



DETERMINATION &
COMMITMENT

The Philadelphia
Contributionship

268th Annual Report

2020

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

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 urban and suburban 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, Maryland and Virginia. 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. The Vector Security Networks Division operates exclusively in the commercial space offering electronic security services, as well as, customized managed network services including broadband and broadband-enabled services, SD-WAN, network deployment, network management and mobile applications.

OUR VISION

To be the most reliable partner
for people seeking
to protect
their homes and their futures.



OUR MISSION

We provide insurance protection that puts people
first, through uniquely personal service, strong
partnerships and an unmatched history of
financial stability.





FRANKLINIA *alatamaha*. Bart. Journ.

W. Bartram Delin. Fenchard Sculp.

ABOUT *Franklinia alatamaha*

Like many things in nature and in life, the story of the rare *Franklinia* tree relies on enterprise, determination, and commitment, all mixed with a spirit of generosity.

The extraordinary story begins in 1765, when Philadelphia botanists John Bartram and his son William discovered a stand of trees on the banks of Georgia's Altamaha River that were unfamiliar to them. William returned and brought seeds of the beautiful deciduous tree back to the city in 1777, and later he named it *Franklinia alatamaha* in honor of his father's great friend Benjamin Franklin.

Remarkably, no other *Franklinias* have been found in the wild. While there is no official count, experts say there are just thousands of the species, so the tree is extremely rare. All of the living *Franklinias* are descendants of the trees William Bartram grew in the family's Philadelphia garden.

Franklinia belongs to the tea family of plants—the Theaceae—and is one of the few showy late-flowering trees. Starting in midsummer, the fragrant white flowers with their spiky bright-yellow stamens open in stages, prolonging the gorgeous display. Combine those blooms with shiny dark-green leaves that turn hues of orange, red, and purple in the fall, and it becomes clear why horticulturists have been determined to nurture the species and keep it alive from generation to generation.

Franklinia is a living example of enthusiastic stewardship. How fitting that it is named after Benjamin Franklin, who helped found The Philadelphia Contributionship, the nation's oldest successful property insurance company, just a dozen years before the tree was discovered and put its roots down firmly in the same city.

Franklin had established the Union Fire Company in Philadelphia in 1736, and as a firefighter, he had seen first-hand how devastating a fire could be for families and the larger community.

In 1752 Franklin and his fellow firefighters formed The Philadelphia Contributionship as a mutual insurance company where policyholders would share risks, and residents jumped at the chance to protect themselves against fire losses.

While today's Contributionship has grown and changed with the times, we, as determined, committed stewards, are proud that our core mission remains the same: We insure homes—where people put down their roots, where families are built, and futures take shape. Yet we don't just insure dwellings; we protect the dreams of the people inside. The communities they comprise. The history that they make. For us, it all comes back to roots. Ours. Yours. And the future you seek to create and we seek to protect.



LETTER TO POLICY HOLDERS

5

In 2020, The Philadelphia Contributionship (TPC) completed its 269th year serving our customers. As did everyone, we faced numerous challenges and opportunities. We incurred historic catastrophe losses, and as with most employers, the pandemic presented additional operational obstacles requiring quick solutions to ensure minimal business interruption. However, through the determination and commitment of the entire TPC team, we finished the year stronger than we started.

The foundation of TPC is our promise to provide quality financially secure insurance accompanied by an outstanding customer experience. Despite the many challenges in 2020, we stayed true to that promise for our members.

INSURANCE GROUP OPERATIONS

Insurance operations were put to the test throughout 2020. After a mild winter, our geographic territory experienced repeated storm events, including Tropical Storm Isaias, the most expensive loss in nine years. Overall, we were impacted by 17 weather catastrophes generating 4,500 claims and nearly \$34 million in losses. In the face of those extraordinary circumstances, our Claims team persevered, allowing us to meet the needs of our customers during their most difficult times.

Direct written premium was \$167.5 million in 2020, down 0.8% from 2019. Net premiums earned grew 1.9% to \$146.3 million. Gross investment income for the year was \$10.4 million, down 10.4% from 2019. Net gains on investments were \$37.8 million bringing total revenue from insurance operations for the year to \$194.5 million.

Losses and loss adjustment expenses, at \$125.5 million, improved 5.1% compared to 2019 despite elevated catastrophe losses, underscoring the continued improvement in the underlying fundamentals of our business. Underwriting expenses were slightly lower consistent with our reduction in policy counts. In total, losses and expenses were \$170.8 million for the year. Overall, after paying \$0.9 million of dividends to our members, the insurance operation produced income before income taxes of \$22.8 million.

Notable 2020 Events:

- Early in 2020, TPC's financial strength rating from the A.M. Best Company was downgraded to A- (Excellent).
- TPC was again named to Philly.com's list of Top Workplaces. This distinction is based solely on employee feedback and affirms that TPC remains an employer of choice.
- Despite nearly 100% of our insurance staff working remotely since March 13, 2020, we were able to maintain our high level of customer service standards for our policyholders and insurance agency partners.

SECURITY GROUP OPERATIONS

The Vector Security and ADS Security branches serve residential, commercial and regional multi-site businesses. Offerings to the residential market utilize an integrated platform which combines home automation functionality (locks, doorbells, garage door controls, thermostats, cameras and lighting) with life safety and security equipment. Commercial product offerings include intrusion protection, fire monitoring, access control and video monitoring. Vector Security Networks, our national account brand, is a leader in the retail, quick-serve convenience store, restaurant and healthcare industries. Services provided to these markets include network services, intrusion protection, fire monitoring, access control, video monitoring, environmental and shooter detection. Keeping pace with rapidly changing technology, Vector continues to introduce and support reliable products and services that provide value to our customers.

Vector Security, Inc. produced earnings before interest, taxes, depreciation and amortization of \$52.5 million, \$6.9 million above 2019. Total revenues for the year were \$355.2 million, \$5.1 million below 2019.

The decline in revenues was primarily associated with our commercial customers who are in the retail industry due to lower spending on capital projects throughout 2020 as a result of the impact of COVID-19.

Included in our financial results are \$1.8 million associated with severance payments, technician pay premiums and other costs resulting from the COVID-19 pandemic. Security companies were designated as essential workers, so all our field servicing teams continued to work throughout the COVID-19 pandemic, although we did move non-essential positions to work from home.

CONSOLIDATED BALANCE SHEET

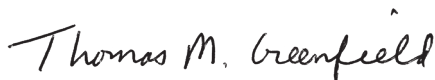
Total assets as of December 31, 2020 are \$1,033.2 million, up 0.4% from 2019. Total liabilities decreased 0.5% to \$652.5 million. Total equity as of December 31, 2020 is \$380.7 million, up 2.1% from 2019. The strength of TPC's financial condition is intact and the company is well-positioned to meet our commitments for the long run.

On May 5, 2020, Ernest E. Jones retired from our Board of Directors. Mr. Jones served as a Director of The Philadelphia Contributionship and Vector Security, Inc. since 2003 and was a member of various Board committees including Risk Management, Nominating and Contributions which he chaired from 2007-2020. We thank him for his dedicated service, valued counsel and for all of his contributions to the Board of Directors and to the Companies.

Our Directors, officers and employees recognize you have many choices when selecting an insurer and security provider. Thank you for choosing The Philadelphia Contributionship and Vector Security. We will continue to strive to be the most reliable partner for people seeking to protect their homes, their property and their futures.



