NATIONAL SECURITY GROUP INC
Form 10-Q
August 15, 2013
Table of Contents

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

FORM 10-Q

(Mark One)

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

For Quarterly Period Ended June 30, 2013
or

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

For the transition period from to .

Commission File Number 0-18649

The National Security Group, Inc.
(Exact name of registrant as specified in its charter)

Delaware (State or Other Jurisdiction of Incorporation or Organization)	63-1020300 (IRS Employer Identification No.)
661 East Davis Street Elba, Alabama (Address of principal executive offices)	36323 (Zip-Code)

Registrant's Telephone Number including Area Code (334) 897-2273

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). þ Yes o No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer (as defined in rule 12b-2 of the Act). (Check One) : Large accelerated filer o Accelerated filer o Non-accelerated filer o Smaller reporting company þ

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes o No þ

As of August 14, 2013, there were 2,494,480 shares, $1.00 par value, of the registrant's common stock outstanding.

1

Table of Contents

THE NATIONAL SECURITY GROUP, INC.

INDEX

PART I. FINANCIAL INFORMATION

Table of Contents

Cautionary Statement Regarding Forward-Looking Statements

Any statement contained in this report which is not a historical fact, or which might otherwise be considered an opinion or projection concerning the Company or its business, whether expressed or implied, is meant as and should be considered a forward-looking statement as that term is defined in the Private Securities Litigation Reform Act of 1995. The following report contains forward-looking statements that are not strictly historical and that involve risks and uncertainties. Such statements include any statements containing the words “expect,” “plan,” “estimate,” “anticipate” or other words of a similar nature. Management cautions investors about forward-looking statements. Forward-looking statements involve certain evaluation criteria, such as risks, uncertainties, estimates, and/or assumptions made by individuals informed of the Company and industries in which we operate. Any variation in the preceding evaluation criteria could cause actual results to differ materially from those expressed or implied by such forward-looking statements. These risks and uncertainties include, without limitation, the following:

The insurance industry is highly competitive, and the Company encounters significant competition in all lines of business from other insurance companies. Many of the competing companies have more abundant financial resources than the Company.

Insurance is a highly regulated industry. It is possible that legislation may be enacted, which would have an adverse effect on the Company's business.

The Company is subject to regulation by state governments for each of the states in which it conducts business. The Company cannot predict the subject of any future regulatory initiative(s) or its (their) impact on the Company's business.

The Company is rated by various insurance rating agencies. If a rating is downgraded from its current level by one of these agencies, sales of the Company's products and stock price could be adversely impacted.

The Company's financial results are adversely affected by increases in policy claims received by the Company. While a manageable risk, this fluctuation is often unpredictable.

The Company's investments are subject to a variety of risks. Investments are subject to defaults and changes in market value. Market value can be affected by changes in interest rates, market performance and the economy.

The Company mitigates risk associated with life policies through implementing effective underwriting and reinsurance strategies. These factors mitigate, not eliminate, risk related to mortality and morbidity exposure. The Company has established reserves for claims and future policy benefits based on amounts determined by independent actuaries. There is no assurance that these estimated reserves will prove to be sufficient or that the Company will not incur claims exceeding reserves, which could result in operating losses and loss of capital.

The Company mitigates risk associated with property and casualty policies through implementing effective underwriting and reinsurance strategies. The Company obtains reinsurance which increases underwriting capacity and limits the risk associated with policy claims. The Company is subject to credit risk with regard to reinsurers as reinsurance does not alleviate the Company's liability to its insured's for the ceded risks. The Company utilizes a third-party to develop a reinsurance treaty with reinsurers who are reliable and financially stable. However, there is no guarantee that booked reinsurance recoverable will actually be recovered. A reinsurer's insolvency or inability to make payments due could have a material adverse impact on the financial condition of the Company.

The Company's ability to continue to pay dividends to shareholders is contingent upon profitability and capital adequacy of the insurance subsidiaries. The insurance subsidiaries operate under regulatory restrictions that could limit the ability to fund future dividend payments of the Company. An adverse event or series of events could materially impact the ability of the insurance subsidiaries to fund future dividends, and consequently, the Board of Directors would have to suspend the declaration of dividends to shareholders.

The Company is subject to the risk of adverse settlements or judgments resulting from litigation of contested claims. It is difficult to predict or quantify the expected results of litigation because the outcome depends on decisions of the court and jury that are based on facts and legal arguments presented at the trial.

Table of Contents

Part I. FINANCIAL INFORMATION
Item 1. Financial Statements

THE NATIONAL SECURITY GROUP, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS (In thousands)

	June 30, 2013	December 31, 2012
ASSETS	(UNAUDITED)	
Investments		
Fixed maturities held-to-maturity, at amortized cost (estimated fair value: 2013 - $1,199; 2012 - $1,609)	$ 1,137	$ 1,502
Fixed maturities available-for-sale, at estimated fair value (cost: 2013 - $74,575; 2012 -$71,678)	76,360	76,294
Equity securities available-for-sale, at estimated fair value (cost: 2013 - $2,466; 2012 - $3,191)	4,275	5,132
Trading securities	19	40
Mortgage loans on real estate, at cost	379	383
Investment real estate, at book value	5,550	5,757
Policy loans	1,359	1,317
Company owned life insurance	5,783	5,931
Other invested assets	3,650	3,777
Total Investments	98,512	100,133
Cash	3,841	6,779
Accrued investment income	812	788
Policy receivables and agents' balances, net	11,290	9,006
Reinsurance recoverable	1,533	1,541
Deferred policy acquisition costs	9,044	9,097
Property and equipment, net	2,258	2,392
Deferred income tax asset	6,465	4,997
Other assets	1,161	983
Total Assets	$ 134,916	$ 135,716
LIABILITIES AND SHAREHOLDERS' EQUITY		
Property and casualty benefit and loss reserves	$ 9,738	$ 11,214
Accident and health benefit and loss reserves	2,361	2,341
Life and annuity benefit and loss reserves	30,044	30,041
Unearned premiums	28,187	25,777
Policy and contract claims	716	995
Other policyholder funds	1,422	1,417
Short-term notes payable and current portion of long-term debt	1,367	1,292
Long-term debt	25,639	25,339
Accrued income taxes	416	296
Other liabilities	5,745	6,777
Total Liabilities	105,635	105,489
Contingencies		
Shareholders' equity		
Common stock	2,494	2,467
Additional paid-in capital	5,147	4,951

Accumulated other comprehensive income	1,723	3,325
Retained earnings	19,917	19,484
Total Shareholders' Equity	29,281	30,227
Total Liabilities and Shareholders' Equity	$ 134,916	$ 135,716

The Notes to Condensed Consolidated Financial Statements (Unaudited) are an integral part of these statements.

Table of Contents

THE NATIONAL SECURITY GROUP, INC.

CONDENSED CONSOLIDATED STATEMENTS OF INCOME (LOSS) (UNAUDITED)
(In thousands, except per share amounts)

	Three months ended June 30,		Six months ended June 30,	
	2013	2012	2013	2012
REVENUES				
Net premiums earned	$13,038	$12,533	$25,972	$26,029
Net investment income	728	1,066	1,812	2,201
Net realized investment gains	1,030	865	1,057	1,071
Other income	145	193	317	390
Total Revenues	14,941	14,657	29,158	29,691
EXPENSES				
Policyholder benefits and settlement expenses	8,260	7,976	17,811	15,821
Amortization of deferred policy acquisition costs	923	915	1,865	1,731
Commissions	1,486	2,018	3,468	3,974
General and administrative expenses	2,201	1,835	4,043	4,323
Litigation settlement and defense costs	—	12,670	—	13,259
Taxes, licenses and fees	474	438	960	930
Interest expense	435	288	877	580
Total Expenses	13,779	26,140	29,024	40,618
Income (Loss) Before Income Taxes	1,162	(11,483)	134	(10,927)
INCOME TAX EXPENSE (BENEFIT)				
Current	88	145	220	173
Deferred	109	(4,322)	(642)	(4,325)
	197	(4,177)	(422)	(4,152)
Net Income (Loss)	$965	$(7,306)	$556	$(6,775)
INCOME (LOSS) PER COMMON SHARE	$0.39	$(2.96)	$0.23	$(2.75)
DIVIDENDS DECLARED PER SHARE	$0.025	$0.10	$0.05	$0.20

The Notes to Condensed Consolidated Financial Statements (Unaudited) are an integral part of these statements.

Table of Contents

THE NATIONAL SECURITY GROUP, INC.

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS (UNAUDITED)
(In thousands)

	Three months ended June 30,		Six months ended June 30,	
	2013	2012	2013	2012
Net income (loss)	$965	$(7,306)	$556	$(6,775)
Other comprehensive loss, net of tax				
Changes in:				
Unrealized gains (losses) on securities, net of reclassification adjustment of $698 and $704 for the six months ended 2013 and 2012, respectively and $680 and $568 for the three months ended 2013 and 2012, respectively	(2,482)	(201)	(1,956)	76
Unrealized gain (loss) on interest rate swap	302	(244)	354	(159)
Other comprehensive loss, net of tax	(2,180)	(445)	(1,602)	(83)
Comprehensive loss	$(1,215)	$(7,751)	$(1,046)	$(6,858)

The Notes to Condensed Consolidated Financial Statements (Unaudited) are an integral part of these statements.

