontrolling interest was adjusted for the net loss of \$235 as well as tax distributions of \$440 related to IRG.

During 2016, the conditions for redemption of the noncontrolling interest were met, and effective October 21, 2016, Vector redeemed the remaining 28% interest from the noncontrolling interest holder for a purchase price of \$19,124 funded through cash on hand and drawings on Vector's revolving credit facility. The difference between the purchase price and the value of the noncontrolling interest as well as the net loss of \$633, and tax distributions of \$814 related to IRG, were offset to Vector's additional paid-in-capital.

Pelican Security Network, Inc. and Pelican Security Services, LLC

On August 31, 2015, Vector acquired selected assets and assumed certain liabilities of Pelican Security Network, Inc. and Pelican Security Services, LLC (Pelican) located in Louisiana, Texas, and Florida for a purchase price of \$14,800. The results of Pelican have been included in the consolidated financial statements since the acquisition date. The assets acquired represent approximately 17,000 customer accounts in Louisiana, Texas, and Florida. The acquisition was accounted for as a business combination.

The aggregate purchase price was \$14,800 which included \$15,300 of intangible assets and \$568 of tangible and current assets and \$188 of noncurrent assets, net of \$1,256 in current liabilities. Of the \$15,300 of intangible assets, \$15,275 was assigned to customer service agreements, which are amortized over 13 years, and \$25 was assigned to covenants not to compete, which are amortized over 5 years.

Funding for the acquisition consisted primarily of \$13,194 in borrowings on Vector's existing revolving credit facility and \$1,606 in the form of a purchase holdback. The payment of the purchase holdback is contingent upon attrition of accounts over the first year. In October 2016, Vector paid the purchase holdback to the seller in the amount of \$1,101. As a result, the value of the customer service agreements intangible asset was reduced by \$505. During 2015, the Vector incurred \$310 in transaction related expenses associated with the acquisition of Pelican, which is included in the accompanying statements of operations and comprehensive (loss) income.

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Others

Vector acquired selected accounts from various Company authorized dealers located in various states. The total purchase price for these accounts was \$13,107 and \$13,335 in 2016 and 2015, respectively. The revenue and associated costs from the monitoring contracts acquired in these transactions have been included in the consolidated financial statements since the acquisition dates. The assets acquired represent approximately 9,900 accounts in 2016 and 9,800 accounts in 2015. The entire aggregate purchase price was assigned to customer service agreements. Substantially all accounts are subject to a one year holdback period of approximately 10% of the purchase price.

Los Angeles Divestiture

On February 29, 2016, Vector sold certain assets and property of its Los Angeles branch location. Pursuant to the asset purchase agreement, Vector sold the interests of accounts receivable with a net book value of \$315, inventory and work in process with a net book value of \$432 and property and equipment with a net book value of \$51 as of the closing date for a total purchase price of \$3,198. Furthermore, in connection with the divestiture, Vector wrote off the remaining net book value of customer intangible assets that were established at the date of the original acquisition of this branch location in the amount of \$1,228, as well as liquidated certain liabilities in the amount of \$27. As a result of the sale of certain assets and property, Vector recorded a gain of \$1,199, which is recorded within gain on branch divestiture in the accompanying consolidated statements of operations and comprehensive income (loss).

Note 9: Borrowings and Credit Arrangements

Long-term debt as of December 31 consists of the following:

	2016	2015
Revolving credit facility - variable interest rate (approximately 2.4% and 2.3% as of December 31, 2016 and 2015, respectively)	\$155,100	\$160,114
Capital leases - bearing interest at rates ranging from 3% to 7% as of December 31, 2016 and 2015	3,649	3,170
	158,176	163,284
Less current maturities	(1,700)	(5,367)
Total long-term debt	\$157,049	\$157,917

During 2016, Vector refinanced its existing debt by obtaining a \$300,000 revolving credit facility that permits Vector to borrow, on a revolving basis, through November 9, 2021. Interest on the entire \$300,000 credit facility is computed at either a base rate or LIBOR rate plus a scaling interest rate spread based upon a total consolidated indebtedness to eligible recurring monthly revenue ratio (Leverage Ratio), as defined in the agreement. Borrowings under this loan agreement are collateralized by Vector's assets, including the customer service agreements.

