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Employers Holdings, Inc.  
Form 10-Q  
August 08, 2013

UNITED STATES SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, DC 20549

FORM 10-Q

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

For the Quarterly Period Ended June 30, 2013

OR

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

For the transition period from \_\_\_\_ to \_\_\_\_

Commission file number: 001-33245

EMPLOYERS HOLDINGS, INC.

(Exact name of registrant as specified in its charter)

Nevada

(State or other jurisdiction

of incorporation or organization)

04-3850065

(I.R.S. Employer

Identification Number)

10375 Professional Circle, Reno, Nevada 89521

(Address of principal executive offices and zip code)

(888) 682-6671

(Registrant's telephone number, including area code)

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

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

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 definitions of "large accelerated filer," "accelerated filer," "non-accelerated filer," and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer R Accelerated filer o Non-accelerated filer o Smaller reporting company o

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

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Class

July 31, 2013

Common Stock, \$0.01 par value per share

31,002,391 shares outstanding

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## PART I – FINANCIAL INFORMATION

## Item 1. Consolidated Financial Statements

## Employers Holdings, Inc. and Subsidiaries

## Consolidated Balance Sheets

(in thousands, except share data)

	As of June 30, 2013 (unaudited)	As of December 31, 2012
Assets		
Available for sale:		
Fixed maturity securities at fair value (amortized cost \$1,989,823 at June 30, 2013 and \$1,869,142 at December 31, 2012)	\$2,070,027	\$2,024,428
Equity securities at fair value (cost \$85,559 at June 30, 2013 and \$81,067 at December 31, 2012)	140,369	125,086
Total investments	2,210,396	2,149,514
Cash and cash equivalents	97,060	140,661
Restricted cash and cash equivalents	4,602	5,353
Accrued investment income	19,786	19,356
Premiums receivable (less bad debt allowance of \$6,730 at June 30, 2013 and \$5,957 at December 31, 2012)	285,329	223,011
Reinsurance recoverable for:		
Paid losses	9,458	9,467
Unpaid losses	801,149	805,386
Deferred policy acquisition costs	45,608	38,852
Deferred income taxes, net	51,291	26,231
Property and equipment, net	15,489	14,680
Intangible assets, net	10,106	10,558
Goodwill	36,192	36,192
Contingent commission receivable—LPT Agreement	20,948	19,141
Other assets	10,061	12,937
Total assets	\$3,617,475	\$3,511,339
Liabilities and stockholders' equity		
Claims and policy liabilities:		
Unpaid losses and loss adjustment expenses	\$2,291,261	\$2,231,540
Unearned premiums	317,735	265,149
Total claims and policy liabilities	2,608,996	2,496,689
Commissions and premium taxes payable	42,611	40,825
Accounts payable and accrued expenses	15,758	19,522
Deferred reinsurance gain—LPT Agreement	274,183	281,043
Notes payable	112,000	112,000
Other liabilities	41,987	21,879
Total liabilities	3,095,535	2,971,958
Commitments and contingencies		
Stockholders' equity:		
Common stock, \$0.01 par value; 150,000,000 shares authorized; 54,371,465 and 54,144,453 shares issued and 30,998,491 and 30,771,479 shares outstanding at June 30, 2013 and December 31, 2012, respectively	544	541
Preferred stock, \$0.01 par value; 25,000,000 shares authorized; none issued	—	—

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Additional paid-in capital	331,977	325,991
Retained earnings	464,210	445,850
Accumulated other comprehensive income, net	87,759	129,549
Treasury stock, at cost (23,372,974 shares at June 30, 2013 and December 31, 2012)	(362,550)	(362,550)
Total stockholders' equity	521,940	539,381
Total liabilities and stockholders' equity	\$3,617,475	\$3,511,339

See accompanying unaudited notes to the consolidated financial statements.

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Employers Holdings, Inc. and Subsidiaries  
Consolidated Statements of Comprehensive Income  
(in thousands, except per share data)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
Revenues	(unaudited)		(unaudited)	
Net premiums earned	\$ 159,953	\$ 118,955	\$ 307,928	\$ 228,855
Net investment income	17,645	18,297	35,050	36,682
Realized gains on investments, net	3,866	945	4,660	2,723
Other income	144	114	247	195
Total revenues	181,608	138,311	347,885	268,455
Expenses				
Losses and loss adjustment expenses	112,638	87,809	220,910	168,327
Commission expense	20,127	16,621	38,520	30,437
Underwriting and other operating expenses	32,249	30,316	63,789	63,305
Interest expense	797	858	1,605	1,760
Total expenses	165,811	135,604	324,824	263,829
Net income before income taxes	15,797	2,707	23,061	4,626
Income tax expense (benefit)	1,209	(2,309)	983	(6,730)
Net income	\$ 14,588	\$ 5,016	\$ 22,078	\$ 11,356
Earnings per common share (Note 10):				
Basic	\$0.47	\$0.16	\$0.71	\$0.35
Diluted	\$0.46	\$0.16	\$0.70	\$0.35
Cash dividends declared per common share	\$0.06	\$0.06	\$0.12	\$0.12
Comprehensive income				
Unrealized gains (losses) during the period (net of tax expense (benefit) of \$(20,886) and \$2,070 for the three months ended June 30, 2013 and 2012, respectively, and \$(20,870) and \$5,324 for the six months ended June 30, 2013 and 2012, respectively)	\$(38,787)	\$ 3,844	\$(38,761)	\$ 9,888
Reclassification adjustment for realized gains in net income (net of taxes of \$1,353 and \$331 for the three months ended June 30, 2013 and 2012, respectively, and \$1,631 and \$952 for the six months ended June 30, 2013 and 2012, respectively)	(2,513)	(614)	(3,029)	(1,771)
Other comprehensive income (loss), net of tax	(41,300)	3,230	(41,790)	8,117
Total comprehensive income (loss)	\$(26,712)	\$ 8,246	\$(19,712)	\$ 19,473
Realized gains on investments, net				
Net realized gains on investments before credit related impairments on fixed maturity securities	\$ 3,934	\$ 1,005	\$ 4,728	\$ 3,252
Other than temporary impairment, credit losses recognized in earnings	(68)	(60)	(68)	(529)
Realized gains on investments, net	\$ 3,866	\$ 945	\$ 4,660	\$ 2,723
See accompanying unaudited notes to the consolidated financial statements.				



Employers Holdings, Inc. and Subsidiaries  
Consolidated Statements of Cash Flows  
(in thousands)

	Six Months Ended	
	June 30,	
	2013	2012
	(unaudited)	
Operating activities		
Net income	\$22,078	\$11,356
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	2,800	2,787
Stock-based compensation	4,169	2,542
Amortization of premium on investments, net	4,310	3,400
Deferred income tax expense	(2,558)	(7,675)
Realized gains on investments, net	(4,660)	(2,723)
Excess tax benefits from stock-based compensation	(349)	—
Other	549	449
Change in operating assets and liabilities:		
Premiums receivable	(63,091)	(56,776)
Reinsurance recoverable for paid and unpaid losses	4,246	21,868
Federal income taxes	2,848	876
Unpaid losses and loss adjustment expenses	59,721	9,426
Unearned premiums	52,586	62,846
Accounts payable, accrued expenses and other liabilities	15,389	7,166
Deferred reinsurance gain—LPT Agreement	(6,860)	(8,276)
Contingent commission receivable—LPT Agreement	(1,807)	(597)
Other	(4,179)	7,306
Net cash provided by operating activities	85,192	53,975
Investing activities		
Purchase of fixed maturities	(211,889)	(181,836)
Purchase of equity securities	(18,190)	(23,303)
Proceeds from sale of fixed maturities	706	34,560
Proceeds from sale of equity securities	18,357	8,451
Proceeds from maturities and redemptions of investments	86,326	110,160
Proceeds from sale of fixed assets	139	75
Capital expenditures and other	(3,206)	(3,326)
Restricted cash and cash equivalents provided by (used in) investing activities	751	(842)
Net cash used in investing activities	(127,006)	(56,061)
Financing activities		
Acquisition of treasury stock	—	(37,322)
Cash transactions related to stock-based compensation	1,572	(279)
Dividends paid to stockholders	(3,708)	(3,822)
Excess tax benefits from stock-based compensation	349	—
Net cash used in financing activities	(1,787)	(41,423)
Net decrease in cash and cash equivalents	(43,601)	(43,509)
Cash and cash equivalents at the beginning of the period	140,661	252,300
Cash and cash equivalents at the end of the period	\$97,060	\$208,791
See accompanying unaudited notes to the consolidated financial statements.		