Scott M. Jenkins
Chairman of the Board



Thomas M. Greenfield
President and Chief Executive Officer



CONSOLIDATED FINANCIAL STATEMENTS

TABLE OF CONTENTS

CONSOLIDATED BALANCE SHEETS

December 31, 2020 and 2019 10

CONSOLIDATED STATEMENTS OF OPERATIONS

Years ended December 31, 2020 and 2019 12

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

Years ended December 31, 2020 and 2019 13

CONSOLIDATED STATEMENTS OF EQUITY

Years ended December 31, 2020 and 2019 14

CONSOLIDATED STATEMENTS OF CASH FLOWS

Years ended December 31, 2020 and 2019 15

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

..... 17

INDEPENDENT AUDITORS' REPORT 45

CONSOLIDATED BALANCE SHEETS

DECEMBER 31, 2020 AND 2019

(IN THOUSANDS, UNLESS OTHERWISE NOTED)

10

ASSETS	2020	2019
INSURANCE GROUP ASSETS		
Investments:		
Fixed income securities	\$ 157,605	\$ 163,507
Convertible bonds	22,528	19,170
Preferred stocks	395	472
Convertible preferred stocks	1,407	663
Common stocks	320,443	298,100
Other invested assets	39,026	39,926
	<u>541,404</u>	<u>521,838</u>
Cash and cash equivalents	24,555	13,100
Reinsurance recoverable and receivable	17,911	20,122
Prepaid reinsurance premiums	4,838	3,164
Premiums receivable	9,594	9,788
Accrued income from investments	1,414	1,493
Income tax recoverable	10,122	6,602
Deferred acquisition costs	16,494	17,915
Property and equipment, net	2,518	2,816
Prepaid pension	1,622	899
Other assets	1,533	769
	<u>632,005</u>	<u>598,506</u>
Total Insurance Group assets		
SECURITY GROUP ASSETS		
Current assets:		
Cash and cash equivalents	529	2,631
Trade accounts receivable, less allowance for doubtful accounts of \$1,727 in 2020 and \$1,698 in 2019	34,417	33,077
Unbilled revenue	13,040	18,719
Contract assets	1,310	816
Inventories	7,800	6,322
Prepaid expenses and other current assets	2,401	2,723
Income taxes receivable	9,255	—
	<u>68,752</u>	<u>64,288</u>
Total current assets		
Property and equipment, net	38,861	36,268
Intangible assets, net	118,894	136,578
Goodwill, net	127,483	145,684
Deferred income taxes	25,659	25,482
Contract assets, noncurrent	2,137	1,973
Other noncurrent assets	2,270	3,126
Deferred charges	17,124	16,986
	<u>401,180</u>	<u>430,385</u>
Total Security Group assets		
Total assets	<u><u>\$ 1,033,185</u></u>	<u><u>\$ 1,028,891</u></u>

SEE NOTES TO CONSOLIDATED FINANCIAL STATEMENTS.

CONSOLIDATED BALANCE SHEETS

DECEMBER 31, 2020 AND 2019

(IN THOUSANDS, UNLESS OTHERWISE NOTED)

LIABILITIES AND EQUITY	2020	2019
INSURANCE GROUP LIABILITIES		
Unpaid losses and loss adjustment expenses	\$ 118,072	\$ 114,164
Unearned premiums	87,206	88,762
Advance premiums	1,967	2,035
Deposit premiums	14,811	15,288
Deferred income taxes	35,584	28,243
Ceded premium payable	1,161	990
Other liabilities	13,299	12,511
Total Insurance Group liabilities	272,100	261,993
SECURITY GROUP LIABILITIES		
Current liabilities:		
Current maturities of long-term debt	5,222	2,063
Accounts payable and accrued expenses	46,156	51,356
Customer deposits	934	996
Unearned revenue	21,963	22,112
Contract liabilities	156	20
Purchase holdbacks	1,511	1,337
Interest rate swap payable	2,603	—
Total current liabilities	78,545	77,884
Long-term debt, less current maturities	288,057	303,975
Unearned revenue	1,920	1,843
Contract liabilities, noncurrent	207	215
Interest rate swap payable, noncurrent	2,268	1,673
Other long-term liabilities	9,411	8,424
Total Security Group liabilities	380,408	394,014
Total liabilities	652,508	656,007
EQUITY		
Unassigned equity	376,390	369,458
Accumulated other comprehensive income	4,287	3,426
Total equity	380,677	372,884
Total liabilities and equity	\$ 1,033,185	\$ 1,028,891

11

CONSOLIDATED STATEMENTS OF OPERATIONS
YEARS ENDED DECEMBER 31, 2020 AND 2019

(IN THOUSANDS, UNLESS OTHERWISE NOTED)

12

	2020	2019
INSURANCE GROUP		
Revenue:		
Net premiums earned	\$ 146,320	\$ 143,577
Gross investment income	10,368	11,567
Net realized and unrealized gains on investments	37,823	74,575
Total revenue	194,511	229,719
Losses and expenses:		
Losses and loss adjustment expenses	125,545	132,257
Underwriting expenses	42,177	42,818
Investment expenses	3,063	2,553
Total losses and expenses	170,785	177,628
Income before other (loss) income, dividends to policyholders, and income tax (benefit) expense	23,726	52,091
Other (loss) income, net	(39)	213
Dividends to policyholders	(870)	(927)
Insurance Group income before income tax (benefit) expense	22,817	51,377
SECURITY GROUP		
Revenue	355,248	360,262
Cost of sales	206,634	216,581
Gross profit	148,614	143,681
Operating expenses:		
Selling, general, and administrative	96,181	96,292
Acquisition-related costs	—	1,838
Depreciation	12,553	10,932
Amortization and impairment of intangible assets and goodwill	49,405	41,919
Total operating expenses	158,139	150,981
Operating loss	(9,525)	(7,300)
Other:		
Interest expense	(12,217)	(10,724)
Other income, net	59	8
Security Group loss before income tax benefit	(21,683)	(18,016)
Income before income tax (benefit) expense	1,134	33,361
Income tax (benefit) expense	(5,798)	3,066
Net income	\$ 6,932	\$ 30,295

SEE NOTES TO CONSOLIDATED FINANCIAL STATEMENTS.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
YEARS ENDED DECEMBER 31, 2020 AND 2019

(IN THOUSANDS, UNLESS OTHERWISE NOTED)

13

	2020	2019
Net income	<u>\$ 6,932</u>	<u>\$ 30,295</u>
Other comprehensive income, net of tax:		
Unrealized gains on securities available-for-sale:		
Unrealized net holding gains arising during the year (net of tax of \$803 in 2020 and \$1,085 in 2019)	3,021	4,083
Less reclassification adjustment for net realized gains included in net income (net of tax of \$102 in 2020 and \$134 in 2019)	<u>383</u>	<u>502</u>
	<u>2,638</u>	<u>3,581</u>
Cash flow hedge:		
Change in fair value of cash flow hedge (net of tax of (\$1,149) in 2020 and (\$600) in 2019)	(4,323)	(2,258)
Less reclassification adjustment for settlement of cash flow hedge included in net income (net of tax of (\$516) in 2020 and (\$84) in 2019)	<u>(1,941)</u>	<u>(317)</u>
	<u>(2,382)</u>	<u>(1,941)</u>
Defined benefit pension plan:		
Change in actuarial assumptions	768	(391)
Asset (loss) gain and amortization of net loss	(72)	973
Experience (loss) gain	<u>(91)</u>	<u>68</u>
Defined benefit pension plan, net actuarial gain arising during the year (net of tax of \$161 in 2020 and \$173 in 2019)	<u>605</u>	<u>650</u>
Other comprehensive income	<u>861</u>	<u>2,290</u>
Comprehensive income	<u>\$ 7,793</u>	<u>\$ 32,585</u>

SEE NOTES TO CONSOLIDATED FINANCIAL STATEMENTS.

CONSOLIDATED STATEMENTS OF EQUITY
YEARS ENDED DECEMBER 31, 2020 AND 2019

(IN THOUSANDS, UNLESS OTHERWISE NOTED)

14

	Unassigned Equity	Accumulated Other Comprehensive Income	Total
BALANCE, JANUARY 1, 2019	\$ 291,132	\$ 53,540	\$ 344,672
Net Income	30,295	—	30,295
Adoption of accounting standard, net of tax	(4,373)	—	(4,373)
Reclassification of unrealized gain on equity securities and other invested assets, net of tax	52,404	(52,404)	—
Other comprehensive income, net of tax	—	2,290	2,290
BALANCE, DECEMBER 31, 2019	369,458	3,426	372,884
Net income	6,932	—	6,932
Other comprehensive income, net of tax	—	861	861
BALANCE, DECEMBER 31, 2020	\$ 376,390	\$ 4,287	\$ 380,677

SEE NOTES TO CONSOLIDATED FINANCIAL STATEMENTS.