On August 1, 2012, Vector entered into a 47 month interest rate swap agreement with a notional amount of \$90,000. This derivative was designated as a cash flow hedge and is recognized on the consolidated balance sheet at its fair value. Changes in fair value are recorded in other comprehensive income, net of taxes. Under the terms of the swap agreement, Vector receives variable-rate interest payments based on 30-day LIBOR and makes fixed-rate payments of 0.835%. The interest rate swap agreement matured in June 2016, and therefore the fair value of the swap as of December 31, 2016 was zero. The fair value of the swap as of December 31, 2015 was approximately \$184, and was recorded as a liability in the consolidated financial statements.

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Vector must pay a quarterly commitment fee based on the Leverage Ratio that ranges from 0.2% to 0.3%. At December 31, 2016, Vector was paying a quarterly commitment fee of approximately 0.2% on the available unused portion of the revolving credit facility. As of December 31, 2016, the available unused portion of the revolving credit facility was \$142,429.

Under Vector's revolving credit facility, approximately \$2,471 and \$2,624 were committed for outstanding letters of credit as of December 31, 2016 and 2015, respectively. There were no amounts drawn on the letters of credit as of December 31, 2016 and 2015.

The credit agreement contains covenants with respect to, among other things, the maintenance of specified financial ratios. These provisions, if violated, could terminate the agreement and cause an acceleration of the maturity date. As of December 31, 2016 and 2015, the Company was in compliance with all such covenants.

The aggregate maturities of debt principal for Vector as of December 31, 2016 are as follows:

2017	\$ 1,700
2018	1,202
2019	690
2020	57
2021	155,100
Total	\$158,749

Note 10: Leases

Vector has various capital leases for equipment (Note 9) that expire at various dates during the next 40 months. Amortization of assets held under capital leases is included with depreciation expense.

Vector leases certain equipment and office space under various operating leases. The future minimum rental commitments for all such noncancelable leases as of December 31, 2016 are as follows:

2017	\$ 4,093
2018	2,954
2019	2,302
2020	1,612
2021	1,061
Thereafter	2,813
Total	\$14,835

Rent expense for leased equipment and office space totaled \$5,835 and \$5,325 for the years ended December 31, 2016 and 2015, respectively.

Note 11: Income Taxes

Income tax (benefit) expense for the years ended December 31 consists of:

2016			2015		
CURRENT	DEFERRED	TOTAL	CURRENT	DEFERRED	TOTAL
\$1,967	\$(1,144)	\$823	\$4,037	\$(6,348)	\$(2,311)

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The expected income tax (benefit) expense for the years ended December 31 differed from the amounts computed by applying the U.S. federal income tax rate of 35% as follows:

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	2016	2015
Computed "expected" income tax expense	\$1,988	\$(1,888)
Increase (decrease) in income taxes resulting from:		
Tax-exempt interest	(562)	(671)
Dividends received deduction	(752)	(894)
State taxes, net of federal benefit	169	300
Provision to return adjustments	(504)	27
Other, net	484	815
	<u>\$ 823</u>	<u>\$(2,311)</u>

The tax effects of temporary differences that give rise to significant portions of the deferred tax assets and deferred tax liabilities as of December 31 are as follows:

	2016	2015
Insurance Group:		
Deferred income tax asset components:		
Unearned premiums and advance premiums	\$ 5,111	\$ 5,033
Unpaid losses and loss adjustment expenses	1,334	1,751
Other-than-temporary impairments	2,063	2,141
Accrued pension liability	1,021	1,083
Deferred compensation	972	755
Other	195	186
Total deferred income tax asset	<u>10,696</u>	<u>10,949</u>
Deferred income tax liability components:		
Deferred acquisition costs	(5,212)	(4,790)
Unrealized investment gains	(28,479)	(23,720)
Unrealized investment gains on convertible securities	(371)	(23)
Other	(1,953)	(1,732)
Total deferred income tax liability	<u>(36,015)</u>	<u>(30,265)</u>
Net deferred income tax liability	<u>\$(25,319)</u>	<u>\$(19,316)</u>
Security Group:		
Deferred income tax asset components:		
Accrued expenses	\$ 4,109	\$ 3,185
Deferred rent	103	111
Inventories and accounts receivable	1,575	1,442
Interest rate swap	—	64
Intangible assets	29,201	26,221
HSS deferred revenue	783	—
Investments in VIS LLC	—	1,426
Total deferred tax asset	<u>35,771</u>	<u>32,449</u>
Deferred income tax liability components:		
Unbilled revenue	(3,902)	(4,949)
Plant and equipment	(4,522)	(4,283)
HSS deferred charges	(2,992)	—
Total deferred income tax liability	<u>(11,416)</u>	<u>(9,232)</u>
Net deferred income tax asset	<u>\$ 24,355</u>	<u>\$ 23,217</u>

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(DOLLARS IN THOUSANDS, UNLESS OTHERWISE NOTED)

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In assessing the realizability of deferred income tax assets, management considers whether it is more likely than not that some portion or all of the deferred income tax assets will not be realized. Management considers the scheduled reversal of deferred income tax liabilities, projected future taxable income, and tax planning strategies in making this assessment. The ultimate realization of deferred income tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. The amount of the deferred income tax asset considered realizable; however, could be reduced in the near term if estimates of future taxable income or statutory tax rates are reduced during the carryforward period. Management has determined that it was not required to establish a valuation allowance against the net deferred income tax asset.

Vector has no remaining state net operating loss carryforwards, as they have been utilized in offsetting state taxable income as of December 31, 2016.

The Company has no unrecognized tax benefits as of December 31, 2016.

There are no tax-related interest or penalties accrued on the consolidated balance sheet at December 31, 2016 and 2015, nor has any tax related interest or penalties been recognized in the consolidated statement of operations for the years ended December 31, 2016 and 2015.

The Company's federal income tax returns for tax years ended December 31, 2010 and prior are closed to examination.

Note 12: Employee Benefit Plans

Defined Benefit Pension Plan

The Insurance Group has a defined benefit pension plan (Plan) covering all employees meeting eligibility requirements. It is the Insurance Group's policy to fund pension costs in accordance with the funding requirements of the Employee Retirement Income Security Act of 1974 and the Internal Revenue Code. The Insurance Group expects to pay contributions to the Plan during 2017 of \$300. The Insurance Group made \$300 contributions to the Plan in both 2016 and 2015, respectively.

The components of the net periodic benefit cost are as follows:

	2016	2015
Interest cost	\$ 310	\$ 312
Expected return on plan assets	(441)	(504)
Amortization of net loss	92	81
Total net periodic benefit cost	<u>\$ (39)</u>	<u>\$ (111)</u>

On December 13, 2006, the Board of Directors of the Company voted to freeze the benefits of the participants in the Plan effective April 1, 2007.

