

PROASSURANCE CORP  
Form 10-Q  
November 04, 2015  
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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10-Q  
(Mark One)

Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934  
For the quarterly period ended September 30, 2015 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 0-16533

ProAssurance Corporation  
(Exact Name of Registrant as Specified in Its Charter)

Delaware 63-1261433  
(State or Other Jurisdiction of  
Incorporation or Organization) (IRS Employer Identification No.)

100 Brookwood Place, Birmingham, AL 35209  
(Address of Principal Executive Offices) (Zip Code)

(205) 877-4400  
(Registrant's Telephone Number, Including Area Code) (Former Name, Former Address, and Former Fiscal Year, if Changed Since Last Report)

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 (§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  No

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  (Do not check if a smaller reporting company) 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

As of October 31, 2015, there were 53,143,027 shares of the registrant's common stock outstanding.

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## Glossary of Terms and Acronyms

When the following terms and acronyms appear in the text of this report, they have the meanings indicated below.

| Term                         | Meaning  |
|------------------------------|--|
| AOCI                         | Accumulated other comprehensive income (loss)  |
| BOLI                         | Business owned life insurance  |
| DPAC                         | Deferred policy acquisition costs  |
| Eastern Re                   | Eastern Re, LTD, S.P.C.  |
| EBUB                         | Earned, but unbilled premium   |
| FAL                          | Funds at Lloyd's   |
| FASB                         | Financial Accounting Standards Board   |
| FHLB                         | Federal Home Loan Bank   |
| GAAP                         | Generally accepted accounting principles in the United States of America               |
| HCPL                         | Healthcare professional liability  |
| IRS                          | Internal Revenue Service   |
| LLC                          | Limited liability company  |
| Lloyd's                      | Lloyd's of London market   |
| LP                           | Limited partnership  |
| Medical Technology Liability | Medical technology and life sciences products liability                                |
| NAV                          | Net asset value  |
| NYSE                         | New York Stock Exchange  |
| NRSRO                        | Nationally recognized statistical rating organization                                  |
| OCI                          | Other comprehensive income (loss)  |
| OTTI                         | Other-than-temporary impairment  |
| PCAOB                        | Public Company Accounting Oversight Board  |
| Revolving Credit Agreement   | ProAssurance's \$250 million revolving credit agreement                                |
| ROE                          | Return on equity   |
| SEC                          | Securities and Exchange Commission   |
| SPC                          | Segregated portfolio cell  |
| Specialty P&C                | Specialty Property and Casualty  |
| Syndicate 1729               | Lloyd's of London Syndicate 1729   |
| Syndicate Credit Agreement   | Unconditional revolving credit agreement with the Premium Trust Fund of Syndicate 1729 |
| TIPS                         | Treasury Inflation Protected Securities  |
| U.K.                         | United Kingdom of Great Britain and Northern Ireland                                   |
| ULAE                         | Unallocated loss adjustment expense  |
| VIE                          | Variable interest entity   |

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Forward-Looking Statements

Any statements in this Form 10-Q that are not historical facts are specifically identified as forward-looking statements. These statements are based upon our estimates and anticipation of future events and are subject to certain risks and uncertainties that could cause actual results to vary materially from the expected results described in the forward-looking statements. Forward-looking statements are identified by words such as, but not limited to, "anticipate," "believe," "estimate," "expect," "hope," "hopeful," "intend," "likely," "may," "optimistic," "possible," "potential," "preliminary," "project," "should," "will" and other analogous expressions. There are numerous factors that could cause our actual results to differ materially from those in the forward-looking statements. Thus, sentences and phrases that we use to convey our view of future events and trends are expressly designated as forward-looking statements as are sections of this Form 10-Q that are identified as giving our outlook on future business.

Forward-looking statements relating to our business include among other things: statements concerning future liquidity and capital requirements, investment valuation and performance, return on equity, financial ratios, net income, premiums, losses and reserve for losses, premium rates and retention of current business, competition and market conditions, the expansion of product lines, the development or acquisition of business in new geographical areas, the availability of acceptable reinsurance, actions by regulators and rating agencies, court actions, legislative actions, payment or performance of obligations under indebtedness, payment of dividends, and other matters.

These forward-looking statements are subject to significant risks, assumptions and uncertainties, including, among other things, the following factors that could affect the actual outcome of future events:

- changes in general economic conditions, including the impact of inflation or deflation and unemployment;
- our ability to maintain our dividend payments;
- regulatory, legislative and judicial actions or decisions that could affect our business plans or operations;
- the enactment or repeal of tort reforms;
- formation or dissolution of state-sponsored insurance entities providing coverages now offered by ProAssurance which could remove or add sizable numbers of insureds from or to the private insurance market;
- changes in the interest rate environment;
- changes in U.S. laws or government regulations regarding financial markets or market activity that may affect the U.S. economy and our business;
- changes in the ability of the U.S. government to meet its obligations that may affect the U.S. economy and our business;
- performance of financial markets affecting the fair value of our investments or making it difficult to determine the value of our investments;
- changes in requirements or accounting policies and practices that may be adopted by our regulatory agencies, the FASB, the SEC, the PCAOB, or the NYSE that may affect our business;
- changes in laws or government regulations affecting the financial services industry, the property and casualty insurance industry or particular insurance lines underwritten by our subsidiaries;
- the effect on our insureds, particularly the insurance needs of our insureds, and our loss costs, of changes in the healthcare delivery system, including changes attributable to the Patient Protection and Affordable Care Act;
- consolidation of our insureds into or under larger entities which may be insured by competitors, or may not have a risk profile that meets our underwriting criteria or which may not use external providers for insuring or otherwise managing substantial portions of their liability risk;
- uncertainties inherent in the estimate of our loss and loss adjustment expense reserve and reinsurance recoverable;
- changes in the availability, cost, quality, or collectability of insurance/reinsurance;
- the results of litigation, including pre- or post-trial motions, trials and/or appeals we undertake;
- effects on our claims costs from mass tort litigation that are different from that anticipated by us;
- allegations of bad faith which may arise from our handling of any particular claim, including failure to settle;

loss or consolidation of independent agents, agencies, brokers, or brokerage firms;  
changes in our organization, compensation and benefit plans;  
changes in the business or competitive environment may limit the effectiveness of our business strategy and  
impact our revenues;  
our ability to retain and recruit senior management;

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the availability, integrity and security of our technology infrastructure or that of our third-party providers of technology infrastructure, including any susceptibility to cyber-attacks which might result in a loss of information or operating capability;

the impact of a catastrophic event, as it relates to both our operations and our insured risks;

the impact of acts of terrorism and acts of war;

the effects of terrorism-related insurance legislation and laws;

assessments from guaranty funds;

our ability to achieve continued growth through expansion into new markets or through acquisitions or business combinations;

changes to the ratings assigned by rating agencies to our insurance subsidiaries, individually or as a group;

provisions in our charter documents, Delaware law and state insurance laws may impede attempts to replace or remove management or may impede a takeover;

state insurance restrictions may prohibit assets held by our insurance subsidiaries, including cash and investment securities, from being used for general corporate purposes;

taxing authorities can take exception to our tax positions and cause us to incur significant amounts of legal and accounting costs and, if our defense is not successful, additional tax costs, including interest and penalties; and

expected benefits from completed and proposed acquisitions may not be achieved or may be delayed longer than expected due to business disruption; loss of customers, employees or key agents; increased operating costs or inability to achieve cost savings; and assumption of greater than expected liabilities, among other reasons.