Employers Holdings, Inc. and Subsidiaries  
Notes to Consolidated Financial Statements  
(Unaudited)

1. Basis of Presentation and Summary of Operations

Employers Holdings, Inc. (EHI) is a Nevada holding company. Through its wholly owned insurance subsidiaries, Employers Insurance Company of Nevada (EICN), Employers Compensation Insurance Company (ECIC), Employers Preferred Insurance Company (EPIC), and Employers Assurance Company (EAC), EHI is engaged in the commercial property and casualty insurance industry, specializing in workers' compensation products and services. Unless otherwise indicated, all references to the "Company" refer to EHI, together with its subsidiaries.

The accompanying consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles (GAAP) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X of the Securities Exchange Act of 1934, as amended. Accordingly, they do not include all of the information and notes required by GAAP for complete financial statements. In the opinion of management, all adjustments (consisting of normal, recurring adjustments) necessary for a fair presentation of the Company's consolidated financial position and results of operations for the periods presented have been included. The results of operations for an interim period are not necessarily indicative of the results for an entire year. These financial statements have been prepared consistent with the accounting policies described in the Company's Annual Report on Form 10-K for the year ended December 31, 2012.

The Company considers an operating segment to be any component of its business whose operating results are regularly reviewed by the Company's chief operating decision makers to make decisions about resources to be allocated to the segment and assess its performance based on discrete financial information. Currently, the Company has one operating segment, workers' compensation insurance and related services.

Use of Estimates

The preparation of the consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, and disclosure of contingent assets and liabilities, at the date of the consolidated financial statements, as well as the reported amounts of revenues and expenses during the reporting period. As a result, actual results could differ from these estimates. The most significant areas that require management judgment are the estimate of unpaid losses and loss adjustment expenses (LAE), evaluation of reinsurance recoverables, recognition of premium revenue, deferred income taxes, investments, and the valuation of goodwill and intangible assets.

Reclassifications

Certain prior period information has been reclassified to conform to the current period presentation.

2. New Accounting Standards

In February 2013, the Financial Accounting Standards Board issued Accounting Standards Update Number 2013-02, Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income (Topic 220). This update requires companies to report the effect of significant reclassifications out of accumulated other comprehensive income on the respective line items in net income if the amount being reclassified is required under GAAP to be reclassified in its entirety to net income. For other amounts that are not required under GAAP to be reclassified in their entirety to net income in the same reporting period, an entity is required to cross-reference other disclosures required under GAAP that provide additional detail about those amounts. This update became effective prospectively for reporting periods beginning after December 15, 2012. The Company adopted this update beginning in the first quarter of 2013. The adoption of this new guidance did not have a material impact on the Company's consolidated financial condition or results of operations.

### 3. Fair Value of Financial Instruments

The carrying value and the estimated fair value of the Company's financial instruments were as follows:

	June 30, 2013		December 31, 2012	
	Carrying Value	Estimated Fair Value	Carrying Value	Estimated Fair Value
	(in thousands)			
Financial assets				
Investments	\$2,210,396	\$2,210,396	\$2,149,514	\$2,149,514
Cash and cash equivalents	97,060	97,060	140,661	140,661
Restricted cash and cash equivalents	4,602	4,602	5,353	5,353
Financial liabilities				
Notes payable	112,000	114,261	112,000	118,207

The Company's estimates of fair value for financial liabilities are based on a combination of the variable interest rates for the Company's existing line of credit and other notes with similar durations to discount the projection of future payments on notes payable, and have been determined to be Level 2 fair value measurements, as defined below.

Assets and liabilities recorded at fair value on the consolidated balance sheets are categorized based upon the levels of judgment associated with the inputs used to measure their fair value. Level inputs are defined as follows:

Level 1 - Inputs are unadjusted quoted market prices for identical assets or liabilities in active markets at the measurement date.

Level 2 - Inputs other than Level 1 prices that are observable for similar assets or liabilities through corroboration with market data at the measurement date.

Level 3 - Inputs that are unobservable that reflect management's best estimate of what market participants would use in pricing the assets or liabilities at the measurement date.

The following methods and assumptions were used to determine the fair value of each class of assets and liabilities recorded at fair value in the consolidated balance sheets.

Fair value of available-for-sale fixed maturity and equity securities is based on quoted market prices, where available, and is obtained primarily from third party pricing services, which generally use Level 1 or Level 2 inputs. The Company obtains a quoted price for each security from third party pricing services. The quoted prices are derived through recently reported trades for identical or similar securities. For securities not actively traded, the third party pricing services may use quoted market prices of similar instruments or discounted cash flow analyses, incorporating inputs that are currently observable in the markets for similar securities. Inputs that are often used in the valuation methodologies include, but are not limited to, broker quotes, benchmark yields, credit spreads, default rates, and prepayment speeds. The Company also performs a quarterly analysis on the prices received from third party pricing services to determine whether the prices are reasonable estimates of fair value, including confirming the fair values of these securities through observable market prices using an alternative pricing source. If differences are noted in this review, the Company may obtain additional information from other pricing services to validate the quoted price.

There were no adjustments to prices obtained from third party pricing services as of June 30, 2013 or December 31, 2012 that were material to the consolidated financial statements.

If quoted market prices and an estimate determined by using objectively verifiable information are unavailable, the Company produces an estimate of fair value based on internally developed valuation techniques, which, depending on the level of observable market inputs, will render the fair value estimate as Level 2 or Level 3. The Company bases all of its estimates of fair value for assets on the bid price as it represents what a third party market participant would be willing to pay in an arm's length transaction.

These methods of valuation will only produce an estimate of fair value if there is objectively verifiable information to produce a valuation. If objectively verifiable information is not available, the Company would be required to produce an estimate of fair value using some of the same methodologies, making assumptions for market based inputs that are unavailable.

Estimates of fair value for fixed maturity securities are based on estimates using objectively verifiable information and are included in the amount disclosed in Level 2 of the hierarchy. The fair value estimates for determining Level 3 fair

value include the Company's assumptions about risk assessments and market participant assumptions based on the best information available, including quotes from market makers and other broker/dealers recognized as market participants, using standard or trade derived inputs, new issue data, monthly payment information, cash flow generation, prepayment speeds, spread adjustments, or rating updates.

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The following table presents the items on the accompanying consolidated balance sheets that are stated at fair value and the fair value measurements.

	June 30, 2013			December 31, 2012		
	Level 1	Level 2	Level 3	Level 1	Level 2	Level 3
	(in thousands)					
Fixed maturity securities						
U.S. Treasuries	\$—	\$152,085	\$—	\$—	\$152,490	\$—
U.S. Agencies	—	89,031	—	—	93,967	—
States and municipalities	—	754,833	—	—	758,516	—
Corporate securities	—	746,808	—	—	676,243	—
Residential mortgage-backed securities	—	239,025	—	—	252,852	—
Commercial mortgage-backed securities	—	51,433	—	—	56,120	—
Asset-backed securities	—	36,812	—	—	34,240	—
Total fixed maturity securities	—	2,070,027	—	—	2,024,428	—
Equity securities	\$140,369	\$—	\$—	\$125,086	\$—	\$—

4. Investments

The cost or amortized cost, gross unrealized gains, gross unrealized losses, and estimated fair value of the Company's investments were as follows:

	Cost or Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
	(in thousands)			
At June 30, 2013				
Fixed maturity securities				
U.S. Treasuries	\$143,294	\$8,830	\$(39)	\$152,085
U.S. Agencies	85,104	3,930	(3)	89,031
States and municipalities	713,702	45,248	(4,117)	754,833
Corporate securities	725,567	31,031	(9,790)	746,808
Residential mortgage-backed securities	231,561	10,260	(2,796)	239,025
Commercial mortgage-backed securities	53,618	423	(2,608)	51,433
Asset-backed securities	36,977	94	(259)	36,812
Total fixed maturity securities	1,989,823	99,816	(19,612)	2,070,027
Equity securities	85,559	55,114	(304)	140,369
Total investments	\$2,075,382	\$154,930	\$(19,916)	\$2,210,396
At December 31, 2012				
Fixed maturity securities				
U.S. Treasuries	\$138,839	\$13,651	\$—	\$152,490
U.S. Agencies	88,202	5,765	—	93,967
States and municipalities	689,776	68,740	—	758,516
Corporate securities	627,047	49,461	(265)	676,243
Residential mortgage-backed securities	236,461	16,488	(97)	252,852
Commercial mortgage-backed securities	54,755	1,410	(45)	56,120
Asset-backed securities	34,062	211	(33)	34,240
Total fixed maturity securities	1,869,142	155,726	(440)	2,024,428
Equity securities	81,067	45,399	(1,380)	125,086
Total investments	\$1,950,209	\$201,125	\$(1,820)	\$2,149,514



The amortized cost and estimated fair value of fixed maturity securities at June 30, 2013, by contractual maturity, are shown below. Expected maturities differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	Amortized Cost (in thousands)	Estimated Fair Value
Due in one year or less	\$ 151,956	\$ 154,046
Due after one year through five years	751,560	784,120
Due after five years through ten years	583,868	614,269
Due after ten years	180,283	190,322
Mortgage and asset-backed securities	322,156	327,270
Total	\$ 1,989,823	\$ 2,070,027

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The following is a summary of investments that have been in a continuous unrealized loss position for less than 12 months and those that have been in a continuous unrealized loss position for 12 months or greater as of June 30, 2013 and December 31, 2012.

