

National Interstate CORP
Form 10-K
March 08, 2011

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

**Form 10-K
Annual Report Pursuant to Section 13 or 15(d) of the
Securities Exchange Act of 1934
For the Fiscal Year Ended December 31, 2010
Commission File No. 000-51130**

National Interstate Corporation
(Exact name of registrant as specified in its charter)

Ohio
*(State or other jurisdiction of
incorporation or organization)*

34-1607394
*(I.R.S. Employer
Identification No.)*

**3250 Interstate Drive
Richfield, Ohio 44286-9000
(330) 659-8900**
(Address and telephone number of principal executive offices)

Securities Registered Pursuant to Section 12(b) of the Act:

Title of each class	Name of Exchange on Which registered
<i>Common Shares, \$0.01 par value</i>	<i>Nasdaq Global Select Market</i>

Securities registered pursuant to Section 12(g) of the Act:
None

Other securities for which reports are submitted pursuant to Section (d) of the Act:
None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ☐ No ☒

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes ☐ No ☒

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

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ☒

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

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

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

State the aggregate market value of the voting and non-voting common equity held by non-affiliates computed by reference to the price at which the common equity was last sold, or the average bid and asked price of such common equity, as of the last business day of the registrant's most recently completed second fiscal quarter: \$130.7 million (based upon non-affiliate holdings of 6,592,469 shares and a market price of \$19.82 at June 30, 2010).

As of February 28, 2011 there were 19,441,868 shares of the Registrant's Common Shares (\$0.01 par value) outstanding.

Documents Incorporated by Reference:

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Proxy Statement for 2011 Annual Meeting of Shareholders (portions of which are incorporated by reference into Part III hereof).

National Interstate Corporation

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FORWARD-LOOKING STATEMENTS

The disclosures in this Form 10-K, including information incorporated by reference, contain forward-looking statements (within the meaning of the Private Securities Litigation Reform Act of 1995). All statements, trend analyses and other information contained in this Form 10-K relative to markets for our products and trends in our operations or financial results, as well as other statements including words such as may, target, anticipate, believe, plan, estimate, expect, intend, project, and other similar expressions, constitute forward-looking statements. We base these statements on our plans and current analyses of our business and the insurance industry as a whole. We caution that these statements may and often do vary from actual results and the differences between these statements and actual results can be material. Factors that could contribute to these differences include, among other things:

general economic conditions, weakness of the financial markets and other factors, including prevailing interest rate levels and stock and credit market performance, which may affect or continue to affect (among other things) our ability to sell our products and to collect amounts due to us, our ability to access capital resources and the costs associated with such access to capital and the market value of our investments;

our ability to manage our growth strategy, including the ongoing integration of Vanliner Group, Inc. (Vanliner);

customer response to new products and marketing initiatives;

tax law and accounting changes;

increasing competition in the sale of our insurance products and services and the retention of existing customers;

changes in legal environment;

regulatory changes or actions, including those relating to the regulation of the sale, underwriting and pricing of insurance products and services and capital requirements;

levels of natural catastrophes, terrorist events, incidents of war and other major losses;

adequacy of insurance reserves; and

availability of reinsurance and ability of reinsurers to pay their obligations.

The forward-looking statements herein are made only as of the date of this report. We assume no obligation to publicly update any forward-looking statements.

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PART I

ITEM 1 Business

Introduction

National Interstate Corporation (the Company, we, our) and its subsidiaries operate as an insurance holding company group that underwrites and sells traditional and alternative property and casualty insurance products primarily to the passenger transportation industry and the trucking industry, general commercial insurance to small businesses in Hawaii and Alaska and personal insurance to owners of recreational vehicles and commercial vehicles throughout the United States. Effective July 1, 2010, with the acquisition of Vanliner Insurance Company (VIC), we also now underwrite and sell insurance products for moving and storage transportation companies. We were organized in Ohio in January 1989. In December 1989, Great American Insurance Company (Great American), a wholly-owned subsidiary of American Financial Group, Inc., became our majority shareholder. Our principal executive offices are located at 3250 Interstate Drive, Richfield, Ohio, 44286 and our telephone number is (330) 659-8900. Securities and Exchange Commission (the SEC) filings, news releases, our Code of Ethics and Conduct and other information may be accessed free of charge through our website at www.NationalInterstate.com. SEC filings are posted to our website as soon as reasonably possible. Information on the website is not part of this Form 10-K.

At December 31, 2010, Great American owned 52.5% of our outstanding shares. Our common shares trade on the Nasdaq Global Select Market under the symbol NATL.

We have five active property and casualty insurance subsidiaries: National Interstate Insurance Company (NIIC), VIC, National Interstate Insurance Company of Hawaii, Inc. (NIIC-HI), Triumphe Casualty Company (TCC) and Hudson Indemnity, Ltd. (HIL), and six active agency and service subsidiaries. We write our insurance policies on a direct basis through NIIC, VIC, NIIC-HI and TCC. NIIC and VIC are licensed in all 50 states and the District of Columbia. NIIC-HI is licensed in Ohio, Hawaii, Michigan and New Jersey. TCC, a Pennsylvania domiciled company, holds licenses for multiple lines of authority, including auto-related lines, in 25 states and the District of Columbia. HIL is domiciled in the Cayman Islands and provides reinsurance for NIIC, NIIC-HI, TCC and VIC primarily for our alternative risk transfer (ART) products. Insurance products are marketed through multiple distribution channels, including independent agents and brokers, program administrators, affiliated agencies and agent internet initiatives. We use our six active agency and service subsidiaries to sell and service our insurance business.

Acquisition of Vanliner Group, Inc.

Effective July 1, 2010, we and our principal insurance subsidiary, NIIC, established our presence in the moving and storage industry with the acquisition of Vanliner from UniGroup, Inc. (UniGroup) for \$113.9 million. The consolidated financial information in this Form 10-K includes the results of Vanliner from the date of acquisition.

Property and Casualty Insurance Operations

We are a specialty property and casualty insurance company with a niche orientation and a focus on the transportation industry. Founded in 1989, we have had an uninterrupted record of profitability in every year since 1990, our first full year of operation. We have also reported an underwriting profit in 20 of the 22 years we have been in business. For the year ended December 31, 2010, we had gross premiums written (direct and assumed) of \$438.6 million and net income of \$39.5 million.

We believe, based upon vehicle filings with the Federal Motor Carrier Safety Administration (FMCSA) and discussions with brokers specializing in transportation insurance, that we are one of the largest writers of insurance for the passenger transportation industry in the United States. We focus on niche insurance markets where we offer insurance products designed to meet the unique needs of targeted insurance buyers that we believe are underserved by the insurance industry. We believe these niche markets typically are too small, too remote or too difficult to attract or sustain most competitors. Examples of products that we write for these markets include captive programs primarily for transportation companies that we also refer to as alternative risk transfer (52.4% of 2010 gross

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premiums written), traditional property and casualty insurance for transportation companies, inclusive of the moving and storage product (28.2%), specialty personal lines, consisting primarily of recreational and commercial vehicle coverages (14.1%) and transportation and general commercial insurance in Hawaii and Alaska (4.1%).

While many companies write property and casualty insurance for transportation companies, we believe, based on financial responsibility filings with the FMCSA, that few write passenger transportation coverage nationwide. We know of only one or two other insurance companies that have offered high limits coverage to motor coach, school bus and limousine operators in all states or nearly all states for more than a few years. We believe that we have been one of the only two insurance companies to consistently provide passenger transportation insurance across all passenger transportation classes and all regions of the country for at least the past ten years. In addition to being one of only two national passenger transportation underwriters, we also believe, based on our discussions with brokers and customers in the passenger transportation insurance market, that we are the only insurance company offering homogeneous (i.e., to insureds in the same industry) group captive insurance programs to this industry.

Product Management Organization. We believe we have a competitive advantage in our major lines of business, in part, as a result of our product management focus. Each of our product lines is headed by a manager solely responsible for achieving that product line's planned results. We believe that the use of a product management organization provides the focus required to successfully offer and manage a diverse set of product lines. For example, we are willing to design custom insurance programs, such as unique billing plans and deductibles, for our large transportation customers based on their needs. Our claims, accounting, information technology and other support functions are organized to align their resources with specific product line initiatives and needs. We believe that most insurance companies rely upon organization structures aligned around functional specialties such as underwriting, actuarial, operations, marketing and claims. Under the traditional functional organization, the managers of each of these functions typically provide service and support to multiple insurance products. Our product managers are responsible for the underwriting, pricing and marketing and they are held accountable for underwriting profitability of a specific insurance product. Other required services and support are provided across product lines by functional managers.

Our Products

We offer over 30 product lines in the specialty property and casualty insurance market, which we group into four general business components (alternative risk transfer, transportation, specialty personal lines and Hawaii and Alaska) based on the class of business, insureds' risk participation or geographic location.

The following table sets forth an analysis of gross premiums written by business component during the years indicated:

	Year Ended December 31,					
	2010		2009		2008	
	Amount	Percent	Amount	Percent	Amount	Percent
	(Dollars in thousands)					
Alternative Risk Transfer	\$ 229,844	52.4%	\$ 192,953	55.9%	\$ 206,342	54.3%
Transportation	123,752	28.2%	66,537	19.3%	87,246	22.9%
Specialty Personal Lines	61,662	14.1%	61,523	17.8%	59,065	15.5%
Hawaii and Alaska	18,104	4.1%	18,576	5.5%	22,489	5.9%
Other	5,268	1.2%	5,288	1.5%	5,154	1.4%

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Gross premiums written	\$ 438,630	100.0%	\$ 344,877	100.0%	\$ 380,296	100.0%
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For 2010, the range of premiums for our business components and their annual premium averages were as follows:

	Premium Range	Annual Averages
Alternative Risk Transfer	\$5,800-\$4,653,000	\$65,800
Transportation	\$3,700-\$60,500	\$15,800
Specialty Personal Lines	\$1,000-\$2,700	\$1,100
Hawaii and Alaska	\$1,900-\$29,600	\$3,600

Alternative Risk Transfer. We underwrite, market and distribute primarily truck and passenger transportation ART insurance products, also known as captives, as well as workers' compensation coverage. Captives are insurance or reinsurance companies that are owned or rented by the participants in the program. Program participants share in the underwriting profits or losses and the investment results associated with the risks of being insured through the program. Participants in these programs typically are interested in the improved risk control, increased participation in the claims settlement process and asset investment features associated with an ART insurance program.

We support two forms of captive programs: member-owned and rental. In a member-owned captive, the participants form, capitalize and manage their own reinsurance company. In a rental captive, the reinsurance company is formed, capitalized and managed by someone other than the participants. The participants in a rental captive program pay a fee to the reinsurance company owner to use the reinsurance facility in their captive program; in other words, the participants rent it. For both member-owned and rental captives, we typically underwrite and price the risk, issue the policies and adjust the claims. A portion of the risk and premium is ceded to the captive insurance program. That captive insurance program serves the same purpose for the captive participants regardless of whether they own the reinsurance company or rent it.

The revenue we earn, our profit margins and the risks we assume are substantially consistent in member-owned captives and rental captives. The primary differences to us are the expenses associated with these programs and who ultimately bears those expenses. In a member-owned captive, the participants own and manage their own reinsurance company. Managing an off-shore insurance company includes general management responsibilities, financial statement preparation, actuarial analysis, investment management, corporate governance, regulatory management and legal affairs. If the actual expenses associated with managing a member-owned captive exceed the funded projections, the participants pay for these added expenses outside the insurance transaction. Included in the premium we charge participants in our rental captive programs is a charge to fund our expenses related to the managing of our Cayman Island reinsurer used for this purpose. Investment management expenses also are included in the premium and we cap the participant's expense contribution regardless of whether or not we collect adequate funds to operate the off-shore reinsurance company.