Additional risks that could arise from our membership in the Lloyd's of London market and our participation in Syndicate 1729 include, but are not limited to, the following:

members of Lloyd's are subject to levies by the Council of Lloyd's based on a percentage of the member's underwriting capacity, currently a maximum of 3%, but can be increased by Lloyd's;

Syndicate operating results can be affected by decisions made by the Council of Lloyd's over which the management of Syndicate 1729 has little ability to control, such as a decision to not approve the business plan of the Syndicate, or a decision to increase the capital required to continue operations, and by our obligation to pay levies to Lloyd's;

Lloyd's insurance and reinsurance relationships and distribution channels could be disrupted or Lloyd's trading licenses could be revoked making it more difficult for Syndicate 1729 to distribute and market its products; and

rating agencies could downgrade their ratings of Lloyd's as a whole.

Our results may differ materially from those we expect and discuss in any forward-looking statements. The principal risk factors that may cause these differences are described in "Item 1A, Risk Factors" in our Form 10-K and other documents we file with the SEC, such as our current reports on Form 8-K, and our regular reports on Form 10-Q. We caution readers not to place undue reliance on any such forward-looking statements, which are based upon conditions existing only as of the date made, and advise readers that these factors could affect our financial performance and could cause actual results for future periods to differ materially from any opinions or statements expressed with respect to future periods in any current statements. Except as required by law or regulations, we do not undertake and specifically decline any obligation to publicly release the result of any revisions that may be made to any forward-looking statements to reflect events or circumstances after the date of such statements or to reflect the occurrence of anticipated or unanticipated events.

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Condensed Consolidated Balance Sheets (Unaudited)  
(In thousands, except share data)

|   | September 30,<br>2015 | December 31,<br>2014 |
|---|-----------------------|----------------------|
| Assets  |                       |                      |
| Investments   |                       |                      |
| Fixed maturities, available for sale, at fair value; amortized cost, \$2,769,432 and \$3,055,477, respectively                  | \$2,826,179           | \$3,145,027          |
| Equity securities, trading, at fair value; cost, \$334,036 and \$283,107, respectively  | 317,886               | 314,482              |
| Short-term investments  | 158,057               | 131,259              |
| Business owned life insurance   | 56,748                | 56,381               |
| Investment in unconsolidated subsidiaries   | 298,375               | 276,501              |
| Other investments, \$29,480 and \$28,958 at fair value, respectively, otherwise at cost or amortized cost                       | 91,410                | 86,057               |
| Total Investments   | 3,748,655             | 4,009,707            |
| Cash and cash equivalents   | 201,342               | 197,040              |
| Premiums receivable   | 239,907               | 202,528              |
| Receivable from reinsurers on paid losses and loss adjustment expenses  | 6,807                 | 6,494                |
| Receivable from reinsurers on unpaid losses and loss adjustment expenses  | 240,239               | 237,966              |
| Prepaid reinsurance premiums  | 36,476                | 32,115               |
| Deferred policy acquisition costs   | 47,662                | 38,790               |
| Deferred tax asset, net   | 7,745                 | —                    |
| Real estate, net  | 38,704                | 39,799               |
| Intangible assets   | 94,530                | 100,733              |
| Goodwill  | 210,725               | 210,725              |
| Other assets  | 90,212                | 93,263               |
| Total Assets  | \$4,963,004           | \$5,169,160          |
| Liabilities and Shareholders' Equity  |                       |                      |
| Liabilities   |                       |                      |
| Policy liabilities and accruals   |                       |                      |
| Reserve for losses and loss adjustment expenses   | \$2,022,261           | \$2,058,266          |
| Unearned premiums   | 401,996               | 345,828              |
| Reinsurance premiums payable  | 23,369                | 17,451               |
| Total Policy Liabilities  | 2,447,626             | 2,421,545            |
| Deferred tax liability, net   | —                     | 18,818               |
| Other liabilities   | 158,588               | 320,853              |
| Long-term debt  | 350,000               | 250,000              |
| Total Liabilities   | 2,956,214             | 3,011,216            |
| Shareholders' Equity  |                       |                      |
| Common shares, par value \$0.01 per share, 100,000,000 shares authorized, 62,498,192 and 62,297,214 shares issued, respectively | 625                   | 623                  |
| Additional paid-in capital  | 364,877               | 359,577              |
| Accumulated other comprehensive income (loss), net of deferred tax expense (benefit) of \$19,051 and \$31,342, respectively     | 36,096                | 58,204               |
| Retained earnings   | 2,022,534             | 1,991,704            |
| Treasury shares, at cost, 9,348,376 shares and 5,763,388 shares, respectively   | (417,342 )            | (252,164 )           |
| Total Shareholders' Equity  | 2,006,790             | 2,157,944            |
| Total Liabilities and Shareholders' Equity  | \$4,963,004           | \$5,169,160          |

See accompanying notes.

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ProAssurance Corporation and Subsidiaries  
Condensed Consolidated Statements of Changes in Capital (Unaudited)  
(In thousands)

|  | Common<br>Stock | Additional<br>Paid-in<br>Capital | Accumulated<br>Other<br>Comprehensive<br>Income (Loss) | Retained<br>Earnings | Treasury<br>Stock | Total       |
|--|-----------------|----------------------------------|--|----------------------|-------------------|-------------|
| Balance at December 31, 2014   | \$623           | \$359,577                        | \$ 58,204  | \$1,991,704          | \$(252,164 )      | \$2,157,944 |
| Common shares reacquired   | —               | —                                | —  | —                    | (165,178 )        | (165,178 )  |
| Common shares issued for<br>compensation   | —               | 2,071                            | —  | —                    | —                 | 2,071       |
| Share-based compensation   | —               | 7,638                            | —  | —                    | —                 | 7,638       |
| Net effect of restricted and<br>performance shares issued and stock<br>options exercised | 2               | (4,409 )                         | —  | —                    | —                 | (4,407 )    |
| Dividends to shareholders  | —               | —                                | —  | (50,418 )            | —                 | (50,418 )   |
| Other comprehensive income (loss)  | —               | —                                | (22,108 )  | —                    | —                 | (22,108 )   |
| Net income   | —               | —                                | —  | 81,248               | —                 | 81,248      |
| Balance at September 30, 2015  | \$625           | \$364,877                        | \$ 36,096  | \$2,022,534          | \$(417,342 )      | \$2,006,790 |

|  | Common<br>Stock | Additional<br>Paid-in<br>Capital | Accumulated<br>Other<br>Comprehensive<br>Income (Loss) | Retained<br>Earnings | Treasury<br>Stock | Total       |
|--|-----------------|----------------------------------|--|----------------------|-------------------|-------------|
| Balance at December 31, 2013   | \$621           | \$349,894                        | \$ 59,661  | \$2,015,603          | \$(31,365 )       | \$2,394,414 |
| Common shares reacquired   | —               | —                                | —  | —                    | (167,242 )        | (167,242 )  |
| Common shares issued for<br>compensation   | —               | 2,679                            | —  | —                    | 229               | 2,908       |
| Share-based compensation   | —               | 8,022                            | —  | —                    | —                 | 8,022       |
| Net effect of restricted and<br>performance shares issued and stock<br>options exercised | 2               | (2,816 )                         | —  | —                    | —                 | (2,814 )    |
| Dividends to shareholders  | —               | —                                | —  | (52,873 )            | —                 | (52,873 )   |
| Other comprehensive income (loss)  | —               | —                                | 7,346  | —                    | —                 | 7,346       |
| Net income   | —               | —                                | —  | 131,451              | —                 | 131,451     |
| Balance at September 30, 2014  | \$623           | \$357,779                        | \$ 67,007  | \$2,094,181          | \$(198,378 )      | \$2,321,212 |
| See accompanying notes.  |                 |                                  |  |                      |                   |             |