	June 30, 2013			December 31, 2012		
	Estimated Fair Value	Gross Unrealized Losses	Number of Issues	Estimated Fair Value	Gross Unrealized Losses	Number of Issues
	(dollars in thousands)					
Less than 12 months:						
Fixed maturity securities						
U.S. Treasuries	\$12,107	\$(39)	) 5	\$—	\$—	—
U.S. Agencies	3,025	(3)	) 1	—	—	—
States and municipalities	96,389	(4,117)	) 26	—	—	—
Corporate securities	292,305	(9,664)	) 110	36,338	(265)	) 12
Residential mortgage-backed securities	80,475	(2,785)	) 36	14,629	(28)	) 6
Commercial mortgage-backed securities	33,254	(2,608)	) 10	10,432	(45)	) 4
Asset-backed securities	28,903	(259)	) 13	16,714	(33)	) 5
Total fixed maturity securities	546,458	(19,475)	) 201	78,113	(371)	) 27
Equity securities	10,005	(268)	) 38	11,645	(1,207)	) 35
Total less than 12 months	\$556,463	\$(19,743)	) 239	\$89,758	\$(1,578)	) 62
12 months or greater:						
Fixed maturity securities						
Corporate securities	\$2,460	\$(126)	) 1	\$—	\$—	—
Residential mortgage-backed securities	511	(11)	) 17	2,341	(69)	) 17
Total fixed maturity securities	2,971	(137)	) 18	2,341	(69)	) 17
Equity securities	331	(36)	) 2	456	(173)	) 4
Total 12 months or greater	\$3,302	\$(173)	) 20	\$2,797	\$(242)	) 21
Total available-for-sale:						
Fixed maturity securities						
U.S. Treasuries	\$12,107	\$(39)	) 5	\$—	\$—	—
U.S. Agencies	3,025	(3)	) 1	—	—	—
States and municipalities	96,389	(4,117)	) 26	—	—	—
Corporate securities	294,765	(9,790)	) 111	36,338	(265)	) 12
Residential mortgage-backed securities	80,986	(2,796)	) 53	16,970	(97)	) 23
Commercial mortgage-backed securities	33,254	(2,608)	) 10	10,432	(45)	) 4
Asset-backed securities	28,903	(259)	) 13	16,714	(33)	) 5
Total fixed maturity securities	549,429	(19,612)	) 219	80,454	(440)	) 44
Equity securities	10,336	(304)	) 40	12,101	(1,380)	) 39
Total available-for-sale	\$559,765	\$(19,916)	) 259	\$92,555	\$(1,820)	) 83

Based on reviews of the fixed maturity securities, the Company determined that unrealized losses as of June 30, 2013 were primarily the result of changes in prevailing interest rates and not the credit quality of the issuers. The fixed maturity securities whose total fair value was less than amortized cost were not determined to be



other-than-temporarily impaired given the severity and duration of the impairment, the credit quality of the issuers, the Company's intent to not sell the securities, and a determination that it is not more likely than not that the Company will be required to sell the securities until fair value recovers to above cost, or maturity.

Based on reviews of the equity securities as of June 30, 2013, the Company recognized an impairment of \$0.1 million in the fair value of one equity security as a result of the severity and duration of the change in fair value of that security.

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Realized gains on investments, net, and the change in unrealized gains (losses) on fixed maturity and equity securities are determined on a specific-identification basis and were as follows:

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2013	2012	2013	2012
	(in thousands)			
Realized gains on investments, net				
Fixed maturity securities				
Gross gains	\$ 1	\$ 592	\$ 1	\$ 2,295
Gross losses	—	—	—	(5 )
Realized gains on fixed maturity securities, net	\$ 1	\$ 592	\$ 1	\$ 2,290
Equity securities				
Gross gains	\$ 3,933	\$ 613	\$ 4,977	\$ 1,161
Gross losses	(68 )	(260 )	(318 )	(728 )
Realized gains on equity securities, net	\$ 3,865	\$ 353	\$ 4,659	\$ 433
Total	\$ 3,866	\$ 945	\$ 4,660	\$ 2,723
Change in unrealized gains (losses)				
Fixed maturity securities	\$(62,851 )	\$ 8,015	\$(75,082 )	\$ 3,558
Equity securities	(687 )	(3,047 )	10,790	8,931
Total	\$(63,538 )	\$ 4,968	\$(64,292 )	\$ 12,489

Net investment income was as follows:

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2013	2012	2013	2012
	(in thousands)			
Fixed maturity securities	\$ 17,280	\$ 18,045	\$ 34,526	\$ 36,289
Equity securities	947	777	1,783	1,424
Cash equivalents and restricted cash	28	94	63	223
	18,255	18,916	36,372	37,936
Investment expenses	(610 )	(619 )	(1,322 )	(1,254 )
Net investment income	\$ 17,645	\$ 18,297	\$ 35,050	\$ 36,682

The Company is required by various state laws and regulations to keep securities or letters of credit in depository accounts with certain states in which it does business. As of June 30, 2013 and December 31, 2012, securities having a fair value of \$592.1 million and \$530.6 million, respectively, were on deposit. These laws and regulations govern not only the amount, but also the types of securities that are eligible for deposit. The deposits are limited to fixed maturity securities in all states. Additionally, certain reinsurance contracts require Company funds to be held in trust for the benefit of the ceding reinsurer to secure the outstanding liabilities assumed by the Company. The fair value of fixed maturity securities held in trust for the benefit of ceding reinsurers at June 30, 2013 and December 31, 2012 was \$32.0 million and \$35.0 million, respectively. Pursuant to the Amended Credit Facility, a portion of the Company's debt was secured by fixed maturity securities and restricted cash and cash equivalents that had a fair value of \$107.2 million and \$110.4 million at June 30, 2013 and December 31, 2012, respectively.

#### 5. Income Taxes

Income tax expense for interim periods is measured using an estimated effective tax rate for the annual period. The following is a reconciliation of the federal statutory income tax rate to the Company's effective tax rates for the periods presented.

Six Months Ended  
June 30,

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	2013		2012	
Expense computed at statutory rate	35.0	%	35.0	%
Dividends received deduction and tax-exempt interest	(19.7	)	(108.9	)
LPT Agreement	(12.0	)	(76.2	)
Other	1.0		4.6	
Effective tax rate	4.3	%	(145.5	)%

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## 6. Liability for Unpaid Losses and Loss Adjustment Expenses

The following table represents a reconciliation of changes in the liability for unpaid losses and LAE.

	Six Months Ended	
	June 30,	
	2013	2012
	(in thousands)	
Unpaid losses and LAE, gross of reinsurance, at beginning of period	\$2,231,540	\$2,272,363
Less reinsurance recoverables for unpaid losses and LAE	805,386	940,840
Net unpaid losses and LAE at beginning of period	1,426,154	1,331,523
Losses and LAE, net of reinsurance, related to:		
Current period	227,926	176,145
Prior periods	1,651	1,054
Total net losses and LAE incurred during the period	229,577	177,199
Deduct payments for losses and LAE, net of reinsurance, related to:		
Current period	21,843	18,520
Prior periods	143,776	128,460
Total net payments for losses and LAE during the period	165,619	146,980
Ending unpaid losses and LAE, net of reinsurance	1,490,112	1,361,742
Reinsurance recoverable for unpaid losses and LAE	801,149	920,047
Unpaid losses and LAE, gross of reinsurance, at end of period	\$2,291,261	\$2,281,789

Total net losses and LAE included in the above table excludes the impact of the amortization of the deferred reinsurance gain—LPT Agreement (Deferred Gain) (Note 7).

The increase in the estimates of incurred losses and LAE attributable to insured events for prior periods was primarily related to the Company's assigned risk business.