Table of Contents

THE NATIONAL SECURITY GROUP, INC.

CONDENSED CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY (UNAUDITED)
Six months ended June 30, 2013 (In thousands)

	Total	Retained Earnings	Accumulated Other Comprehensive Income	Common Stock	Additional Paid-in Capital
Balance at December 31, 2012	$30,227	$19,484	$3,325	$2,467	$4,951
Net income for the six months ended June 30, 2013	556	556			
Other comprehensive loss (net of tax)	(1,602)		(1,602)		
Common stock issued	27			27	
Additional paid-in capital	196				196
Cash dividends	(123)	(123)			
Balance at June 30, 2013 (UNAUDITED):	$29,281	$19,917	$1,723	$2,494	$5,147

The Notes to Condensed Consolidated Financial Statements (Unaudited) are an integral part of these statements.

Table of Contents

THE NATIONAL SECURITY GROUP, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED) (In thousands)

	Six months ended June 30,	
	2013	2012
Cash Flows from Operating Activities		
Net income (loss)	$556	$(6,775)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Depreciation expense and amortization/accretion, net	398	286
Increase in cash surrender value of company owned life insurance	148	(171)
Net realized gains on investments	(1,057)	(1,071)
Deferred income taxes	(642)	(4,325)
Amortization of deferred policy acquisition costs	1,865	1,731
Changes in assets and liabilities:		
Change in accrued investment income	(24)	(70)
Change in reinsurance recoverable	8	818
Policy acquisition costs deferred	(1,812)	(1,876)
Change in accrued income taxes/recoverable	120	173
Change in net policy liabilities and claims	(1,614)	(1,376)
Change in other assets/liabilities, net	(587)	(345)
Change in litigation settlement	—	13,000
Other, net	233	18
Net cash provided by (used in) operating activities	(2,408)	17
Cash Flows from Investing Activities		
Purchase of:		
Available-for-sale securities	(9,619)	(15,195)
Trading securities and short-term investments	—	(40)
Real estate held for investment	—	(32)
Property and equipment	(67)	(161)
Proceeds from sale or maturities of:		
Held-to-maturity securities	364	994
Available-for-sale securities	8,319	17,572
Trading securities and short-term investments	—	83
Real estate held for investment	207	—
Property and equipment	6	6
Other invested assets, net	3	41
Net cash provided by (used in) investing activities	(787)	3,268
Cash Flows from Financing Activities		
Change in other policyholder funds	5	21
Increase in long-term debt	300	—
Change in short-term notes payable	75	140
Dividends paid	(123)	(494)
Net cash provided by (used in) financing activities	257	(333)
Net change in cash and cash equivalents	(2,938)	2,952
Cash and cash equivalents, beginning of year	6,779	3,393
Cash and cash equivalents, end of period	$3,841	$6,345

The Notes to Condensed Consolidated Financial Statements (Unaudited) are an integral part of these statements.

8

Table of Contents

THE NATIONAL SECURITY GROUP, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

NOTE 1 – SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation and Basis of Presentation
The accompanying condensed consolidated financial statements include the accounts of The National Security Group, Inc. (the Company) and its wholly-owned subsidiaries: National Security Insurance Company (NSIC), National Security Fire and Casualty Company (NSFC) and NATSCO, Inc. (NATSCO). NSFC includes a wholly-owned subsidiary - Omega One Insurance Company (Omega). In the opinion of Management, the unaudited financial statements presented herein include all accruals necessary to present fairly the Company's financial position at June 30, 2013, and the results of operations, cash flows and changes in shareholders' equity for the interim periods ended June 30, 2013 and 2012, in conformity with accounting principles generally accepted in the United States. All significant intercompany transactions and accounts have been eliminated. The condensed consolidated financial statements of the Company presented herein have not been audited by independent auditors, except for the Consolidated Balance Sheet at December 31, 2012. Financial statements and notes to condensed consolidated financial statements included in this Form 10-Q report should be read in conjunction with the Company's 2012 Form 10-K report, as certain notes and other pertinent information have been abbreviated or omitted in this report. Financial results for the three-month and six-month period ended June 30, 2013 are not necessarily indicative of future results.

Description of Business
NSIC is licensed in the states of Alabama, Florida, Georgia, Mississippi, South Carolina, Tennessee and Texas and was organized in 1947 to provide life and burial insurance policies to the home service market. Business is now produced by both company and independent agents. Primary products include ordinary life, accident and health, supplemental hospital, and cancer insurance products.

NSFC is licensed in Alabama, Arkansas, Florida, Georgia, Kentucky, Mississippi, Oklahoma, South Carolina, Tennessee and West Virginia. In addition, NSFC operates on a surplus lines basis in Louisiana, Missouri, and Texas. NSFC operates in various property and casualty lines, the most significant of which are: dwelling property fire and extended coverage, homeowners and mobile homeowners.

Omega is licensed in the states of Alabama and Louisiana. Omega operates in the property and casualty homeowners line of business.

The Company is incorporated under the laws of the State of Delaware. Its common stock is traded on the NASDAQ Global Market under the ticker symbol NSEC. Pursuant to the regulations of the United States Securities and Exchange Commission (SEC), the Company is considered a "Smaller Reporting Company" as defined by SEC Rule 12b-2 of the Exchange Act. The Company has elected to comply with the scaled disclosure requirements of Regulation S-K and only two years of financial statements are included herein.

Use of Estimates
The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Among the more significant estimates included in these consolidated financial statements are reserves for future policy benefits, liabilities for losses and loss adjustment expenses, reinsurance recoverable asset on associated loss and loss adjustment expense liabilities, deferred policy acquisition costs, deferred income tax assets and liabilities, assessments of other-than-temporary impairments on

investments and accruals for contingencies. Actual results could differ from those estimates.

Investments

The Company's securities are classified as follows:

- Securities Held-to-Maturity. Bonds, notes and redeemable preferred stock for which the Company has the positive intent and ability to hold to maturity are reported at cost, adjusted for amortization of premiums and accretion of discounts which are recognized in interest income using methods which approximate level yields over the period to maturity.

9

Table of Contents

THE NATIONAL SECURITY GROUP, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

- Securities Available-for-Sale. Bonds, notes, common stock and non-redeemable preferred stock, not classified as either held-to-maturity or trading, are reported at fair value and adjusted for other-than-temporary declines in fair value.

- Trading Securities. Trading securities are classified as such on the balance sheet and reported at fair value.

Unrealized gains and losses on investments, net of tax, on securities available-for-sale are reflected directly in shareholders' equity as a component of accumulated other comprehensive income (loss), and accordingly, have no effect on operating results until realized.

Changes in fair value of trading securities are recognized in net income.

Realized gains and losses on the sale of investments available-for-sale are determined using the specific-identification method and include write downs on available-for-sale investments considered to have other-than-temporary declines in market value.

When a fixed maturity security has a decline in value, where fair value is below amortized cost, an other-than-temporary impairment (OTTI) is triggered in circumstances where:

- the Company has the intent to sell the security

- it is more likely-than-not that the Company will be required to sell the security before recovery of its amortized cost basis

- the Company does not expect to recover the entire amortized cost basis of the security.

If the Company intends to sell the security or if it is more-likely-than-not the Company will be required to sell the security before recovery, an OTTI is recognized as a realized loss in the income statement equal to the difference between the security's amortized cost and its fair value. If the Company does not intend to sell the security or it is not more-likely-than not that the Company will be required to sell the security before recovery, the OTTI is separated into an amount representing the credit loss, which is recognized as a realized loss in the statement of operations, and the amount related to all other factors, which is recognized in other comprehensive income.

When an equity security has a decline in value, where fair value is below cost, that is deemed to be other-than-temporary, the Company reduces the book value of the security to its current fair value, recognizing the decline as a realized loss in the statement of operations. Any future increases in the market value of investments written down are reflected as changes in unrealized gains as part of accumulated other comprehensive income within shareholders' equity.

Interest on fixed income securities is credited to income as it accrues on the principal amounts outstanding adjusted for amortization of premiums and accretion of discounts computed utilizing the effective interest rate method. Premiums and discounts on mortgage backed securities are amortized or accreted using anticipated prepayments with changes in anticipated prepayments accounted for prospectively. The model used to determine anticipated prepayment assumptions for mortgage backed securities uses separate home sale, refinancing, curtailment and pay-off assumptions derived from a variety of industry sources. Mortgage backed security valuations are subject to prospective adjustments in yield due to changes in prepayment assumptions. The utilization of the prospective method will result in a recalculated effective yield that will equate the carrying amount of the investment to the present value of the projected future cash flows. The recalculated yield is used to accrue income on investments for subsequent periods.

Mortgage loans and policy loans are stated at the unpaid principal balance of such loans, net of any related allowance for uncollectible amounts.