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ProAssurance Corporation and Subsidiaries  
Condensed Consolidated Statements of Income and Comprehensive Income (Unaudited)  
(In thousands, except per share data)

|   | Three Months Ended |            | Nine Months Ended |            |
|---|--------------------|------------|-------------------|------------|
|   | September 30       |            | September 30      |            |
|   | 2015               | 2014       | 2015              | 2014       |
| Revenues  |                    |            |                   |            |
| Net premiums earned   | \$ 182,085         | \$ 177,028 | \$ 529,277        | \$ 525,061 |
| Net investment income   | 26,942             | 32,830     | 82,201            | 92,788     |
| Equity in earnings (loss) of unconsolidated subsidiaries                          | (221               | ) 298      | 3,821             | 2,767      |
| Net realized investment gains (losses):   |                    |            |                   |            |
| Other-than-temporary impairment (OTTI) losses                                     | (3,795             | ) (1,425   | ) (8,275          | ) (1,475   |
| Portion of OTTI losses recognized in other comprehensive income before taxes      | 385                | 268        | 2,174             | 268        |
| Net impairment losses recognized in earnings                                      | (3,410             | ) (1,157   | ) (6,101          | ) (1,207   |
| Other net realized investment gains (losses)                                      | (33,222            | ) (6,974   | ) (29,519         | ) 8,866    |
| Total net realized investment gains (losses)                                      | (36,632            | ) (8,131   | ) (35,620         | ) 7,659    |
| Other income  | 2,759              | 1,808      | 6,504             | 6,055      |
| Total revenues  | 174,933            | 203,833    | 586,183           | 634,330    |
| Expenses  |                    |            |                   |            |
| Losses and loss adjustment expenses   | 119,824            | 106,486    | 350,739           | 306,591    |
| Reinsurance recoveries  | (11,018            | ) (7,264   | ) (32,855         | ) (18,948  |
| Net losses and loss adjustment expenses   | 108,806            | 99,222     | 317,884           | 287,643    |
| Underwriting, policy acquisition and operating expenses                           | 53,025             | 54,185     | 157,908           | 158,856    |
| Segregated portfolio cells dividend expense (income)                              | (1,933             | ) (483     | ) 1,481           | 2,355      |
| Interest expense  | 3,637              | 3,606      | 10,978            | 10,697     |
| Total expenses  | 163,535            | 156,530    | 488,251           | 459,551    |
| Income before income taxes  | 11,398             | 47,303     | 97,932            | 174,779    |
| Provision for income taxes  |                    |            |                   |            |
| Current expense (benefit)   | 17,277             | 15,591     | 31,406            | 37,884     |
| Deferred expense (benefit)  | (16,155            | ) (3,066   | ) (14,722         | ) 5,444    |
| Total income tax expense (benefit)  | 1,122              | 12,525     | 16,684            | 43,328     |
| Net income  | 10,276             | 34,778     | 81,248            | 131,451    |
| Other comprehensive income (loss), after tax, net of reclassification adjustments | (4,953             | ) (14,646  | ) (22,108         | ) 7,346    |
| Comprehensive income  | \$ 5,323           | \$ 20,132  | \$ 59,140         | \$ 138,797 |
| Earnings per share:   |                    |            |                   |            |
| Basic   | \$ 0.19            | \$ 0.59    | \$ 1.47           | \$ 2.20    |
| Diluted   | \$ 0.19            | \$ 0.59    | \$ 1.46           | \$ 2.19    |
| Weighted average number of common shares outstanding:                             |                    |            |                   |            |
| Basic   | 54,007             | 58,676     | 55,339            | 59,807     |
| Diluted   | 54,232             | 58,931     | 55,554            | 60,047     |
| Cash dividends declared per common share  | \$ 0.31            | \$ 0.30    | \$ 0.93           | \$ 0.90    |
| See accompanying notes.   |                    |            |                   |            |

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ProAssurance Corporation and Subsidiaries  
Condensed Consolidated Statements of Cash Flows (Unaudited)  
(In thousands)

|  | Nine Months Ended September 30 |             |
|--|--------------------------------|-------------|
|  | 2015                           | 2014        |
| Operating Activities   |                                |             |
| Net income   | \$81,248                       | \$131,451   |
| Adjustments to reconcile income to net cash provided by operating activities:              |                                |             |
| Depreciation and amortization, net of accretion  | 28,249                         | 29,800      |
| Net realized investment (gains) losses   | 35,620                         | (7,659)     |
| Share-based compensation   | 7,638                          | 8,022       |
| Deferred income taxes  | (14,722)                       | ) 5,444     |
| Policy acquisition costs, net amortization (net deferral)                                  | (8,872)                        | ) (5,249)   |
| Equity in earnings of unconsolidated subsidiaries, excluding income distributions received | (4,661)                        | ) 1,246     |
| Other  | (823)                          | ) (740)     |
| Other changes in assets and liabilities, excluding effect of business combinations:        |                                |             |
| Premiums receivable  | (37,379)                       | ) (42,406)  |
| Reinsurance related assets and liabilities   | (1,029)                        | ) (19,829)  |
| Other assets   | 5,191                          | 33,823      |
| Reserve for losses and loss adjustment expenses  | (36,005)                       | ) (78,558)  |
| Unearned premiums  | 56,168                         | 55,565      |
| Other liabilities  | (5,100)                        | ) (9,827)   |
| Net cash provided (used) by operating activities   | 105,523                        | 101,083     |
| Investing Activities   |                                |             |
| Purchases of:  |                                |             |
| Fixed maturities, available for sale   | (466,248)                      | ) (511,894) |
| Equity securities, trading   | (211,437)                      | ) (85,986)  |
| Other investments  | (25,360)                       | ) (25,109)  |
| Funding of qualified affordable housing tax credit limited partnerships                    | (903)                          | ) (8,439)   |
| Investment in unconsolidated subsidiaries  | (43,142)                       | ) (30,394)  |
| Proceeds from sales or maturities of:  |                                |             |
| Fixed maturities, available for sale   | 738,377                        | 486,702     |
| Equity securities, trading   | 172,502                        | 102,765     |
| Other investments  | 18,369                         | 15,074      |
| Distributions from unconsolidated subsidiaries   | 23,390                         | 3,850       |
| Net sales or maturities (purchases) of short-term investments                              | (26,861)                       | ) 177,013   |
| Cash received in acquisitions  | —                              | 35,013      |
| Unsettled security transactions, net change  | (473)                          | ) (127)     |
| (Increase) decrease in restricted cash   | —                              | 78,000      |
| Purchases of capital assets  | (6,382)                        | ) (2,139)   |
| Other  | (1,514)                        | ) 5,606     |
| Net cash provided (used) by investing activities   | 170,318                        | 239,935     |
| Continued on following page.   |                                |             |

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|  | Nine Months Ended September 30 |              |
|--|--------------------------------|--------------|
|  | 2015                           | 2014         |
| Financing Activities                                 |                                |              |
| Borrowing under revolving credit agreement           | 100,000                        | —            |
| Repurchase of common stock                           | (165,178)                      | ) (163,146 ) |
| Dividends to shareholders                            | (201,158)                      | ) (53,820 )  |
| Other  | (5,203)                        | ) (5,430 )   |
| Net cash provided (used) by financing activities     | (271,539)                      | ) (222,396 ) |
| Increase (decrease) in cash and cash equivalents     | 4,302                          | 118,622      |
| Cash and cash equivalents at beginning of period     | 197,040                        | 129,383      |
| Cash and cash equivalents at end of period           | 201,342                        | 248,005      |
| Significant non-cash transactions                    |                                |              |
| Deposit transferred as consideration for acquisition | \$—                            | \$205,244    |
| Dividends declared and not yet paid                  | \$16,454                       | \$17,318     |
| See accompanying notes.                              |                                |              |