CONSOLIDATED STATEMENTS OF CASH FLOWS
YEARS ENDED DECEMBER 31, 2020 AND 2019

(IN THOUSANDS, UNLESS OTHERWISE NOTED)

	2020	2019
CASH FLOW FROM OPERATING ACTIVITIES		
Net income	\$ 6,932	\$30,295
Adjustments to reconcile net income to net cash provided by operating activities:		
Net realized and unrealized gains on investments	(37,823)	(74,575)
Depreciation, amortization and impairment	63,977	55,127
Deferred income taxes	4,457	10,322
Gains on disposals of property and equipment	(227)	(207)
Change in assets and liabilities, net of effects of acquisitions:		
Reinsurance recoverable and receivable	2,211	(5,882)
Prepaid reinsurance premiums	(1,674)	(371)
Premiums receivable	194	99
Accrued income from investments	79	(40)
Deferred acquisition costs	1,421	(1,077)
Unpaid losses and loss adjustment expenses	3,908	17,606
Unearned premiums	(1,556)	4,890
Advance premiums	(68)	(871)
Deposit premiums	(477)	(143)
Other liabilities	3,670	840
Income taxes and other receivables	(12,775)	(3,747)
Prepaid expenses and other assets	(401)	(3,670)
Trade accounts receivable, unbilled revenue, and inventories	2,203	(11,316)
Accounts payable, accrued expenses and purchase holdbacks	(4,213)	6,742
Unearned revenue and customer deposits	(6)	6,981
Deferred charges	(138)	1,527
Net cash provided by operating activities	\$ 29,694	\$ 32,530

CONSOLIDATED STATEMENTS OF CASH FLOWS (CONTINUED)
YEARS ENDED DECEMBER 31, 2020 AND 2019

(IN THOUSANDS, UNLESS OTHERWISE NOTED)

16

	2020	2019
CASH FLOW FROM INVESTING ACTIVITIES		
Cash paid for acquisitions, net of cash received	\$ (13,346)	\$ (202,502)
Purchases of property, plant and equipment	(12,254)	(11,640)
Proceeds from disposals of property and equipment	256	214
Purchases of fixed income securities	(26,845)	(58,021)
Purchases of convertible bonds	(19,866)	(9,910)
Purchases of common stocks	(80,165)	(60,373)
Purchases of convertible preferred stocks	(705)	(178)
Purchases of other invested assets	(5,000)	(714)
Proceeds from sales of fixed income securities	27,378	34,977
Proceeds from sales of convertible bonds	3,313	8,734
Proceeds from maturities/calls of fixed income securities	25,950	18,346
Proceeds from the sales of common stocks	96,705	61,497
Proceeds from the sales of convertible preferred stocks	127	1,202
Net cash used in investing activities	<u>(4,452)</u>	<u>(218,368)</u>
CASH FLOW FROM FINANCING ACTIVITIES		
Proceeds from revolving credit agreements	164,421	322,651
Payments on revolving credit agreements	(177,973)	(143,777)
Principal payments on capital leases	(2,337)	(2,018)
Cash paid for debt issuance costs	—	3,368
Net cash (used in) provided by financing activities	<u>(15,889)</u>	<u>180,224</u>
Net increase (decrease) in cash and cash equivalents	9,353	(5,614)
CASH AND CASH EQUIVALENTS, BEGINNING	<u>15,731</u>	<u>21,345</u>
CASH AND CASH EQUIVALENTS, ENDING	<u>\$ 25,084</u>	<u>\$ 15,731</u>
SUPPLEMENTARY CASH FLOWS INFORMATION		
Interest paid	<u>\$ 11,364</u>	<u>\$ 9,787</u>
Income taxes paid	<u>\$ —</u>	<u>\$ —</u>
SUPPLEMENTARY SCHEDULE OF NONCASH INVESTING AND FINANCING ACTIVITIES		
In conjunction with acquisitions, the Security Group: Recorded purchase holdbacks	<u>\$ 930</u>	<u>\$ 866</u>
Capital leases	<u>\$ 3,130</u>	<u>\$ 1,890</u>

SEE NOTES TO CONSOLIDATED FINANCIAL STATEMENTS.

Note 1 Nature of Operations and 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., Vector Intelligent Solutions, LLC (VIS), and ADS Security, LLC (ADS) (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. Effective June 2019, Vector dissolved Vector Mexico and liquidated its operations. There was no material gain or loss on this liquidation.

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, Maryland and Virginia. The Insurance Group had approximately 162,000 policyholders at December 31, 2020.

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 370,000 residential and commercial customers as of December 31, 2020. No such customer accounted for more than 10 percent of the December 31, 2020 and 2019 trade accounts receivable balance or revenue as of or 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.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2020 AND 2019

(DOLLARS IN THOUSANDS, UNLESS OTHERWISE NOTED)

18

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, 2020 or 2019.

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, 2020 and 2019 were determined to be recoverable.

Liability for Unpaid Losses and Loss Adjustment Expenses

The reserving process for the unpaid loss and loss adjustment expenses (LAE) provides for the Insurance Group's best estimate at a particular point in time of the ultimate unpaid cost of all losses and loss adjustment expenses incurred, including settlement and administration of claims, and is based on facts and circumstances known and includes losses that have been incurred but not yet reported. The process includes using actuarial methodologies to assist in establishing these estimates, judgments relative to estimates of future claims severity and frequency, the length of time before claims will develop to their ultimate level and the possible changes in the law and other external factors that are often beyond the Insurance Group's control. The methods used to select the estimated claim reserves include the expected loss ratio method, loss development methods, frequency-severity methods, and the Bornhuetter-Ferguson (B-F) method. The process produces carried reserves set by management's best estimate and is the result of numerous best estimates made by line of business, accident year, and broken out between losses and loss adjustment expenses. The amount of loss and loss adjustment expense reserves for reported claims is based primarily upon a case-by-case evaluation of coverage, liability, injury severity, and any other information considered pertinent to estimating the exposure presented by the loss. The amounts of loss and loss adjustment expense reserves for unreported claims are determined using historical information by line of insurance as adjusted to current conditions.

Due to the inherent uncertainty associated with the reserving process, the ultimate liability may differ, perhaps substantially, from the original estimate. Such estimates are regularly reviewed and updated and any resulting adjustments are included in the current year's results. These liabilities are closely monitored and are recomputed periodically using the most recent information on reported claims and a variety of statistical techniques. Specifically, on at least a quarterly basis, the Insurance Group reviews, by line of business, existing reserves, new claims, changes to existing case reserves and paid claims with respect to the current and prior years.

Investments

Prior to the adoption of Financial Accounting Standards Board (FASB) Accounting Standards Update (ASU) No. 2016-01, *Financial Instruments - Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities*, as of January 1, 2019, investments in equity securities and limited partnerships were classified as available-for-sale securities, stated at fair value, and unrealized holding gains and losses, net of related tax effects, were recorded directly to accumulated other comprehensive income. With the adoption of ASU No. 2016-01, investments in equity securities and limited partnerships are still stated at fair value but unrealized holding gains and losses are credited or charged through net realized and unrealized gains on investments to net income as incurred.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

DECEMBER 31, 2020 AND 2019

(DOLLARS IN THOUSANDS, UNLESS OTHERWISE NOTED)

Fixed Income Securities

All fixed income securities 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 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 noncredit related portion of the loss. The credit related portion is recorded as a charge in the consolidated statement of operations while the noncredit related portion is recorded through other comprehensive income (loss) and included as a component of accumulated other comprehensive income in the consolidated balance sheets.

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.

Interest income is 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.

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 and unrealized gains on investments in the consolidated statements of operations.

Preferred & Common stocks

Preferred and common stocks are carried at estimated fair value, with changes in estimated fair value reported in net realized and unrealized gains on investments in the consolidated statements of operations.

Other Invested Assets

Other invested assets consist of investments in limited partnerships that invest in oil and gas interests, commercial and residential real estate and equity and debt securities of public and privately held companies. These investments are carried at fair value and the changes in estimated fair value are reported in net realized and unrealized gains on investments on the consolidated statements of operations.

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 \$15,931 and \$15,423 at December 31, 2020 and 2019, respectively. Depreciation is provided using the straight-line method over the estimated useful lives of depreciable assets. Estimated useful lives range

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

DECEMBER 31, 2020 AND 2019

(DOLLARS IN THOUSANDS, UNLESS OTHERWISE NOTED)

20 from 3 to 15 years with the exception of buildings, which are depreciated over approximately 25 years. Land is not subject to depreciation. Depreciation expense for the years ended December 31, 2020 and 2019 was \$507 and \$961, respectively.