Investment real estate is reported at cost, less allowances for depreciation computed on the straight-line basis. Investment real estate consists primarily of timberland and undeveloped commercial real estate. Real estate is carried at cost.

Table of Contents

THE NATIONAL SECURITY GROUP, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

Other investments consist primarily of investments in notes and equity investments in limited liability companies. The Company has no influence or control over the operating or financial policies of the investee limited liability companies, and consequently, these investments are accounted for using the cost method.

The Company owns life insurance (COLI) contracts on certain management and supervisory employees each having a face amount of approximately $2,000,000. The Company's original investment in company owned life insurance was $5,000,000. The primary purpose of the program is to offset future employee benefit expenses through earnings on the cash value of the policies. The Company is the owner and principal beneficiary of these policies. The life insurance contracts are carried at their current cash surrender value. Cash surrender value at June 30, 2013 and December 31, 2012 was $5,783,000 and $5,931,000, respectively. Changes in cash surrender values are included in investment income in the current period. The change in surrender value included in earnings for the three-month periods ended June 30, 2013 and 2012 was a decline of $198,000 and an increase of $54,000, respectively. The change in surrender value included in earnings for the six-month periods ended June 30, 2013 and 2012 was a decline of $148,000 and an increase of $171,000, respectively. Death proceeds from the contracts are recorded when the proceeds become payable under the terms of the policy. There were no proceeds received from the COLI during 2013 or 2012.

Cash and short-term investments are carried at cost, which approximates market value.

Investments with other-than-temporary impairment in value are written down to estimated realizable values and losses recognized in the determination of operating results. The fair value of the investment becomes its new cost basis.

Fair Values of Financial Instruments
The Company uses the following methods and assumptions to estimate fair values:

Investments

- Fixed income security fair values are based on quoted market prices when available. If not available, fair values are based on values obtained from investment brokers and independent pricing services.

- Equity security fair values are based on quoted market prices.

- Multiple observable inputs are not available for some of our investments, primarily private placements and limited partnerships. Management values these investments either using non-binding broker quotes or pricing models that utilize market based assumptions that have limited observable inputs. These investments compose less than 1% of total assets.

Receivables and reinsurance recoverable - The carrying amounts reported approximate fair value.

Interest rate swaps - The estimated fair value of the interest rate swaps is based on valuations received from financial institution counterparties.

Trust preferred securities obligations and line of credit obligations - The carrying amounts reported for these instruments are equal to the principal balance outstanding and approximate their fair value.

Policy Receivables
Receivable balances are reported at unpaid balances, less a provision for credit losses.

Accounts Receivable

Accounts receivable are reported at net realizable value. Management determines the allowance for doubtful accounts based on historical losses and current economic conditions. On a continuing basis, management analyzes delinquent receivables, and once these receivables are determined to be uncollectible, they are written off through a charge against an existing allowance account or against earnings.

Table of Contents

THE NATIONAL SECURITY GROUP, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

Property and Equipment
Property and equipment is carried at cost less accumulated depreciation and includes expenditures that substantially increase the useful lives of existing property and equipment. Significant costs incurred for internally developed software are capitalized and amortized over estimated useful lives of 3 years. Maintenance, repairs, and minor renovations are charged to expense as incurred. Upon sale or retirement of property and equipment, the costs and related accumulated depreciation are eliminated from the respective account and the resulting gain or loss is included in the results of operations. The Company provides for depreciation of property and equipment using the straight-line method designed to amortize costs over estimated useful lives. Estimated useful lives range up to 40 years for buildings and from 3-10 years for electronic data processing equipment and furniture and fixtures. Property and equipment are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable.

Statement of Cash Flows
For purposes of reporting cash flows, cash includes cash-on-hand, demand deposits with banks and overnight investments.

Premium Revenue
Life insurance premiums are recognized as revenues when due. Property and casualty insurance premiums include direct writings plus reinsurance assumed less reinsurance ceded and are recognized on a pro rata basis over the terms of the policies. Unearned premiums represent that portion of direct premiums written that are applicable to the unexpired terms of policies in force and is reported as a liability. Prepaid reinsurance premiums represent the unexpired portion of premiums ceded to reinsurers and are reported as an asset.

Deferred Policy Acquisition Costs
The costs of acquiring new insurance business are deferred and amortized over the lives of the policies. Deferred costs include commissions, premium taxes, other agency compensation and expenses, and other underwriting expenses directly related to the level of new business produced.

Acquisition costs relating to life contracts are amortized over the premium paying period of the contracts, or the first renewal period of term policies, if earlier. Assumptions utilized in amortization are consistent with those utilized in computing policy liabilities.

The method of computing the deferred policy acquisition costs for property and casualty policies limits the amount deferred to a percentage of related unearned premiums.

Earnings Per Share
Earnings per share of common stock is based on the weighted average number of shares outstanding during each year. The adjusted weighted average shares outstanding were 2,467,062 in 2013 and 2,466,600 in 2012.

Reinsurance
The Company's insurance operations re-insure certain risks in order to limit losses, minimize exposure to large risks, provide additional capacity for future growth and effect business-sharing arrangements. See Note 10 for additional information regarding the Company's reinsurance practices.

Income Taxes

The Company uses the asset and liability method of accounting for income taxes. Deferred income taxes arise from the recognition of temporary differences between financial statement carrying amounts and the tax bases of the Company's assets and liabilities and operating loss carry-forwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. A valuation allowance is provided when it is more likely than not that some portion of the deferred tax asset will not be realized. The effect of a change in tax rates is recognized in the period the new rate is enacted.

The Company evaluates all tax positions taken on its U.S. federal income tax return. No material uncertainties exist for any tax positions taken by the Company.

Table of Contents

THE NATIONAL SECURITY GROUP, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

Contingencies
Liabilities for loss contingencies arising from, but not limited to, litigation, claims, assessments, fines and penalties are recorded when it is probable that a liability has been incurred and the amount of the assessment and/or remediation can be reasonably estimated. Significant attorney fees are estimated and recorded when incurred.

Reclassifications
Certain 2012 amounts have been reclassified from the prior year consolidated financial statements to conform to the 2013 presentation.

Advertising
The Company expenses advertising costs as incurred. Advertising costs charged to expense were $31,000 for the three months ended June 30, 2013 ($28,000 for the three months ended June 30, 2012). Advertising costs charged to expense were $84,000 for the six months ended June 30, 2013 ($61,000 for the six months ended June 30, 2012). Advertising cost consists primarily of agent convention expense and print media.

Concentration of Credit Risk
The Company maintains cash balances which are generally held in non-interest bearing demand deposit accounts. Through December 31, 2012, these balances were insured by the FDIC with no balance limits. On January 1, 2013, $250,000 per account balance limits were reinstated. At June 30, 2013, the net amount exceeding FDIC insured limits was $2,347,000 at one financial institution. The Company has not experienced any losses in such accounts. Management of the Company reviews financial information of the financial institution on a quarterly basis and believes the Company is not exposed to any significant credit risk on cash and cash equivalents.

Policy receivables are reported at unpaid balances. Policy receivables are generally offset by associated unearned premium liabilities and are not subject to significant credit risk. Receivables from agents, less provision for credit losses, are composed of balances due from independent agents. At June 30, 2013, the single largest balance due from one agent totaled $1,485,000.

Reinsurance contracts do not relieve the Company of its obligations to policyholders. A failure of a reinsurer to meet their obligation could result in losses to the insurance subsidiaries. Allowances for losses are established if amounts are believed to be uncollectible. At June 30, 2013 and December 31, 2012, no amounts were deemed uncollectible. The Company, at least annually, evaluates the financial condition of all reinsurers and evaluates any potential concentrations of credit risk. At June 30, 2013, management does not believe the Company is exposed to any significant credit risk related to its reinsurance program.

Recently Adopted Accounting Standards

Disclosures about Offsetting Assets and Liabilities for Financial Instruments and Derivative Instruments
In December 2011, the FASB issued guidance requiring expanded disclosures, including both gross and net information, for financial instruments and derivative instruments that are either offset in the reporting entity's financial statements or those that are subject to an enforceable master netting arrangement or similar agreement. The Company adopted the new guidance on January 1, 2013 and applied it retrospectively. The guidance impacts disclosures only and will have no impact on the Company's results of operations or financial position. The Company does not have any derivative instruments subject to master netting arrangements at June 30, 2013.

In February 2013, the FASB issued an accounting standards update that requires additional disclosures for reclassification adjustments from accumulated other comprehensive income (AOCI). These additional disclosures include changes in AOCI balances by component and significant items reclassified out of AOCI. These disclosures must be presented either on the face of the affected financial statement or in the notes to the financial statements. The disclosures are effective beginning in the first quarter of 2013 and are to be provided on a prospective basis. These disclosures are presented in Note 12.