## 7. LPT Agreement

The Company is party to a 100% quota share retroactive reinsurance agreement (LPT Agreement) under which \$1.5 billion in liabilities for losses and LAE related to claims incurred by EICN prior to July 1, 1995 were reinsured for consideration of \$775.0 million. The LPT Agreement provides coverage up to \$2.0 billion. The initial Deferred Gain resulting from the LPT Agreement was recorded as a liability in the accompanying consolidated balance sheets as Deferred reinsurance gain—LPT Agreement. The Company is also entitled to receive a contingent profit commission under the LPT Agreement. The contingent profit commission is an amount based on the favorable difference between actual paid losses and LAE and expected paid losses and LAE as established in the LPT Agreement. The Company records its estimate of contingent profit commission in the accompanying consolidated balance sheets as Contingent commission receivable—LPT Agreement and a corresponding liability is recorded on the accompanying consolidated balance sheets in Deferred reinsurance gain—LPT Agreement. The Deferred Gain is being amortized using the recovery method. Amortization is determined by the proportion of actual reinsurance recoveries to total estimated recoveries over the life of the LPT Agreement, except for the contingent profit commission, which is amortized through June 30, 2024. The amortization is recorded in losses and LAE incurred in the accompanying consolidated statements of comprehensive income. Any adjustments to the Deferred Gain are recorded in losses and LAE incurred in the accompanying consolidated statements of comprehensive income. There were no adjustments to the estimated reserves ceded under the LPT Agreement in the current period.

The Company amortized \$8.7 million and \$8.9 million of the Deferred Gain for the six months ended June 30, 2013 and 2012, respectively. The remaining Deferred Gain was \$274.2 million and \$281.0 million as of June 30, 2013 and December 31, 2012, respectively. The estimated remaining liabilities subject to the LPT Agreement were \$655.6 million and \$672.3 million as of June 30, 2013 and December 31, 2012, respectively. Losses and LAE paid with respect to the LPT Agreement totaled \$621.8 million and \$605.1 million through June 30, 2013 and December 31, 2012, respectively.



8. Accumulated Other Comprehensive Income, net

Accumulated other comprehensive income, net, is comprised of unrealized gains on investments classified as available-for-sale, net of deferred tax expense. The following table summarizes the components of accumulated other comprehensive income, net:

	June 30, 2013 (in thousands)	December 31, 2012
Net unrealized gain on investments, before taxes	\$ 135,014	\$ 199,305
Deferred tax expense on net unrealized gains	(47,255	) (69,756
Total accumulated other comprehensive income, net	\$87,759	\$ 129,549

9. Stock-Based Compensation

The Company awarded stock options, restricted stock units (RSUs) and performance share units (PSUs) to certain officers and Directors of the Company as follows:

	Number Awarded	Weighted Average Fair Value on Date of Grant	Weighted Average Exercise Price	Aggregate Fair Value on Date of Grant (in millions)
March 2013				
Stock options <sup>(1)</sup>	162,800	\$7.04	\$22.24	\$ 1.1
RSUs <sup>(1)</sup>	73,894	22.24	—	1.6
PSUs <sup>(2)</sup>	147,440	22.24	—	3.3
May 2013				
RSUs <sup>(1)</sup>	14,550	24.74	—	0.4

The stock options and RSUs awarded in March 2013 were awarded to certain officers of the Company and vest 25% on March 19, 2014, and each of the subsequent three anniversaries of that date. The stock options and RSUs (1) are subject to accelerated vesting in certain circumstances, such as: death or disability, or in connection with change of control of the Company. The stock options expire seven years from the date of grant.

The RSUs awarded in May 2013 were granted to non-employee Directors of the Company and have a service vesting period of one year from the grant date.

The PSUs have a performance period of three years and are subject to certain performance goals, based on the (2) Company's statutory combined ratio, with payouts that range from 0% to 200% of the target awards. The values shown in the table represent the target number of PSUs awarded.

A total of 136,047 and 101,261 stock options were exercised during the six months ended June 30, 2013 and the year ended December 31, 2012, respectively.

## 10. Earnings Per Share

Basic earnings per share includes no dilution and is computed by dividing income applicable to stockholders by the weighted average number of shares outstanding for the period. Diluted earnings per share reflects the potential dilutive impact of all convertible securities on earnings per share. Diluted earnings per share includes shares assumed issued under the “treasury stock method,” which reflects the potential dilution that would occur if outstanding options were to be exercised. The following table presents the net income and the weighted average shares outstanding used in the earnings per common share calculations.

	Three Months Ended		Six Months Ended	
	June 30, 2013	2012	June 30, 2013	2012
	(in thousands, except share data)			
Net income available to stockholders—basic and diluted	\$ 14,588	\$ 5,016	\$ 22,078	\$ 11,356
Weighted average number of shares outstanding—basic	31,079,713	31,537,452	30,997,552	32,093,328
Effect of dilutive securities:				
PSUs	209,795	20,229	167,388	8,975
Stock options	296,893	82,385	279,405	83,547
RSUs	55,215	45,570	71,399	56,741
Dilutive potential shares	561,903	148,184	518,192	149,263
Weighted average number of shares outstanding—diluted	31,641,616	31,685,636	31,515,744	32,242,591

Diluted earnings per share excludes outstanding options and other common stock equivalents in periods where the inclusion of such options and common stock equivalents would be anti-dilutive. The following table presents options and RSUs that were excluded from diluted earnings per share.

	Three Months Ended		Six Months Ended	
	June 30, 2013	2012	June 30, 2013	2012
Options excluded as the exercise price was greater than the average market price	—	934,597	—	934,597
Options and RSUs excluded under the treasury method as the potential proceeds on settlement or exercise price was greater than the value of shares acquired	162,800	654,123	511,477	555,084

## Item 2. Management's Discussion and Analysis of Consolidated Financial Condition and Results of Operations

You should read the following discussion and analysis in conjunction with our consolidated financial statements and the related notes thereto included in Item 1 of Part I. Unless otherwise indicated, all references to "we," "us," "our," "the Company," or similar terms refer to Employers Holdings, Inc. (EHI), together with its subsidiaries. The information contained in this quarterly report is not a complete description of our business or the risks associated with an investment in our common stock. We urge you to carefully review and consider the various disclosures made by us in this quarterly report and in our other reports filed with the Securities and Exchange Commission (SEC), including our Annual Report on Form 10-K for the year ended December 31, 2012 (Annual Report).

The Private Securities Litigation Reform Act of 1995 provides a safe harbor for forward-looking statements if accompanied by meaningful cautionary statements identifying important factors that could cause actual results to differ materially from those discussed. You should not place undue reliance on these statements, which speak only as of the date of this report. Forward-looking statements include those related to our expected financial position, business, financing plans, litigation, future premiums, revenues, earnings, pricing, investments, business relationships, expected losses, loss experience, loss reserves, acquisitions, competition, the impact of changes in interest rates, rate increases with respect to our business, and the insurance industry in general. Statements including words such as "expect," "intend," "plan," "believe," "estimate," "may," "anticipate," "will" or similar statements of a future or forward-looking nature identify forward-looking statements.

We undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events, or otherwise, except as required by law. All forward-looking statements address matters that involve risks and uncertainties that could cause actual results to differ materially from historical or anticipated results, depending on a number of factors. These risks and uncertainties include, but are not limited to, those described in our Annual Report and other documents that we have filed with the SEC.

### Overview

We are a Nevada holding company. Through our insurance subsidiaries, we provide workers' compensation insurance coverage to select, small businesses in low to medium hazard industries. Workers' compensation insurance is provided under a statutory system wherein most employers are required to provide coverage for their employees' medical, disability, vocational rehabilitation, and/or death benefit costs for work-related injuries or illnesses. We provide workers' compensation insurance in 31 states and the District of Columbia, with a concentration in California, where over one-half of our business is generated. Our revenues are primarily comprised of net premiums earned, net investment income, and net realized gains on investments.

We target small businesses, as we believe that this market is traditionally characterized by fewer competitors, more attractive pricing, and stronger persistency when compared to the U.S. workers' compensation insurance industry in general. We believe we are able to price our policies at levels that are competitive and profitable over the long-term. Our underwriting approach is to consistently underwrite small business accounts at appropriate and competitive prices without sacrificing long-term profitability and stability for short-term top-line revenue growth.

Our goal is to maintain our focus on disciplined underwriting and to continue to pursue profitable growth opportunities across market cycles; however, we continue to be affected by persistently low investment yields and continuing high levels of unemployment nationally. We do not believe overall economic conditions will change significantly in the near-term.

We market and sell our workers' compensation insurance products through independent local, regional, and national agents and brokers; through our strategic partnerships and alliances, including our principal partners ADP, Inc. and Anthem Blue Cross of California; and through relationships with national, regional, and local trade groups and associations.

### Results of Operations

Overall, net income was \$14.6 million and \$22.1 million for the three and six months ended June 30, 2013, respectively, compared to \$5.0 million and \$11.4 million for the corresponding periods of 2012. We recognized underwriting losses of \$5.1 million and \$15.3 million for the three and six months ended June 30, 2013, respectively, compared to underwriting losses of \$15.8 million and \$33.2 million for the same periods of 2012. Underwriting income or loss is determined by deducting losses and LAE, commission expense, and underwriting and other



operating expenses from net premiums earned. Key factors that affected our financial performance during the three and six months ended June 30, 2013, compared to the same periods of 2012, include:

• Gross premiums written increased 24.2% and 23.4%;

• Net premiums earned increased 34.5% and 34.6%;

• Losses and LAE increased 28.3% and 31.2%;

• Underwriting and other operating expenses increased 6.4% and 0.8%;

Income tax expenses increased \$3.5 million and \$7.7 million; and

Unrealized gains on investments, net of deferred tax expense, decreased \$44.5 million and \$49.9 million.