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:

	2020	2019
Land	\$ 200	\$ 200
Buildings and improvements	7,082	5,950
Home security package systems	40,787	37,736
Furniture and fixtures	5,805	6,180
Vehicles and equipment	37,180	30,400
Construction-in-progress	175	2,541
	<u>91,229</u>	<u>83,007</u>
Less accumulated depreciation	<u>(52,368)</u>	<u>(46,739)</u>
Total property and equipment	<u>\$ 38,861</u>	<u>\$ 36,268</u>

Revenue Recognition

Vector's major sources of revenue are equipment sales, installation, monitoring and managed network services. 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) No. 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.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

DECEMBER 31, 2020 AND 2019

(DOLLARS IN THOUSANDS, UNLESS OTHERWISE NOTED)

As part of Vector's residential business, it offers certain packages, whereby they bundle 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. These 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. Under these arrangements, Vector's performance obligations include monitoring and related services (such as maintenance agreements) as well as a right to use the security system. Revenue associated with the monitoring and related service performance obligation is recognized as those services are provided. Revenue associated with the right to use the security system is recognized over the life of the contract.

21

In transactions in which the security system is sold outright to the customer, Vector's performance obligations include monitoring and related services as well as the sale and installation of the security system. For such arrangements, Vector allocates the transaction price to each performance obligation based on a relative standalone selling price. Revenue associated with the sale and installation of security system performance obligation is recognized as the installation is completed. Revenue associated with the monitoring and related service performance obligation is recognized as those services are provided.

As part of its managed network service offerings, Vector's performance obligations include provision of internet access and network management services, as well as installation of computer and communications equipment to customers. For such arrangements, Vector allocates the transaction price to each performance obligation based on a relative standalone selling price. Revenue associated with the sale and installation of equipment is recognized as the installation is completed. Revenue associated with the network management services is recognized as those services are provided.

Vector incurs certain incremental contract costs (primarily sales commissions) related to acquiring customers and records these costs as deferred charges in its consolidated balance sheet. Amortization expense relating to these deferred charges was \$6,817 and \$7,217 for the years ended December 31, 2020 and 2019, respectively, and is included in selling, general and administrative expense in the consolidated statements of operations.

Inventories

Inventories, consisting primarily of security and home automation products, are stated at the lower of average cost and net realizable value.

Intangible Assets

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.

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 \$517 and \$1,039 during 2020 and 2019, respectively.

Customer service agreements include newly acquired customer service agreements, that have been purchased through Vector's authorized dealer program or through other acquisitions and are being amortized on a straight-line basis over periods ranging from seven to thirteen years, which reflects Vector's historical attrition rates.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

DECEMBER 31, 2020 AND 2019

(DOLLARS IN THOUSANDS, UNLESS OTHERWISE NOTED)

22

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.

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 percent 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, 2020 or 2019.

Cash Equivalents

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

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

DECEMBER 31, 2020 AND 2019

(DOLLARS IN THOUSANDS, UNLESS OTHERWISE NOTED)

23

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 debt insurance costs and other related costs incurred in obtaining the debt financing currently in place, which are being amortized over the term of the related debts and are recorded within prepaid expenses and other current assets and other noncurrent assets on the consolidated balance sheets.

Accumulated 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 sheets. Such items, along with net income, are components of comprehensive income and are reflected in the consolidated statements of comprehensive income (loss).

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

	UNREALIZED GAINS ON AVAILABLE FOR- SALE SECURITIES	CASH FLOW HEDGE	DEFINED BENEFIT PENSION PLAN	ACCUMULATED OTHER COMPREHENSIVE INCOME
Balance, January 1, 2019	\$ 54,645	\$ 748	\$ (1,853)	\$ 53,540
Other comprehensive income (loss) before reclassifications	4,083	(1,624)	582	3,042
Reclassification of unrealized gain on equity securities and other invested assets	(52,404)	—	—	(52,404)
Amounts reclassified from accumulated other comprehensive income (loss)	(502)	(317)	68	(752)
Balance, December 31, 2019	5,822	(1,193)	(1,203)	3,426
Other comprehensive income (loss) before reclassifications	3,021	(441)	696	3,276
Amounts reclassified from accumulated other comprehensive income (loss)	(383)	(1,941)	(91)	(2,415)
Balance, December 31, 2020	\$ 8,460	\$ (3,575)	\$ (598)	\$ 4,287

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2020 AND 2019

(DOLLARS IN THOUSANDS, UNLESS OTHERWISE NOTED)

- 24 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
	2020	2019	
Unrealized gain on securities available-for-sale:			
Realized gains on sale of securities	\$ 484	\$ 636	NET REALIZED GAINS ON INVESTMENTS
Gain on cash flow hedges:			
Interest rate derivative contracts	2,457	401	INTEREST EXPENSE
Change in retirement plan liabilities adjustment:			
Amortization of actuarial losses	115	(85)	(a)
Total reclassifications before income tax expense	3,056	952	
Less Income tax expense	641	200	
Total reclassifications net of income tax expense	\$ 2,415	\$ 752	

- (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.

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 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, 2022. The Company is currently assessing the effect that this ASU will have on its results of operations, financial position and cash flows

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 2021, with early adoption is permitted. The Company is in the process of assessing the impact this ASU will have on its consolidated financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

DECEMBER 31, 2020 AND 2019

(DOLLARS IN THOUSANDS, UNLESS OTHERWISE NOTED)

Subsequent Events

In preparing these consolidated financial statements, management has evaluated events and transactions for potential recognition or disclosure through March 2, 2021, the date the consolidated financial statements were available to be issued. See Note 12 for disclosure regarding the termination of the Defined Benefit Pension Plan.

25

Note 2 Investments

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

	2020			
	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	\$ 754	\$ 122	\$ —	\$ 876
Obligations of states and political subdivisions	42,353	4,125	(12)	46,466
Corporate securities	55,903	3,630	(10)	59,523
Mortgage-backed and asset- backed securities	48,096	2,823	(179)	50,740
Total fixed income securities	147,106	10,700	(201)	157,605
Preferred stocks	334	138	(77)	395
Common stocks	151,142	169,426	(125)	320,443
Total	\$ 298,582	\$ 180,264	\$ (403)	\$ 478,443
	2019			
	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	\$ 3,747	\$ 76	\$ —	\$ 3,823
Obligations of states and political subdivisions	36,752	3,031	(16)	39,767
Corporate securities	48,368	2,013	(10)	50,371
Mortgage-backed and asset- backed securities	67,482	2,131	(67)	69,546
Total fixed income securities	156,349	7,251	(93)	163,507
Preferred stocks	472	—	—	472
Common stocks	165,770	133,707	(1,377)	298,100
Total	\$ 322,591	\$ 140,958	\$ (1,470)	\$ 462,079

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2020 AND 2019

(DOLLARS IN THOUSANDS, UNLESS OTHERWISE NOTED)

26

Convertible securities carried at fair value in the consolidated balance sheet as follows:

	COST		ESTIMATED FAIR VALUE	
	2020	2019	2020	2019
Convertible bonds	\$ 19,328	\$ 17,398	\$ 22,528	\$ 19,170
Convertible preferred stocks	\$ 1,259	\$ 663	\$ 1,407	\$ 663

Other investments in limited partnerships carried at fair value in the consolidated balance sheet as follows:

	COST		ESTIMATED FAIR VALUE	
	2020	2019	2020	2019
Other Invested Assets	\$ 45,240	\$ 40,648	\$ 39,026	\$ 39,926

The amortized cost and estimated fair value of fixed income securities and convertible bonds at December 31, 2020, 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	\$ 4,949	\$ 5,004
Due after one year through five years	61,012	67,321
Due after five years through ten years	27,575	30,478
Due after ten years	24,802	26,590
	118,338	129,393
Mortgage-backed and asset-backed securities	48,096	50,740
Total	\$ 166,434	\$ 180,133

Net realized and unrealized gains on investments consisted of the following:

	2020	2019
Realized gains on sales of investments	\$ 20,999	\$ 10,436
Realized losses on sales of investments	(15,258)	(3,762)
Change in fair value of convertible securities	1,088	2,624
Change in fair value of equity securities	36,894	62,660
Change in fair value of other invested assets	(5,492)	2,912
Other-than-temporary impairment charges	(408)	(295)
	\$ 37,823	\$ 74,575

The Company had on deposit, as required by various state regulatory agencies, fixed income securities with a fair value of \$2,869 and \$2,896 and cash equivalents of \$924 and \$842 at December 31, 2020 and 2019, respectively.