All other loss, expense and profit margin components are substantially the same for our member-owned or rental captive insurance programs. The advantage of a member-owned captive program to the participants is the ability to change policy issuing companies and service providers without changing the makeup of their group. Rental captive participants are not obligated to capitalize their own reinsurer. They generally enjoy a slightly lower expense structure and their captive program expenses are fixed for the policy year regardless of the amount of expenses actually incurred to operate the reinsurer and facilitate participant meetings.

The premiums generated by each of the captive insurance programs offered by us are developed in a similar manner. The most important component of the premium charged is the development of the participants' loss fund. The loss fund represents the amount of premium needed to cover the participants' expected losses in the layer of risk being ceded to the captive reinsurer. Participants may share in the losses on a quota share or excess of loss basis. For a quota share

program, the participation percentage ranges from 5.0% to 60.0% of losses up to \$1 million. For excess of loss programs, the loss fund typically involves the first loss layer which, depending on the captive program, currently ranges from the first \$50,000 to the first \$350,000 of loss per occurrence. Once the participants' loss fund is established, all other expenses related to the coverages and services being provided are derived by a formula agreed to in advance by the captive participants and the service providers. We are the primary or only service provider to every rental captive program we support. The service providers issue policies, adjust claims,

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provide loss control consulting services, assume the risk for losses exceeding the captive program retention and either manage the member-owned reinsurance company needed to facilitate the transfer of risk to the participants or provide a rental reinsurance facility that serves the same purpose. These items, which are included in premiums charged to the insured, range from approximately 30.0% to 70.0% of a \$1 million policy premium depending on the program structure and the loss layer ceded to the captive.

We entered the alternative risk transfer market in 1995 through an arrangement with an established captive insurance consultant. Together, we created what we believe, based on our discussions with brokers and customers in the passenger transportation insurance market, was the first homogeneous, member-owned captive insurance program, TRAX U.S. Captive Insurance Programsm, for passenger transportation operators. Since 1996, we have established additional ART products for passenger and commercial transportation, including but not limited to, rental cars, taxi cabs, liquefied petroleum gas distributors, buses, crane and rigging operators and trucks. We established our first group program for the moving and storage industry in November 2010 subsequent to the Vanliner acquisition. We expect to introduce additional transportation captives in 2011. As of December 31, 2010, we insured approximately 600 transportation companies in captive insurance programs. No one customer in our alternative risk transfer business accounted for 10.0% or more of the revenues of this component of our business during 2010. We also have partnered with insureds and agents in programs, whereby the insured or agent shares in underwriting results and investment income with our Cayman Islands-based reinsurance subsidiary.

Transportation. We believe that we are one of the largest writers of insurance for the passenger transportation industry in the United States. In our transportation component, we underwrite commercial auto liability, general liability, physical damage and motor truck cargo and related coverages for truck and passenger operators. Passenger transportation operators include charter and tour bus companies, municipal transit systems, school transportation contractors, limousine companies, inter-city bus services and community service and paratransit operations. Effective with the July 1, 2010 acquisition of VIC, we also provide tailored coverages to the moving and storage industry including, but not limited to, commercial auto liability, physical damage, workers compensation, employers liability, cargo, commercial umbrella, commercial property, general liability, crime, equipment breakdown, inland marine and movers and warehousemen's liability. No one customer in our transportation component accounted for 10.0% or more of the revenues of this component during 2010.

Specialty Personal Lines. We believe our specialty recreational vehicle, or RV insurance program, differs from those offered by traditional personal auto insurers because we offer coverages written specifically for RV owners, including those who live in their RV full-time. We offer coverage for campsite liability, vehicle replacement coverage and coverage for trailers, golf carts and campsite storage facilities. In addition to our RV product, we also offer companion personal auto coverage to RV policyholders. This product covers the automobiles owned by our insured RV policyholders. One feature of our companion auto product that we believe is not generally available from other insurers is the application of a single deductible when an insured RV and the insured companion auto being towed are both damaged in an accident. We also assume all of the net risk related to policies for recreational vehicle risks underwritten by us and issued by Great American, our majority shareholder. Also included in the specialty personal lines component is the commercial vehicle product, which we began offering in 2006 and is offered in twelve states as of December 31, 2010. This product provides coverage for companies with vehicles used by contractors, artisans and other small businesses. We currently insure vehicles ranging from private passenger autos to customized vans and dump trucks. We continue to leverage current technology advances to enhance our existing distribution channels for the commercial vehicle product.

Hawaii and Alaska. We opened our Hawaii office in 1995. The insurance products managed by the Hawaii office are general commercial insurance sold to Hawaiian small business owners and transportation insurance. We believe that we are one of the leading writers of transportation insurance in that state. Through our office in Hawaii, we entered the Alaskan insurance market in 2005, offering similar products to those we offer in Hawaii.

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The following table sets forth the geographic distribution of our direct premiums written for the years indicated:

	Year Ended December 31,			
	2010		2009	
	Volume	Percent of Total (Dollars in thousands)	Volume	Percent of Total
California	\$ 56,019	13.0%	\$ 40,693	12.0%
Texas	46,248	10.7%	39,156	11.6%
New York	26,609	6.2%	18,554	5.5%
Massachusetts	20,529	4.8%	15,119	4.5%
Florida	19,329	4.5%	16,441	4.9%
North Carolina	18,912	4.4%	15,267	4.5%
Missouri	17,140	4.0%	6,374	1.9%
Hawaii	16,790	3.9%	18,452	5.5%
Pennsylvania	16,094	3.7%	14,848	4.4%
All other states	192,885	44.8%	153,068	45.2%
Direct premiums written	\$ 430,555	100.0%	\$ 337,972	100.0%

Concentration by Statutory Line of Business

The following table sets forth our direct premiums written by statutory line of business for the years indicated:

	Year Ended December 31,			
	2010		2009	
	Volume	Percent of Total (Dollars in thousands)	Volume	Percent of Total
Auto and other liability	\$ 254,058	59.0%	\$ 197,766	58.5%
Auto physical damage	88,256	20.5%	72,375	21.4%
Workers compensation	78,956	18.3%	57,143	16.9%
All other lines	9,285	2.2%	10,688	3.2%
Direct premiums written	\$ 430,555	100.0%	\$ 337,972	100.0%

Underwriting

We employ a pricing segmentation approach in our underwriting that makes extensive use of proprietary data and pricing methodologies. Our pricing strategy enables our product managers to manage rate structures by evaluating detailed policyholder information, such as loss experience based on driver characteristics, financial responsibility scores (where legally permissible) and the make/model of vehicles. This pricing segmentation approach requires extensive involvement of product managers, who are responsible for the underwriting profitability of a specific product line with direct oversight of product design and rate level structure by our most senior managers. Individual product managers work closely with our pricing and database managers to generate rate level indications and other relevant data. We use this data coupled with information from the National Council on Compensation Insurance and the actuarial loss costs obtained from the Insurance Services Office, an insurance industry advisory service organization, as a benchmark in the formulation of pricing for our products. We believe the quality of our proprietary data, combined with our rigorous approach, has permitted us to respond more quickly than our competitors to adverse trends and to obtain appropriate pricing and risk selection for each individual account.

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Risk selection and pricing decisions are discussed regularly by product line underwriters and product managers. We believe this group's input and deliberation on pricing and risk selection reaffirms our philosophy and underwriting culture and aids in avoiding unknown exposures. Underwriting files at both our regional and corporate offices are audited by senior management on a regular basis for compliance with our price and risk selection criteria. Product managers are responsible for the underwriting profitability resulting from these risk selection and pricing decisions and the incentive-based portion of their compensation is based, in part, on that profitability.

Marketing and Distribution

We offer our products through multiple distribution channels including independent agents and brokers, program administrators, affiliated agencies and agent internet initiatives. During the year ended December 31, 2010, approximately 87% of our gross premiums written were generated by independent agents and brokers and approximately 13% were generated by our affiliated agencies. Together, our top two independent agents/brokers accounted for less than 12% of our gross premiums written during 2010.

Reinsurance

We are involved in both the cession and assumption of reinsurance. We reinsure a portion of our business to other insurance companies. Ceding reinsurance permits diversification of our risks and limits our maximum loss arising from large or unusually hazardous risks or catastrophic events. We are subject to credit risk with respect to our reinsurers, because the ceding of risk to a reinsurer generally does not relieve us of liability to our insureds until claims are fully settled. To mitigate this credit risk, we cede business only to reinsurers if they meet our credit ratings criteria of an A.M. Best rating of A- or better. If a reinsurer is not rated by A.M. Best or their rating falls below A- , our contract with them generally requires that they secure outstanding obligations with cash, a trust or a letter of credit that we deem acceptable.

We are party to agreements with Great American pursuant to which we assume a majority of the premiums written by Great American primarily for RV risks. We then pay Great American a service fee based on these premiums. Great American also participates in several of our commercial transportation reinsurance programs. Ceded premiums written with Great American were \$2.2 million, \$3.1 million and \$3.5 million for the years ended December 31, 2010, 2009 and 2008, respectively.

Claims Management and Administration

We believe that effective claims management is critical to our success and that our process is cost efficient, delivers the appropriate level of claims service and produces superior claims results. We are focused on controlling claims from their inception with thorough investigation, accelerated communication to insureds and claimants and compressing the cycle time of claim resolution to control both loss cost and claim handling cost.

Claims arising under our insurance policies are reviewed, supervised and handled by our internal claims department. As of December 31, 2010, our claims organization employed 127 people (26% of our employee group) and operated out of three regional offices. All of our claims employees have been trained to handle claims according to our customer-focused claims management processes and procedures and are subject to periodic audit. We systematically conduct continuing education for our claims staff in the areas of best practices, fraud awareness, legislative changes and litigation management. All large claim reserves are reviewed on a quarterly basis by executive claims management and adjusters frequently participate in audits and large loss reviews with participating reinsurers. We also employ a formal large loss review methodology that involves senior company management, executive claims management and adjusting staff in a quarterly review of all large loss exposures.

We provide 24-hour, 7 days per week, toll-free service for our policyholders to report claims. In 2010, adjusters were able to initiate contact with approximately 94% of policyholder claimants within 8 hours of first notice of a loss and approximately 82% of third-party claimants. When we receive the first notice of loss, our claims personnel open a file and establish appropriate reserving to maximum probable exposure (based on our historical claim settlement experience) as soon as practicable and continually revise case reserves as new information develops. We maintain and implement a fraud awareness program designed to educate our claims employees and others

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throughout the organization of fraud indicators. Potentially fraudulent claims are referred for special investigation and fraudulent claims are contested.

Our physical damage claims processes involve the utilization and coordination of internal staff, vendor resources and property specialists. We pay close attention to the vehicle repair process, which we believe reduces the amount we pay for repairs, storage costs and auto rental costs. Our ART programs have dedicated claims personnel and claims services tailored to each program. Each ART program has a dedicated claims manager, receives extra communications pertaining to reserve changes and/or payments and has dedicated staff resources. In the ART programs, 97% of customers completing our survey in 2010 rated us as timely in our claims handling and 95% for the same period rated their claims as thoroughly investigated.

We employ highly qualified and experienced liability adjusters who are responsible for overseeing all injury-related losses including those in litigation. We identify and retain specialized outside defense counsel to litigate such matters. We negotiate fee arrangements with retained defense counsel and attempt to limit our litigation costs. The liability focused adjusters manage these claims by placing a priority on detailed file documentation and emphasizing investigation, evaluation and negotiation of liability claims.

Reserves for Unpaid Losses and Loss Adjustment Expenses (LAE)

We estimate liabilities for the costs of losses and LAE for both reported and unreported claims based on historical trends adjusted for changes in loss costs, underwriting standards, policy provisions, product mix and other factors. Estimating the liability for unpaid losses and LAE is inherently judgmental and is influenced by factors that are subject to significant variation. We monitor items such as the effect of inflation on medical, hospitalization, material repair and replacement costs, general economic trends and the legal environment. While the ultimate liability may be greater than recorded loss reserves, the reserve tail for transportation coverage is generally shorter than that associated with many other casualty coverages and, therefore, generally can be established with less uncertainty than coverages having longer reserve tails.