A primary measure of our performance is our ability to increase stockholders' equity, including the impact of the Deferred reinsurance gain—LPT Agreement (Deferred Gain), over the long-term; however, during periods of rising interest rates, the fair value of the fixed income component of our investment portfolio may be negatively impacted, thereby reducing stockholders' equity. During the second quarter of 2013, the unrealized gain in our portfolio, net of deferred tax expense, declined by \$41.3 million, principally as a result of the upward movement in interest rates during the quarter. The following table shows our stockholders' equity including the Deferred Gain, stockholders' equity on a GAAP basis, and number of common shares outstanding.

	June 30, 2013 (in thousands, except share data)	December 31, 2012
Stockholders' equity including the Deferred Gain <sup>(1)</sup>	\$796,123	\$820,424
GAAP stockholders' equity	\$521,940	\$539,381
Common shares outstanding	30,998,491	30,771,479

<sup>(1)</sup> Stockholders' equity, including the Deferred Gain, is a non-GAAP measure that is defined as total stockholders' equity plus the Deferred Gain, which we believe is an important supplemental measure of our capital position.

The comparative components of net income are set forth in the following table:

	Three Months Ended		Six Months Ended	
	June 30, 2013	2012	June 30, 2013	2012
	(in thousands)			
Gross premiums written	\$190,068	\$153,094	\$365,031	\$295,888
Net premiums written	186,996	150,364	359,022	290,728
Net premiums earned	\$159,953	\$118,955	\$307,928	\$228,855
Net investment income	17,645	18,297	35,050	36,682
Realized gains on investments, net	3,866	945	4,660	2,723
Other income	144	114	247	195
Total revenues	181,608	138,311	347,885	268,455
Losses and LAE	112,638	87,809	220,910	168,327
Commission expense	20,127	16,621	38,520	30,437
Underwriting and other operating expenses	32,249	30,316	63,789	63,305
Interest expense	797	858	1,605	1,760
Income tax expense (benefit)	1,209	(2,309)	983	(6,730)
Total expenses	167,020	133,295	325,807	257,099
Net income	\$14,588	\$5,016	\$22,078	\$11,356
Less amortization of the Deferred Gain related to losses	\$3,275	\$3,828	\$6,580	\$7,984
Less amortization of the Deferred Gain related to contingent commission	406	256	788	525
Less impact of LPT Contingent Commission Adjustments <sup>(1)</sup>	1,024	227	1,299	363
Net income before impact of the LPT Agreement <sup>(2)</sup>	\$9,883	\$705	\$13,411	\$2,484

Any adjustment to the contingent profit commission under the LPT Agreement results in a cumulative adjustment to the Deferred Gain, which is also recognized in losses and LAE incurred in the consolidated statement of income (1) and comprehensive income, such that the Deferred Gain reflects the balance that would have existed had the revised contingent profit commission been recognized at the inception of the LPT Agreement (LPT Contingent Commission Adjustments).

(2) We define net income before impact of the LPT Agreement as net income before the impact of: (a) amortization of Deferred Gain; (b) adjustments to LPT Agreement ceded reserves; and (c) adjustments to contingent commission

receivable–LPT Agreement. Deferred Gain reflects the unamortized gain from our LPT Agreement. Under GAAP, this gain is deferred and is being amortized using the recovery method. Amortization is determined by the proportion of actual reinsurance recoveries to total estimated recoveries over the life of the LPT Agreement, except for the contingent profit commission, which is amortized through June 30, 2024. The amortization is reflected in losses and LAE. We periodically reevaluate the remaining direct reserves subject to the LPT Agreement and the expected losses and LAE subject to the contingent profit commission under the LPT Agreement. Our reevaluation results in corresponding adjustments, if needed, to reserves,

ceded reserves, contingent commission receivable, and the Deferred Gain, with the net effect being an increase or decrease, as the case may be, to net income. Net income before impact of the LPT Agreement is not a measurement of financial performance under GAAP, but rather reflects a difference in accounting treatment between statutory and GAAP, and should not be considered in isolation or as an alternative to net income before income taxes or net income, or any other measure of performance derived in accordance with GAAP.

We present net income before impact of the LPT Agreement because we believe that it is an important supplemental measure of operating performance to be used by analysts, investors, and other interested parties in evaluating us. The LPT Agreement was a non-recurring transaction under which the Deferred Gain does not effect our ongoing operations, and, consequently, we believe this presentation is useful in providing a meaningful understanding of our operating performance. In addition, we believe this non-GAAP measure, as we have defined it, is helpful to our management in identifying trends in our performance because the excluded item has limited significance on our current and ongoing operations.

#### Net Premiums Earned

Net premiums earned increased 34.5% and 34.6% for the three and six months ended June 30, 2013, compared to the corresponding periods in 2012. These increases were primarily due to increasing policy count, increasing average policy size, and higher net rate.

The following table shows the percentage change in our in-force premium, policy count, average policy size, payroll exposure upon which our premiums are based, and net rate.

	As of June 30, 2013	
	Year-to-Date Increase	Year-Over-Year Increase
In-force premiums	9.8	% 23.9
In-force policy count	3.9	15.2
Average in-force policy size	5.6	7.5
In-force payroll exposure	4.1	12.4
Net rate <sup>(1)</sup>	5.5	10.1

Net rate, defined as total premium in-force divided by total insured payroll exposure, is a function of a variety of (1) factors, including rate changes, underwriting risk profiles and pricing, and changes in business mix related to economic and competitive pressures.

Our in-force premiums and number of policies in-force by select states were as follows:

State	June 30, 2013		December 31, 2012		June 30, 2012		December 31, 2011	
	Premiums In-force	Policies In-force	Premiums In-force	Policies In-force	Premiums In-force	Policies In-force	Premiums In-force	Policies In-force
	(dollars in thousands)							
California	\$349,253	47,659	\$317,890	46,829	\$274,379	42,577	\$221,910	36,867
Illinois	31,583	3,284	30,555	3,302	28,816	3,125	24,744	2,433
Georgia	25,329	3,566	22,985	3,150	19,882	2,628	16,393	2,050
Florida	19,041	3,117	17,676	2,918	16,909	2,723	15,226	2,399
Nevada	16,001	3,847	15,522	3,876	15,748	3,845	14,639	3,718
Other	148,583	21,459	132,714	19,739	120,473	17,073	101,009	13,226
Total	\$589,790	82,932	\$537,342	79,814	\$476,207	71,971	\$393,921	60,693

Our strategic partnerships and alliances generated \$134.8 million and \$109.5 million, or 22.9% and 23.0%, of our in-force premiums as of June 30, 2013 and 2012, respectively. We believe that the bundling of products and services through these relationships contributes to higher retention rates than business generated by our independent agents. These relationships also allow us to access new customers that we may not have access to through our independent agent distribution channel. We continue to expand our existing relationships and actively seek new partnerships and alliances.

In September 2012, the California legislature passed Senate Bill No. 863 (SB 863), which was subsequently signed into law. SB 863 includes a number of reforms to California's workers' compensation system, including increases to

permanent disability benefits offset by reforms designed to reduce costs in the system. According to the Workers' Compensation Insurance Rating Bureau, the cost savings are expected to be achieved through a number of measures, including: the creation of a new dispute resolution process outside of the Workers' Compensation Appeals Board for medical treatments and billing issues; new controls on liens; and calls for new fee schedules for physicians, interpreters, ambulatory surgery centers, and home health care.

Any cost savings associated with SB 863 will be dependent on the implementation of the provisions of the bill and are not included in our current rate filings. We will evaluate SB 863's mandated regulations as they are adopted and will adjust our rate filings as indicated. We can offer no assurance that SB 863 will result in any cost savings for us or any indication as to when, if ever, any cost savings might occur.

We set our own premium rates in California based upon actuarial analyses of current and anticipated loss trends with a goal of maintaining underwriting profitability. Due to increasing loss costs, primarily medical cost inflation, we have increased our filed premium rates in California by a cumulative 41.3% since the beginning of 2009.

The following table sets forth the percentage increases to our filed California rates effective for new and renewal policies incepting on or after the dates shown.

Effective Date	Premium Rate Change Filed in California	
February 1, 2009	10.0	%
August 15, 2009	10.5	
March 15, 2010	3.0	
March 15, 2011	2.5	
September 15, 2011	3.9	
June 15, 2012	6.0	

We expect that total premiums in 2013 across our markets will reflect:

- overall net rate increases;
- decelerating policy count growth; and
- increasing average policy size.