Intangibles-Goodwill and Other
In July 2012, the FASB issued guidance related to impairment of indefinite-lived intangible assets other than goodwill. The new guidance allows an entity to first make a qualitative assessment of whether it is more likely than not that the

THE NATIONAL SECURITY GROUP, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

fair value of an indefinite-lived intangible asset is less than its carrying amount before applying the quantitative impairment test. An entity is required to perform the quantitative test only if it determines that it is more likely than not that the fair value of an indefinite-lived intangible asset is less than its carrying amount. The Company adopted this guidance January 1, 2013. No interim testing was required as of June 30, 2013, and we do not expect a material effect on results of operations or financial position following annual testing.

NOTE 2 – VARIABLE INTEREST ENTITIES

The Company holds a passive interest in a limited partnership that is considered to be a Variable Interest Entity (VIE) under the provisions of FIN 46(R). The Company is not the primary beneficiary of the entity and is not required to consolidate under FIN 46(R). The entity is a private placement investment fund formed for the purpose of investing in private equity investments. The Company owns less than 1% of the limited partnership. The carrying value of the investment totals $325,000 and is included as a component of Other Invested Assets in the accompanying condensed consolidated balance sheets.

In December 2005, the Company formed National Security Capital Trust I, a statutory trust created under the Delaware Statutory Trust Act, for the sole purpose of issuing, in private placement transactions, $9,000,000 of trust preferred securities (TPS) and using the proceeds thereof, together with the equity proceeds received from the Company in the initial formation of the Trust, to purchase $9,279,000 of variable rate subordinated debentures issued by the Company. The Company owns all voting securities of the Trust and the subordinated debentures are the sole assets of the Trust. The Trust will meet the obligations of the TPS with the interest and principal paid on the subordinated debentures. The Company received net proceeds from the TPS transactions, after commissions and other costs of issuance, of $9,005,000. The Company also holds all the voting securities issued by the Trust and such trusts are considered to be VIE's. The Trust is not consolidated because the Company is not the primary beneficiary of the trust. The Subordinated Debentures, disclosed in Note 7, are reported in the accompanying Consolidated Balance Sheets as a component of long-term debt. The Company's equity investments in the Trust total $279,000 and are included in Other Assets in the accompanying condensed consolidated balance sheets.

In June 2007, the Company formed National Security Capital Trust II for the sole purpose of issuing, in private placement transactions, $3,000,000 of trust preferred securities (TPS) and using the proceeds thereof, together with the equity proceeds received from the Company in the initial formation of the Trust, to purchase $3,093,000 unsecured junior subordinated deferrable interest debentures. The Company owns all voting securities of the Trust and the subordinated debentures are the sole assets of the Trust. The Trust will meet the obligations of the TPS with the interest and principal paid on the subordinated debentures. The Company received net proceeds from the TPS transactions, after commissions and other costs of issuance, of $2,995,000. The Company also holds all the voting securities issued by the Trust and such trusts are considered to be VIE's. The Trust is not consolidated because the Company is not the primary beneficiary of the Trust. The Subordinated Debentures, disclosed in Note 7, are reported in the accompanying condensed consolidated balance sheets as a component of long-term debt. The Company's equity investments in the Trust total $93,000 and are included in Other Assets in the accompanying condensed consolidated balance sheets.

Table of Contents

THE NATIONAL SECURITY GROUP, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

NOTE 3 – INVESTMENTS

The amortized cost and aggregate fair values of investments in available-for-sale securities as of June 30, 2013 are as follows:

Available-for-sale securities:	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Corporate debt securities	$34,281	$1,704	$417	$35,568
Trust preferred securities	538	6	—	544
Mortgage backed securities	8,765	94	318	8,541
Private label mortgage backed securities	6,206	180	10	6,376
Obligations of states and political subdivisions	16,908	742	128	17,522
U.S. Treasury securities and obligations of U.S. Government corporations and agencies	7,877	159	227	7,809
Total fixed maturities	74,575	2,885	1,100	76,360
Equity securities	2,466	2,238	429	4,275
Total	$77,041	$5,123	$1,529	$80,635

The amortized cost and aggregate fair values of investments in held-to-maturity securities as of June 30, 2013 are as follows:

Held-to-maturity securities:	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Mortgage backed securities	$870	$53	$—	$923
Obligations of states and political subdivisions	145	1	—	146
U.S. Treasury securities and obligations of U.S. Government corporations and agencies	122	8	—	130
Total	$1,137	$62	$—	$1,199

The amortized cost and aggregate fair values of investments in available-for-sale securities as of December 31, 2012 are as follows:

Available-for-sale securities:	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Corporate debt securities	$31,387	$2,430	$80	$33,737
Trust preferred securities	537	50	—	587
Mortgage backed securities	8,595	175	85	8,685
Private label mortgage backed securities	7,679	294	9	7,964
Obligations of states and political subdivisions	16,160	1,359	3	17,516
U.S. Treasury securities and obligations of U.S. Government corporations and agencies	7,320	487	2	7,805
Total fixed maturities	71,678	4,795	179	76,294
Equity securities	3,191	2,398	457	5,132
Total	$74,869	$7,193	$636	$81,426

The amortized cost and aggregate fair values of investments in held-to-maturity securities as of December 31, 2012 are as follows:

Held-to-maturity securities:	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Mortgage backed securities	$1,194	$91	$—	$1,285
Obligations of states and political subdivisions	145	2	—	147
U.S. Treasury securities and obligations of U.S. Government corporations and agencies	163	14	—	177
Total	$1,502	$107	$—	$1,609

Table of Contents

THE NATIONAL SECURITY GROUP, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

The amortized cost and aggregate fair value of debt securities at June 30, 2013, by contractual maturity, are presented in the following table. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	(Dollars in Thousands)	
	Amortized Cost	Fair Value
Available-for-sale securities:		
Due in one year or less	$1,695	$1,737
Due after one year through five years	14,867	15,990
Due after five years through ten years	24,381	24,823
Due after ten years	33,632	33,810
Total	$74,575	$76,360
Held-to-maturity securities:		
Due in one year or less	$—	$—
Due after one year through five years	445	465
Due after five years through ten years	27	28
Due after ten years	665	706
Total	$1,137	$1,199

A summary of securities available-for-sale with unrealized losses as of June 30, 2013, along with the related fair value, aggregated by the length of time that investments have been in a continuous unrealized loss position, is as follows:

	Less than 12 months		12 months or longer		Total		
June 30, 2013	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Total Securities in a Loss Position
Fixed maturities							
Corporate debt securities	$10,246	$380	$974	$37	$11,220	$417	25
Mortgage backed securities	4,608	287	856	31	5,464	318	16
Private label mortgage backed securities	498	10	—	—	498	10	3
Obligations of state and political subdivisions	2,824	113	342	15	3,166	128	9
U.S. Treasury securities and obligations of U.S. Government corporations and agencies	3,925	178	449	49	4,374	227	8
Equity securities	—	—	857	429	857	429	1
	$22,101	$968	$3,478	$561	$25,579	$1,529	62

Table of Contents

THE NATIONAL SECURITY GROUP, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

A summary of securities available-for-sale with unrealized losses as of December 31, 2012, along with the related fair value, aggregated by the length of time that investments have been in a continuous unrealized loss position, is as follows:

	Less than 12 months		12 months or longer		Total		
December 31, 2012	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Total Securities in a Loss Position
Fixed maturities							
Corporate debt securities	$2,226	$31	$963	$49	$3,189	$80	7
Mortgage backed securities	2,904	77	165	8	3,069	85	8
Private label mortgage backed securities	206	8	65	1	271	9	2
Obligations of state and political subdivisions	356	3	—	—	356	3	1
U.S. Treasury securities and obligations of U.S. Government corporations and agencies	495	2	—	—	495	2	1
Equity securities	—	—	829	457	829	457	1
	$6,187	$121	$2,022	$515	$8,209	$636	20

There were no securities held-to-maturity with unrealized losses as of June 30, 2013 and December 31, 2012.

The Company conducts periodic reviews to identify and evaluate securities in an unrealized loss position in order to identify other-than-temporary impairments. For securities in an unrealized loss position, the Company assesses whether the Company has the intent to sell the security or more-likely-than-not will be required to sell the security before the anticipated recovery. If either of these conditions is met, the Company is required to recognize an other-than-temporary impairment with the entire unrealized loss reported in earnings. For securities in an unrealized loss position that do not meet these conditions, the Company assesses whether the impairment of a security is other-than-temporary. If the impairment is determined to be other-than-temporary, the Company is required to separate the other-than-temporary impairments into two components: the amount representing the credit loss and the amount related to all other factors. The credit loss is the portion of the amortized book value in excess of the net present value of the projected future cash flows discounted at the effective interest rate implicit in the debt security prior to impairment. The credit loss component of other-than-temporary impairments is reported in earnings, whereas the amount relating to factors other than credit losses are recorded in other comprehensive income, net of taxes.

Management has evaluated each security in a significant unrealized loss position. The Company has no material exposure to sub-prime mortgage loans and less than 4% of the fixed income investment portfolio is rated below investment grade. In evaluating whether or not the equity loss positions were other-than-temporary impairments, Management evaluated financial information on each company and where available, reviewed analyst reports from at least two independent sources. Based on a review of the available financial information, the prospect for future earnings of each company and consideration of the Company’s intent and ability to hold the securities until market values recovered, it was determined that the securities in an accumulated loss position in the portfolio were temporary impairments.