We review loss reserve adequacy and claims adjustment effectiveness quarterly. We focus significant management attention on claims reserved above \$100,000. Further, our reserves are certified by accredited actuaries from Great American to state regulators annually. Reserves are routinely adjusted as additional information becomes known. These adjustments are reflected in current year operations.

The following tables present the development of our loss reserves, net of reinsurance, on a U.S. generally accepted accounting principles (GAAP) basis for the calendar years 2000 through 2010. The top line of each table shows the estimated liability for unpaid losses and LAE recorded at the balance sheet date for the indicated year. The next line, *As re-estimated at December 31, 2010*, shows the re-estimated liability as of December 31, 2010. The remainder of the table presents intervening development from the initially estimated liability. This development results from additional information and experience in subsequent years. The middle line shows a net

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cumulative (deficiency) redundancy which represents the aggregate percentage (increase) decrease in the liability initially estimated. The lower portion of the table indicates the cumulative amounts paid as of successive periods.

2000	2001	2002	2003	2004	2005	2006	2007	2008
(Dollars in thousands)								
\$ 30,292	\$ 48,456	\$ 67,162	\$ 86,740	\$ 111,644	\$ 151,444	\$ 181,851	\$ 210,302	\$ 262,440
31,810	47,541	61,794	78,797	98,005	135,635	166,043	199,142	250,185
32,751	48,494	63,462	84,485	106,409	143,991	176,179	209,448	261,154
33,473	47,479	64,687	83,862	103,416	142,929	173,860	207,281	250,185
31,884	47,250	63,037	81,991	99,768	139,994	169,879	199,142	
31,488	46,400	62,564	79,673	99,487	138,108	166,043		
31,590	46,961	60,551	79,084	99,362	135,635			
31,757	46,880	61,268	79,163	98,005				
31,410	47,361	62,437	78,797					
31,505	48,243	61,794						
32,105	47,541							
31,810								
(1,518)	915	5,368	7,943	13,639	15,809	15,808	11,160	12,255
(5.0)%	1.9%	8.0%	9.2%	12.2%	10.4%	8.7%	5.3%	4.7%
14,924	18,048	22,792	29,616	37,049	51,901	63,314	67,673	91,615
20,077	28,510	36,927	48,672	59,038	85,193	95,752	111,841	145,279
24,313	35,718	48,660	61,001	76,617	101,340	119,984	141,484	
26,869	40,615	53,531	68,594	84,070	112,474	133,976		
28,591	43,474	57,697	71,904	89,821	117,073			
30,180	45,365	59,035	74,938	91,206				
30,813	45,828	61,179	75,137					
30,863	47,396	61,021						
31,549	47,128							
31,590								

The following is a reconciliation of our net liability to the gross liability for unpaid losses and LAE:

2001	2002	2003	2004	2005	2006	2007	2008
(Dollars in thousands)							
\$ 48,456	\$ 67,162	\$ 86,740	\$ 111,644	\$ 151,444	\$ 181,851	\$ 210,302	\$ 262,440

6	22,395	35,048	41,986	59,387	71,763	84,115	91,786	137,561	
8	\$ 70,851	\$ 102,210	\$ 128,726	\$ 171,031	\$ 223,207	\$ 265,966	\$ 302,088	\$ 400,001	\$
0	\$ 47,541	\$ 61,794	\$ 78,797	\$ 98,005	\$ 135,635	\$ 166,043	\$ 199,142	\$ 250,185	\$
0	34,026	48,292	51,593	57,016	59,778	59,889	51,097	96,016	
0	\$ 81,567	\$ 110,086	\$ 130,390	\$ 155,021	\$ 195,413	225,932	\$ 250,239	\$ 346,201	\$
2)	\$ (10,716)	\$ (7,876)	\$ (1,664)	\$ 16,010	\$ 27,794	40,034	\$ 51,849	\$ 53,800	\$
0)%	(15.1)%	(7.7)%	(1.3)%	9.4%	12.5%	15.1%	17.2%	13.4%	

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These tables do not present accident or policy year development data. Furthermore, in evaluating the re-estimated liability and cumulative (deficiency) redundancy, it should be noted that each amount includes the effects of changes in amounts for prior periods. Conditions and trends that have affected development of the liability in the past may not necessarily exist in the future. Accordingly, it may not be appropriate to extrapolate future redundancies or deficiencies based on this table.

The preceding table shows our calendar year development for each of the last ten years resulting from reevaluating the original estimate of the loss and LAE liability on both a net and gross basis. Gross reserves are liabilities for direct and assumed losses and LAE before a reduction for amounts ceded. At December 31, 2010, our liability on a gross basis was \$798.6 million and our asset for ceded reserves was \$202.5 million. The difference between gross development and net development is ceded loss and LAE reserve development. The range of dollar limits ceded by us is much greater and therefore more volatile than the range of dollar limits we retain, which could cause more volatility in estimates for ceded losses. Therefore, ceded reserves are more susceptible to development than net reserves. Net calendar year reserve development affects our income for the year while ceded reserve development or savings affects the income of reinsurers.

Investments*General*

We approach investment and capital management with the intention of supporting insurance operations by providing a stable source of income to supplement underwriting income. The goals in our investment policy are to protect capital while optimizing investment income and capital appreciation and maintaining appropriate liquidity. Our Board of Directors has established investment guidelines and reviews the portfolio performance at least quarterly for compliance with its established guidelines.

During 2010, we sold securities, primarily U.S government and government agency obligations, to generate funds to finance the acquisition of Vanliner. Subsequent to the acquisition, we experienced a shift in the mix of our fixed maturities portfolio due to reinvesting Vanliner's acquired cash balances in corporate obligations, as these securities generally offered the mix of yield and duration that best met our business needs.

The following tables present the percentage distribution and yields of our investment portfolio for the dates given:

	At December 31,	
	2010	2009
Short term investments	0.0%	0.1%
Fixed maturities:		
State and local government obligations	28.8%	26.0%
Corporate obligations	24.8%	11.3%
Residential mortgage-backed securities	21.0%	19.6%
U.S. Government and government agency obligations	19.7%	35.6%
Redeemable preferred stock	1.3%	1.9%
Foreign government obligations	0.6%	0.0%
Commercial mortgage-backed securities	0.6%	0.7%
Total fixed maturities	96.8%	95.1%

Equity securities:		
Common stocks	3.1%	4.6%
Perpetual preferred stocks	0.1%	0.2%
Total equity securities	3.2%	4.8%
Total	100.0%	100.0%

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The following table presents the yields of our investment portfolio for the dates given:

	Year Ended December 31,		
	2010	2009	2008
Yield on short term investments:			
Excluding realized gains and losses	1.0%	1.0%	5.5%
Including realized gains and losses	1.0%	1.0%	5.5%
Yield on fixed maturities:			
Excluding realized gains and losses	3.4%	3.7%	4.5%
Including realized gains and losses	3.8%	3.5%	3.4%
Yield on equity securities			
Excluding realized gains and losses	1.2%	2.3%	3.5%
Including realized gains and losses	5.1%	16.5%	(42.8%)
Yield on all investments:			
Excluding realized gains and losses	3.3%	3.7%	4.4%
Including realized gains and losses	3.9%	4.1%	(0.3%)

The table below compares total returns on our fixed maturities and equity securities to comparable public indices. We benchmark our fixed maturity portfolio, excluding redeemable preferred stock, to the Barclays Intermediate Aggregate Index because we believe it best matches our investment strategy and the resulting composition of our portfolio. For similar reasons we benchmark our equity investments in common stock against the Standard & Poor's 500 Index. Both our performance and the indices include investment income, realized gains and losses and changes in unrealized gains and losses.

	Year Ended December 31,		
	2010	2009	2008
Fixed maturities:			
National Interstate Total Return on Fixed Maturities	5.5%	7.1%	3.9%
Barclays Intermediate Aggregate Index	5.9%	6.5%	4.9%
Equity securities:			
National Interstate Total Return on all other Equity	8.1%	30.8%	(29.6%)
Standard & Poor's 500 Index	15.1%	26.5%	(37.0%)

Fixed Maturity Investments

Our fixed maturity portfolio is primarily invested in investment grade securities. The following table shows our fixed maturity securities by Standard & Poor's Corporation (S&P) or comparable rating as of December 31, 2010:

S&P or Comparable Rating	Amortized Cost	Fair Value	% of Total
	(Dollars in thousands)		
AAA, AA, A	\$ 787,805	\$ 794,028	87.5%
BBB	67,030	67,990	7.5%

Total Investment Grade	854,835	862,018	95.0%
BB	9,029	9,294	1.0%
B	22,740	23,093	2.5%
CCC	5,021	4,268	0.5%
CC, C, D	9,584	8,902	1.0%
Total Non-Investment Grade	46,374	45,557	5.0%
Total	\$ 901,209	\$ 907,575	100.0%

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The maturity distribution of fixed maturity investments held as of December 31, 2010 is as follows (actual maturities may differ from scheduled maturities due to the borrower having the right to call or prepay certain obligations):

	December 31, 2010	
	Fair	
	Value	% of Total
	(Dollars in thousands)	
One year or less	\$ 28,058	3.1%
More than one year to five years	297,256	32.8%
More than five years to ten years	277,955	30.6%
More than ten years	101,998	11.2%
	705,267	77.7%
Mortgage-backed securities	202,308	22.3%
Total fixed maturities	\$ 907,575	100.0%

The fixed income investment funds are generally invested in securities with intermediate-term maturities with an objective of optimizing total return while allowing flexibility to react to changes in market conditions and maintaining sufficient liquidity to meet policyholder obligations. At December 31, 2010, the weighted average modified duration (unadjusted for call provision) was approximately 4.4 years, the weighted average effective duration (adjusted for call provisions) was 3.7 years and the weighted average maturity was 5.5 years. The concept of weighted average effective duration takes into consideration the probability of the exercise of the various call features associated with many of the fixed income securities we hold. Fixed income securities are frequently issued with call provisions that provide the issuer the option of accelerating the maturity of the security.

Competition

The commercial transportation insurance industry is highly competitive and, except for regulatory considerations, there are relatively few barriers to entry. We compete with numerous insurance companies and reinsurers, including large national underwriters and smaller niche insurance companies. In particular, in the commercial specialty insurance market we compete against, among others, Lancer Insurance Company, RLI Corporation, American Alternative Insurance Corporation, Great West Casualty Company (a subsidiary of Old Republic International Corporation), Northland Insurance Company (a subsidiary of the Travelers Companies, Inc.) and Sentry Insurance. In our specialty personal lines and Hawaii and Alaska markets our primary competitors are Progressive Corporation and American Modern Home Insurance Company (a subsidiary of Munich Re Group), and Island Insurance Company and First Insurance, respectively. In the moving and storage market we compete against, among others, Zurich Insurance Company and Transguard Insurance Company of America. We compete in the property and casualty insurance marketplace with other insurers on the basis of price, coverages offered, product and program design, claims handling, customer service quality, agent commissions where applicable, geographic coverage, reputation and financial strength ratings by independent rating agencies. We compete by developing product lines to satisfy specific market needs and by maintaining relationships with our independent agents and customers who rely on our expertise. This expertise, along with our reputation for offering specialty underwriting products, is our principal means of distinguishing ourselves from our competitors.

We believe we have a competitive advantage in our major lines of business as a result of the extensive experience of our management, our superior service and products, our willingness to design custom insurance programs for our large transportation customers and the extensive use of current technology with respect to our insureds and independent agent force. However, we are not top-line oriented and will readily sacrifice premium volume during periods that we believe exhibit unrealistic rate competition. Accordingly, should competitors determine to buy market share with unprofitable rates, our insurance subsidiaries could experience limited growth or a decline in business until market pricing returns to what we view as profitable levels.