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ProAssurance Corporation and Subsidiaries

Notes to Condensed Consolidated Financial Statements (Unaudited)

September 30, 2015

## 1. Basis of Presentation

The accompanying unaudited Condensed Consolidated Financial Statements include the accounts of ProAssurance Corporation and its consolidated subsidiaries (ProAssurance, PRA or the Company). The financial statements have been prepared in accordance with GAAP for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. 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 considered necessary for a fair presentation, consisting of normal recurring adjustments, have been included. ProAssurance's results for the nine months ended September 30, 2015 are not necessarily indicative of the results that may be expected for the year ending December 31, 2015. The accompanying Condensed Consolidated Financial Statements should be read in conjunction with the Consolidated Financial Statements and Notes contained in ProAssurance's December 31, 2014 report on Form 10-K. In connection with its preparation of the Condensed Consolidated Financial Statements, ProAssurance evaluated events that occurred subsequent to September 30, 2015 for recognition or disclosure in its financial statements and notes to financial statements.

ProAssurance operates in four reportable segments as follows: Specialty P&C, Workers' Compensation, Lloyd's Syndicate, and Corporate. For more information on the nature of products and services provided and for financial information by segment, refer to Note 12 of the Notes to Condensed Consolidated Financial Statements.

## Other Liabilities

Other liabilities consisted of the following:

| (In millions)           | September 30, 2015 | December 31, 2014 |
|-------------------------|--------------------|-------------------|
| SPC dividends payable   | \$16.7             | \$15.8            |
| Unpaid dividends        | 16.5               | 167.7             |
| All other               | 125.4              | 137.4             |
| Total other liabilities | \$158.6            | \$320.9           |

SPC dividends payable are the cumulative undistributed earnings contractually payable to the external preferred shareholders of SPCs operated by ProAssurance's Cayman Islands subsidiary, Eastern Re.

Unpaid dividends represents common stock dividends declared by ProAssurance's Board of Directors that had not yet been paid. Unpaid dividends at December 31, 2014 reflect a special dividend declared in late 2014 that was paid in January 2015.

## Accounting Changes Adopted

## Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity

Effective for fiscal years beginning after December 15, 2014, the FASB issued guidance regarding the requirements for reporting discontinued operations. Under the new guidance, reporting entities are required to report disposals of business components only if the disposal represents a strategic shift in the entity's operations that will have a major effect on the entity's operations and financial results. The new guidance expands disclosure requirements for reported discontinued operations and requires disclosure of pre-tax profit or loss attributable to significant disposals not reported as discontinued operations. ProAssurance adopted the guidance as of January 1, 2015. Adoption of the guidance had no effect on ProAssurance's results of operations or financial position.

## Disclosures for Investments in Certain Entities that Calculate Net Asset Value per Share (or Its Equivalent)

Effective for fiscal years beginning after December 15, 2015, the FASB issued guidance which removed the requirement to categorize within the fair value hierarchy all investments for which fair value is measured using the net asset value per share practical expedient. The guidance also revised disclosure requirements for investments measured or eligible to be measured at fair value using the net asset value per share practical expedient. ProAssurance adopted the guidance as of June 30, 2015 as early adoption is permitted. Adoption of the guidance had no effect on ProAssurance's results of operations or financial position as it affected disclosures only.



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Accounting Changes Not Yet Adopted

Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved after the Requisite Service Period

Effective for fiscal years beginning after December 15, 2015, the FASB issued guidance for share-based payments in which the terms of the award provide that a performance target can be achieved after completion of the requisite service period. The new guidance provides that compensation cost for such awards should be recognized in the period in which it becomes probable that the performance target will be achieved and should represent the compensation cost attributable to the period(s) for which the requisite service has already been rendered. ProAssurance plans to adopt the guidance beginning January 1, 2016. Adoption of the guidance is expected to have no effect on ProAssurance's results of operations or financial position as ProAssurance has no awards with performance targets extending beyond the requisite service period.

Revenue from Contracts with Customers

Effective for fiscal years beginning after December 15, 2017, the FASB issued guidance related to revenue from contracts with customers. The core principle of the new guidance is that revenue should be recognized to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. ProAssurance plans to adopt the guidance beginning January 1, 2018. As the majority of ProAssurance's revenues come from insurance contracts which fall under the scope of other FASB standards, adoption of the guidance is expected to have no material effect on ProAssurance's results of operations or financial position.

Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern

Effective for fiscal years ending after December 15, 2016 and interim periods beginning after December 15, 2016, the FASB issued guidance that establishes principles and definitions related to management's evaluation of whether there is substantial doubt about the organization's ability to continue as a going concern. For each interim and annual reporting period, the new guidance requires management to evaluate the organization's ability to meet its obligations as they are due within one year of the date the financial statements are issued and requires disclosure when there is substantial doubt regarding the organization's ability to continue as a going concern. ProAssurance plans to adopt the guidance on its effective date. Adoption is expected to have no effect on ProAssurance's results of operations or financial position.

Simplifying the Presentation of Debt Issuance Costs

Effective for fiscal years beginning after December 15, 2015, the FASB issued guidance related to the presentation of debt issuance costs. The new guidance requires that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts. Related guidance issued by the SEC permits issuance costs associated with line-of-credit arrangements to be presented as an asset and subsequently amortized proportionally over the term of the arrangement. ProAssurance plans to adopt the guidance beginning January 1, 2016. Adoption of the guidance is not expected to have a material effect on ProAssurance's results of operations or financial position.

Amendments to the Consolidation Analysis

Effective for fiscal years beginning after December 15, 2015, the FASB issued additional guidance regarding the consolidation of legal entities such as limited partnerships, limited liability corporations, and securitization structures (collateralized debt obligations, collateralized loan obligations, and mortgage-backed security transactions). The new standard modifies the evaluation of whether or not entities are VIEs and the consolidation analysis of entities involved with VIEs, particularly those having fee arrangements and related party relationships. ProAssurance is in the process of evaluating the effect, if any, of the new guidance on its results of operations and financial position and plans to adopt the guidance beginning January 1, 2016. Adoption of the guidance is not expected to have a material effect on ProAssurance's results of operations or financial position.

Customer's Accounting for Fees Paid in a Cloud Computing Arrangement

Effective for fiscal years beginning after December 15, 2015, the FASB issued additional guidance regarding accounting for cloud computing arrangements. Under the new guidance, customers participating in cloud computing arrangements that include a software license should account for the software license element of the arrangement consistent with the acquisition of other software licenses. Customers should account for cloud computing arrangements that do not include a software license as a



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service contract, following existing guidance for service contracts. ProAssurance is in the process of evaluating the effect that the use of the new method would have on its results of operations and financial position and plans to adopt the guidance beginning January 1, 2016. Adoption of the guidance is not expected to have a material effect on ProAssurance's results of operations or financial position.

**Disclosures about Short-Duration Contracts**

Effective for fiscal years beginning after December 15, 2015 and interim periods within fiscal years beginning after December 15, 2016, the FASB issued guidance that requires insurance entities that issue short-duration contracts to provide detailed disclosures relative to the reserve for losses and loss adjustment expenses in annual reporting periods and a roll-forward of the reserve for losses and loss adjustment expenses in interim reporting periods. The guidance also requires disclosures regarding significant changes in the methodologies and assumptions used to calculate the reserve for losses and loss adjustment expenses, including reasons for and the effects of such changes. ProAssurance plans to adopt the guidance beginning January 1, 2016. Adoption of the guidance is not expected to have a material effect on ProAssurance's results of operations or financial position as it affects disclosures only.