For the six months ended June 30, 2013, the Company realized no additional other-than-temporary impairments. The single largest accumulated loss not realized as an impairment was in the equity portfolio and totaled $429,000. The second largest loss position was in the bond portfolio and totaled $56,000. The third largest loss position was in the bond portfolio and totaled $52,000.

For the year ended December 31, 2012, the Company realized $87,000 in other-than-temporary impairments. The single largest accumulated loss not realized as an impairment was in the equity portfolio and totaled $457,000. The second largest loss position was in the bond portfolio and totaled $39,000. The third largest loss position was in the bond portfolio and totaled $27,000.

Table of Contents

THE NATIONAL SECURITY GROUP, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

Major categories of investment income are summarized as follows (dollars in thousands):

	Three months ended June 30,		Six months ended June 30,	
	2013	2012	2013	2012
Fixed maturities	$815	$879	$1,640	$1,762
Equity securities	45	54	73	112
Mortgage loans on real estate	6	8	13	13
Investment real estate	41	11	81	22
Policy loans	26	21	50	46
Company owned life insurance change in surrender value	(198)	54	(148)	171
Other, principally short-term investments	50	89	208	177
	785	1,116	1,917	2,303
Less: Investment expenses	57	50	105	102
Net investment income	$728	$1,066	$1,812	$2,201

Major categories of investment gains and losses are summarized as follows (dollars in thousands):

	Three months ended June 30,		Six months ended June 30,	
	2013	2012	2013	2012
Fixed maturities	$102	$55	$127	$128
Equity securities	928	734	928	734
Trading securities	—	—	—	2
Other, principally real estate	—	76	2	207
Other-than-temporary impairments	—	—	—	—
Net realized investment gains	$1,030	$865	$1,057	$1,071

An analysis of the net change in unrealized appreciation on available-for-sale securities follows (dollars in thousands):

	June 30, 2013 (UNAUDITED)	December 31, 2012
Net change in unrealized appreciation on available-for-sale securities before deferred tax	$(2,963)	$(153)
Deferred income tax	1,007	52
Net change in unrealized appreciation on available-for-sale securities	$(1,956)	$(101)

NOTE 4 – FAIR VALUE OF FINANCIAL ASSETS AND FINANCIAL LIABILITIES

Our available-for-sale securities consists of fixed maturity and equity securities which are recorded at fair value in the accompanying consolidated balance sheets. The change in the fair value of these investments, unless deemed to be other-than-temporarily impaired, is recorded as a component of other comprehensive income.

We are permitted to elect to measure financial instruments and certain other items at fair value, with the change in fair value recorded in earnings. We elected not to measure any eligible items using the fair value option.

Table of Contents

THE NATIONAL SECURITY GROUP, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

Accounting standards define fair value as the price that would be received to sell an asset or would be paid to transfer a liability in an orderly transaction between market participants at the measurement date, and establishes a framework to make the measurement of fair value more consistent and comparable. In determining fair value, we primarily use prices and other relevant information generated by market transactions involving identical or comparable assets.

The Company categorizes assets and liabilities carried at their fair value based upon a fair value hierarchy:

Level 1 – Quoted prices in active markets for identical assets or liabilities that the Company has the ability to access at the measurement date.

Level 1 assets and liabilities consist of money market fund deposits and certain of our marketable debt and equity instruments, including equity instruments offsetting deferred compensation, that are traded in an active market with sufficient volume and frequency of transactions.

Level 2 - Observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets with insufficient volume or infrequent transactions (less active markets); or model-derived valuations in which all significant inputs are observable or can be derived principally from or corroborated by observable market data for substantially the full term of the assets or liabilities.

Level 2 assets include certain of our marketable debt and equity instruments with quoted market prices that are traded in less active markets or priced using a quoted market price for similar instruments. Level 2 assets also include marketable equity instruments with security-specific restrictions that would transfer to the buyer, marketable debt instruments priced using indicator prices which represent non-binding market consensus prices that can be corroborated by observable market quotes, as well as derivative contracts and debt instruments priced using inputs that are observable in the market or can be derived principally from or corroborated by observable market data. Marketable debt instruments in this category generally include commercial paper, bank time deposits, repurchase agreements for fixed-income instruments, and a majority of floating-rate notes, corporate bonds, and municipal bonds.

Level 3 - Unobservable inputs to the valuation methodology that are significant to the measurement of fair value of assets or liabilities.

Level 3 assets and liabilities include marketable debt instruments, non-marketable equity investments, derivative contracts, and company issued debt whose values are determined using inputs that are both unobservable and significant to the values of the instruments being measured. Level 3 assets also include marketable debt instruments that are priced using indicator prices that we were unable to corroborate with observable market quotes.

Marketable debt instruments in this category generally include asset-backed securities and certain of our floating-rate notes, corporate bonds, and municipal bonds.

Table of Contents

THE NATIONAL SECURITY GROUP, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

Assets/Liabilities Measured at Fair Value on a Recurring Basis

Financial assets and liabilities measured at fair value on a recurring basis as of June 30, 2013 are summarized in the following table by the type of inputs applicable to the fair value measurements (unaudited) (in thousands):

	Fair Value Measurements at Reporting Date Using			
Description	Total	Level 1	Level 2	Level 3
Financial Assets				
Fixed maturities available-for-sale				
Corporate debt securities	$35,568	$—	$35,568	$—
Trust preferred securities	544	—	544	—
Mortgage backed securities	8,541	—	8,541	—
Private label mortgage backed securities	6,376	—	6,376	—
Obligations of states and political subdivisions	17,522	—	17,522	—
U.S. Treasury securities and obligations of U.S. Government corporations and agencies	7,809	7,809	—	—
Trading securities	19	19	—	—
Equity securities available-for-sale	4,275	3,418	—	857
Total Financial Assets	$80,654	$11,246	$68,551	$857
Financial Liabilities				
Interest rate swap	$984	$—	$—	$984
Total Financial Liabilities	$984	$—	$—	$984

The methods and assumptions the Company uses to estimate the fair value of assets and liabilities measured at fair value on a recurring basis are summarized below.

Fixed maturities available-for-sale — The fair values of the Company's public fixed maturity securities are generally based on prices obtained from independent pricing services. Consistent with the fair value hierarchy described above, securities with validated quotes from pricing services are generally reflected within Level 2, as they are primarily based on observable pricing for similar assets and/or other market observable inputs.

Trading securities — Trading securities consist primarily of mutual funds whose fair values are determined consistent with similar instruments described above under "Fixed Maturities" and below under "Equity Securities."

Equity securities — Equity securities consist principally of investments in common and preferred stock of publicly traded companies and privately traded securities. The fair values of our publicly traded equity securities are based on quoted market prices in active markets for identical assets and are classified within Level 1 in the fair value hierarchy. Estimated fair values for our privately traded equity securities require a substantial level of judgment. Privately traded equity securities are classified within Level 3.

Interest rate swaps — Interest rate swaps are recorded at fair value either as assets, within other assets or as liabilities, within other liabilities. The fair values of our interest rate swaps are provided by a third party broker and are classified within Level 3.

As of June 30, 2013, Level 3 fair value measurements of assets include $857,000 of equity securities in a local community bank whose value is based on an evaluation of the financial statements of the entity. The Company does not develop the unobservable inputs used in measuring fair value.

As of June 30, 2013, Level 3 fair value measurements of liabilities include $984,000 net fair value of various interest rate swap agreements whose value is based on analysis provided by a third party broker. The Company does not develop the unobservable inputs used in measuring fair value. Additional information regarding the interest rate swap agreements is provided in Note 7.

Table of Contents

THE NATIONAL SECURITY GROUP, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

The table below presents a reconciliation for all assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the six months ended June 30, 2013 (in thousands):

For the six months ended June 30, 2013 (unaudited)	Equity Securities Available-for-Sale	Interest Rate Swap
Beginning balance	$829	$(1,521)
Total gains or losses (realized and unrealized):		
Included in earnings	—	—
Included in other comprehensive income	28	537
Purchases:	—	—
Sales:	—	—
Issuances:	—	—
Settlements:	—	—
Transfers in/(out) of Level 3	—	—
Ending balance	$857	$(984)
The amount of total gains or losses for the period included in earnings attributable to the change in unrealized gains or losses relating to assets and liabilities still held as of June 30, 2013:	$—	$—

For the six months ended June 30, 2013, there were no assets or liabilities measured at fair values on a nonrecurring basis.