As of December 31, 2020 and 2019, the Company's fixed income investment portfolio had gross unrealized losses of \$201 and \$93, 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:

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

DECEMBER 31, 2020 AND 2019

(DOLLARS IN THOUSANDS, UNLESS OTHERWISE NOTED)

27

	LESS THAN 12 MONTHS		12 MONTHS OR MORE		TOTAL	
	FAIR VALUE	UNREALIZED LOSSES	FAIR VALUE	UNREALIZED LOSSES	FAIR VALUE	UNREALIZED LOSSES
December 31, 2020:						
Fixed income securities:						
U.S. Treasury securities and obligations of U.S. government corporations and agencies	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —
Obligations of states and political subdivisions	135	(12)	—	—	135	(12)
Corporate securities	240	(10)	—	—	240	(10)
Mortgage-backed and asset-backed securities	2,099	(72)	3,910	(107)	6,009	(179)
Total fixed income securities	\$ 2,474	\$ (94)	\$ 3,910	\$ (107)	\$ 6,384	\$ (201)

	LESS THAN 12 MONTHS		12 MONTHS OR MORE		TOTAL	
	FAIR VALUE	UNREALIZED LOSSES	FAIR VALUE	UNREALIZED LOSSES	FAIR VALUE	UNREALIZED LOSSES

December 31, 2019:

Fixed income securities:

U.S. Treasury securities and obligations of U.S. government corporations and agencies

\$ — \$ — \$ — \$ — \$ — \$ —

Obligations of states and political subdivisions

2,346 (16) — — 2,346 (16)

Corporate securities

1,795 (10) — — 1,795 (10)

Mortgage-backed and asset-backed securities

3,027 (34) 3,895 (33) 6,922 (67)

Total fixed income securities

\$ 7,168 \$ (60) \$ 3,895 \$ (33) \$ 11,063 \$ (93)

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.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2020 AND 2019

(DOLLARS IN THOUSANDS, UNLESS OTHERWISE NOTED)

28

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 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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

DECEMBER 31, 2020 AND 2019

(DOLLARS IN THOUSANDS, UNLESS OTHERWISE NOTED)

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.

29

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, 2020 and 2019, the fair value using net asset value for the Company's other invested assets were \$39,026 and \$39,926, respectively.

At December 31, 2020 and 2019, one investment in a limited partnership included in other invested assets comprising 43 percent and 51 percent, respectively, 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 withdraw, 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 percent 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.

At December 31, 2020 and 2019, one investment in a limited partnership included in other invested assets comprising 15 percent and 0 percent, respectively, 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 withdraw, 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 5 percent early withdrawal charge. Withdrawals made by the Company more than 36 months and less than 72 months from initial contribution are subject to a 3 percent 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.

At December 31, 2020 and 2019, one investment in a master limited partnership included in other invested assets comprising 23 percent and 30 percent, respectively, of other invested assets contains a stipulation that redemptions by the Company within 12 months following its initial investment are subject to a 1 percent 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.

At December 31, 2020 and 2019, one investment in a limited partnership comprising 14 percent and 14 percent, respectively, of other invested assets has a term of seven years after the final closing, with an option for up to three additional one year periods at the discretion of the general partner.

At December 31, 2020 and 2019, one investment in a limited partnership included in other invested assets comprising 4 percent and 4 percent, respectively, 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 percent 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.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2020 AND 2019

(DOLLARS IN THOUSANDS, UNLESS OTHERWISE NOTED)

30

The following table summarizes fair value measurements by level within the fair value hierarchy at December 31, 2020 and 2019 for assets and liabilities measured at fair value on a recurring basis:

2020				
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	\$ 876	\$ 876	\$ —	\$ —
Obligations of states and political subdivisions	46,466	—	46,466	—
Corporate securities	59,523	—	59,523	—
Mortgage-backed and asset-backed securities	50,740	—	50,740	—
Total fixed income securities	157,605	876	156,729	—
Convertible bonds	22,528	—	3,247	19,281
Preferred stocks	395	—	—	395
Convertible preferred stocks	1,407	—	421	986
Common stocks	320,443	320,331	—	112
Total bonds and stocks	\$ 502,378	\$ 321,207	\$ 160,397	\$ 20,774
2019				
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	\$ 3,823	\$ 3,823	\$ —	\$ —
Obligations of states and political subdivisions	39,767	—	39,767	—
Corporate securities	50,371	—	50,371	—
Mortgage-backed and asset-backed securities	69,546	—	69,546	—
Total fixed income securities	163,507	3,823	159,684	—
Convertible bonds	19,170	—	14,156	5,014
Preferred stocks	472	—	—	472
Convertible preferred stocks	663	—	—	663
Common stocks	298,100	297,990	—	110
Total bonds and stocks	\$ 481,912	\$ 301,813	\$ 173,840	\$ 6,259

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.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

DECEMBER 31, 2020 AND 2019

(DOLLARS IN THOUSANDS, UNLESS OTHERWISE NOTED)

Note 4 Liability for Unpaid Losses and Loss Adjustment Expenses

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

	2020	2019
Balance as of January 1	\$ 114,164	\$ 96,558
Less reinsurance recoverable	<u>(18,778)</u>	<u>(13,299)</u>
Net balance at January 1	<u>95,386</u>	<u>83,259</u>
Incurred related to:		
Current year	135,469	136,199
Prior years	<u>(9,924)</u>	<u>(3,942)</u>
Total incurred	<u>125,545</u>	<u>132,257</u>
Paid related to:		
Current year	86,749	87,497
Prior years	<u>32,818</u>	<u>32,633</u>
Total paid	<u>119,567</u>	<u>120,130</u>
Net balance as of December 31	101,364	95,386
Plus reinsurance recoverable	<u>16,708</u>	<u>18,778</u>
Balance at December 31	<u>\$ 118,072</u>	<u>\$ 114,164</u>

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 2020 and 2019 by \$9,924 and \$3,942, respectively. The decrease in 2020 is due to better than expected development of losses incurred, primarily in the homeowners property and specialty property segments, and primarily related to the 2018 and 2019 accident years. The decrease in 2019 is due to better than expected development of losses incurred, primarily in the homeowners liability and other liability segments, and primarily related to the 2014, 2015 and 2018 accident years.

The following tables present information about incurred and paid claims development as of December 31, 2020 net of reinsurance, as well as cumulative claim frequency and the total of IBNR reserves plus expected development on reported claims that the Insurance Group included in unpaid losses and loss adjustment expenses as of December 31, 2020. The tables include unaudited information about incurred and paid claims development for the years ended December 31, 2013 through 2019, which is presented as required supplementary information.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
 DECEMBER 31, 2020 AND 2019

(DOLLARS IN THOUSANDS, UNLESS OTHERWISE NOTED)

32

Homeowners

Incurred Losses and Allocated Loss Adjustment Expenses, Net of Reinsurance

ACCIDENT YEAR	UNAUDITED								AS OF DECEMBER 31, 2020	
	2013	2014	2015	2016	2017	2018	2019	2020	TOTAL IBNR PLUS EXPECTED ON REPORTED	CUMULATIVE NUMBER OF REPORTED CLAIMS
2013	49,259	47,510	44,736	45,123	44,610	44,338	44,364	44,136	154	4,847
2014		67,879	64,035	64,722	64,678	63,785	63,662	63,477	171	7,033
2015			59,902	55,851	54,839	54,783	54,029	53,664	211	5,574
2016				51,560	51,007	49,720	50,084	48,683	641	5,448
2017					52,190	52,034	52,087	51,373	1,644	6,322
2018						78,829	78,111	76,520	2,544	10,253
2019							94,843	93,854	6,260	10,571
2020								95,093	16,792	9,575
								Total	\$ 526,800	

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

ACCIDENT YEAR	UNAUDITED							
	2013	2014	2015	2016	2017	2018	2019	2020
2013	29,281	39,921	41,195	42,637	43,946	43,867	43,862	43,909
2014		48,758	56,644	59,671	62,226	63,191	63,386	63,306
2015			40,780	49,251	51,165	52,116	53,002	53,328
2016				35,608	44,198	45,782	47,152	47,694
2017					33,973	44,966	47,173	48,496
2018						55,747	70,668	71,576
2019							63,357	82,996
2020								62,562
							Total	\$ 473,867
							All outstanding liabilities before 2013, net of reinsurance	9,262
							Liabilities for losses and loss adjustment expenses, net of reinsurance	\$ 62,195