#### Net Investment Income and Realized Gains on Investments, Net

We invest our holding company assets, statutory surplus, and the funds supporting our insurance liabilities, including unearned premiums and unpaid losses and LAE. We invest in fixed maturity securities, equity securities, and cash equivalents. Net investment income includes interest and dividends earned on our invested assets and amortization of premiums and discounts on our fixed maturity securities, less bank service charges and custodial and portfolio management fees. We have established a high quality/short duration bias in our investment portfolio.

Net investment income decreased 3.6% and 4.4% for the three and six months ended June 30, 2013, compared to the same periods of 2012. The decrease was primarily related to decreases in the average pre-tax book yield on invested assets to 3.4% and 3.5% for the three and six months ended June 30, 2013, compared to 3.7% for the same periods of 2012. The tax-equivalent yield on invested assets decreased to 4.2% at June 30, 2013, compared to 4.8% at June 30, 2012.

Realized gains and losses on our investments are reported separately from our net investment income. Realized gains and losses on investments include the gain or loss on a security at the time of sale compared to its original or adjusted cost (equity securities) or amortized cost (fixed maturity securities). Realized losses are also recognized when securities are written down as a result of an other-than-temporary impairment.

Net realized gains on investments were \$3.9 million and \$4.7 million for the three and six months ended June 30, 2013, respectively, compared to \$0.9 million and \$2.7 million for the corresponding periods of 2012.

Additional information regarding our Investments is set forth under “—Liquidity and Capital Resources—Investments.”

#### Combined Ratio

The combined ratio, expressed as a percentage, is a key measurement of underwriting profitability. The combined ratio is the sum of the loss and LAE ratio, the commission expense ratio, and underwriting and other operating expenses ratio. When the combined ratio is below 100%, we have recorded underwriting income, and conversely, when the combined ratio is greater than 100%, we cannot be profitable without investment income. Because we only have one operating segment, holding company expenses are included in our calculation of the combined ratio.

The following table provides the calculation of our calendar year combined ratios.

	Three Months Ended		Six Months Ended		
	June 30, 2013	2012	June 30, 2013	2012	
Loss and LAE ratio	70.4	% 73.8	% 71.7	% 73.6	%
Underwriting and other operating expenses ratio	20.2	25.5	20.8	27.6	
Commission expense ratio	12.6	14.0	12.5	13.3	
Combined ratio	103.2	% 113.3	% 105.0	% 114.5	%



Loss and LAE Ratio. Expressed as a percentage, this is the ratio of losses and LAE to net premiums earned. Losses and LAE represents our largest expense item and includes claim payments made, amortization of the Deferred Gain, estimates for future claim payments and changes in those estimates for current and prior periods, and costs associated with investigating, defending, and adjusting claims. The quality of our financial reporting depends in large part on accurately predicting our losses and LAE, which are inherently uncertain as they are estimates of the ultimate cost of individual claims based on actuarial estimation techniques.

Our indemnity claims frequency (the number of claims expressed as a percentage of payroll) was relatively unchanged for the three and six months ended June 30, 2013, compared to the same periods of 2012, and our loss experience indicates a downward trend in medical and indemnity costs per claim that are reflected in our current accident year loss estimate. We believe our current accident year loss estimate is adequate; however, ultimate losses will not be known with any certainty for many years.

Overall, losses and LAE increased 28.3% and 31.2% for the three and six months ended June 30, 2013, compared to the same periods of 2012. This increase was primarily due to higher net earned premiums in 2013. Prior accident year loss development in both periods was primarily related to our assigned risk business. Our current accident year loss estimates were 73.0% and 74.0% for the three and six months ended June 30, 2013, compared to 77.0% for the three and six months ended June 30, 2012. The decrease in our current accident year loss estimate is primarily the result of net rate increases more than offsetting increases in loss costs.

Excluding the impact from the LPT Agreement, losses and LAE would have been \$117.3 million and \$92.1 million, or 73.4% and 77.4% of net premiums earned, for the three months ended June 30, 2013 and 2012, respectively. For the six months ended June 30, 2013 and 2012, losses and LAE would have been \$229.6 million and \$177.2 million, or 74.6% and 77.4% of net premiums earned, respectively.

The table below reflects the losses and LAE reserve adjustments.

	Three Months Ended		Six Months Ended	
	June 30, 2013	2012	June 30, 2013	2012
	(in thousands)		(in thousands)	
Prior accident year (unfavorable) loss development, net	\$ (522 )	\$ (529 )	\$ (1,651 )	\$ (1,054 )
Amortization of the Deferred Gain related to losses	3,275	3,828	6,580	7,984
Amortization of the Deferred Gain related to contingent commission	406	256	788	525
Impact of LPT Contingent Commission Adjustments	1,024	227	1,299	363

Underwriting and Other Operating Expenses Ratio. The underwriting and other operating expenses ratio is the ratio (expressed as a percentage) of underwriting and other operating expenses to net premiums earned and measures an insurance company's operational efficiency in producing, underwriting, and administering its insurance business. Underwriting and other operating expenses are those costs that we incur to underwrite and maintain the insurance policies we issue, excluding commission. These expenses include premium taxes and certain other general expenses that vary with, and are primarily related to, producing new or renewal business. Other underwriting expenses include policyholder dividends, changes in estimates of future write-offs of premiums receivable, general administrative expenses such as salaries and benefits, rent, office supplies, depreciation, and all other operating expenses not otherwise classified separately. Policy acquisition costs are variable based on premiums earned; however, other operating costs are more fixed in nature and become a smaller percentage of net premiums earned as premiums increase.

Our underwriting and other operating expenses ratio decreased 5.3 and 6.8 percentage points, while our underwriting and other operating expenses increased 6.4% and 0.8% for the three and six months ended June 30, 2013, respectively, compared to the same periods of 2012, primarily due to net premiums earned increasing at a faster rate than our expenses during these periods. During the three months ended June 30, 2013, our compensation related expenses increased \$1.8 million, premium taxes and assessments expenses increased \$1.2 million and information technology expenses increased \$0.7 million, compared to the same period of 2012. During the six months ended June 30, 2013, our compensation related expenses increased \$2.7 million, premium taxes and assessments expenses increased \$2.4



million and information technology expenses increased \$1.1 million, compared to the same period of 2012. These increases were reduced by the impact of the new accounting guidance for deferred policy acquisition costs (DAC) that was implemented in 2012, which increased our underwriting and other operating expenses by \$2.2 million and \$5.2 million for the three and six months ended June 30, 2012. Excluding the impact of the new DAC guidance in 2012, underwriting and other operating expenses would have increased 14.7% and 9.8% for the three and six months ended June 30, 2013, compared to the same periods of 2012.

**Commission Expense Ratio.** The commission expense ratio is the ratio (expressed as a percentage) of commission expense to net premiums earned and measures the cost of compensating agents and brokers for the business we have underwritten.

Commission expense includes direct commissions to our agents and brokers for the premiums that they produce for us, as well as incentive payments, other marketing costs, and fees.

Our commission expense ratio decreased 1.4 and 0.8 percentage points, while our commission expense increased 21.1% and 26.6% for the three and six months ended June 30, 2013, respectively, compared to the same periods of 2012. These increases were primarily due to higher net premiums earned in 2013.

#### **Income Tax Expense (Benefit)**

Income tax expense (benefit) was \$1.2 million and \$1.0 million for the three and six months ended June 30, 2013, respectively, compared to \$(2.3) million and \$(6.7) million for the corresponding periods of 2012. The effective tax rates were 7.7% and 4.3% for the three and six months ended June 30, 2013, respectively, compared to (85.3)% and (145.5)% for the same periods of 2012. The increased tax expenses for the three and six months ended June 30, 2013, compared to the same periods of 2012, were primarily due to decreases in tax exempt income as a percentage of pre-tax net income and increases in projected annual net income before taxes.

#### **Liquidity and Capital Resources**

##### **Parent Company**

**Operating Cash and Cash Equivalents.** We are a holding company and our ability to fund our operations is contingent upon existing capital and the ability of our insurance subsidiaries' to pay dividends up to the holding company.

Payment of dividends by our insurance subsidiaries is restricted by state insurance laws and regulations, including laws establishing minimum solvency and liquidity thresholds. We require cash to pay stockholder dividends, repurchase common stock, make interest and principal payments on our outstanding debt obligations, provide additional surplus to our insurance subsidiaries, and fund our operating expenses.

The holding company had \$76.1 million of cash and cash equivalents and fixed maturity securities maturing within the next 24 months at June 30, 2013. Ten million dollars of our line of credit is payable on each of December 31, 2013 and 2014. We believe that the liquidity needs of the holding company over the next 24 months will be met with cash, maturing investments, and dividends from our insurance subsidiaries.