Financial assets and liabilities measured at fair value on a recurring basis as of December 31, 2012 are summarized in the following table by the type of inputs applicable to the fair value measurements (in thousands):

	Fair Value Measurements at Reporting Date Using			
Description	Total	Level 1	Level 2	Level 3
Financial Assets				
Fixed maturities available-for-sale				
Corporate debt securities	$33,737	$—	$33,737	$—
Trust preferred securities	587	—	587	—
Mortgage backed securities	8,685	—	8,685	—
Private label mortgage backed securities	7,964	—	7,964	—
Obligations of states and political subdivisions	17,516	—	17,516	—
U.S. Treasury securities and obligations of U.S. Government corporations and agencies	7,805	7,805	—	—
Trading securities	40	40	—	—
Equity securities available-for-sale	5,132	4,303	—	829
Total Financial Assets	$81,466	$12,148	$68,489	$829
Financial Liabilities				
Interest rate swap	$1,521	$—	$—	$1,521
Total Financial Liabilities	$1,521	$—	$—	$1,521

Table of Contents

THE NATIONAL SECURITY GROUP, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

The table below presents a reconciliation for all assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the year ended December 31, 2012 (in thousands):

For the year ended December 31, 2012	Equity Securities Available-for-Sale	Interest Rate Swap
Beginning balance	$642	$(1,196)
Total gains or losses (realized and unrealized):		
Included in earnings	—	—
Included in other comprehensive income	44	(325)
Purchases:	143	—
Sales:	—	—
Issuances:	—	—
Settlements:	—	—
Transfers in/(out) of Level 3	—	—
Ending balance	$829	$(1,521)
The amount of total gains or losses for the period included in earnings attributable to the change in unrealized gains or losses relating to assets and liabilities still held as of December 31, 2012:	$—	$—

For the year ended December 31, 2012, there were no assets or liabilities measured at fair values on a nonrecurring basis.

The Company is exposed to certain risks in the normal course of its business operations. The primary risk that is managed through the use of derivatives is interest rate risk on floating rate borrowings. This risk is managed through the use of interest rate swap agreements which are designated as cash flow hedges. For cash flow hedges, the effective portion of the gain or loss on the interest rate swap is included as a component of other comprehensive income and reclassified into earnings in the same period during which the hedged transaction is recognized in earnings. The Company does not hold or issue derivatives that are not designated as hedging instruments. See Note 7 for additional information about the interest rate swap agreements.

The following methods and assumptions were used to estimate fair value of each class of financial instrument for which it is practical to estimate that value:

Cash and cash equivalents — the carrying amount is a reasonable estimate of fair value.

Mortgage loans — the carrying amount is a reasonable estimate of fair value due to the restrictive nature and limited marketability of the mortgage notes.

Policy loans — the carrying amount is a reasonable estimate of fair value.

Company owned life insurance — the carrying amount is a reasonable estimate of fair value.

Other invested assets — the carrying amount is a reasonable estimate of fair value.

Other policyholder funds — the carrying amount is a reasonable estimate of fair value.

Debt — the carrying amount is a reasonable estimate of fair value.

Table of Contents

THE NATIONAL SECURITY GROUP, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

The carrying amount and estimate fair value of the Company's financial instruments as of June 30, 2013 and December 31, 2012 are as follows (in thousands):

	June 30, 2013 (UNAUDITED)		December 31, 2012	
	Carrying Value	Estimated Fair Value	Carrying Value	Estimated Fair Value
Assets and related instruments				
Mortgage loans	$379	$379	$383	$383
Policy loans	1,359	1,359	1,317	1,317
Company owned life insurance	5,783	5,783	5,931	5,931
Other invested assets	3,650	3,650	3,777	3,777
Liabilities and related instruments				
Other policyholder funds	1,422	1,422	1,417	1,417
Short-term notes payable and current portion of long-term debt	1,367	1,367	1,292	1,292
Long-term debt	25,639	25,639	25,339	25,339

NOTE 5 – PROPERTY AND EQUIPMENT

Major categories of property and equipment are summarized as follows (dollars in thousands):

	June 30, 2013 (UNAUDITED)	December 31, 2012
Building and improvements	$3,185	$3,185
Electronic data processing equipment	1,832	1,814
Furniture and fixtures	904	912
	5,921	5,911
Less accumulated depreciation	3,663	3,519
	$2,258	$2,392

Depreciation expense for the six months ended June 30, 2013 was $201,000 ($433,000 for the year ended December 31, 2012).

NOTE 6 – INCOME TAXES

The Company recognizes tax-related interest and penalties as a component of tax expense. The Company has not incurred any income tax related interest and penalties during the six-month period ended June 30, 2013 and incurred no income tax related interest and penalties during 2012. The Company files income tax returns in the U.S. federal jurisdiction and various states. The Company is not subject to examinations by authorities related to its U.S. federal or state income tax filings for years prior to 2009. Tax returns have been filed through the year 2011. Extensions have been filed for 2012.

Net deferred tax liabilities are determined based on the estimated future tax effects of differences between the financial statement and tax basis of assets and liabilities given the provisions of the enacted tax laws. Management believes that, based on its historical pattern of taxable income, the Company will produce sufficient income in the future to realize its deferred tax assets. The Company recognized net deferred tax asset positions of $6,465,000 at June 30, 2013 and $4,997,000 at December 31, 2012.

Table of Contents

THE NATIONAL SECURITY GROUP, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

The tax effect of significant differences representing deferred tax assets and liabilities are as follows (dollars in thousands):

	June 30, 2013 (UNAUDITED)	December 31, 2012
General expenses	$1,293	$1,211
Unearned premiums	1,915	1,751
Claims liabilities	440	243
Litigation settlement	3,570	3,570
AMT credit	246	246
NOL carryforward	2,873	2,711
Other-than-temporary impairments on securities owned	164	164
Unrealized loss on interest rate swaps	335	518
Deferred tax assets	10,836	10,414
Trading securities	—	(1)
Depreciation	(77)	(94)
Deferred policy acquisition costs	(3,074)	(3,093)
Unrealized gains on securities available-for-sale	(1,220)	(2,229)
Deferred tax liabilities	(4,371)	(5,417)
Net deferred tax asset	$6,465	$4,997

The appropriate income tax effects of changes in temporary differences are as follows (dollars in thousands):

	Six months ended June 30,	
	2013 (UNAUDITED)	2012
Deferred policy acquisition costs	$(19)	$49
Other-than-temporary impairments	—	27
Trading securities	(1)	—
Unearned premiums	(164)	(113)
General expenses	(82)	(61)
Depreciation	(17)	(24)
Claim liabilities	(197)	22
Litigation settlement	—	(3,995)
NOL carryforward	(162)	(230)
Deferred income tax benefit	$(642)	$(4,325)

Table of Contents

THE NATIONAL SECURITY GROUP, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

Total income tax (benefit) expense varies from amounts computed by applying current federal income tax rates to income or loss before income taxes. The reasons for these differences and the approximate tax effects are as follows:

	Six months ended June 30,			
	2013		2012	
Federal income tax rate applied to pre-tax income/loss	34.0	%	34.0	%
Dividends received deduction and tax-exempt interest	(48.2	)%	0.8	%
Company owned life insurance	37.7	%	0.5	%
Small life deduction	(197.3	)%	2.1	%
Life reserve tax adjustment	(147.4	)%	—	%
Other, net	6.2	%	0.6	%
Effective federal income tax rate	(315.0	)%	38.0	%

NOTE 7 – NOTES PAYABLE AND LONG-TERM DEBT

Short-term debt and current portion of long-term debt consisted of the following as of June 30, 2013 and December 31, 2012:

	(Dollars in thousands)	
	2013 (UNAUDITED)	2012
Line of credit with variable interest rate equal to the Wall Street Journal (WSJ) prime rate, subject to a 5.0% floor; maturity January 2014. Interest payments due quarterly. Unsecured.	$200	$125
Current portion of installment note payable due November 2013 with variable interest rate equal to the WSJ prime rate plus 1%; Unsecured	1,167	1,167
	$1,367	$1,292

Long-term debt consisted of the following as of June 30, 2013 and December 31, 2012:

	(Dollars in thousands)	
	2013 (UNAUDITED)	2012
Line of credit with variable interest rate equal to the WSJ prime rate, subject to a 4.5% floor; maturity September 2017. Interest payments due monthly. Secured.	$3,934	$3,634
Long term portion of installment note with variable interest rate equal to the WSJ prime rate plus 1% and adjustable each November; maturity November 2021. Interest payable annually with principal payable in equal annual installments. Next principal installment on long term portion due November 2014. Unsecured.	9,333	9,333
Subordinated debentures issued on December 15, 2005 with fixed interest rate of 8.83% each distribution period thereafter until December 15, 2015 when the coupon rate shall equal the 3-Month LIBOR plus 3.75% applied to the outstanding principal; maturity December 2035. Interest payments due quarterly. All may be redeemed at any time following the tenth anniversary of issuance. Unsecured.	9,279	9,279

Subordinated debentures issued on June 21, 2007 with a floating interest rate equal to the 3-Month LIBOR plus 3.40% applied to the outstanding principal; maturity June 15, 2037. Interest payments due quarterly. All may be redeemed at any time following the fifth anniversary of issuance. Unsecured.	3,093	3,093
	$25,639	$25,339

25

Table of Contents

THE NATIONAL SECURITY GROUP, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

The subordinated debentures (debentures) have the same maturities and other applicable terms and features as the associated trust preferred securities (TPS). Payment of interest may be deferred for up to 20 consecutive quarters; however, stockholder dividends cannot be paid during any extended interest payment period or any time the debentures are in default. All have stated maturities of thirty years. None of the TPS securities require the Company to maintain minimum financial covenants. The Company has guaranteed that amounts paid to the Trusts will be remitted to the holders of the associated TPS. This guarantee, when taken together with the obligations of the Company under the debentures, the Indentures pursuant to which the debentures were issued, and the related trust agreement (including obligations to pay related trust fees, expenses, debt and other obligations with respect to the TPS), provides a full and unconditional guarantee of amounts due the Trusts. The amount guaranteed is not expected to at any time exceed the obligations of the TPS, and no additional liability has been recorded related to the guarantee.