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

DECEMBER 31, 2020 AND 2019

(DOLLARS IN THOUSANDS, UNLESS OTHERWISE NOTED)

Other Liability

33

Incurred Losses and Allocated Loss Adjustment Expenses, Net of Reinsurance

ACCIDENT YEAR	UNAUDITED								AS OF DECEMBER 31, 2020	
	2013	2014	2015	2016	2017	2018	2019	2020	TOTAL IBNR PLUS EXPECTED ON REPORTED	CUMULATIVE NUMBER OF REPORTED CLAIMS
2013	7,333	7,133	7,562	7,678	7,869	7,968	7,879	7,877	26	250
2014		6,909	8,493	10,031	10,554	10,242	9,921	9,945	58	272
2015			7,888	8,125	8,108	8,016	7,649	7,353	224	281
2016				7,264	7,171	6,851	7,279	6,755	432	236
2017					6,792	6,464	6,098	5,862	1,448	255
2018						6,685	6,732	7,711	3,067	260
2019							7,408	6,985	4,013	230
2020								6,204	5,643	94
								<u>Total</u>	<u>\$ 58,692</u>	

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

ACCIDENT YEAR	UNAUDITED								
	2013	2014	2015	2016	2017	2018	2019	2020	
2013	191	770	2,357	5,473	7,282	7,800	7,800	7,802	
2014		20	1,484	4,338	8,209	9,474	9,825	9,827	
2015			174	904	3,414	5,559	7,004	7,089	
2016				167	1,146	2,819	5,220	5,992	
2017					75	770	2,425	3,533	
2018						104	869	2,650	
2019							86	479	
2020								54	
							<u>Total</u>	<u>\$ 37,426</u>	
								All outstanding liabilities before 2013, net of reinsurance	<u>2,981</u>
								Liabilities for losses and loss adjustment expenses, net of reinsurance	<u>\$ 24,247</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2020 AND 2019

(DOLLARS IN THOUSANDS, UNLESS OTHERWISE NOTED)

- 34 The reconciliation of the net incurred and paid loss development tables to the liability for losses and loss adjustment expenses in the consolidated balance sheets is as follows:

	DECEMBER 31, 2020
Net outstanding liabilities	
Homeowners	\$ 62,195
Other liability	24,247
Other short-duration insurance lines	9,525
Liabilities for unpaid losses and allocated loss adjustment expenses, net of reinsurance	95,967
Reinsurance recoverable on unpaid claims:	
Homeowners	11,700
Other liability	2,793
Other short-duration insurance lines	2,215
Total reinsurance recoverable on unpaid losses	16,708
Unallocated loss adjustment expenses	5,397
Total gross liability for unpaid losses and loss adjustment expenses	\$ 118,072

The methods used to select the estimated claim reserves include the expected loss ratio method, loss development methods, frequency-severity methods, and the Bornhuetter-Ferguson (B-F) method, applied to paid losses and incurred losses. Cumulative claim frequency was calculated using the sum of all individual claimants. Claims that were presented to the Company, investigated, and ultimately closed without any loss or loss adjustment expense payments would be included in the cumulative claim frequency information shown above.

There was one change in methodology: the removal of the Berquist-Sherman (B-S) method.

The following is supplementary information about average historical claims duration as of December 31, 2020.

Average Annual Percentage Payout of Incurred Claims by Age, Net of Reinsurance

	UNAUDITED							
Years	1	2	3	4	5	6	7	8
Homeowners	71.1%	19.2%	3.2%	2.9%	2.3%	0.3%	0.0%	0.0%
Other Liability	1.8%	11.4%	24.8%	32.8%	14.8%	3.9%	1.3%	0.0%

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 assumed under the reinsurance agreements.

The Insurance Group had no assumed premiums earned in 2020 and 2019 and had ceded premiums earned in 2020 and 2019 of \$22,777 and \$20,347, respectively. Losses and loss adjustment expenses are net of reinsurance recoveries of \$10,377 and \$15,586 in 2020 and 2019, respectively. Amounts paid to reinsurers related to the unexpired portion of reinsured contracts were \$4,838 and \$3,164 as of December 31, 2020 and 2019, respectively.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

DECEMBER 31, 2020 AND 2019

(DOLLARS IN THOUSANDS, UNLESS OTHERWISE NOTED)

The Insurance Group had no significant concentration in risk from any one unaffiliated reinsurer as of December 31, 2020 and 2019.

35

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 2021, the maximum amount of dividends that can be paid by the Contributionship without such approval is \$33,197. The Contributionship paid no ordinary dividends during 2020 and 2019.

The surplus of the Contributionship and its subsidiaries, as determined in accordance with statutory accounting practices, is \$331,974 and \$312,037 at December 31, 2020 and 2019, respectively. The net loss of the Contributionship and its subsidiaries, as determined in accordance with statutory accounting practices, is \$4,663 and \$10,843 for the years ended December 31, 2020 and 2019, 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, 2020 and 2019, the Contributionship and its subsidiaries maintained statutory-basis surplus in excess of the minimum prescribed risk-based capital requirements. As of December 31, 2020 and 2019, 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:

	2020	2019
Balance as of January 1	\$ 145,684	\$ 21,154
Goodwill acquired during the year	177	137,176
Amortization	(18,378)	(12,646)
Balance as of December 31	<u>\$ 127,483</u>	<u>\$ 145,684</u>

The amortization period for goodwill is 10 years.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2020 AND 2019

(DOLLARS IN THOUSANDS, UNLESS OTHERWISE NOTED)

36

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

	2020		2019	
	GROSS CARRYING AMOUNT	ACCUMULATED AMORTIZATION	GROSS CARRYING AMOUNT	ACCUMULATED AMORTIZATION
Customer service agreements	\$ 250,966	\$ 150,591	\$ 256,349	\$ 143,387
Customer relationships	10,460	5,934	10,460	5,130
Covenants not to compete	123	62	121	57
Covenants not to solicit	2,084	1,921	2,084	1,661
Trade Names	20,150	6,381	20,150	2,351
Total	<u>\$ 283,783</u>	<u>\$ 164,889</u>	<u>\$ 289,164</u>	<u>\$ 152,586</u>

Amortization expense, excluding impairment charges, for other intangible assets was \$30,510 and \$28,234 for the years ended December 31, 2020 and 2019, respectively.

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

2021	\$ 47,944
2022	44,831
2023	38,355
2024	28,785
2025	23,408
Thereafter	<u>63,054</u>
Total	<u>\$ 246,377</u>

Note 8 Acquisitions

ADS Security, L.P.

On June 3, 2019, Vector, through its subsidiary, acquired 100 percent of the membership units of ADS Security, L.P. for \$190,000. Following the closing date, Vector converted ADS Security, L.P. to a limited liability company, under the name ADS Security, LLC. The ADS acquisition provides Vector the ability to continue to expand its market presence in the security industry by leveraging the ADS brand name and other best practices throughout the Southeastern region of the United States. Funding for the acquisition consisted primarily of borrowings on Vector's newly refinanced revolving credit facility (see Note 9). The consolidated financial statements reflect the operations of the acquired business starting from the effective date of the acquisition. Expenses related to business acquisition are recognized as incurred and are included in acquisition-related costs in the consolidated statements of operations and comprehensive income.

Vector accounted for this business combination under the acquisition method of accounting. The assets acquired and liabilities assumed in connection with business acquisition were recorded at the date of acquisition at their estimated fair values, with any excess of the purchase price over the estimated fair values of the net assets acquired recorded as goodwill, which Vector expects will be deductible for tax purposes. Significant judgment is required in estimating the fair value of assets acquired and liabilities assumed. Accordingly, Vector engaged a third-party valuation specialist to assist in these determinations. The fair value estimates are based on available historical information and on future expectations and assumptions deemed reasonable by management but are inherently uncertain.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

DECEMBER 31, 2020 AND 2019

(DOLLARS IN THOUSANDS, UNLESS OTHERWISE NOTED)

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

37

Cash	\$ 260
Trade accounts receivable	5,168
Unbilled revenue	1,002
Prepaid expenses and other current assets	2,217
Net fixed assets	10,599
Deferred charges	3,411
Debt-capital leases	(2,283)
Accounts payable and accrued expenses	(5,637)
Unearned revenue	(2,060)
Other noncurrent liabilities	(223)
Customer service agreements	20,220
Trade names	20,150
Goodwill	<u>137,176</u>
Total	<u>\$ 190,000</u>

The transaction is subject to two post-closing adjustment calculations as defined in the purchase agreement. The first calculation was prepared sixty-days post-closing based on closing net working capital, funded debt, and transaction expenses, as defined in the purchase agreement. No further consideration was transferred as a result of this sixty-day post-closing calculation. A second post-closing calculation was required to be completed by January 31, 2020 based on year-end bonuses, as defined in the purchase agreement. This second calculation resulted in additional purchase price consideration of approximately \$177 which was paid to the seller in January 2020.