**Simplifying the Accounting for Measurement-Period Adjustments**

Effective for fiscal years beginning after December 15, 2015 and interim periods within those fiscal years, the FASB issued guidance that requires an acquirer to recognize adjustments to estimated amounts that are identified during the measurement period in the reporting period in which the adjustment amounts are determined. An acquirer must also record, in the same period's financial statements, the effect on earnings of changes in depreciation, amortization, or other income effects, if any, as a result of the change to the estimated amounts, calculated as if the accounting had been completed at the acquisition date. The amendments also require an entity to present separately on the face of the income statement or disclose in the notes the portion of the amount recorded in current-period earnings by line item that would have been recorded in previous reporting periods if the adjustment to the estimated amounts had been recognized as of the acquisition date. ProAssurance plans to adopt the guidance beginning January 1, 2016. Adoption of the guidance is not expected to have a material effect on ProAssurance's results of operations or financial position.

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2. Fair Value Measurement

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. A three level hierarchy has been established for valuing assets and liabilities based on how transparent (observable) the inputs are that are used to determine fair value, with the inputs considered most observable categorized as Level 1 and those that are the least observable categorized as Level 3. Hierarchy levels are defined as follows:

- Level 1: quoted (unadjusted) market prices in active markets for identical assets and liabilities. For ProAssurance, Level 1 inputs are generally quotes for debt or equity securities actively traded in exchange or over-the-counter markets.
- Level 2: market data obtained from sources independent of the reporting entity (observable inputs). For ProAssurance, Level 2 inputs generally include quoted prices in markets that are not active, quoted prices for similar assets or liabilities, and results from pricing models that use observable inputs such as interest rates and yield curves that are generally available at commonly quoted intervals.
- Level 3: the reporting entity's own assumptions about market participant assumptions based on the best information available in the circumstances (non-observable inputs). For ProAssurance, Level 3 inputs are used in situations where little or no Level 1 or 2 inputs are available or are inappropriate given the particular circumstances. Level 3 inputs include results from pricing models for which some or all of the inputs are not observable, discounted cash flow methodologies, single non-binding broker quotes and adjustments to externally quoted prices that are based on management judgment or estimation.

Fair values of assets measured at fair value on a recurring basis as of September 30, 2015 and December 31, 2014 are shown in the following tables. The tables also indicate the fair value hierarchy of the valuation techniques utilized to determine those fair values. For some assets, the inputs used to measure fair value may fall into different levels of the fair value hierarchy. When this is the case, the asset is categorized based on the level of the most significant input to the fair value measurement. Assessments of the significance of a particular input to the fair value measurement require judgment and consideration of factors specific to the assets being valued.

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| (In thousands)  | September 30, 2015                       |             |           | Total<br>Fair Value |
|---|--|-------------|-----------|---------------------|
|   | Fair Value Measurements Using<br>Level 1 | Level 2     | Level 3   |                     |
| Assets:   |  |             |           |                     |
| Fixed maturities, available for sale  |  |             |           |                     |
| U.S. Treasury obligations   | \$—                                      | \$ 111,919  | \$—       | \$ 111,919          |
| U.S. Government-sponsored enterprise obligations  | —  | 26,000      | —         | 26,000              |
| State and municipal bonds   | —  | 967,786     | —         | 967,786             |
| Corporate debt, multiple observable inputs  | 2,329                                    | 1,302,377   | —         | 1,304,706           |
| Corporate debt, limited observable inputs   | —  | —           | 7,820     | 7,820               |
| Residential mortgage-backed securities  | —  | 254,878     | —         | 254,878             |
| Agency commercial mortgage-backed securities  | —  | 11,204      | —         | 11,204              |
| Other commercial mortgage-backed securities   | —  | 39,134      | —         | 39,134              |
| Other asset-backed securities   | —  | 96,464      | 6,268     | 102,732             |
| Equity securities   |  |             |           |                     |
| Financial   | 66,614                                   | —           | —         | 66,614              |
| Utilities/Energy  | 41,686                                   | —           | —         | 41,686              |
| Consumer oriented   | 55,320                                   | —           | 23        | 55,343              |
| Industrial  | 50,447                                   | —           | —         | 50,447              |
| Bond funds  | 75,688                                   | —           | —         | 75,688              |
| All other   | 15,071                                   | 13,037      | —         | 28,108              |
| Short-term investments  | 154,858                                  | 3,199       | —         | 158,057             |
| Other investments   | 2,769                                    | 26,194      | 517       | 29,480              |
| Total assets categorized within the fair value hierarchy  | \$464,782                                | \$2,852,192 | \$ 14,628 | 3,331,602           |
| LP/LLC interests carried at NAV which approximates fair value. These interests, reported as a part of Investment in unconsolidated subsidiaries, are not categorized within the fair value hierarchy. |  |             |           | 156,850             |
| Total assets at fair value  |  |             |           | \$3,488,452         |

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| (In thousands)  | December 31, 2014                        |             |          | Total<br>Fair Value |
|---|--|-------------|----------|---------------------|
|   | Fair Value Measurements Using<br>Level 1 | Level 2     | Level 3  |                     |
| Assets:   |  |             |          |                     |
| Fixed maturities, available for sale  |  |             |          |                     |
| U.S. Treasury obligations   | \$—                                      | \$ 166,512  | \$—      | \$ 166,512          |
| U.S. Government-sponsored enterprise obligations  | —  | 39,563      | —        | 39,563              |
| State and municipal bonds   | —  | 1,057,590   | 5,025    | 1,062,615           |
| Corporate debt, multiple observable inputs  | —  | 1,404,020   | —        | 1,404,020           |
| Corporate debt, limited observable inputs   | —  | —           | 13,081   | 13,081              |
| Residential mortgage-backed securities  | —  | 276,056     | —        | 276,056             |
| Agency commercial mortgage-backed securities  | —  | 15,493      | —        | 15,493              |
| Other commercial mortgage-backed securities   | —  | 51,063      | —        | 51,063              |
| Other asset-backed securities   | —  | 111,855     | 4,769    | 116,624             |
| Equity securities   |  |             |          |                     |
| Financial   | 79,341                                   | —           | —        | 79,341              |
| Utilities/Energy  | 25,629                                   | —           | —        | 25,629              |
| Consumer oriented   | 65,670                                   | —           | —        | 65,670              |
| Industrial  | 55,460                                   | —           | —        | 55,460              |
| Bond funds  | 55,196                                   | —           | —        | 55,196              |
| All other   | 33,186                                   | —           | —        | 33,186              |
| Short-term investments  | 131,199                                  | 60          | —        | 131,259             |
| Other investments   | 6,050                                    | 22,908      | —        | 28,958              |
| Total assets categorized within the fair value hierarchy  | \$451,731                                | \$3,145,120 | \$22,875 | 3,619,726           |
| LP/LLC interests carried at NAV which approximates fair value. These interests, reported as a part of Investment in unconsolidated subsidiaries, are not categorized within the fair value hierarchy. |  |             |          | 133,250             |
| Total assets at fair value  |  |             |          | \$3,752,976         |

The fair values for securities included in the Level 2 category, with the few exceptions described below, were developed by one of several third party, nationally recognized pricing services, including services that price only certain types of securities. Each service uses complex methodologies to determine values for securities and subject the values they develop to quality control reviews. Management selected a primary source for each type of security in the portfolio and reviewed the values provided for reasonableness by comparing data to alternate pricing services and to available market and trade data. Values that appeared inconsistent were further reviewed for appropriateness. Any value that did not appear reasonable was discussed with the service that provided the value and would have been adjusted, if necessary. No such adjustments were necessary in 2015 or 2014.