The Company has entered into various swap agreements related to the trust preferred securities. On March 19, 2009, the Company entered into a forward swap effective September 17, 2012, with a notional amount of $3,000,000 and designated the swap as a hedge against changes in cash flows attributable to changes in the benchmark interest rate (LIBOR) associated with the subordinated debentures issued June 21, 2007. Commencing September 17, 2012, under the terms of the forward swap, the Company receives interest at the three-month LIBOR rate plus 3.4% and pay interest at the fixed rate of 7.02%. This forward swap will effectively fix the interest rate on $3,000,000 in debt until September of 2019.

On May 26, 2010, the Company entered into a forward swap with a notional amount of $9,000,000 effective December 15, 2015, which will hedge against changes in cash flows following the termination of the fixed rate period. Quarterly, commencing March 16, 2016 under the terms of the forward swap, the Company will pay interest at a fixed rate of 8.49% until March 15, 2020.

The swaps entered into in 2009 and 2010 have fair values of $317,000 (liability) and $667,000 (liability), respectively, for a total liability of $984,000 at June 30, 2013 ($1,521,000 at December 31, 2012). The swap liability is reported as a component of other liabilities on the condensed consolidated balance sheets. A net valuation gain of $354,000 is included in accumulated other comprehensive income related to the swap agreements for the current period. A net valuation loss of $214,000 was included in accumulated other comprehensive income related to the swap at December 31, 2012.

We use dollar offset at the hedge's inception and for each reporting period thereafter to assess whether the derivative used in a hedging transaction is expected to be, and has been, effective in offsetting changes in the fair value of the hedged item. Since inception, no portion of the hedged item has been deemed ineffective. For all hedges, we discontinue hedge accounting if it is determined that a derivative is not expected to be, or has ceased to be, effective as a hedge.

The Company’s interest rate swaps include provisions requiring the Company to post collateral when the derivative is in a net liability position. The Company has securities on deposit with fair market values of $1,474,000 (all of which is posted as collateral). At December 31, 2012, the Company had securities on deposit with fair market values of $1,557,000, all of which is posted as collateral. See Note 4 for additional information about the interest rate swaps.

In January 2013, the Company renewed an unsecured line of credit for $700,000, with an interest rate of 5%, to be made available for general corporate purposes. As of June 30, 2013, $200,000 was drawn on this line ($125,000 at December 31, 2012).

In July 2012, the Company executed a promissory note in the amount of $13,000,000 payable to the Bagley Family Revocable Trust with an interest rate of WSJ prime plus 1% (4.25% at June 30, 2013 and December 31, 2012). The purpose of this promissory note is to finance the settlement obligation related to the Mobile Attic litigation. As of June 30, 2013 and December 31, 2012, a total of $10,500,000 was outstanding with principal payments due in equal annual installments of $1,167,000 payable each November beginning in 2013. Installment payments due within 12 months of the balance sheet date are classified as current portion of long term debt. The promissory note allows for the Company to defer payments in years in which its P&C subsidiaries incur substantial catastrophe losses thus allowing capital management flexibility in the P&C subsidiaries. Under the terms of the promissory note, annual debt service payments on the note must equal or exceed any payment of dividends to shareholders in the preceding twelve months.

Table of Contents

THE NATIONAL SECURITY GROUP, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

In September 2012, the Company obtained a secured line of credit in the amount of $4,000,000 with an interest rate equal to the WSJ prime (4.5% at December 31, 2012) and subject to a 4.5% floor. As of June 30, 2013, $3,934,000 was drawn on this line ($3,634,000 at December 31, 2012) . The line of credit is secured by timber property investments of the Company.

NOTE 8 – REINSURANCE

The Company's insurance operations utilize reinsurance in order to limit losses, minimize exposure to large risks, provide additional capacity for future growth and effect business-sharing arrangements. Life reinsurance is accomplished through yearly renewable term coverage. Property and casualty reinsurance is placed on both a quota-share and excess of loss basis. Reinsurance ceded arrangements do not discharge the insurance subsidiaries as the primary insurer, except for cases involving a novation. Failure of re-insurers to honor their obligations could result in losses to the insurance subsidiaries. The insurance subsidiaries evaluate the financial conditions of their reinsurance companies and monitor concentrations of credit risk arising from similar geographic regions, activities, or economic characteristics of the companies to minimize their exposure to significant losses from reinsurance insolvencies.

In the normal course of business, NSFC seeks to reduce the loss that may arise from catastrophes or other individually significant large loss events that cause unfavorable underwriting results by re-insuring certain levels of risk in various areas of exposure with reinsurance companies. NSFC maintains a catastrophe reinsurance agreement to cover losses from catastrophic events, primarily hurricanes.

Under the catastrophe reinsurance program, the Company retains the first $4,000,000 in losses from each catastrophe event. Reinsurance coverage is maintained in four layers as follows:

Layer	Reinsurers' Limits of Liability
First Layer	100% of $6,000,000 in excess of $4,000,000
Second Layer	100% of $7,500,000 in excess of $10,000,000
Third Layer	100% of $25,000,000 in excess of $17,500,000
Fourth Layer	100% of $30,000,000 in excess of $42,500,000

Each reinsurance layer covers events occurring from January 1-December 31 of the contract year. All significant reinsurance companies under the program carry A.M. Best ratings of A- (Excellent) or higher, or equivalent ratings.

The Company's catastrophe reinsurance contract allows for one reinstatement. The Company maintains reinstatement premium protection (RPP) to cover reinstatement premiums incurred. The RPP further reduces risk from a major catastrophe and serves to strengthen the Company's capital position by reducing the modeled 100 year event net cost.

Amounts recoverable from re-insurers are estimated in a manner consistent with the claim liability associated with the underlying insurance policies. Amounts paid for prospective reinsurance contracts are reported as prepaid reinsurance premiums and amortized over the remaining contract period.

In the normal course of business, NSIC seeks to limit its exposure to loss on any single insured and to recover a portion of benefits paid by ceding reinsurance to reinsurance companies under excess coverage contracts. NSIC retains a maximum of $50,000 of coverage per individual life. The cost of reinsurance is amortized over the contract period of the reinsurance.

At June 30, 2013, the largest reinsurance recoverable of a single reinsurer was $133,000 ($295,000 at December 31, 2012). Amounts reported as ceded incurred losses in both 2013 and 2012 were related to the development of losses from prior year catastrophes.

Table of Contents

THE NATIONAL SECURITY GROUP, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

The effect of reinsurance on premiums written and earned in the property and casualty segment is as follows (dollars in thousands):

	Three months ended June 30, 2013		Three months ended June 30, 2012	
	Written	Earned	Written	Earned
Direct	$15,619	$13,568	$15,325	$13,210
Assumed	—	—	—	—
Ceded	(2,188)	(2,192)	(2,416)	(2,396)
Net	$13,431	$11,376	$12,909	$10,814

	Six months ended June 30, 2013		Six months ended June 30, 2012	
	Written	Earned	Written	Earned
Direct	$29,099	$26,895	$28,291	$26,617
Assumed	—	—	—	—
Ceded	(4,320)	(4,331)	(4,071)	(4,059)
Net	$24,779	$22,564	$24,220	$22,558

The effect of reinsurance on premiums written and earned in the life segment is as follows (dollars in thousands):

	Three months ended June 30, 2013		Three months ended June 30, 2012	
	Written	Earned	Written	Earned
Direct	$1,621	$1,673	$1,718	$1,734
Assumed	—	—	—	—
Ceded	(11)	(11)	(15)	(15)
Net	$1,610	$1,662	$1,703	$1,719

	Six months ended June 30, 2013		Six months ended June 30, 2012	
	Written	Earned	Written	Earned
Direct	$3,283	$3,438	$3,412	$3,506
Assumed	—	—	—	—
Ceded	(30)	(30)	(35)	(35)
Net	$3,253	$3,408	$3,377	$3,471

NOTE 9 – EMPLOYEE BENEFIT PLANS

The Company and its subsidiaries have an established retirement savings plan (401K Plan). All full-time employees are eligible to participate, and all employer contributions are fully vested for employees who have completed 1,000 hours of service in the year of contribution. Company matching contributions for the three months ended June 30, 2013 and 2012 amounted to $49,000 and $52,000, respectively. Company matching contributions for the six months ended June 30, 2013 and 2012 amounted to $97,000 and $102,000, respectively. The Company contributes dollar-for-dollar matching contributions up to 5% of compensation subject to government limitations.