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Ratings

A.M. Best assigned our current group rating of **A** (Excellent) to our domestic insurance companies. The A.M. Best rating is based on, and applies to, NIIC and its wholly owned insurance company subsidiaries, NIIC-HI, TCC and VIC (the group). According to A.M. Best, **A** ratings are assigned to insurers that have, on balance, excellent balance sheet strength, operating performance and business profile when compared to the standards established by A.M. Best and, in A.M. Best's opinion, have a strong ability to meet their ongoing obligations to policyholders. The objective of A.M. Best's rating system is to provide potential policyholders and other interested parties an opinion of an insurer's financial strength and ability to meet ongoing obligations, including paying claims. This rating reflects A.M. Best's analysis of our balance sheet, financial position, capitalization and management. This rating is subject to periodic review and may be revised downward, upward or revoked at the sole discretion of A.M. Best. Any changes in our rating category could affect our competitive position.

Regulation

State Regulation

General

Our insurance subsidiaries are subject to regulation in all fifty states, Washington D.C. and the Cayman Islands. The extent of regulation varies, but generally derives from statutes that delegate regulatory, supervisory and administrative authority to a department of insurance in each state in which the companies transact insurance business. These statutes and regulations generally require each of our insurance subsidiaries to register with the state insurance department where the company is domiciled and to furnish annually financial and other information about the operations of the company. Certain transactions and other activities by our insurance companies must be approved by Ohio, Missouri, Pennsylvania or Cayman Islands regulatory authorities, where our active insurance company subsidiaries are domiciled, before the transaction takes place.

The regulation, supervision and administration also relate to statutory capital and reserve requirements and standards of solvency that must be met and maintained, the payment of dividends, changes of control of insurance companies, the licensing of insurers and their agents, the types of insurance that may be written, the regulation of market conduct, including underwriting and claims practices, provisions for unearned premiums, losses, LAE and other obligations, the ability to enter and exit certain insurance markets, the nature of and limitations on investments, premium rates or restrictions on the size of risks that may be insured under a single policy, privacy practices, deposits of securities for the benefit of policyholders, payment of sales compensation to third parties and the approval of policy forms and guaranty funds.

State insurance departments also conduct periodic examinations of the business affairs of our insurance companies and require us to file annual financial and other reports, prepared under statutory accounting principles, relating to the financial condition of companies and other matters. These insurance departments conduct periodic examinations of the books and records, financial reporting, policy filings and market conduct of our insurance companies doing business in their states, generally once every three to five years, although target financial, market conduct and other examinations may take place at any time. These examinations are generally carried out in cooperation with the insurance departments of other states in which our insurance companies transact insurance business under guidelines promulgated by the National Association of Insurance Commissioners (NAIC). Any adverse findings by insurance departments could result in significant fines and penalties, negatively affecting our profitability.

Generally, state regulators require that all material transactions among affiliated companies in our holding company system to which any of our insurance subsidiaries is a party, including sales, loans, reinsurance agreements, management agreements and service agreements must be fair and reasonable. In addition, if the transaction is material or of a specified category, prior notice and approval (or absence of disapproval within a specified time limit) by the insurance department where the subsidiary is domiciled is required.

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Statutory Accounting Principle (SAP)

SAP is a basis of accounting developed to assist insurance regulators in monitoring and regulating the solvency of insurance companies. One of the primary goals is to measure an insurer's statutory surplus. Accordingly, statutory accounting focuses on valuing assets and liabilities of our insurance subsidiaries at financial reporting dates in accordance with appropriate insurance law and regulatory provisions applicable in each insurer's domiciliary state. Insurance departments utilize SAP to help determine whether our insurance companies will have sufficient funds to timely pay all the claims of our policyholders and creditors. GAAP gives more consideration to matching of revenue and expenses than SAP. As a result, assets and liabilities will differ in financial statements prepared in accordance with GAAP as compared to SAP.

SAP, as established by the NAIC and adopted, for the most part, by the various state insurance regulators determine, among other things, the amount of statutory surplus and net income of our insurance subsidiaries and thus determine, in part, the amount of funds they have available to pay as dividends to us.

Restrictions on Paying Dividends

State insurance law restricts the ability of our insurance subsidiaries to declare shareholder dividends and requires our insurance companies to maintain specified levels of statutory capital and surplus. The amount of an insurer's surplus following payment of any dividends must be reasonable in relation to the insurer's outstanding liabilities and adequate to meet its financial needs. Limitations on dividends are generally based on net income or statutory capital and surplus.

The maximum amount of dividends that our insurance companies can pay to us in 2011 without seeking regulatory approval is \$27.4 million. The Company did not receive dividends from its insurance companies in either 2010 or 2009.

Assessments and Fees Payable

Virtually all states require insurers licensed to do business in their state to bear a portion of the loss suffered by insureds as a result of the insolvency of other insurers. Significant assessments could limit the ability of our insurance subsidiaries to recover such assessments through tax credits or other means. We paid assessments of \$3.5 million, \$1.7 million and \$2.4 million, during the years ended December 31, 2010, 2009 and 2008, respectively. Our estimated liability for anticipated assessments was \$4.7 million and \$3.2 million for the years ended December 31, 2010 and 2009, respectively.

Risk-Based Capital (RBC) Requirements

In order to enhance the regulation of insurer solvency, the NAIC has adopted formulas and model laws to determine minimum capital requirements and to raise the level of protection that statutory surplus provides for policyholder obligations. The model law provides for increasing levels of regulatory intervention as the ratio of an insurer's total adjusted capital and surplus decreases relative to its RBC, culminating with mandatory control of the operations of the insurer by the domiciliary insurance department at the so-called mandatory control level. At December 31, 2010, the capital and surplus of all of our insurance companies substantially exceeded the RBC requirements.

Restrictions on Cancellation, Non-Renewal or Withdrawal

Many states in which we conduct business have laws and regulations that limit the ability of our insurance companies licensed in that state to exit a market, cancel policies or not renew policies. Some states prohibit us from withdrawing

one or more lines of business from the state, except pursuant to a plan approved by the state insurance regulator, which may disapprove a plan that may lead to market disruption.

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Federal Regulation

General

The federal government generally does not directly regulate the insurance business. However, federal legislation and administrative policies in several areas, including age and sex discrimination, consumer privacy, terrorism and federal taxation and motor-carrier safety, do affect our insurance business. The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank Act), among other things, established a Federal Insurance Office (FIO) within the U.S. Treasury. Under this law, regulations will need to be created for the FIO to carry out its mandate to focus on systemic risk oversight. The FIO is required to gather information regarding the insurance industry and submit to Congress a plan to modernize and improve insurance regulation in the U.S. At this time, it is difficult to predict the extent, if any, to which the Dodd-Frank Act, or any resulting regulations, will impact the Company's insurance operations. We will continue to monitor all significant federal insurance legislation.

The Terrorism Risk Insurance Act (the Act)

The Terrorism Risk Insurance Program Reauthorization Act of 2007 extended the temporary federal program that provides for a transparent system of shared public and private compensation for insured losses resulting from acts of terrorism. The Act requires commercial insurers to make terrorism coverage available for commercial property/casualty losses, including workers' compensation. Commercial auto, burglary/theft, surety, professional liability and farmowners multiple-peril are not included in the program. The event trigger under the Act provides that in the case of a certified act of terrorism, no federal compensation shall be paid by the Secretary of Treasury unless aggregate industry losses exceed \$100 billion. The federal government will pay 85% of covered terrorism losses that exceed the insurer deductibles, in excess of the event trigger.

We are continuing to take the steps necessary to comply with the Act, as well as the state regulations in implementing its provisions, by providing required notices to commercial policyholders describing coverage provided for certified acts of terrorism (as defined by the Act). We do not anticipate terrorism losses to have a material impact on our results of operations.

To our knowledge and based on our internal review and control process for compliance, we believe we have been in compliance in all material respects with the laws, rules and regulations described above.

Employees

At December 31, 2010, we employed 494 people. None of our employees are covered by collective bargaining arrangements.

ITEM 1A Risk Factors

All material risks and uncertainties currently known regarding our business operations are included in this section. If any of the following risks, or other risks and uncertainties that we have not yet identified or that we currently consider not to be material, actually occur, our business, prospects, financial condition, results of operations and cash flows could be materially and adversely affected.

Market fluctuations, changes in interest rates or a need to generate liquidity can have significant and negative effects on our investment portfolio.

Our results of operations depend in part on the performance of our invested assets. As of December 31, 2010, 96.8% of our investment portfolio (excluding cash and cash equivalents) was invested in fixed maturities and 3.2% was invested in equity securities. As of December 31, 2010, approximately 28.8% of our fixed maturity portfolio was invested in State and local government obligations and approximately 95.0% of the fixed maturities were invested in fixed maturities rated investment grade (credit rating of AAA to BBB-) by Standard & Poor's Corporation.

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Investment returns are an important part of our overall profitability. We cannot predict which industry sectors in which we maintain investments may suffer losses as a result of potential declines in commercial and economic activity, or how any such decline might impact the ability of companies within the affected industry sectors to pay interest or principal on their securities and we cannot predict how or to what extent the value of any underlying collateral might be affected. Accordingly, adverse fluctuations in the fixed income or equity markets could adversely impact our profitability, financial condition or cash flows.

Initiatives taken by the U.S. and foreign governments have helped to stabilize the financial markets and restore liquidity to the banking system and credit markets. Although economic conditions and financial markets have improved, if market conditions were to deteriorate, our investment portfolio could be adversely impacted.

Historically, we have not had the need to sell our investments to generate liquidity. If we were forced to sell portfolio securities that have unrealized losses for liquidity purposes rather than holding them to maturity or recovery, we would recognize investment losses on those securities when that determination was made.

We may not have access to capital in the future due to an economic downturn.

We may need new or additional financing in the future to conduct our operations, expand our business or refinance existing indebtedness. Any sustained weakness in the general economic conditions and/or financial markets in the United States or globally could affect adversely our ability to raise capital on favorable terms or at all. From time to time we have relied, and may also rely in the future, on access to financial markets as a source of liquidity for operations, acquisitions and general corporate purposes. Our access to funds under our \$50 million unsecured Credit Agreement ("Credit Agreement") is dependent on the ability of the financial institutions that are parties to the facility to meet their funding commitments. Those financial institutions may not be able to meet their funding commitments if they experience shortages of capital and liquidity or if they experience excessive volumes of borrowing requests within a short period of time. Financial markets in the U.S. experienced extreme volatility during the latter part of 2008 and early 2009, which was characterized by the bankruptcy, failure, collapse or sale of various financial institutions and an unprecedented level of intervention from the United States federal government. Although access to credit markets eased significantly in 2010, further economic disruptions and any resulting limitations on future funding, including any restrictions on access to funds under our Credit Agreement, could have a material adverse effect on our results of operations and financial condition.

If we expand our operations too rapidly and do not manage that expansion effectively, our financial performance and stock price could be adversely affected.

We intend to grow by developing new products, expanding into new product lines and expanding our insurance distribution network. Continued growth could impose significant demands on our management, including the need to identify, recruit, maintain and integrate additional employees. Our historical growth rates may not accurately reflect our future growth rates or our growth potential. We may experience higher than anticipated indemnity losses arising from new and expanded insurance products. In addition, our systems, procedures and internal controls may not be adequate to support our operations as they expand.

In addition to these organic growth strategies, we regularly explore opportunities to acquire other companies or selected books of business. Upon the announcement of an acquisition, our stock price may fall depending on the size of the acquisition, the purchase price and the potential dilution to existing shareholders. It is also possible that an acquisition could dilute earnings per share.