**Share Repurchases.** In November 2010, the EHI Board of Directors (Board of Directors) authorized a share repurchase program for repurchases of up to \$100 million of the Company's common stock from November 8, 2010 through June 30, 2012 (the 2011 Program). In November 2011, the Board of Directors authorized a \$100 million expansion of the 2011 Program, to \$200 million, and extended the repurchase authority pursuant to the 2011 Program through June 30, 2013. From inception of the 2011 Program through June 30, 2013, when the 2011 Program expired, we repurchased a total of 9,426,131 shares of common stock at an average price of \$15.79 per share, including commissions, for a total of \$148.8 million.

**Outstanding Debt.** In December 2010, we entered into a Third Amended and Restated Credit Agreement with Wells Fargo (Amended Credit Facility) under which we were provided with: (a) \$100.0 million line of credit through December 31, 2011; (b) \$90.0 million line of credit from January 1, 2012 through December 31, 2012; (c) \$80.0 million line of credit from January 1, 2013 through December 31, 2013; (d) \$70.0 million line of credit from January 1, 2014 through December 31, 2014; and (e) \$60.0 million line of credit from January 1, 2015 through December 31, 2015. Amounts outstanding bear interest at a rate equal to, at our option: (a) a fluctuating rate of 1.75% above prime rate or (b) a fixed rate that is 1.75% above the LIBOR rate then in effect. The Amended Credit Facility is secured by fixed maturity securities and restricted cash and cash equivalents that had a fair value of \$107.2 million and \$110.4 million at June 30, 2013 and December 31, 2012, respectively. The Amended Credit Facility contains customary non-financial covenants and requires us to maintain \$5.0 million of cash and cash equivalents at all times at the holding company. We are currently in compliance with all applicable covenants.

Our capital structure is comprised of outstanding debt and stockholders' equity. As of June 30, 2013, our capital structure consisted of \$80.0 million principal balance on our Amended Credit Facility, \$32.0 million in surplus notes maturing in 2034, and \$796.1 million of stockholders' equity, including the Deferred Gain. Outstanding debt was 12.3% of total capitalization, including the Deferred Gain, as of June 30, 2013.

Operating Subsidiaries

Operating Cash and Cash Equivalents. The primary sources of cash for our insurance operating subsidiaries are funds generated from underwriting operations, investment income, maturities and sales of investments, and capital contributions from the parent holding company. The primary uses of cash are payments of claims and operating expenses, purchases of investments, and payments of dividends to the parent holding company, which are subject to state insurance laws and regulations.

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Our insurance subsidiaries had \$356.6 million of cash and cash equivalents and fixed maturity securities maturing within the next 24 months at June 30, 2013. We believe that our subsidiaries' liquidity needs over the next 24 months will be met with cash from operations, investment income, and maturing investments.

We purchase reinsurance to protect us against the costs of severe claims and catastrophic events. On July 1, 2013, we entered into a new reinsurance program that is effective through June 30, 2014. The reinsurance program consists of one treaty covering excess of loss and catastrophic loss events in five layers of coverage. Our reinsurance coverage is \$195.0 million in excess of our \$5.0 million retention on a per occurrence basis, subject to a \$2.0 million annual aggregate deductible and certain exclusions. We believe that our reinsurance program meets our needs and that we are sufficiently capitalized.

Various state regulations require us to keep securities or letters of credit on deposit with certain states in which we do business. Securities having a fair value of \$592.1 million and \$530.6 million were on deposit at June 30, 2013 and December 31, 2012, respectively. These laws and regulations govern both the amount and types of fixed maturity securities that are eligible for deposit. Additionally, certain reinsurance contracts require Company funds to be held in trust for the benefit of the ceding reinsurer to secure the outstanding liabilities we assumed. The fair value of fixed maturity securities held in trust for the benefit of ceding reinsurers was \$32.0 million and \$35.0 million at June 30, 2013 and December 31, 2012, respectively.

#### Cash Flows

We monitor cash flows at both the consolidated and subsidiary levels. We use trend and variance analyses to project future cash needs, making adjustments to our forecasts as appropriate.

The table below shows our net cash flows for the six months ended:

	June 30, 2013	2012	
	(in thousands)		
Cash and cash equivalents provided by (used in):			
Operating activities	\$85,192	\$53,975	
Investing activities	(127,006	) (56,061	)
Financing activities	(1,787	) (41,423	)
Decrease in cash and cash equivalents	\$(43,601	) \$(43,509	)

**Operating Activities.** Major components of net cash provided by operating activities for the six months ended June 30, 2013 included net premiums received of \$297.4 million, investment income received of \$38.9 million, and amounts recovered from reinsurers of \$17.9 million. These were partially offset by claims payments of \$181.7 million, underwriting and other operating expenses paid of \$47.3 million (including premium taxes paid of \$12.7 million), and commissions paid of \$36.2 million.

Major components of net cash provided by operating activities for the six months ended June 30, 2012 included net premiums received of \$234.9 million, investment income received of \$40.3 million, and amounts recovered from reinsurers of \$20.7 million. These were partially offset by claims payments of \$165.7 million, underwriting and other operating expenses paid of \$48.7 million (including premium taxes paid of \$10.3 million), and commissions paid of \$23.4 million.

**Investing Activities.** The major components of net cash used in investing activities for the six months ended June 30, 2013 and 2012 were the purchases of fixed maturity and equity securities.

**Financing Activities.** The majority of cash used in financing activities for the six months ended June 30, 2013 was related to dividends paid to stockholders, partially offset by cash received related to the exercise of stock options. The majority of cash used in financing activities for the six months ended June 30, 2012 was to repurchase \$37.3 million of our common stock and to pay dividends to stockholders.

#### Investments

The cost or amortized cost of our investment portfolio was \$2.1 billion and the fair value was \$2.2 billion as of June 30, 2013.

We employ an investment strategy that emphasizes asset quality and considers the durations of fixed maturity securities against anticipated claim payments and expenditures, other liabilities, and capital needs. Our investment

portfolio is structured so that investments mature periodically in reasonable relation to current expectations of future claim payments. Currently, we make claim payments from positive cash flow from operations and use excess cash to invest in operations, invest in marketable securities, return capital to our stockholders, and fund growth.

As of June 30, 2013, our investment portfolio, which is classified as available-for-sale, consisted of 93.6% fixed maturity securities whose fair values may fluctuate due to interest rate changes. We strive to limit interest rate risk by managing the duration of our fixed maturity securities. Our fixed maturity securities (excluding cash and cash equivalents) had a duration of 4.2 at June 30,

2013. To minimize interest rate risk, our portfolio is weighted toward short-term and intermediate-term bonds; however, our investment strategy balances consideration of duration, yield, and credit risk. Our investment guidelines require that the minimum weighted average quality of our fixed maturity securities portfolio be "AA-." Our fixed maturity securities portfolio had a weighted average quality of "AA" as of June 30, 2013, with 61.6% of the portfolio rated "AA" or better, based on market value.

We carry our portfolio of equity securities on our balance sheet at fair value. We minimize our exposure to equity price risk by investing primarily in the equity securities of mid-to-large capitalization issuers and by diversifying our equity holdings across several industry sectors. Equity securities represented 6.4% of our investment portfolio at June 30, 2013.

Given current economic uncertainty and continuing market volatility, we believe that our current asset allocation best meets our strategy to preserve capital for policyholders, to provide sufficient income to support insurance operations, and to effectively grow book value over a long-term investment horizon.

The following table shows the estimated fair value, the percentage of the fair value to total invested assets, and the average tax equivalent yield based on the fair value of each category of invested assets as of June 30, 2013.

Category	Estimated Fair Value	Percentage of Total	Tax Equivalent Yield	
	(in thousands, except percentages)			
U.S. Treasuries	\$ 152,085	6.9	% 2.3	%
U.S. Agencies	89,031	4.0	3.0	
States and municipalities	754,833	34.1	5.6	
Corporate securities	746,808	33.8	3.4	
Residential mortgage-backed securities	239,025	10.8	3.9	
Commercial mortgage-backed securities	51,433	2.3	2.7	
Asset-backed securities	36,812	1.7	1.1	
Equity securities	140,369	6.4	5.6	
Total	\$ 2,210,396	100.0	%	
Weighted average tax equivalent yield			4.2	%

The following table shows the percentage of total estimated fair value of our fixed maturity securities as of June 30, 2013 by credit rating category, using the lower of ratings assigned by Moody's Investor Services and/or Standard & Poor's.