Level 2 Valuations

Below is a summary description of the valuation methodologies primarily used by the pricing services for securities in the Level 2 category, by security type:

U.S. Treasury obligations were valued based on quoted prices for identical assets, or, in markets that are not active, quotes for similar assets, taking into consideration adjustments for variations in contractual cash flows and yields to maturity.

U.S. Government-sponsored enterprise obligations were valued using pricing models that consider current and historical market data, normal trading conventions, credit ratings, and the particular structure and characteristics of the

security being valued, such as yield to maturity, redemption options, and contractual cash flows. Adjustments to model inputs or model results were included in the valuation process when necessary to reflect recent regulatory, government or corporate actions or significant economic, industry or geographic events affecting the security's fair value.

State and municipal bonds were valued using a series of matrices that considered credit ratings, the structure of the security, the sector in which the security falls, yields, and contractual cash flows. Valuations were further adjusted, when necessary, to reflect the expected effect on fair value of recent significant economic or geographic events or ratings changes.

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Corporate debt with multiple observable inputs consisted primarily of corporate bonds, but also included a small number of bank loans. The methodology used to value Level 2 corporate bonds was the same as the methodology previously described for U.S. Government-sponsored enterprise obligations. Bank loans were valued based on an average of broker quotes for the loans in question, if available. If quotes were not available, the loans were valued based on quoted prices for comparable loans or, if the loan was newly issued, by comparison to similar seasoned issues. Broker quotes were compared to actual trade prices on a regular basis to permit assessment of the reliability of the quotes; unreliable quotes were not considered in quoted averages.

Residential and commercial mortgage backed securities. Agency pass-through securities were valued using a pricing matrix which considers the issuer type, coupon rate and longest cash flows outstanding. The matrix used was based on the most recently available market information. Agency and non-agency collateralized mortgage obligations were both valued using models that consider the structure of the security, current and historical information regarding prepayment speeds, ratings and ratings updates, and current and historical interest rate and interest rate spread data. Other asset-backed securities were valued using models that consider the structure of the security, monthly payment information, current and historical information regarding prepayment speeds, ratings and ratings updates, and current and historical interest rate and interest rate spread data. Spreads and prepayment speeds considered collateral type. Equity securities were securities not traded on an exchange on the valuation date. The securities were valued using the most recently available quotes for the securities.

Short-term investments are securities maturing within one year, carried at cost which approximated the fair value of the security due to the short term to maturity.

Other investments consisted of convertible bonds valued using a pricing model that incorporated selected dealer quotes as well as current market data regarding equity prices and risk free rates. If dealer quotes were unavailable for the security being valued, quotes for securities with similar terms and credit status were used in the pricing model. Dealer quotes selected for use were those considered most accurate based on parameters such as underwriter status and historical reliability.

Level 3 Valuations

Below is a summary description of the valuation processes and methodologies used as well as quantitative information regarding securities in the Level 3 category.

Level 3 Valuation Processes

Level 3 securities are priced by the Chief Investment Officer.

Level 3 valuations are computed quarterly. Prices are evaluated quarterly against prior period prices and the expected change in price.

The securities noted in the disclosure are primarily NRSRO rated debt instruments for which comparable market inputs are commonly available for evaluating the securities in question. Valuation of these debt instruments is not overly sensitive to changes in the unobservable inputs used.

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## Level 3 Valuation Methodologies

State and municipal bonds consisted of auction rate municipal bonds valued internally using either published quotes for similar securities or values produced by discounted cash flow models using yields currently available on fixed rate securities with a similar term and collateral, adjusted to consider the effect of a floating rate and a premium for illiquidity.

Corporate debt with limited observable inputs consisted of corporate bonds valued using dealer quotes for similar securities or discounted cash flow models using yields currently available for similar securities. Similar securities are defined as securities of comparable credit quality that have like terms and payment features. Assessments of credit quality were based on NRSRO ratings, if available, or were subjectively determined by management if not available. At September 30, 2015, 93% of the securities were rated; the average rating was A-. At December 31, 2014, 80% of the securities were rated; the average rating was A-.

Other asset-backed securities consisted of securitizations of receivables valued using dealer quotes for similar securities or discounted cash flow models using yields currently available for similar securities.

Equity securities and Other investments consisted of common stock and convertible securities for which limited observable inputs were available at September 30, 2015. The securities were valued internally based on expected cash flows, including the expected final recovery, discounted at a yield that considered the lack of liquidity and the financial status of the issuer.

## Quantitative Information Regarding Level 3 Valuations

| (In millions)                                 | Fair Value at         |                      | Valuation Technique          | Unobservable Input       | Range<br>(Weighted Average) |
|---|-----------------------|----------------------|------------------------------|--------------------------|-----------------------------|
|   | September<br>30, 2015 | December<br>31, 2014 |                              |                          |                             |
| Assets:                                       |                       |                      |                              |                          |                             |
| State and municipal bonds                     | \$—                   | \$5.0                | Market Comparable Securities | Comparability Adjustment | 0% - 10% (5%)               |
|   |                       |                      | Discounted Cash Flows        | Comparability Adjustment | 0% - 10% (5%)               |
| Corporate debt with limited observable inputs | \$7.8                 | \$13.1               | Market Comparable Securities | Comparability Adjustment | 0% - 5% (2.5%)              |
|   |                       |                      | Discounted Cash Flows        | Comparability Adjustment | 0% - 5% (2.5%)              |
| Other asset-backed securities                 | \$6.3                 | \$4.8                | Market Comparable Securities | Comparability Adjustment | 0% - 5% (2.5%)              |
|   |                       |                      | Discounted Cash Flows        | Comparability Adjustment | 0% - 5% (2.5%)              |
| Equity securities and Other investments       | \$0.5                 | \$—                  | Discounted Cash Flows        | Comparability Adjustment | 0% - 10% (5%)               |

The significant unobservable inputs used in the fair value measurement of the above listed securities were the valuations of comparable securities with similar issuers, credit quality and maturity. Changes in the availability of comparable securities could result in changes in the fair value measurements.

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## Fair Value Measurements - Level 3 Assets

The following tables (the Level 3 Tables) present summary information regarding changes in the fair value of assets measured at fair value using Level 3 inputs.