If we grow through acquisitions, we could have difficulty in integrating an acquired company, which may cause us not to realize expected revenue increases, cost savings, increases in geographic or product presence, and other projected

benefits from the acquisition. The integration could result in the loss of key employees, disruption of our business or the business of the acquired company, or otherwise harm our ability to retain customers and employees or achieve the anticipated benefits of the acquisition. Time and resources spent on integration may also impair our ability to grow our existing businesses. Also, the negative effect of any financial commitments required by regulatory authorities or rating agencies in acquisitions or business combinations may be greater than expected.

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Any failure by us to manage our growth effectively could have a material adverse effect on our business, financial condition or results of operations.

Our growth strategy includes expanding into product lines in which we have limited experience.

We are continually evaluating new lines of business to add to our product mix. In some instances, we have limited experience with marketing and managing these new product lines and insuring the types of risks involved. Our failure to effectively analyze new underwriting risks, set adequate premium rates and establish reserves for these new products or efficiently adjust claims arising from these new products could have a material adverse effect on our business, financial condition or results of operations. During the start up period for new products, we generally set more conservative loss reserves in recognition of the inherent risk. This could adversely affect our statutory capital, net income and ability to pay dividends.

Because we are primarily a transportation insurer, conditions in that industry could adversely affect our business.

Approximately 80.6% of our gross premiums written for the year ended December 31, 2010 and 75.2% for the year ended December 31, 2009 were generated from transportation insurance policies, including ART programs for transportation companies. Adverse developments in the market for transportation insurance, including those which could result from potential declines in commercial and economic activity, could cause our results of operations to suffer. The transportation insurance industry is cyclical. Historically, the industry has been characterized by periods of price competition and excess capacity followed by periods of high premium rates and shortages of underwriting capacity. These fluctuations in the business cycle have and could continue to negatively impact our revenues.

Additionally, our results may be affected by risks that impact the transportation industry related to severe weather conditions, such as rainstorms, snowstorms, hail and ice storms, floods, hurricanes, tornadoes, earthquakes and tsunamis, as well as explosions, terrorist attacks and riots. Our transportation insurance business also may be affected by cost trends that negatively impact profitability, such as a continuing economic downturn, inflation in vehicle repair costs, vehicle replacement parts costs, used vehicle prices, fuel costs and medical care costs. Increased costs related to the handling and litigation of claims may also negatively impact our profitability.

We face competition from companies with greater financial resources, broader product lines, higher ratings and stronger financial performance than us, which may impair our ability to retain existing customers, attract new customers and maintain our profitability and financial strength.

The commercial transportation insurance business is highly competitive and, except for regulatory considerations, there are relatively few barriers to entry. Many of our competitors are substantially larger and may enjoy better name recognition, substantially greater financial resources, higher ratings by rating agencies, broader and more diversified product lines and more widespread agency relationships than we do. We compete with large national underwriters and smaller niche insurance companies. In particular, in the commercial specialty insurance market we compete against, among others, Lancer Insurance Company, RLI Corporation, American Alternative Insurance Corporation, Great West Casualty Company (a subsidiary of Old Republic International Corporation), Northland Insurance Company (a subsidiary of the Travelers Companies, Inc.) and Sentry Insurance. In our specialty personal lines and Hawaii and Alaska our primary competitors are Progressive Corporation and American Modern Home Insurance Company (a subsidiary of Munich Re Group), and Island Insurance Company and First Insurance, respectively. In the moving and storage market we compete against, among others, Zurich Insurance Company and Transguard Insurance Company of America. Our underwriting profits could be adversely impacted if new entrants or existing competitors try to compete with our products, services and programs or offer similar or better products at or below our prices.

We have continued to develop ART programs, attracting new customers as well as transitioning existing traditional customers into these programs. Our alternative risk transfer component constituted approximately 52.4% of our gross premiums written for the year ended December 31, 2010 and 55.9% of our gross written premiums for the same period in 2009. We are subject to ongoing competition for both the individual customers and entire programs. The departure of an entire program due to competition could adversely affect our results.

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If we are not able to attract and retain independent agents and brokers, our revenues could be negatively affected.

We compete with other insurance carriers to attract and retain business from independent agents and brokers. Some of our competitors offer a larger variety of products, lower prices for insurance coverage or higher commissions than we offer. Our top ten independent agents/brokers accounted for an aggregate of 28.6% of our gross premiums written, and our top two independent agents/brokers accounted for an aggregate of 11.4% of our gross premiums written during the year ended December 31, 2010. If we are unable to attract and retain independent agents/brokers to sell our products, our ability to compete and attract new customers and our revenues would suffer.

We are subject to comprehensive regulation and our ability to earn profits may be restricted by these regulations.

We are subject to comprehensive regulation by government agencies in the states and foreign jurisdictions where our active insurance company subsidiaries are domiciled (Ohio, Missouri, Pennsylvania and the Cayman Islands) and, to a lesser degree, where these subsidiaries issue policies and handle claims. Failure by one of our insurance company subsidiaries to meet regulatory requirements could subject us to regulatory action. The regulations and associated examinations may have the effect of limiting our liquidity and may adversely affect results of operations.

In addition, state insurance department examiners perform periodic financial, market conduct and other examinations of insurance companies. Compliance with applicable laws and regulations is time consuming and personnel-intensive. In addition to financial examinations, we may be subject to market conduct examinations of our claims and underwriting practices. Any adverse findings by insurance departments could result in significant fines and penalties, negatively affecting our profitability.

In July 2010, the Dodd-Frank Act was signed into law. Among other things, this law established the Federal Insurance Office within the U.S. Treasury and authorizes it to gather information regarding the insurance industry and submit to Congress a plan to modernize and improve insurance regulation in the U.S.

Existing insurance-related laws and regulations may become more restrictive in the future or new or more restrictive regulation, including changes in current tax or other regulatory interpretations affecting the alternative risk transfer insurance model, could make it more expensive for us to conduct our business, restrict the premiums we are able to charge or otherwise change the way we do business. In addition, the economic and financial market turmoil may result in some type of federal oversight of the insurance industry. For a further discussion of the regulatory framework in which we operate, see the subsection of Business entitled Regulation.

We cannot predict the impact that changing climate conditions, including legal, regulatory and social responses thereto, may have on our business.

Various scientists, environmentalists, international organizations, regulators and other commentators believe that global climate change has added, and will continue to add, to the unpredictability, frequency and severity of natural disasters (including, but not limited to, hurricanes, tornadoes, freezes, other storms and fires) in certain parts of the world. In response, a number of legal and regulatory measures and social initiatives have been introduced in an effort to reduce greenhouse gas and other carbon emissions that may be chief contributors to global climate change.

We cannot predict the impact that changing climate conditions, if any, will have on us or our customers. However, it is possible that the legal, regulatory and social responses to climate change could have a negative effect on our results of operations or our financial condition.

As a holding company, we are dependent on the results of operations of our insurance company subsidiaries to meet our obligations and pay future dividends.

We are a holding company and a legal entity separate and distinct from our insurance company subsidiaries. As a holding company without significant operations of our own, one of our sources of funds are dividends and other distributions from our insurance company subsidiaries. As discussed under the subsection of **Business** entitled

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Regulation, statutory and regulatory restrictions limit the aggregate amount of dividends or other distributions that our insurance subsidiaries may declare or pay within any twelve-month period without advance regulatory approval and require insurance companies to maintain specified levels of statutory capital and surplus. Insurance regulators have broad powers to prevent reduction of statutory capital and surplus to inadequate levels and could refuse to permit the payment of dividends calculated under any applicable formula. As a result, we may not be able to receive dividends from our insurance subsidiaries at times and in amounts necessary to meet our operating needs, to pay dividends to our shareholders or to pay corporate expenses.

We are currently rated A (Excellent) by A.M. Best, their third highest rating out of 16 rating categories. A decline in our rating below A- could adversely affect our position in the insurance market, make it more difficult to market our insurance products and cause our premiums and earnings to decrease.

Financial ratings are an important factor influencing the competitive position of insurance companies. A.M. Best ratings, which are commonly used in the insurance industry, currently range from A++ (Superior) to F (In Liquidation), with a total of 16 separate ratings categories. A.M. Best currently assigns us a financial strength rating of

A (Excellent). The objective of A.M. Best's rating system is to provide potential policyholders and other interested parties an opinion of an insurer's financial strength and ability to meet ongoing obligations, including paying claims. This rating reflects A.M. Best's analysis of our balance sheet, financial position, capitalization and management. It is not an evaluation of an investment in our common shares, nor is it directed to investors in our common shares and is not a recommendation to buy, sell or hold our common shares. This rating is subject to periodic review and may be revised downward, upward or revoked at the sole discretion of A.M. Best.

If our rating is reduced by A.M. Best below an A-, we believe that our competitive position in the insurance industry could suffer, and it could be more difficult for us to market our insurance products. A downgrade could result in a significant reduction in the number of insurance contracts we write and in a substantial loss of business to other competitors with higher ratings, causing premiums and earnings to decrease.

New claim and coverage issues are continually emerging in the insurance industry and these new issues could negatively impact our revenues, our business operations or our reputation.

As insurance industry practices and regulatory, judicial and industry conditions change, unexpected and unintended issues related to pricing, claims, coverage and business practices may emerge. Plaintiffs often target property and casualty insurers in purported class action litigation relating to claims handling and insurance sales practices. The resolution and implications of new underwriting, claims and coverage issues could have a negative effect on our insurance business by extending coverage beyond our underwriting intent, increasing the size of claims or otherwise requiring us to change our business practices. The effects of unforeseen emerging claim and coverage issues could negatively impact our revenues, results of operations and our reputation.

If our claims payments and related expenses exceed our reserves, our financial condition and results of operations could be adversely affected.

Our success depends upon our ability to accurately assess and price the risks covered by the insurance policies that we write. We establish reserves to cover our estimated liability for the payment of all losses and LAE incurred with respect to premiums earned on the insurance policies that we write. Reserves do not represent an exact calculation of liability. Rather, reserves are estimates of our expectations regarding the ultimate cost of resolution and administration of claims under the insurance policies that we write. These estimates are based upon actuarial and statistical projections, assessments of currently available data, historical claims information, as well as estimates and assumptions regarding future trends in claims severity and frequency, judicial theories of liability and other factors. We continually refine our reserve estimates in an ongoing process as experience develops and claims are reported and

settled. Each year, our reserves are certified by an accredited actuary from Great American.

Establishing an appropriate level of reserves is an inherently uncertain process. The following factors may have a substantial impact on our future actual losses and LAE experience:

the amount of claims payments;

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the expenses that we incur in resolving claims;

legislative and judicial developments; and

changes in economic conditions, including the effect of inflation.

Unfavorable development in any of these factors could cause our level of reserves to be inadequate. To the extent that actual losses and LAE exceed expectations and the reserves reflected on our financial statements, we will be required to immediately reflect those changes by increasing reserves. When we increase reserves, the pre-tax income for the period in which we do so will decrease by a corresponding amount. In addition to having a negative effect on pre-tax income, increasing or strengthening reserves cause a reduction in our insurance companies' surplus and could cause a downgrading of the rating of our insurance company subsidiaries. Such a downgrade could, in turn, adversely affect our ability to sell insurance policies.

We may not be successful in reducing our risk and increasing our underwriting capacity through reinsurance arrangements, which could adversely affect our business, financial condition and results of operations.