The Insurance Group recognizes the overfunded or underfunded status of its defined benefit pension plan as an asset (other assets) or liability (other liabilities) in the consolidated balance sheet. Changes in the funded status during any given period of time are recognized as a change in other comprehensive income.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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(DOLLARS IN THOUSANDS, UNLESS OTHERWISE NOTED)

The table set forth below reconciles the defined benefit pension plan's funded status reconciled with the amount in the consolidated balance sheet as of December 31:

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	2016	2015
Benefit obligation as of January 1	\$8,144	\$ 8,730
Interest cost	310	312
Distributions	(483)	(481)
Change due to change in assumptions and experience	(59)	(417)
Benefit obligation as of December 31	7,912	8,144
Plan assets as of January 1	6,862	7,258
Employer contributions	300	300
Actual return on assets	467	(216)
Distributions	(483)	(480)
Plan assets as of December 31	7,146	6,862
Funded status	\$ (766)	\$(1,282)

The net actuarial loss recognized in accumulated other comprehensive income, pre-tax in the consolidated balance sheet as of December 31 is as follows:

	2016	2015
	\$2,918	\$ 3,096

Assumptions used in determining the actuarial present value of the projected benefit obligation were as follows at December 31:

	2016	2015
Weighted-average discount rate	3.80%	3.97%
Expected long-term rate of return on assets	6.50	7.00
Rate of increase in compensation levels	N/A	N/A

The expected long-term rate of return on assets reflects the average rate of earnings expected on the funds invested or to be invested to provide for the benefits included in the projected benefit obligation. The selected rate considers the historical and expected future investment trends of the present and expected assets in the Plan.

There were \$483 and \$480 of benefit payments made under the Plan in 2016 and 2015, respectively. Expected payments under the Plan in future years are as follows at December 31, 2016:

2017	\$ 501
2018	494
2019	487
2020	494
2021	503
2022 - 2026	\$2,479

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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The Plan had approximately 71% of its investments invested in common stocks, 19% invested in corporate bonds and the remainder invested in U.S. Government and mortgage-backed securities and cash and cash equivalents for both year ending 2016 and 2015.

The following table provides the fair value measurements of the Plan assets by level within the fair value hierarchy at December 31. These assets are measured at fair value on a recurring basis.

DESCRIPTION	TOTAL	2016		
		FAIR VALUE MEASUREMENTS USING:		
		QUOTED PRICES IN ACTIVE MARKETS FOR IDENTICAL ASSETS (LEVEL 1)	SIGNIFICANT OTHER OBSERV- ABLE INPUTS (LEVEL 2)	SIGNIFICANT UNOBSERVABLE INPUTS (LEVEL 3)
Fixed income securities:				
U.S. Treasury securities and obligations of U.S. government corporations and agencies	\$ 275	\$ 224	\$ 51	\$—
Obligations of states and political subdivisions	209	—	209	—
Corporate securities	1,325	—	1,325	—
Total fixed income securities	1,809	224	1,585	—
Common stocks	5,067	5,067	—	—
	\$6,876	\$5,291	\$1,585	\$—
DESCRIPTION	TOTAL	2015		
		FAIR VALUE MEASUREMENTS USING:		
		QUOTED PRICES IN ACTIVE MARKETS FOR IDENTICAL ASSETS (LEVEL 1)	SIGNIFICANT OTHER OBSERVABLE INPUTS (LEVEL 2)	SIGNIFICANT UNOBSERVABLE INPUTS (LEVEL 3)
Fixed income securities:				
U.S. Treasury securities and obligations of U.S. government corporations and agencies	\$ 371	\$ 318	\$ 53	\$—
Obligations of states and political subdivisions	209	—	209	—
Corporate securities	1,386	—	1,386	—
Total fixed income securities	1,966	318	1,648	—
Common stocks	4,772	4,772	—	—
	\$6,738	\$5,090	\$1,648	\$—

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2016 AND 2015

(DOLLARS IN THOUSANDS, UNLESS OTHERWISE NOTED)

See Note 3 for additional information regarding the Company's categorization of fair value of financial instruments.

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The remainder of Plan assets not included above are comprised of cash and cash equivalents.

The objective of the portfolio is to maximize the total rate of return while controlling investment risk and to ensure sufficient funding status of the Plan as actuarially determined by the total return objective.