| (In thousands)  | September 30, 2015                               |  |                   |                            |  | Total     |
|---|--|--|-------------------|----------------------------|--|-----------|
|   | Level 3 Fair Value Measurements – Assets         |  |                   |                            |  |           |
|   | U.S.<br>Government-<br>Enterprise<br>Obligations | State and<br>sponsored<br>Municipal<br>Bonds | Corporate<br>Debt | Asset-backed<br>Securities | Equity<br>Securities<br>and Other<br>Investments |           |
| Balance June 30, 2015   | \$—  | \$—  | \$8,468           | \$ 4,777                   | \$ 1,036   | \$14,281  |
| Total gains (losses) realized and unrealized:   |  |  |                   |                            |  |           |
| Included in earnings, as a part of:   |  |  |                   |                            |  |           |
| Net investment income   | —  | —  | —                 | —                          | —  | —         |
| Net realized investment gains (losses)  | —  | —  | (311 )            | —                          | —  | (311 )    |
| Included in other comprehensive income  | —  | —  | 300               | (9 )                       | (53 )  | 238       |
| Purchases   | —  | —  | —                 | 1,500                      | 584  | 2,084     |
| Sales   | —  | —  | (648 )            | —                          | —  | (648 )    |
| Transfers in  | —  | —  | 11                | —                          | —  | 11        |
| Transfers out   | —  | —  | —                 | —                          | (918 )   | (918 )    |
| Balance September 30, 2015  | \$—  | \$—  | \$7,820           | \$ 6,268                   | \$ 540   | \$14,628  |
| Change in unrealized gains (losses) included in earnings for the above period for Level 3 assets held at period-end | \$—  | \$—  | \$—               | \$—                        | \$(109 )   | \$(109 )  |
|   | September 30, 2015                               |  |                   |                            |  |           |
|   | Level 3 Fair Value Measurements – Assets         |  |                   |                            |  |           |
|   | U.S.<br>Government-<br>Enterprise<br>Obligations | State and<br>sponsored<br>Municipal<br>Bonds | Corporate<br>Debt | Asset-backed<br>Securities | Equity<br>Securities<br>and Other<br>Investments | Total     |
| (In thousands)  |  |  |                   |                            |  |           |
| Balance December 31, 2014   | \$—  | \$5,025                                      | \$13,081          | \$ 4,769                   | \$—  | \$22,875  |
| Total gains (losses) realized and unrealized:   |  |  |                   |                            |  |           |
| Included in earnings, as a part of:   |  |  |                   |                            |  |           |
| Net investment income   | —  | —  | 17                | —                          | —  | 17        |
| Net realized investment gains (losses)  | —  | —  | (309 )            | —                          | —  | (309 )    |
| Included in other comprehensive income  | —  | (459 )                                       | 38                | (1 )                       | (133 )   | (555 )    |
| Purchases   | —  | —  | 1,515             | 1,500                      | 1,700  | 4,715     |
| Sales   | —  | —  | (1,484 )          | —                          | —  | (1,484 )  |
| Transfers in  | —  | —  | 11                | —                          | —  | 11        |
| Transfers out   | —  | (4,566 )                                     | (5,049 )          | —                          | (918 )   | (10,533 ) |
| Balance September 30, 2015  | \$—  | \$—  | \$7,820           | \$ 6,268                   | \$ 540   | \$14,628  |



|  |     |     |     |     |        |   |        |   |
|--|-----|-----|-----|-----|--------|---|--------|---|
| Change in unrealized gains (losses)<br>included in earnings for the above<br>period for Level 3 assets held at<br>period-end | \$— | \$— | \$— | \$— | \$(109 | ) | \$(109 | ) |
|--|-----|-----|-----|-----|--------|---|--------|---|

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| (In thousands)  | September 30, 2014                       |                                     |                |                         |   | Total    |   |
|---|--|-------------------------------------|----------------|-------------------------|---|----------|---|
|   | Level 3 Fair Value Measurements – Assets |                                     |                |                         |   |          |   |
|   | U.S. Government-Enterprise Obligations   | State and sponsored Municipal Bonds | Corporate Debt | Asset-backed Securities | Equity Securities and Other Investments |          |   |
| Balance June 30, 2014   | \$—                                      | \$7,148                             | \$14,544       | \$ 5,960                | \$—                                     | \$27,652 |   |
| Total gains (losses) realized and unrealized:   |  |                                     |                |                         |   |          |   |
| Included in earnings, as a part of:   |  |                                     |                |                         |   |          |   |
| Net investment income   | —  | (4                                  | ) 16           | —                       | —                                       | 12       |   |
| Included in other comprehensive income  | —  | (76                                 | ) 35           | (6                      | ) —                                     | (47      | ) |
| Purchases   | —  | —                                   | —              | —                       | —                                       | —        |   |
| Sales   | —  | (1,474                              | ) (1,160       | ) —                     | —                                       | (2,634   | ) |
| Transfers out   | —  | —                                   | —              | (1,181                  | ) —                                     | (1,181   | ) |
| Balance September 30, 2014  | \$—                                      | \$5,594                             | \$13,435       | \$ 4,773                | \$—                                     | \$23,802 |   |
| Change in unrealized gains (losses) included in earnings for the above period for Level 3 assets held at period-end | \$—                                      | \$—                                 | \$—            | \$—                     | \$—                                     | \$—      |   |

| (In thousands)  | September 30, 2014                       |                                     |                |                         |   | Total    |   |
|---|--|-------------------------------------|----------------|-------------------------|---|----------|---|
|   | Level 3 Fair Value Measurements – Assets |                                     |                |                         |   |          |   |
|   | U.S. Government-Enterprise Obligations   | State and sponsored Municipal Bonds | Corporate Debt | Asset-backed Securities | Equity Securities and Other Investments |          |   |
| Balance December 31, 2013   | \$—                                      | \$7,338                             | \$14,176       | \$ 6,814                | \$—                                     | \$28,328 |   |
| Total gains (losses) realized and unrealized:   |  |                                     |                |                         |   |          |   |
| Included in earnings, as a part of:   |  |                                     |                |                         |   |          |   |
| Net investment income   | —  | (10                                 | ) 48           | —                       | —                                       | 38       |   |
| Net realized investment gains (losses)  | —  | (95                                 | ) 3            | —                       | —                                       | (92      | ) |
| Included in other comprehensive income  | 1  | (34                                 | ) 702          | 63                      | —                                       | 732      |   |
| Purchases   | 1,000                                    | 1,861                               | 2,000          | 3,340                   | —                                       | 8,201    |   |
| Sales   | —  | (1,731                              | ) (1,469       | ) (61                   | ) —                                     | (3,261   | ) |
| Transfers in  | —  | 2,119                               | —              | 305                     | —                                       | 2,424    |   |
| Transfers out   | (1,001                                   | ) (3,854                            | ) (2,025       | ) (5,688                | ) —                                     | (12,568  | ) |
| Balance September 30, 2014  | \$—                                      | \$5,594                             | \$13,435       | \$ 4,773                | \$—                                     | \$23,802 |   |
| Change in unrealized gains (losses) included in earnings for the above period for Level 3 assets held at period-end | \$—                                      | \$—                                 | \$—            | \$—                     | \$—                                     | \$—      |   |
| Transfers   |  |                                     |                |                         |   |          |   |

There were no transfers between the Level 1 and Level 2 categories during the three and nine months ended September 30, 2015 or 2014.

Transfers shown in the preceding Level 3 tables were as of the end of the period and were to or from Level 2.

All transfers during the three and nine months ended September 30, 2015 and 2014 related to securities held for which the level of market activity for identical or nearly identical securities varies from period to period. The securities were valued using multiple observable inputs when those inputs were available; otherwise the securities were valued using limited observable inputs.

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Notes to Condensed Consolidated Financial Statements (Unaudited)

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## Fair Values Not Categorized

Investments in unconsolidated subsidiaries at both September 30, 2015 and December 31, 2014 included interests in investment fund LPs/LLCs that measure fund assets at fair value on a recurring basis and that provide a NAV for the interest. The carrying value of these interests is based on the NAV provided, and was considered to approximate the fair value of the interests. In accordance with GAAP, the fair value of these investments was not classified within the fair value hierarchy. Additional information regarding these investments is as follows:

| (In thousands)                   | Unfunded      | Fair Value    |              |
|----------------------------------|---------------|---------------|--------------|
|                                  | Commitments   | September 30, | December 31, |
|                                  | September 30, | September 30, | December 31, |
|                                  | 2015          | 2015          | 2014         |
| Investments in LPs/LLCs:         |               |               |              |
| Private debt funds (1)           | \$20,023      | \$44,595      | \$37,296     |
| Long equity fund (2)             | None          | 6,521         | 6,747        |
| Long/short equity funds (3)      | None          | 30,099        | 25,301       |
| Non-public equity funds (4)      | \$52,125      | 63,309        | 51,811       |
| Multi-strategy fund of funds (5) | None          | 8,372         | 8,271        |
| Structured credit fund (6)       | None          | 3,954         | 3,824        |
|                                  |               | \$156,850     | \$133,250    |

(1) Comprised of interests in two unrelated LP funds that are structured to provide interest distributions primarily through diversified portfolios of private debt instruments. One LP allows redemption by special consent; the other does not permit redemption. Income and capital are to be periodically distributed at the discretion of the LPs over an anticipated time frame that spans from 3 to 8 years.