In order to reduce our underwriting risk and increase our underwriting capacity, we transfer portions of our insurance risk to other insurers through reinsurance contracts. Ceded premiums written amounted to 19.2% and 20.2%, respectively, of our gross premiums written for the years ended December 31, 2010 and 2009. The availability, cost and structure of reinsurance protection are subject to prevailing market conditions that are outside of our control and which may affect our level of business and profitability. We continually assess and continue to increase our participation in the risk retention for certain products in part because we believe the current price increases in the reinsurance market are excessive for the reinsurance exposure assumed. In order for these contracts to qualify for reinsurance accounting and to provide the additional underwriting capacity that we desire, the reinsurer generally must assume significant risk and have a reasonable possibility of a significant loss. Our reinsurance facilities are generally subject to annual renewal. We may be unable to maintain our current reinsurance facilities or obtain other reinsurance facilities in adequate amounts and at favorable rates. If we are unable to renew our expiring facilities or obtain new reinsurance facilities, either our net exposure to risk would increase or, if we are unwilling to bear an increase in net risk exposures, we would have to reduce the amount of risk we underwrite which could adversely impact our results of operations.

We are subject to credit risk with respect to the obligations of our reinsurers and certain of our insureds. The inability of our risk sharing partners to meet their obligations could adversely affect our profitability.

Although the reinsurer is liable to us to the extent of risk ceded by us, we remain ultimately liable to the policyholder on all risks, even those reinsured. As a result, ceded reinsurance arrangements do not limit our ultimate obligations to policyholders to pay claims. We are subject to credit risks with respect to the financial strength of our reinsurers. We are also subject to the risk that our reinsurers may dispute their obligations to pay our claims. As a result, we may not recover sufficient amounts for claims that we submit to our reinsurers in a timely manner, if at all. As of December 31, 2010, we had a total of \$165.0 million of unsecured reinsurance recoverables. In addition, our reinsurance agreements are subject to specified limits and we would not have reinsurance coverage to the extent that we exceed those limits.

With respect to our insurance programs, we are subject to credit risk with respect to the payment of claims and on the portion of risk exposure either ceded to the captives or retained by our clients. The credit worthiness of prospective risk sharing partners is a factor we consider when entering into or renewing these alternative risk transfer programs. We typically collateralize balances due through funds withheld, letters of credit or trust agreements. To date, we have

not, in the aggregate, experienced material difficulties in collecting balances from our risk sharing partners. No assurance can be given, however, regarding the future ability of these entities to meet their obligations. The inability of our risk sharing partners to meet their obligations could adversely affect our profitability.

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Our inability to retain our senior executives and other key personnel could adversely affect our business.

Our success depends, in part, upon the ability of our executive management and other key personnel to implement our business strategy and on our ability to attract and retain qualified employees. Although historically we had not entered into employment agreements with our executive management, in 2007 we entered into a multi-year employment agreement with our president and chief executive officer, David W. Michelson. Mr. Michelson is also party to an employee retention agreement with us. A failure of Mr. Michelson's employment and employee retention agreements to achieve their desired result, our loss of other senior executives or our failure to attract and develop talented new executives and managers could adversely affect our business and the market price for our common shares.

In addition, we must forecast volume and other factors in changing business environments with reasonable accuracy and adjust our hiring and employment levels accordingly. Our failure to recognize the need for such adjustments, or our failure or inability to react appropriately on a timely basis, could lead either to over-staffing (which would adversely affect our cost structure) or under-staffing (impairing our ability to service our current product lines and new lines of business). In either event, our financial results and customer relationships could be adversely affected.

Your interests as a holder of our common shares may be different than the interests of our majority shareholder, Great American Insurance Company.

As of December 31, 2010, American Financial Group, Inc., (AFG) through its wholly-owned subsidiary Great American, owns 52.5% of our outstanding common shares. The interests of AFG may differ from the interests of our other shareholders. AFG's representatives hold four out of nine seats of our Board. As a result, American Financial Group, Inc. has the ability to exert significant influence over our policies and affairs including the power to affect the election of our Directors, appointment of our management and the approval of any action requiring a shareholder vote, such as amendments to our Amended and Restated Articles of Incorporation or Code of Regulations, transactions with affiliates, mergers or asset sales.

Subject to the terms of our right of first refusal to purchase its shares in certain circumstances, American Financial Group, Inc. may be able to prevent or cause a change of control of the Company by either voting its shares against or for a change of control or selling its shares and causing a change of control. The ability of our majority shareholder to prevent or cause a change of control could delay or prevent a change of control or cause a change of control to occur at a time when it is not favored by other shareholders. As a result, the trading price of our common shares could be adversely affected.

We may have conflicts of interest with our majority shareholder, Great American Insurance Company, which we would be unable to resolve in our favor.

From time to time, Great American and its affiliated companies engage in underwriting activities and enter into transactions or agreements with us or in competition with us, which may give rise to conflicts of interest. We do not have any agreement or understanding with any of these parties regarding the resolution of potential conflicts of interest. In addition, we may not be in a position to influence any party's decision not to engage in activities that would give rise to a conflict of interest. These parties may take actions that are not in the best interests of our other shareholders.

We rely on Great American to provide certain services to us including actuarial and consultative services for legal, accounting and internal audit issues and other support services. If Great American no longer controlled a majority of our shares, it is possible that many of these services would cease or, alternatively, be provided at an increased cost to us. This could impact our personnel resources, require us to hire additional professional staff and generally increase our operating expenses.

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Provisions in our organizational documents, Ohio corporate law and the insurance laws of Ohio, Missouri and Pennsylvania could impede an attempt to replace or remove our management or Directors or prevent or delay a merger or sale, which could diminish the value of our common shares.

Our Amended and Restated Articles of Incorporation and Code of Regulations, the corporate laws of Ohio and the insurance laws of various states contain provisions that could impede an attempt to replace or remove our management or Directors or prevent the sale of our Company that shareholders might consider to be in their best interests. These provisions include, among others:

- a classified Board of Directors consisting of nine Directors divided into two classes;
- the inability of our shareholders to remove a Director from the Board without cause;
- requiring a vote of holders of 50% of the common shares to call a special meeting of the shareholders;
- requiring a two-thirds vote to amend the shareholder protection provisions of our Code of Regulations and to amend the Amended and Restated Articles of Incorporation;
- requiring the affirmative vote of a majority of the voting power of our shares represented at a special meeting of shareholders;
- excluding the voting power of interested shares to approve a control share acquisition under Ohio law; and
- prohibiting a merger, consolidation, combination or majority share acquisition between us and an interested shareholder or an affiliate of an interested shareholder for a period of three years from the date on which the shareholder first became an interested shareholder, unless previously approved by our Board.

These provisions may prevent shareholders from receiving the benefit of any premium over the market price of our common shares offered by a bidder in a potential takeover. In addition, the existence of these provisions may adversely affect the prevailing market price of our common shares if they are viewed as discouraging takeover attempts.

The insurance laws of most states require prior notice or regulatory approval of changes in control of an insurance company or its holding company. The insurance laws of the States of Ohio, Missouri and Pennsylvania, where our U.S. insurance companies are domiciled, provide that no corporation or other person may acquire control of a domestic insurance or reinsurance company unless it has given notice to such insurance or reinsurance company and obtained prior written approval of the relevant insurance regulatory authorities. Any purchaser of 10% or more of our aggregate outstanding voting power could become subject to these regulations and could be required to file notices and reports with the applicable regulatory authorities prior to such acquisition. In addition, the existence of these provisions may adversely affect the prevailing market price of our common shares if they are viewed as discouraging takeover attempts. For further discussion of insurance laws, see the subsection of Business entitled Regulation.

Future sales of our common shares may affect the trading price of our common shares.

We cannot predict what effect, if any, future sales of our common shares or the availability of common shares for future sale will have on the trading price of our common shares. Sales of substantial amounts of our common shares in the public market by Great American or our other shareholders, or the possibility or perception that such sales could occur, could adversely affect prevailing market prices for our common shares. If such sales reduce the market price of our common shares, our ability to raise additional capital in the equity markets may be adversely affected.

We have registered all of the common shares owned by Great American and Alan Spachman, our chairman, pursuant to a registration statement on Form S-3. As of December 31, 2010, Great American and Mr. Spachman own 10,200,000 and 1,589,525 respectively, of our issued and outstanding shares. This concentration of ownership could affect the number of shares available for purchase or sale on a daily basis. This factor could result in price volatility and serve to depress the liquidity and market prices of our common shares.

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In addition, in 2005, we filed a registration statement on Form S-8 under the Securities Act to register 1,338,800 common shares issued or reserved for issuance for awards granted under our Long Term Incentive Plan. Shares registered under the registration statement on Form S-8 also could be sold into the public markets, subject to applicable vesting provisions and any volume limitations and other restrictions applicable to our officers and Directors selling shares under Rule 144. The sale of the shares under these registration statements in the public market, or the possibility or perception that such sales could occur, could adversely affect prevailing market prices for our common shares.

ITEM 1B Unresolved Staff Comments

None.

ITEM 2 Properties

We own two adjacent buildings that house our corporate headquarters and the surrounding real estate located in Richfield, Ohio. The buildings consist of approximately 177,000 square feet of office space on 17.5 acres. We occupy approximately 157,000 square feet and lease the remainder to unaffiliated tenants.

We lease office space in Honolulu, Hawaii; Mechanicsburg, Pennsylvania; Fenton, Missouri; and St. Thomas in the United States Virgin Islands. These leases account for approximately 62,000 square feet of office space. These leases expire within thirty-one months. The monthly rents, exclusive of operating expenses, to lease these facilities currently total approximately \$109,000. We believe that these leases could be renewed or replaced at commercially reasonable rates without material disruption to our business.

ITEM 3 Legal Proceedings

We are subject at times to various claims, lawsuits and legal proceedings arising in the ordinary course of business. All legal actions relating to claims made under insurance policies are considered in the establishment of our loss and LAE reserves. In addition, regulatory bodies, such as state insurance departments, the SEC, the Department of Labor and other regulatory bodies may make inquiries and conduct examinations or investigations concerning our compliance with insurance laws, securities laws, labor laws and the Employee Retirement Income Security Act of 1974, as amended.

Our insurance companies also have lawsuits pending in which the plaintiff seeks extra-contractual damages from us in addition to damages claimed or in excess of the available limits under an insurance policy. These lawsuits, which are in various stages, generally mirror similar lawsuits filed against other carriers in the industry. Although we are vigorously defending these lawsuits, the outcomes of these cases cannot be determined at this time. We have established loss and LAE reserves for lawsuits as to which we have determined that a loss is both probable and estimable. In addition to these case reserves, we also establish reserves for claims incurred but not reported to cover unknown exposures and adverse development on known exposures. Based on currently available information, we believe that our reserves for these lawsuits are reasonable and that the amounts reserved did not have a material effect on our financial condition or results of operations. However, if any one or more of these cases results in a judgment against or settlement by us for an amount that is significantly greater than the amount so reserved, the resulting liability could have a material effect on our financial condition, cash flows and results of operations.

ITEM 4 [Removed and Reserved]

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Our common shares are listed and traded on the Nasdaq Global Select Market under the symbol NATL. The information presented in the table below represents the high and low sales prices per share reported on the NASDAQ for the periods indicated.

	2010		2009	
	High	Low	High	Low
First Quarter	\$ 21.19	\$ 16.06	\$ 19.89	\$ 12.95
Second Quarter	21.98	18.66	18.19	13.03
Third Quarter	22.83	17.57	21.20	14.51
Fourth Quarter	23.00	19.98	21.72	16.06

There were approximately 58 shareholders of record of our common shares at February 28, 2011.

Dividend Policy

The Board has instituted a policy authorizing us to pay quarterly dividends on our common shares in an amount to be determined at each quarterly Board of Directors meeting. The Board recently announced its intention to increase the quarterly dividend to \$0.09 per share for 2011. The Board intends to continue to review our dividend policy annually during each regularly scheduled first quarter meeting, with the anticipation of considering annual dividend increases. We declared and paid quarterly dividends of \$0.08 and \$0.07 per common share in 2010 and 2009, respectively.