28

THE NATIONAL SECURITY GROUP, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

In January 2006, the Company established a non-qualified plan under which directors are allowed to defer all or a portion of directors' fees into various investment options.

The supplemental executive retirement plan (SERP) became effective March 1, 2008 and covers named executive officers with the Company contributing 15% of executive compensation to the plan. Contributions to the plan are fully vested upon the earlier of death, disability, change in control, or ten years of participation in the plan. Costs for amounts credited of the non-qualified deferred compensation plans for the three months ended June 30, 2013 and 2012 amounted to approximately $37,000 and $4,000, respectively. Costs for amounts credited of the non-qualified deferred compensation plans for the six months ended June 30, 2013 and 2012 amounted to approximately $113,000 and $87,000, respectively.

The Company and its subsidiaries established an Employee Stock Ownership Plan (ESOP) in January 2010, to enable its eligible employees to acquire a proprietary interest in the Company's common stock and to provide retirement and other benefits to such employees. The Company incurred $50,000 in costs related to the ESOP during the first six months of 2013. No costs were incurred during the first six months of 2012 related to the ESOP.

NOTE 10 – REGULATORY REQUIREMENTS AND DIVIDEND RESTRICTIONS

The Company is dependent on dividends from its insurance subsidiaries to fund operations and payment of shareholder dividends. Dividend payments from the insurance subsidiaries are subject to regulatory review/approval and statutory limitations. The statutory limitations are outlined as follows:

The amount of dividends paid from NSIC to the Company in any year may not exceed, without prior approval of regulatory authorities, the greater of 10% of statutory surplus as of the end of the preceding year, or the statutory net gain from operations for the preceding year. At December 31, 2012, NSIC's retained earnings unrestricted for the payment of dividends in the next twelve months amounted to $1,034,000.

NSFC is similarly restricted in the amount of dividends payable to the Company; dividends may not exceed the greater of 10% of statutory surplus as of the end of the preceding year, or net income for the preceding year. At December 31, 2012, NSFC's retained earnings unrestricted for the payment of dividends in the next twelve months amounted to $2,468,000.

The payment of any subsidiary dividend requires prior notice to the regulatory authorities who may disallow the dividend if, in their judgment, payment of the dividend would have an adverse effect on the surplus of the subsidiary.

At June 30, 2013, securities with market values of $3,583,000 ($3,785,000 at December 31, 2012) were deposited with various states pursuant to statutory requirements.

NOTE 11 – SHAREHOLDERS' EQUITY

During the six months ended June 30, 2013, and year ended December 31, 2012, changes in shareholders' equity consisted of a net income of $556,000 and net loss of $6,671,000, respectively; dividends paid of $123,000 in 2013 and $802,000 in 2012; changes in accumulated other comprehensive loss, net of applicable taxes, of $1,602,000 in 2013 and $315,000 in 2012. Other comprehensive loss consists of accumulated unrealized gains and losses on securities and unrealized gains and losses on interest rate swaps.

Preferred Stock
Preferred Stock may be issued in one or more series as shall from time to time be determined and authorized by the Board of Directors. The directors may make specific provisions regarding (a) the voting rights, if any (b) whether such dividends are to be cumulative or noncumulative (c) the redemption provisions, if any (d) participating rights, if any (e) any sinking fund or other retirement provisions (f) dividend rates (g) the number of shares of such series and (h) liquidation preference.

Table of Contents

THE NATIONAL SECURITY GROUP, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

Common Stock

The holders of the Class A Common Stock will have one-twentieth of one vote per share, and the holders of the common stock will have one vote per share. There is currently no Class A Common Stock issued or outstanding.

In the event of any liquidation, dissolution or distribution of the assets of the Company remaining after the payments to the holders of the Preferred Stock of the full preferential amounts to which they may be entitled as provided in the resolution or resolutions creating any series thereof, the remaining assets of the Company shall be divided and distributed among the holders of both classes of common stock, except as may otherwise be provided in any such resolution or resolutions.

The table below provides information regarding the Company's preferred and common stock as of June 30, 2013 and December 31, 2012:

	June 30, 2013			December 31, 2012		
	Authorized	Issued	Outstanding	Authorized	Issued	Outstanding
Preferred Stock, $1 par value	500,000	—	—	500,000	—	—
Class A Common Stock, $1 par value	2,000,000	—	—	2,000,000	—	—
Common Stock, $1 par value	3,000,000	2,494,480	2,494,480	3,000,000	2,466,600	2,466,600

On June 28, 2013, 27,880 shares of common stock were issued to directors as compensation under the 2009 Equity Incentive Plan previously approved by shareholders.

NOTE 12 – ACCUMULATED OTHER COMPREHENSIVE INCOME

The balance of and changes in each component of accumulated other comprehensive income (loss) (“AOCI”) for the six months ended June 30, 2013, net of income taxes, are as follows (dollars in thousands):

	Gains and Losses on Cash Flow Hedges	Unrealized Gains and Losses on Available-for-Sale Securities	Total
Beginning balance	$(1,003)	$4,328	$3,325
Other comprehensive income before reclassifications	354	(1,597)	(1,243)
Amounts reclassified from accumulated other comprehensive income	—	(359)	(359)
Net current period other comprehensive income	354	(1,956)	(1,602)
Ending balance	$(649)	$2,372	$1,723

30

Table of Contents

THE NATIONAL SECURITY GROUP, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

The following table presents the amounts reclassified out of AOCI for the six months ended June 30, 2013 (dollars in thousands):

Details about Accumulated Other Comprehensive Income Components	Amounts Reclassified from Accumulated Other Comprehensive Income	Affected Line Item in the Statement Where Net Income is Presented
Unrealized Gains and Losses on Available-for-Sale Securities	$1,057	Net realized investment gains
	1,057	Total before tax
	(359)	Tax (expense) or benefit
	$698	Net of Tax

NOTE 13 – SEGMENTS

The Company's property and casualty insurance operations comprise one business segment. The property and casualty insurance segment consists of seven lines of business: dwelling fire and extended coverage, homeowners (including mobile homeowners), ocean marine, other liability, private passenger auto liability, commercial auto liability and auto physical damage. Management organizes the business utilizing a niche strategy focusing on lower valued dwellings. Our chief decision makers (President, Chief Financial Officer and Chief Executive Officer) review results and operating plans making decisions on resource allocations on a company-wide basis. The Company's products are primarily produced through agents within the states in which we operate. The Company's life and accident and health operations comprise the second business segment. The life and accident and health insurance segment consists of two lines of business: traditional life insurance and accident and health insurance.

Premium revenues and operating income by industry segment for the three and six months ended June 30, 2013 and 2012 are summarized below (dollars in thousands):

Three months ended June 30, 2013	Total	P&C Insurance Operations	Life Insurance Operations	Non-Insurance Operations
REVENUE				
Net premiums earned	$13,038	$11,376	$1,662	$—
Net investment income	728	219	490	19
Net realized investment gains	1,030	1,028	2	—
Other income	145	145	—	—
	14,941	12,768	2,154	19
BENEFITS AND EXPENSES				
Policyholder benefits paid	8,260	7,076	1,184	—
Amortization of deferred policy acquisition costs	923	638	285	—
Commissions	1,486	1,396	90	—
General and administrative expenses	2,201	1,363	549	289
Taxes, licenses and fees	474	423	51	—
Interest expense	435	—	17	418
	13,779	10,896	2,176	707
Income (Loss) Before Income Taxes	$1,162	$1,872	$(22)	$(688)

Table of Contents

THE NATIONAL SECURITY GROUP, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

Three months ended June 30, 2012	Total	P&C Insurance Operations	Life Insurance Operations	Non-Insurance Operations
REVENUE				
Net premiums earned	$12,533	$10,814	$1,719	$—
Net investment income	1,066	529	520	17
Net realized investment gains	865	75	790	—
Other income	193	192	1	—
	14,657	11,610	3,030	17
BENEFITS AND EXPENSES				
Policyholder benefits paid	7,976	6,763	1,213	—
Amortization of deferred policy acquisition costs	915	686	229	—
Commissions	2,018	1,908	110	—
General and administrative expenses	1,835	1,111	644	80
Litigation settlement and defense costs	12,670	—	—	12,670
Taxes, licenses and fees	438	385	53	—
Interest expense	288	—	35	253
	26,140	10,853	2,284	13,003
Income (Loss) Before Income Taxes	$(11,483)	$757	$746	$(12,986)

Six months ended June 30, 2013	Total	P&C Insurance Operations	Life Insurance Operations	Non-Insurance Operations
REVENUE				
Net premiums earned	$25,972	$22,564	$3,408	$—
Net investment income	1,812	696	1,078	38
Net realized investment gains	1,057	1,030	27	—
Other income	317	315	2	—
	29,158	24,605	4,515	38
BENEFITS AND EXPENSES				
Policyholder benefits paid	17,811	15,629	2,182	—
Amortization of deferred policy acquisition costs	1,865	1,299	566	—
Commissions	3,468	3,282	186	—
General and administrative expenses	4,043	2,608	990	445
Taxes, licenses and fees	960	835		