Duncan Security Systems, Inc.

On July 2, 2019, Vector acquired selected assets and assumed certain liabilities of Duncan Security Systems, Inc. (Duncan) located in Tennessee for a purchase price of \$2,176. The results of Duncan have been included in the consolidated financial statements since the acquisition date. The assets acquired represent approximately 2,500 customer accounts. The transaction was accounted for as an asset acquisition.

The aggregate purchase price of \$2,176 included \$2,306 of intangible assets and \$58 of tangible and current assets, net of \$188 in current liabilities. The intangible asset was assigned to customer service agreements, which are amortized over 13 years.

Funding for the acquired assets and assumed liabilities consisted primarily of \$2,042 in borrowings on Vector's existing revolving credit facility and \$134 in the form of a purchase holdback. The payment of the purchase holdback is contingent upon attrition of accounts over the first year. During 2020, the purchase holdback obligation was settled with no payment required.

Others

Vector acquired selected accounts from various Company authorized dealers located in various states. The total purchase price for these accounts was \$13,462 and \$10,514 in 2020 and 2019, 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 7,400 accounts in 2020 and 6,200 accounts in 2019. The entire aggregate purchase price was assigned to customer service agreements, which are amortized over 7 years. Substantially all accounts are subject to a one year holdback period of approximately 10 percent of the purchase price. The transaction was accounted for as an asset acquisition.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2020 AND 2019

(DOLLARS IN THOUSANDS, UNLESS OTHERWISE NOTED)

38

Note 9 Borrowings and Credit Arrangements

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

	2020	2019
Revolving credit facility - variable interest rate (approximately 2.1% and 3.5% as of December 31, 2020 and 2019, respectively)	\$ 287,948	\$ 301,500
Capital leases - bearing interest at rates ranging from 3% to 7% as of December 31, 2020 and 2019	5,331	4,538
	293,279	306,038
Less current maturities	(5,222)	(2,063)
Long-term debt, less current maturities	\$ 288,057	\$ 303,975

During 2019, Vector refinanced its existing debt by obtaining a \$450,000 revolving credit facility that permits Vector to borrow, on a revolving basis, through June 3, 2024. Interest on the entire \$450,000 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 January 13, 2017, Vector entered into a 48 month interest rate swap agreement with a notional amount of \$70,000. On January 22, 2019, Vector entered into a 36 month interest rate swap agreement with a notional amount of \$25,000. On June 3, 2019, Vector entered into a 48 month interest rate swap agreement with a notional amount of \$100,000. These derivatives are designated as cash flow hedges and are recognized on the consolidated balance sheets at fair value. This derivative was designated as a cash flow hedge and is recognized on the consolidated balance sheets 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 ranging from 1.81 percent to 2.63 percent. The fair value of the swap as of December 31, 2020 and 2019 was (\$4,871) and (\$1,673), respectively and was recorded as a liability in the consolidated financial statements.

Vector must pay a quarterly commitment fee based on the Leverage Ratio that ranges from 0.15 percent to 0.30 percent. At December 31, 2020, Vector was paying a quarterly commitment fee of approximately 0.25 percent on the available unused portion of the revolving credit facility. As of December 31, 2020, the available unused portion of the revolving credit facility was \$159,972.

Under Vector's revolving credit facility, approximately \$2,080 and \$2,545 were committed for outstanding letters of credit as of December 31, 2020 and 2019. There were no amounts drawn on the letters of credit as of December 31, 2020 and 2019.

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, 2020 and 2019, Vector was in compliance with all such covenants.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

DECEMBER 31, 2020 AND 2019

(DOLLARS IN THOUSANDS, UNLESS OTHERWISE NOTED)

The aggregate maturities of debt principal for Vector as of December 31, 2020 are as follows:

39

2021	\$ 5,222
2022	1,776
2023	1,036
2024	<u>285,245</u>
Total	<u>\$ 293,279</u>

Note 10 Leases

Vector has various capital leases for equipment (Note 9) that expire at various dates during the next 48 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, 2020 are as follows:

2021	\$ 5,012
2022	4,278
2023	3,061
2024	1,923
2025	588
Thereafter	<u>291</u>
Total	<u>\$ 15,153</u>

Rent expense for leased equipment and office space totaled \$6,870 and \$7,031 for the years ended December 31, 2020 and 2019, respectively.

Note 11 Income Taxes

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

2020			2019		
CURRENT	DEFERRED	TOTAL	CURRENT	DEFERRED	TOTAL
<u>\$ (10,255)</u>	<u>\$ 4,457</u>	<u>\$ (5,798)</u>	<u>\$ (6,643)</u>	<u>\$ 9,709</u>	<u>\$ 3,066</u>

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 21 percent as follows:

	2020	2019
Computed "expected" income tax expense (benefit)	\$ 242	\$ 7,006
Decrease in income taxes resulting from:		
Tax-exempt interest	(144)	(161)
Dividends received deduction	(327)	(357)
State taxes, net of federal benefit	(329)	(923)
Provision to return adjustments	(186)	(123)
Tax rate differential	(4,897)	(2,498)
Other, net	(157)	122
	<u>\$ (5,798)</u>	<u>\$ 3,066</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

DECEMBER 31, 2020 AND 2019

(DOLLARS IN THOUSANDS, UNLESS OTHERWISE NOTED)

40

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:

	2020	2019
Insurance Group:		
Deferred income tax asset components:		
Unearned premiums and advance premiums	\$ 3,542	\$ 3,681
Unpaid losses and loss adjustment expenses	1,274	1,179
Other-than-temporary impairments	985	915
Accrued pension liability	159	320
Deferred compensation	1,063	986
Other	549	364
Total deferred income tax asset	7,572	7,445
Deferred income tax liability components:		
Deferred acquisition costs	(3,464)	(3,763)
Unrealized investment gains	(37,139)	(29,598)
Other	(2,553)	(2,327)
Total deferred income tax liability	(43,156)	(35,688)
Net deferred income tax liability	\$ (35,584)	\$ (28,243)
Security Group:		
Deferred income tax asset components:		
Accrued expenses	\$ 3,450	\$ 3,657
Deferred rent	7	50
Net operating loss	637	2,214
Inventories and accounts receivable	1,214	1,034
Intangible assets	28,859	27,770
Unearned revenue	525	529
Contract liabilities	748	810
Interest rate swap	1,286	480
Research & development credit	183	67
Total deferred tax asset	36,909	36,611
Deferred income tax liability components:		
Unbilled revenue	(635)	(1,289)
Plant and equipment	(6,107)	(5,119)
Deferred charges	(4,508)	(4,612)
Prepaid expenses	—	(109)
Total deferred income tax liability	(11,250)	(11,129)
Net deferred income tax asset	\$ 25,659	\$ 25,482

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.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

DECEMBER 31, 2020 AND 2019

(DOLLARS IN THOUSANDS, UNLESS OTHERWISE NOTED)

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.

41

On March 27, 2020, the Coronavirus Aid, Relief, and Economic Security Act (CARES Act) was enacted in response to the COVID-19 pandemic. The CARES Act, among other things, permits net operating loss carryovers and carrybacks to offset 100% of taxable income for taxable years beginning before 2021. In addition, the CARES Act allows net operating losses incurred in 2018, 2019, and 2020 to be carried back to each of the five preceding taxable years to generate a refund of previously paid income taxes. The Company has filed a carryback claim for the 2019 net operating losses and will be filing a carryback claim for the 2020 net operating losses which results in a current income tax receivable of \$19,377 on the consolidated balance sheets. The current effective tax rate benefit related to the CARES Act is \$7,788.

As of December 31, 2020 Vector has net operating loss carryforwards for state income tax purposes which begin to expire in 2024.