The declaration and payment of dividends remains subject to the discretion of the Board, and will depend on, among other things, our financial condition, results of operations, capital and cash requirements, future prospects, regulatory and contractual restrictions on the payment of dividends by insurance company subsidiaries and other factors deemed relevant by the Board. In addition, our ability to pay dividends would be restricted in the event of a default on our unsecured Credit Agreement, our failure to make payment obligations with respect to such agreement or our election to defer interest payments on the agreement.

We are a holding company without significant operations of our own. Our principal sources of funds are dividends and other distributions from our subsidiaries including our insurance company subsidiaries. Our ability to receive dividends from our insurance company subsidiaries is also subject to limits under applicable state insurance laws.

Equity Compensation Plan Information

The table below shows information regarding awards outstanding and common shares available for issuance (as of December 31, 2010) under the National Interstate Corporation Long Term Incentive Plan, as amended.

Equity Compensation Plans	Number of Securities to be Issued upon Exercise of Outstanding Options (a)	Weighted-Average Exercise Price of Outstanding Options (b)	Number of Securities Available for Future Issuance
			under Equity Compensation Plans (Excluding Securities Reflected in Column (a)) (c)
Approved by shareholders	561,550	\$ 18.39	773,338
Not approved by shareholders	none	N/A	none

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The following graph shows the percentage change in cumulative total shareholder return on our common shares measured by dividing (i) the sum of (A) the cumulative amount of dividends, assuming dividend reinvestment during the periods presented and (B) the difference between our share price at the end and the beginning of the periods presented by (ii) the share price at the beginning of the periods presented. The graph demonstrates our cumulative five-year total returns compared to those of the Center for Research in Security Prices (CSRP) Total Return Index for Nasdaq and the CSRP Total Return Index for Nasdaq Insurance Stocks assuming a \$100 investment at the close of trading on the last trading day preceding the first day of the fifth preceding fiscal year, or December 30, 2005 (\$19.07) through December 31, 2010 (\$21.41).

2010 Stock Performance Graph

Cumulative 5-Year Total Return as of December 31, 2010
(Assumes a \$100 investment at the close of trading on December 30, 2005)

Company/Index	2005	2006	2007	2008	2009	2010
NATL Common Stock	\$ 100	\$ 128	\$ 176	\$ 96	\$ 93	\$ 119
Nasdaq Insurance Stocks	100	113	113	105	110	123
Nasdaq Index	100	110	119	57	83	98

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The following table sets forth selected consolidated financial information for the periods ended and as of the dates indicated. These historical results are not necessarily indicative of the results to be expected from any future period. You should read this selected consolidated financial data together with our consolidated financial statements and the related notes and the section of this Form 10-K entitled Management's Discussion and Analysis of Financial Condition and Results of Operations.

	2010	At and for the Year Ended December 31,				2006
		2009	2008	2007		
	(Dollars in thousands, except per share data)					
Operating Data:						
Gross premiums written(1)	\$ 438,630	\$ 344,877	\$ 380,296	\$ 346,006	\$ 305,504	
Net premiums written(2)	\$ 354,529	\$ 275,046	\$ 298,081	\$ 272,142	\$ 241,916	
Premiums earned	\$ 358,371	\$ 279,079	\$ 290,741	\$ 257,561	\$ 217,319	
Net investment income	23,298	19,324	22,501	22,141	17,579	
Net realized gains (losses) on investments	4,324	2,561	(22,394)	(653)	1,193	
Gain on bargain purchase	7,453					
Other	3,680	3,488	2,868	4,137	2,387	
Total revenues	397,126	304,452	293,716	283,186	238,478	
Losses and loss adjustment expenses	256,408	169,755	188,131	149,501	129,491	
Commissions and other underwriting expenses	67,639	57,245	62,130	50,922	42,671	
Other operating and general expenses	17,197	13,076	12,605	12,140	9,472	
Expense on amounts withheld(3)	3,450	3,535	4,299	3,708	2,147	
Interest expense	294	717	833	1,550	1,522	
Total expenses	344,988	244,328	267,998	217,821	185,303	
Income before income taxes	52,138	60,124	25,718	65,365	53,175	
Provision for income taxes	12,629	13,675	15,058	21,763	17,475	
Net income	\$ 39,509	\$ 46,449	\$ 10,660	\$ 43,602	\$ 35,700	
Selected GAAP Ratios:						
Losses and loss adjustment expense ratio(4)	71.5%	60.8%	64.7%	58.0%	59.6%	
Underwriting expense ratio(5)	22.7%	24.0%	24.7%	22.9%	22.9%	
Combined ratio(6)	94.2%	84.8%	89.4%	80.9%	82.5%	
Return on equity(7)	13.6%	19.1%	5.0%	22.6%	22.8%	
Per Share Data:						
Earnings per common share, basic	\$ 2.04	\$ 2.41	\$ 0.55	\$ 2.27	\$ 1.87	

Earnings per common share, assuming dilution	2.03	2.40	0.55	2.25	1.85
Book value per common share, basic (at year end)(8)	\$ 15.99	\$ 14.06	\$ 11.20	\$ 11.08	\$ 9.07
Weighted average number of common shares outstanding, basic	19,343	19,301	19,285	19,193	19,136
Weighted average number of common shares outstanding, diluted	19,452	19,366	19,366	19,348	19,302
Common shares outstanding (at year end)	19,357	19,302	19,295	19,312	19,159
Cash dividends per common share	\$ 0.32	\$ 0.28	\$ 0.24	\$ 0.20	\$ 0.16

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			At December 31,		
	2010	2009	2008	2007	2006
Balance Sheet Data:					
Cash and investments	\$ 965,204	\$ 614,974	\$ 563,714	\$ 492,916	\$ 406,454
Securities lending collateral			84,670	139,305	158,928
Reinsurance recoverables	208,590	149,949	150,791	98,091	90,070
Total assets	1,488,605	955,753	990,812	898,634	806,248
Unpaid losses and loss adjustment expenses	798,645	417,260	400,001	302,088	265,966
Long-term debt	20,000	15,000	15,000	15,464	15,464
Total shareholders' equity	309,578	271,317	216,074	212,806	173,763

		At and for the Year Ended December 31,			
	2010	2009	2008	2007	2006
Selected Statutory Data(9):					
Policyholder surplus(10)	\$ 273,647	\$ 238,390	\$ 190,134	\$ 182,302	\$ 148,266
Combined ratio(11)	93.9%	85.8%	89.0%	78.3%	82.4%

- (1) The sum of premiums written on insurance policies issued by us and premiums assumed by us on policies written by other insurance companies.
- (2) Gross premiums written less premiums ceded to reinsurance companies.
- (3) We invest funds in the participant loss layer for several of the alternative risk transfer programs. We receive investment income and incur an equal expense on the amounts owed to alternative risk transfer participants. Expense on amounts withheld represents investment income that we remit back to alternative risk transfer participants. The related investment income is included in our Net investment income line on our Consolidated Statements of Income.
- (4) The ratio of losses and LAE to premiums earned.
- (5) The ratio of the net of the sum of commissions and other underwriting expenses, other operating and general expenses less other income to premiums earned.
- (6) The sum of the loss and LAE ratio and the underwriting expense ratio.
- (7) The ratio of net income to the average of the shareholders' equity at the beginning and end of the year.
- (8) Book value per common share is computed using only unrestricted outstanding common shares. As of December 31, 2010 and 2009 total unrestricted common shares were 19,357,000 and 19,302,000, respectively. There were no unvested restricted shares prior to 2007.
- (9) While financial data is reported in accordance with GAAP for shareholder and other investment purposes, it is reported on a statutory basis for insurance regulatory purposes. Certain statutory expenses differ from amounts

reported under GAAP. Specifically, under GAAP, premium taxes and other variable costs incurred in connection with writing new and renewal business are capitalized and amortized on a pro rata basis over the period in which the related premiums are earned. On a statutory basis, these items are expensed as incurred. In addition, certain other expenses, such as those related to the expensing or amortization of computer software, are accounted for differently for statutory purposes than the treatment accorded under GAAP.

- (10) The statutory policyholder surplus of NIIC, which includes the statutory policyholder surplus of its subsidiaries, VIC, NIIC-HI and TCC.
- (11) Statutory combined ratio of NIIC represents the sum of the following ratios: (1) losses and LAE incurred as a percentage of net earned premium and (2) underwriting expenses incurred as a percentage of net written premiums.

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ITEM 7 Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion and analysis of our historical consolidated financial statements should be read in conjunction with our audited consolidated financial statements and the related notes included elsewhere in this Form 10-K.

Overview

We are a holding company with operations being conducted by our subsidiaries.

Our specialty property and casualty insurance companies are licensed in all 50 states, the District of Columbia and the Cayman Islands. We generate underwriting profits by providing what we view as specialized insurance products, services and programs not generally available in the marketplace. While many companies write property and casualty insurance for transportation companies, we believe that few write passenger transportation coverage nationwide and very few write coverage for several of the classes of passenger transportation insurance written by us and our subsidiaries. We focus on niche insurance markets where we offer insurance products designed to meet the unique needs of targeted insurance buyers that we believe are underserved by the insurance industry. These niche markets typically possess what we view as barriers to entry, such as being too small, too remote or too difficult to attract or sustain most competitors. Examples of products that we write for these markets include captive programs for transportation companies that we refer to as our alternative risk transfer (ART) programs (52.4% of 2010 gross premiums written), property and casualty insurance for transportation companies (28.2%), specialty personal lines, primarily recreational vehicle and commercial vehicle coverage (14.1%) and transportation and general commercial insurance in Hawaii and Alaska (4.1%). Effective July 1, 2010, with the acquisition of Vanliner Insurance Company (VIC), which is described in further detail below, we also now underwrite and sell insurance products for moving and storage transportation companies, which is included in our transportation component. We strive to become a market leader in the specialty markets that we choose and serve by offering what we believe are specialized products, excellent customer service and superior claims response.

We write commercial insurance for various sizes of transportation fleets. Because of the number of smaller fleets nationwide, we have more opportunities to write smaller risks than larger ones. When general economic conditions improve, entrepreneurs are encouraged to start new transportation companies, which typically commence operations as a smaller risk and a potential traditional insurance customer for us. During periods of economic downturn, smaller risks are more prone to failure due to a decrease in leisure travel and consolidation in the industry. An increase in the number of larger risks results in more prospective ART insurance customers. We generally do not believe that smaller fleets that generate annual premiums of less than \$75,000 are large enough to retain the risks associated with participation in one of the ART programs we currently offer.

By offering insurance products to all sizes of risks, we believe we have hedged against the possibility that there will be a reduction in demand for the products we offer. We believe that we will continue to have opportunities to grow and profit with both traditional and ART customers based on our assumptions regarding future economic and competitive conditions. We generally incur low start-up costs for new businesses, typically less than \$500,000 incurred over several quarters. We believe our flexible processes and scalable systems, along with controlled increase of businesses, allow us to manage costs and match them with the revenue flow.

The factors that impact our growth rate are consistent across all products. However, the trends impacting each of these factors may vary from time to time for individual products. Those factors are as follows:

Submissions

The increase or decrease in the number of new applications we receive. This is influenced by the effectiveness of our marketing activities compared to the marketing activities of our competitors in each market.

The change in the number of current policyholders that are available for a renewal quote. The number of policyholders available for renewal changes based upon the economic conditions impacting our customer groups and the extent of consolidation that may be taking place within the industries we support.

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Quotes

The change in the percentage of the new applications received that do not receive a quote from us. We do not quote risks that do not meet our risk selection criteria or for which we have not been provided complete application data. We refer to this ratio as the declination ratio and an increasing declination ratio usually results in reduced opportunities to write new business.

Sales

The change in percentage of the quotes we issue that are actually sold. We refer to this ratio as the hit ratio. Hit ratios are affected by the number of competitors, the prices quoted by these competitors and the degree of difference between the competitors pricing, terms and conditions and ours.