Rating	Percentage of Total Estimated Fair Value	
"AAA"	10.0	%
"AA"	51.6	
"A"	27.3	
"BBB"	10.9	
Below investment grade	0.2	
Total	100.0	%

Investments that we currently own could be subject to default by the issuer or could suffer declines in fair value that become other-than-temporary. We regularly assess individual securities as part of our ongoing portfolio management, including the identification of other-than-temporary declines in fair value. Our other-than-temporary assessment includes reviewing the extent and duration of declines in the fair value of investments below amortized cost, historical and projected financial performance and near-term prospects of the issuer, the outlook for industry sectors, credit rating, and macro-economic changes. We also make a determination as to whether it is not more likely than not that we will be required to sell the security before its fair value recovers above cost, or maturity.

Based on our review of fixed maturity and equity securities, we believe that we appropriately identified the declines in the fair values of our unrealized losses at June 30, 2013. We determined that the unrealized losses on fixed maturity securities were primarily the result of prevailing interest rates and not the credit quality of the issuers. The fixed maturity securities whose fair value was less than amortized cost were not determined to be other-than-temporarily

impaired given the severity and duration of the impairment, the credit quality of the issuers, the Company's intent to not sell the securities, and a determination that it is not more likely than not that the Company will be required to sell the securities until fair value recovers to above cost, or maturity.

Based on reviews of the equity securities as of June 30, 2013, the Company recognized an impairment of \$0.1 million in the fair value of one equity security as a result of the severity and duration of the change in fair value of that security.

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The cost or amortized cost, gross unrealized gains, gross unrealized losses, and estimated fair value of our investments were as follows:

	Cost or Amortized Cost (in thousands)	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
At June 30, 2013				
Fixed maturity securities				
U.S. Treasuries	\$143,294	\$8,830	\$(39)	\$152,085
U.S. Agencies	85,104	3,930	(3)	89,031
States and municipalities	713,702	45,248	(4,117)	754,833
Corporate securities	725,567	31,031	(9,790)	746,808
Residential mortgaged-backed securities	231,561	10,260	(2,796)	239,025
Commercial mortgaged-backed securities	53,618	423	(2,608)	51,433
Asset-backed securities	36,977	94	(259)	36,812
Total fixed maturity securities	1,989,823	99,816	(19,612)	2,070,027
Equity securities	85,559	55,114	(304)	140,369
Total investments	\$2,075,382	\$154,930	\$(19,916)	\$2,210,396

Contractual Obligations and Commitments

The following table identifies our long-term debt and contractual obligations as of June 30, 2013:

	Payment Due By Period				More Than 5 Years
	Total	Less Than 1-Year	1-3 Years	4-5 Years	
(in thousands)					
Operating leases	\$20,220	\$3,421	\$10,923	\$5,259	\$617
Notes payable <sup>(1)</sup>	143,837	11,304	74,758	2,854	54,921
Capital leases	2,212	715	1,139	358	—
Losses and LAE reserves <sup>(2)(3)</sup>	2,291,261	302,141	363,669	223,954	1,401,497
Total contractual obligations	\$2,457,530	\$317,581	\$450,489	\$232,425	\$1,457,035

Notes payable obligations reflect payments for the principal and estimated interest expense based on LIBOR rates (1) plus a margin. The estimated interest expense was based on the contractual obligations of the debt outstanding as of June 30, 2013. The interest rates range from 1.4% to 4.5%.

Estimated losses and LAE reserve payment patterns have been computed based on historical information. Our calculation of loss and LAE reserve payments by period is subject to the same uncertainties associated with determining the level of reserves and to the additional uncertainties arising from the difficulty of predicting when (2) claims (including claims that have not yet been reported to us) will be paid. Actual payments of losses and LAE by period will vary, perhaps materially, from the above table to the extent that current estimates of losses and LAE reserves vary from actual ultimate claims amounts due to variations between expected and actual payout patterns.

(3) The losses and LAE reserves are presented gross of reinsurance recoverables for unpaid losses, which are as follows for each of the periods presented above:

	Recoveries By Period				More Than 5 Years
	Total	Less Than 1-Year	1-3 Years	4-5 Years	
(in thousands)					
Reinsurance recoverables for unpaid losses	\$(801,149)	\$(40,618)	\$(78,134)	\$(73,570)	\$(608,827)

Off-Balance Sheet Arrangements

We have no off-balance sheet arrangements.

Critical Accounting Policies



These unaudited interim consolidated financial statements include amounts based on the use of estimates and judgments of management for those transactions that are not yet complete. We believe that the estimates and judgments that were most critical to the preparation of the consolidated financial statements involved the following: (a) reserves for losses and LAE; (b) reinsurance recoverables; (c) recognition of premium income; (d) deferred income taxes; (e) valuation of investments; and (f) goodwill and

intangible asset impairment. These estimates and judgments require the use of assumptions about matters that are highly uncertain and therefore are subject to change as facts and circumstances develop. Our accounting policies are discussed under "Critical Accounting Policies" in Management's Discussion and Analysis of Financial Condition and Results of Operations in our Annual Report.

**Item 3. Quantitative and Qualitative Disclosures About Market Risk**

Market risk is the risk of potential economic loss principally arising from adverse changes in the fair value of financial instruments. The major components of market risk affecting us are credit risk, interest rate risk, and equity price risk, and are described in detail in our Annual Report. We have not experienced any material changes in market risk since December 31, 2012.

The primary market risk exposure to our investment portfolio, which consists primarily of fixed maturity securities, is interest rate risk. We have the ability to hold fixed maturity securities to maturity and we strive to limit interest rate risk by managing duration. As of June 30, 2013, our fixed maturity securities portfolio had a duration of 4.2. We continually monitor the impact of interest rate changes on our investment portfolio and liquidity obligations. Changes to our market risk, if any, since December 31, 2012 are reflected in Management's Discussion and Analysis of Financial Condition and Results of Operations and the financial statements contained in this Form 10-Q.

**Item 4. Controls and Procedures**

Under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, we have evaluated the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (Exchange Act)) as of the end of the period covered by this report. Based on that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective as of the end of the period covered by this report. There have not been any changes in our internal control over financial reporting (as defined in Rule 13a-15(f) under the Exchange Act) during the period covered by this report that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

## PART II – OTHER INFORMATION

## Item 1. Legal Proceedings

From time-to-time, the Company is involved in pending and threatened litigation in the normal course of business in which claims for monetary damages are asserted. In the opinion of management, the ultimate liability, if any, arising from such pending or threatened litigation is not expected to have a material effect on our results of operations, liquidity, or financial position.

## Item 1A. Risk Factors

We have disclosed in our Annual Report the most significant risk factors that can impact year-to-year comparisons and that may affect the future performance of the Company's business. On a quarterly basis, we review these disclosures and update the risk factors, as appropriate. As of the date of this report, there have been no material changes to the risk factors contained in our Annual Report.

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

The following table summarizes the repurchases of our common stock for the three months ended June 30, 2013:

Period	Total Number of Shares Purchased	Average Price Paid Per Share <sup>(1)</sup>	Total Number of Shares Purchased as Part of Publicly Announced Program	Approximate Dollar Value of Shares that May Yet be Purchased Under the Program <sup>(2)</sup> (in millions)
April 1 – April 30, 2013	—	\$—	—	\$51.2
May 1 – May 31, 2013	—	—	—	51.2
June 1 – June 30, 2013	—	—	—	51.2
Total	—	\$—	—	

(1) Includes fees and commissions paid on stock repurchases.

(2) On November 3, 2010, the Board of Directors authorized a share repurchase program for repurchases of up to \$100 million of the Company's common stock (the 2011 Program). On November 2, 2011, the Board of Directors authorized a \$100 million expansion of the 2011 Program, to \$200 million. The 2011 Program expired on June 30, 2013.

## Item 3. Defaults Upon Senior Securities

None.

## Item 4. Mine Safety Disclosures

Not applicable.

## Item 5. Other Information

None.

## Item 6. Exhibits

Exhibit No.	Description of Exhibit	Included Herewith	Incorporated by Reference Herein		
			Form	Exhibit	Filing Date
31.1	Certification of Douglas D. Dirks Pursuant to Section 302	X			
31.2	Certification of William E. Yocke Pursuant to Section 302	X			
32.1	Certification of Douglas D. Dirks Pursuant to Section 906	X			
32.2	Certification of William E. Yocke Pursuant to Section 906	X			
*101.INS	XBRL Instance Document	X			
*101.SCH	XBRL Taxonomy Extension Schema Document	X			
*101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document	X			
*101.DEF	XBRL Taxonomy Extension Definition Linkbase Document	X			
*101.LAB	XBRL Taxonomy Extension Label Linkbase Document	X			
*101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document	X			

SIGNATURES

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

EMPLOYERS HOLDINGS, INC.

Date: August 8, 2013

/s/ Douglas D. Dirks  
Douglas D. Dirks  
President and Chief Executive Officer  
Employers Holdings, Inc.

Date: August 8, 2013

/s/ William E. Yocke  
William E. Yocke  
Executive Vice President and Chief Financial Officer  
Employers Holdings, Inc.  
(Principal Financial and Accounting Officer)