The Plan's investment guidelines are as follows:

- No more than 5% of fixed income securities rated below "A" by either Standard and Poor's or Moody's may be purchased. None may be rated below "Baa."
- Average duration of bonds will range from 4 to 7 years, depending on the market outlook.
- Prohibitions
 - a) Unincorporated businesses
 - b) Private placements or direct mortgages without approval
 - c) Financial guarantees

Other Benefit Plans

The Company maintains other benefit plans, including defined contribution plans (401(k)), with a cash or deferred arrangement covering all employees meeting eligibility requirements. Participants may elect to contribute, on a pretax basis, up to the Internal Revenue Service limit. The Company's matching contributions were \$2,445 in 2016 and \$2,336 in 2015.

The Company has a voluntary deferred compensation plan for certain employees meeting Plan eligibility requirements (the Participants) under which salaries and annual incentive awards can be deferred. The Participants deferred receipt of \$466 and \$266 in 2016 and 2015, respectively. The Participants have the option of being paid at termination of employment or on the fifth March 1st immediately following the date on which the annual compensation or base salary would have been payable. The Company made payments of \$94 in 2016 and \$99 in 2015. Amounts accrued under the plan were \$3,660 and \$2,778 as of December 31, 2016 and 2015, respectively.

The Company provides certain postretirement health care benefits. Net periodic postretirement benefit cost for 2016 and 2015 was \$23 and \$26, respectively.

For measurement purposes, health care cost trend increases do not affect the Company's costs due to the fact that the Company has limited the maximum dollar amount of benefits that will be paid. The weighted average discount rate used was 3.80% and 3.97% in 2016 and 2015, respectively.

Board of Directors
The Philadelphia Contributionship Mutual Holding Company
Philadelphia, Pennsylvania

We have audited the accompanying consolidated financial statements of The Philadelphia Contributionship Mutual Holding Company and its subsidiaries (the Company), which comprise the consolidated balance sheet as of December 31, 2016 and 2015, and the related consolidated statements of operations, comprehensive income (loss), equity, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We did not audit the consolidated financial statements of Vector Security Holdings, Inc., a wholly-owned subsidiary, whose statements reflect total assets constituting 36% and 39%, respectively, of consolidated total assets at December 31, 2016 and 2015, and total revenues constituting 69% and 69%, respectively, of consolidated total revenues for the years then ended. Those financial statements were audited by other auditors, whose report has been furnished to us, and our opinion, insofar as it related to the amounts included for Vector Security Holdings, Inc. for the years ended December 31, 2016 and 2015, is based solely on the report of the other auditors. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

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

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, based on our audits and the report of the other auditors, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of The Philadelphia Contributionship Mutual Holding Company and its subsidiaries as of December 31, 2016 and 2015, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.



Philadelphia, Pennsylvania
February 28, 2017

DIRECTORS & OFFICERS

DIRECTORS

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President, S. M. Jenkins & Co.
General Partner, Jenkins Partners, L.P.

Bruce M. Eckert
Founder, Eastern Insurance Holdings, Inc.

Ira H. Fuchs
President, BITNET, LLC

Phoebe A. Haddon
Chancellor, Rutgers University - Camden

Harry E. Hill, III
President & CEO,
Empire Abrasive Equipment Company
President & CEO, Delaware Car Company

Craig N. Johnson
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Ernest E. Jones, Esquire
President, EJones Consulting, LLC

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Alfred W. Putnam, Jr.
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The Philadelphia Contributionship
Consultant

Marna C. Whittington, Ph.D.
Retired Investment Executive

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Chairman
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President & CEO
Kevin L. Tate, Vice President,
CFO and Treasurer
Stephen A. McGowan,
Assistant Vice President, Controller and
Assistant Treasurer
Stacey M. Manzo,
Secretary

ANNUAL MEETING

The 265th Annual meeting of the Members of
the Company will be held on Monday, April 24,
2017, at 11:00 a.m. at the Company's office.

THE PHILADELPHIA CONTRIBUTIONSHIP

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