Rates

The change in our rate structure from period to period. The rates we file and quote are impacted by several factors including: the cost and extent of the reinsurance we purchase; our operating efficiencies; our average loss costs, which reflect the effectiveness of our underwriting; our underwriting profit expectations; and our claims adjusting processes. The difference between our rates and the rates of our competitors is the primary factor impacting the revenue growth of our established product lines.

Product Offerings and Distribution

We operate in multiple markets with multiple distribution approaches to attempt to reduce the probability that an adverse competitive response in any single market will have a significant impact on our overall business. We also attempt to maintain several new products, product line extensions or product distribution approaches in active development status so we are able to take advantage of market opportunities. We select from potential new product ideas based on our stated new business criteria and the anticipated competitive response.

Acquisition of Vanliner Group, Inc. (Vanliner)

Effective July 1, 2010, we and our principal insurance subsidiary, National Interstate Insurance Company (NIIC), completed the acquisition of Vanliner from UniGroup, Inc. (UniGroup) whereby NIIC acquired all of the issued and outstanding capital stock of Vanliner and we acquired certain information technology assets. As part of this acquisition, UniGroup agreed to provide us with comprehensive financial guarantees, including a four and a half-year balance sheet guaranty whereby both favorable and unfavorable balance sheet developments inure to UniGroup. Through the acquisition of Vanliner, NIIC acquired VIC, a market leader in providing insurance for the moving and storage industry. Obtaining a presence in this industry was our primary strategic objective associated with the acquisition. VIC's moving and storage insurance premiums associated with policies in-force totaled approximately \$90 million as of December 31, 2010, representing approximately 78% of its total business. Beginning July 1, 2010, the date we completed the acquisition, Vanliner's results are included as part of our transportation component, with the exception of VIC's moving and storage group captive program, which is a part of our alternative risk transfer component. Additional disclosures regarding the Vanliner acquisition are contained in Note 3 Acquisition of Vanliner Group, Inc.

Industry and Trends

The property/casualty (P/C) insurance industry is cyclical, with periods of rising premium rates and shortages of underwriting capacity (hard market) followed by periods of substantial price competition and excess capacity (soft market). Despite experiencing continued soft market conditions during 2010, the P/C insurance industry generated a year-over-year increase in premiums written for the first time since 2007. The industry's underwriting results were relatively flat during 2010, as a significant increase in the frequency of low-severity catastrophe-related losses was offset by significant favorable development on prior-year loss reserves according to available industry data compiled by A.M. Best through the first nine months of 2010. The industry faces several unfavorable trends in the coming year such as, but not limited to, prolonged recession-driven pricing instability, diminishing savings from prior-year reserve development and the continuance of relatively low investment returns.

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Despite relatively flat pricing since 2004, improved risk selection and an overall improvement in the risk quality of our book of business have enabled us to attain combined ratios better than our corporate objective of 96.0% or lower. Since our inception in 1989 we have placed a consistent emphasis on underwriting profit. Though our combined ratio may fluctuate from year to year, over the past five years we have exceeded our underwriting profit objective by achieving an average GAAP combined ratio of 86.4%. We believe the following factors contribute to our performance, which is consistently above industry standards:

Our business model and bottom line orientation have resulted in disciplined and consistent risk assessment and pricing adequacy.

Our ability to attract and retain some of the best transportation companies in the industries we serve and to insure them directly or through our captive programs.

Our stable operating expenses which have historically been at or below the revenue growth rate.

During 2010, interest rates remained low, which increased the value of many of our fixed income holdings. As such, we sold securities, primarily to generate funds for the Vanliner acquisition, which resulted in realized gains from investments. We have historically maintained a high quality investment portfolio, focusing primarily on investment grade fixed income investments. During 2010, we sold securities, primarily U.S. government and government agency obligations, to generate funds to finance the acquisition of Vanliner. Subsequent to the acquisition, we experienced a shift in the mix of our fixed maturities portfolio due to reinvesting Vanliner's acquired cash balances in corporate obligations, as these securities generally offered the mix of yield and duration that best met our business needs. Although we cannot provide any assurances, at December 31, 2010, with over 92% of our investment portfolio comprised of investment grade fixed income, investment grade preferred stock and cash and cash equivalents, we believe we remain properly positioned as we head into 2011.

As noted above, the P/C insurance industry saw a significant upswing in the frequency of low-severity catastrophe-related losses in 2010, including tornadoes, winter storms, hail and floods, while experiencing a relatively quiet hurricane season. For weather-related events such as hurricanes, tornados and hailstorms, we conduct an analysis at least annually pursuant to which we input our in-force exposures (vehicle values in all states and property limits in Hawaii) into an independent catastrophe model that predicts our probable maximum loss at various statistical confidence levels. Our estimated probable maximum loss is impacted by changes in our in-force exposures as well as changes to the assumptions inherent in the catastrophe model. Hurricane and other weather-related events have not had a material negative impact on our past results.

Our transportation insurance business in particular, including Vanliner's moving and storage insurance product, is also affected by cost trends that negatively impact profitability such as inflation in vehicle repair costs, vehicle replacement parts costs, used vehicle prices, fuel costs and medical care costs. We routinely obtain independent data for vehicle repair inflation, vehicle replacement parts costs, used vehicle prices, fuel costs and medical care costs and adjust our pricing routines to attempt to more accurately project the future costs associated with insurance claims. Historically, these increased costs have not had a material adverse impact on our results. Of course, we would expect a negative impact on our future results if we fail to properly account for and project for these inflationary trends. Increased litigation of claims may also negatively impact our profitability.

As described below, the average revenue dollar per personal lines policy is significantly lower than typical commercial policies. Profitability in the specialty personal lines component is dependent on proper pricing and the efficiency of underwriting and policy administration. We have continued to monitor rate levels and have adjusted them during 2010, as warranted. We continuously strive to improve our underwriting and policy issuance functions to keep this cost element as low as possible by utilizing current technology advances.

To succeed as a transportation underwriter and personal lines underwriter, we must understand and be able to quantify the different risk characteristics of the risks we consider quoting. Certain coverages are more stable and predictable than others and we must recognize the various components of the risks we assume when we write any specific class of insurance business. Examples of trends that can change and, therefore, impact our profitability are loss frequency, loss severity, geographic loss cost differentials, societal and legal factors impacting loss costs (such as tort reform, punitive damage inflation and increasing jury awards) and changes in regulation impacting the insurance relationship. Any changes in these factors that are not recognized and priced for accordingly will affect

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our future profitability. We believe our product management organization provides the focus on a specific risk class needed to stay current with the trends affecting each specific class of business we write.

Revenues

We derive our revenues primarily from premiums from our insurance policies and income from our investment portfolio. Our underwriting approach is to price our products to achieve an underwriting profit even if it requires us to forego volume. As with all P/C insurance companies, the impact of price changes is reflected in our financial results over time. Price changes on our in-force policies occur as they are renewed, which generally takes twelve months for our entire book of business and up to an additional twelve months to earn a full year of premium at the renewal rate. Insurance rates charged on renewing policies decreased slightly in 2010 compared to 2009.

There are distinct differences in the timing of premiums written in traditional transportation insurance compared to the majority of our ART insurance component. We write traditional transportation insurance policies throughout all twelve months of the year and commence new annual policies at the expiration of the old policy. Under most ART programs, all members of the group share a common renewal date. These common renewal dates are scheduled throughout the calendar year. Any new ART program participant that joins after the common date will be written for other than a full annual term so its next renewal date coincides with the common expiration date of the program it has joined. Historically, most of our group programs had common renewal dates in the first six months of the year, but with the growth from new ART programs, we are now experiencing renewal dates throughout the calendar year. The ART component of our business accounted for 52.4% of total gross premiums written during 2010 as compared to 55.9% in 2009.

The projected profitability from traditional transportation accounts and transportation captive businesses are substantially comparable. Increased investment income opportunities generally are available with traditional insurance, but the lower acquisition expenses and persistence of the captive programs generally provide for lower operating expenses from these programs. The lower expenses associated with our captives generally offset the projected reductions in investment income potential. From a projected profitability perspective, we are ambivalent as to whether a transportation operator elects to purchase traditional insurance or one of our ART program options.

All of our transportation products, traditional or ART, are priced to achieve targeted underwriting margins. Because traditional insurance tends to have a higher operating expense structure, the portion of the premiums available to pay losses tends to be lower for a traditional insurance quote versus an ART insurance quote. We use a cost plus pricing approach that projects future losses based upon the insured's historic losses and other factors. Operating expenses, premium taxes and a profit margin are then added to the projected loss component to achieve the total premium to be quoted. The lower the projected losses, expenses and taxes, the lower the total quoted premiums regardless of whether it is a traditional or ART program quotation. Quoted premiums are computed in accordance with our approved insurance department filings in each state.

Our specialty personal lines products are also priced to achieve targeted underwriting margins. The average premium per policy for this business component is significantly less than transportation lines.

We approach investment and capital management with the intention of supporting insurance operations by providing a stable source of income to supplement underwriting income. The goals of our investment policy are to protect capital while optimizing investment income and capital appreciation and maintaining appropriate liquidity. We follow a formal investment policy and the Board reviews the portfolio performance at least quarterly for compliance with the established guidelines. In 2010, income from new investments was lower due to the continued low interest rate environment, but the value of many of our existing holdings increased. As a result, we recorded a \$4.3 million pre-tax net realized gain on investments in 2010, which includes gains from securities sold to generate funds for the Vanliner

acquisition, as compared to the \$2.6 million pre-tax net realized gain recorded in 2009.

Expenses

Losses and loss adjustment expenses (LAE) are a function of the amount and type of insurance contracts we write and of the loss experience of the underlying risks. We record losses and LAE based on an actuarial analysis of the estimated losses we expect to be reported on contracts written. We seek to establish case reserves at the maximum

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probable exposure based on our historical claims experience. Our ability to estimate losses and LAE accurately at the time of pricing our contracts is a critical factor in determining our profitability. Vanliner's losses and LAE are recorded based on the same manner of actuarial analysis and claims reserving practices as our preexisting (legacy) operations. The amount reported under losses and LAE in any period includes payments in the period net of the change in the value of the reserves for unpaid losses and LAE between the beginning and the end of the period.

Commissions and other underwriting expenses consist principally of brokerage and agent commissions and to a lesser extent premium taxes. The brokerage and agent commissions are reduced by ceding commissions received from assuming reinsurers that represent a percentage of the premiums on insurance policies and reinsurance contracts written and vary depending upon the amount and types of contracts written. The cost structure of Vanliner's commissions and other underwriting expenses is comparable to the cost structure of our legacy operations and has not materially affected our underwriting profitability.

Other operating and general expenses consist primarily of personnel expenses (including salaries, benefits and certain costs associated with awards under our equity compensation plans, such as stock compensation expense) and other general operating expenses. Our personnel expenses are primarily fixed in nature and do not vary with the amount of premiums written. During 2010, we significantly increased our employee headcount in conjunction with the Vanliner acquisition. The personnel expenses attributable to Vanliner are in line with our legacy operations relative to the premium base they support and have not materially affected our operating results. Interest expenses associated with outstanding debt and Expense on amounts withheld are disclosed separately from operating and general expenses. We invest funds in the participant loss layer for several of our ART programs. We receive investment income and incur an equal expense on the amounts owed to ART participants. Expense on amounts withheld represents investment income that we remit back to ART participants. The related investment income is included in the Net investment income line on our Consolidated Statements of Income.

Results of Operations

Overview

The following table sets forth our 2010, 2009 and 2008 net income from operations, after-tax net realized gains (losses) from investments, change in valuation allowance on deferred tax assets related to net capital losses and the after-tax impact from Vanliner's guaranteed runoff business, all of which are non-GAAP financial measures that we believe are useful tools for investors and analysts in analyzing ongoing operating trends, as well as the gain on bargain purchase of Vanliner and net income.