As of December 31, 2020 and 2019, the liability for unrecognized tax benefits was \$450 and \$298, respectively. The net change in liability was the result of Research and Development credits being claimed for the current and prior periods, as well as an associated accrual for interest. Vector recognizes accrued interest and penalties related to unrecognized tax benefits in income tax expense. In 2020, Vector accrued approximately \$38 of interest (net of federal benefit) related to Research and Development credits. As of December 31, 2020 and 2019, a total of \$63 and \$25, respectively, were accrued related to interest and penalties.

There are no tax-related interest or penalties accrued on the consolidated balance sheet at December 31, 2020 and 2019, nor has any tax related interest or penalties been recognized in the consolidated statement of operations for the years ended December 31, 2020 and 2019.

The Company's federal income tax returns for tax years ended December 31, 2015 and prior are closed to examination.

Note 12 Employee Benefit Plans

Defined Benefit Pension Plan

The Insurance Group made no contributions to the Plan in 2020 and 2019, respectively.

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

	2020	2019
Interest cost	\$ 182	\$ 239
Expected return on plan assets	(269)	(397)
Amortization of net loss	50	85
Total net periodic benefit cost before settlement	(37)	(73)
Effect of settlement	81	—
Total net periodic benefit cost after settlement	\$ 44	\$ (73)

On July 28, 2020, the Board of Directors of the Company voted to terminate the defined benefit pension plan effective October 1, 2020. Upon termination, the Company offered lump sum payments to vested former and active employees. For those electing a lump sum, payments were processed on December 18, 2020. With respect to the remaining participants, the Company will put the plan out to bid in the first quarter 2021 and the life insurance company selected will assume all responsibility for future payments to participants.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

DECEMBER 31, 2020 AND 2019

(DOLLARS IN THOUSANDS, UNLESS OTHERWISE NOTED)

42

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 sheets. Changes in the funded status during any given period of time are recognized as a change in other comprehensive income.

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:

	<u>2020</u>	<u>2019</u>
Benefit obligation as of January 1	\$ 6,546	\$ 6,376
Interest cost	182	239
Distributions	(930)	(478)
Change due to change in assumptions and experience	<u>(857)</u>	<u>409</u>
Benefit obligation as of December 31	<u>4,941</u>	<u>6,546</u>
Plan assets as of January 1	7,445	6,379
Actual return on assets	48	1,544
Distributions	<u>(930)</u>	<u>(478)</u>
Plan assets as of December 31	<u>6,563</u>	<u>7,445</u>
Funded status	<u>\$ 1,622</u>	<u>\$ 899</u>

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

	<u>2020</u>	<u>2019</u>
	<u>\$ 756</u>	<u>\$ 1,523</u>

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

	<u>2020</u>	<u>2019</u>
Weighted-average discount rate	1.75%	2.85%
Expected long-term rate of return on assets	3.75	6.50
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 \$930 and \$478 of benefit payments made under the Plan in 2020 and 2019, respectively. Expected payments under the Plan in future years are as follows at December 31, 2020:

2021	\$ 5,034
------	----------

As of December 31, 2020, the Plan had 100 percent of its investments in cash and cash equivalents. As of December 31, 2019, The Plan had approximately 69 percent of its investments invested in common stocks, 18 percent invested in corporate bonds and the remainder invested in U.S. Government and mortgage-backed securities and cash and cash equivalents.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

DECEMBER 31, 2020 AND 2019

(DOLLARS IN THOUSANDS, UNLESS OTHERWISE NOTED)

The following table provides the fair value measurements of the Plan assets by level within the fair value hierarchy at December 31, 2019. These assets are measured at fair value on a recurring basis.

43

DESCRIPTION	2019			
	TOTAL	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	\$ 438	\$ 438	\$ —	\$ —
Obligations of states and political subdivisions	261	—	261	—
Corporate securities	1,370	—	1,370	—
Total fixed income securities	2,069	438	1,631	—
Common stocks	5,135	5,135	—	—
Mutual funds	50	50	—	—
	\$ 7,254	\$ 5,623	\$ 1,631	\$ —

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

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 percent 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 \$2,546 in 2020 and \$3,119 in 2019.

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2020 AND 2019

(DOLLARS IN THOUSANDS, UNLESS OTHERWISE NOTED)

44 be deferred. The Participants deferred receipt of \$2,008 and \$1,674 in 2020 and 2019, respectively. The Participants have the option of being paid at termination of employment or on the fifth March 1 immediately following the date on which the annual compensation or base salary would have been payable. The Company made payments of \$579 in 2020 and \$109 in 2019. Amounts accrued under the plan were \$9,967 and \$8,124 as of December 31, 2020 and 2019, respectively.

The Company provides certain postretirement health care benefits. Net periodic postretirement benefit cost for 2020 and 2019 was \$30 and \$33, 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 1.56 percent and 2.85 percent in 2020 and 2019, respectively.

Independent Auditors' Report

To the Board of Directors of The Philadelphia Contributionship Mutual Holding Company

Report on the Consolidated Financial Statements

We have audited the accompanying consolidated financial statements of The Philadelphia Contributionship Mutual Holding Company and its subsidiaries (the Contributionship) which comprise the consolidated balance sheets as of December 31, 2020 and 2019, and the related consolidated statements of operations, comprehensive income, equity, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Consolidated 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 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 auditors' 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

46 policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

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

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of The Philadelphia Contributionship Mutual Holding Company and its subsidiaries as of December 31, 2020 and 2019, 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.

Report on Required Supplemental Information

Accounting principles generally accepted in the United States of America require that the certain information for years 2013 - 2019 related to the Contributionship's liability for unpaid losses and loss expenses, included in Note 4 on pages 32-34 supplement the financial statements. Such information is required by the Financial Accounting Standards Board who considers it to be an essential part of financial reporting for placing the consolidated financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's response to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Baker Tilly US, LLP

Philadelphia, Pennsylvania

March 2, 2021

BakerTilly US, LLP trading as BakerTilly is a member of the global network of BakerTilly International Ltd., the members of which are separate and independent legal entities. © 2020 BakerTilly US, LLP



CREDITS

Photography

Front cover: *Franklinia alatamaha* flower. Universal Images Group North America LLC / DeAgostini / Alamy

Page 1: *Franklinia alatamaha* flower bud. Gina Kelly / Alamy

Page 2: *Franklinia alatamaha*. Original drawing by William Bartram (date unknown). Violetta Delafield-Benjamin Smith Barton Collection, American Philosophical Society

Page 4: *Franklinia alatamaha* tree in situ at Bartram's Garden, Philadelphia. Eva Monheim

Pages 8–9: *Franklinia alatamaha* fruit. Courtesy of Laura Blanchard

Page 47: Autumn leaves of *Franklinia alatamaha*. Eva Monheim

Page 48: Arrangement of autumn leaves with fruit of *Franklinia alatamaha*. Eva Monheim

"About *Franklinia alatamaha*" written by Joanne Camas

Special thanks to Carol Smith, historian/archivist, for her guidance.

Design: Malish & Pagonis



DIRECTORS & OFFICERS

DIRECTORS

Scott M. Jenkins
Chairman of the Board
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, J.D., LL.M.
Chancellor Emerita and University
Professor of Law, Rutgers University

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

Andrew L. Lewis, IV
Consultant

Ronald J. Naples
Chairman Emeritus, Quaker Chemical
Corporation

Alfred W. Putnam, Jr.
Chairman Emeritus, Faegre Drinker
Biddle & Reath LLP

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

HONORARY DIRECTORS

Craig N. Johnson
Ernest E. Jones, Esquire
Mary Patterson McPherson, Ph.D.
Kaighn Smith, M.D.
Bernard C. Watson, Ph.D.
Minturn T. Wright, III, Esquire

OFFICERS

Scott M. Jenkins
Chairman

Thomas M. Greenfield
President & CEO

Kevin L. Tate
Vice President, CFO and Treasurer

Stephen A. McGowan
Assistant Vice President, Controller and
Assistant Treasurer

Stacey M. Manzo
Assistant Vice President, Secretary

ANNUAL MEETING

The 269th Annual meeting of the
Members of the Company will be held
virtually on Monday, April 26, 2021,
at 11:00 a.m.



The Philadelphia Contributionship

DEPENDABLE INSURANCE PARTNERS SINCE 1752

The Philadelphia Contributionship
212 South Fourth Street
Philadelphia, Pa 19106-9232

215.627.1752 888.627.1752 www.1752.com