(2) The fund is an LP that holds long equities of public international companies. Redemptions are allowed at the end of any calendar month with a prior notice requirement of 15 days and are paid within 10 days of the end of the calendar month of the redemption request.

(3) Comprised of interests in multiple unrelated LP funds. The funds hold primarily long and short North American equities, and target absolute returns using strategies designed to take advantage of event-driven market opportunities. The funds generally permit quarterly or semi-annual capital redemptions subject to notice requirements of 30 to 90 days. For some funds, redemptions above specified thresholds (lowest threshold is 90%) may be only partially payable until after a fund audit is completed and are then payable within 30 days.

(4) Comprised of interests in three unrelated LP funds, each structured to provide capital appreciation through diversified investments in private equity, which can include investments in buyout, venture capital, mezzanine debt, distressed debt and other private equity-oriented LPs. One LP allows redemption by special consent; the others do not permit redemption. Income and capital are to be periodically distributed at the discretion of the LP over time frames that are anticipated to span up to 9 years.

(5) This fund is an LLC structured to build and manage low volatility, multi-manager portfolios that have little or no correlation to the broader fixed income and equity security markets. Redemptions are not permitted but the LLC Board is permitted discretion to periodically extend offers to repurchase units of the LLC.

(6) This fund is an LP seeking to obtain superior risk-adjusted absolute returns by acquiring and actively managing a diversified portfolio of debt securities, including bonds, loans and other asset-backed instruments. Redemptions are allowed at any quarter-end with a prior notice requirement of 90 days.

ProAssurance may not sell, transfer or assign its interest in any of the above LPs/LLCs without special consent from the LP/LLC.



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## Financial Instruments - Methodologies Other Than Fair Value

The following table provides the estimated fair value of our financial instruments that, in accordance with GAAP for the type of investment, are measured using a methodology other than fair value. All fair values provided fall within the Level 3 fair value category.

| (In thousands)             | September 30, 2015 |            | December 31, 2014 |            |
|----------------------------|--------------------|------------|-------------------|------------|
|                            | Carrying Value     | Fair Value | Carrying Value    | Fair Value |
| Financial assets:          |                    |            |                   |            |
| BOLI                       | \$56,748           | \$56,748   | \$56,381          | \$56,381   |
| Other investments          | \$61,930           | \$62,573   | \$57,099          | \$57,994   |
| Other assets               | \$22,755           | \$22,739   | \$22,440          | \$22,399   |
| Financial liabilities:     |                    |            |                   |            |
| Senior notes due 2023      | \$250,000          | \$269,198  | \$250,000         | \$276,503  |
| Revolving credit agreement | \$100,000          | \$100,000  | \$—               | \$—        |
| Other liabilities          | \$14,292           | \$14,288   | \$14,656          | \$14,645   |

The fair value of the BOLI was equal to the cash surrender value associated with the policies on the valuation date. Other investments listed in the table above include interests in certain investment fund LPs/LLCs accounted for using the cost method, investments in FHLB common stock carried at cost, and an annuity investment carried at amortized cost. The estimated fair value of the LP/LLC interests was based on the equity value of the interest provided by the LP/LLC managers for the most recent quarter, which approximates the fair value of the interest. The estimated fair value of the FHLB common stock was based on the amount ProAssurance would receive if its membership were canceled, as the membership cannot be sold. The fair value of the annuity represents the present value of the expected future cash flows discounted using a rate available in active markets for similarly structured instruments. Other assets and Other liabilities primarily consisted of related investment assets and liabilities associated with funded deferred compensation agreements. Fair values of the funded deferred compensation assets and liabilities were based on the NAVs provided by the underlying funds. Other assets also included a secured note receivable and an unsecured receivable under a revolving credit agreement. Fair value of these receivables was based on the present value of expected cash flows from the receivables, discounted at market rates on the valuation date for receivables with similar credit standings and similar payment structures. Other liabilities also included certain contractual liabilities related to prior business combinations. The fair values of the business combination liabilities were based on the present value of the expected future cash outflows, discounted at ProAssurance's assumed incremental borrowing rate on the valuation date for unsecured liabilities with similar repayment structures.

The fair value of the long-term debt was estimated based on the present value of expected future cash outflows, discounted at rates available on the valuation date for similar debt issued by entities with a similar credit standing to ProAssurance.



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The recorded cost basis and estimated fair value of available-for-sale fixed maturities at September 30, 2015, by contractual maturity, are shown below. Actual maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

| (In thousands)                                   | Amortized Cost | Due in one year or less | Due after one year through five years | Due after five years through ten years | Due after ten years | Total Fair Value |
|--|----------------|-------------------------|---------------------------------------|--|---------------------|------------------|
| Fixed maturities, available for sale             |                |                         |                                       |  |                     |                  |
| U.S. Treasury obligations                        | \$109,416      | \$14,796                | \$82,117                              | \$11,729                               | \$3,277             | \$111,919        |
| U.S. Government-sponsored enterprise obligations | 24,748         | 2,322                   | 16,109                                | 7,427                                  | 142                 | 26,000           |
| State and municipal bonds                        | 929,645        | 48,062                  | 327,284                               | 444,040                                | 148,400             | 967,786          |
| Corporate debt                                   | 1,306,358      | 87,645                  | 718,812                               | 472,990                                | 33,079              | 1,312,526        |
| Residential mortgage-backed securities           | 247,601        |                         |                                       |  |                     | 254,878          |
| Agency commercial mortgage-backed securities     | 10,945         |                         |                                       |  |                     | 11,204           |
| Other commercial mortgage-backed securities      | 38,595         |                         |                                       |  |                     | 39,134           |
| Other asset-backed securities                    | 102,124        |                         |                                       |  |                     | 102,732          |
|  | \$2,769,432    |                         |                                       |  |                     | \$2,826,179      |

Excluding obligations of the U.S. Government or U.S. Government-sponsored enterprises, no investment in any entity or its affiliates exceeded 10% of Shareholders' equity at September 30, 2015.

Cash and securities with a carrying value of \$49.3 million at September 30, 2015 were on deposit with various state insurance departments to meet regulatory requirements. ProAssurance also held securities with a carrying value of \$126.6 million at September 30, 2015 that are pledged as collateral security for advances under the Revolving Credit Agreement (see Note 8 of the Notes to Condensed Consolidated Financial Statements for additional detail on the Revolving Credit Agreement).

As a member of Lloyd's and a capital provider to Syndicate 1729, ProAssurance is required to maintain capital at Lloyd's, referred to as FAL. ProAssurance investments at September 30, 2015 included fixed maturities with a fair value of \$89.3 million and short term investments with a fair value of approximately \$0.4 million on deposit with Lloyd's in order to satisfy these FAL requirements.

**BOLI**

ProAssurance holds BOLI policies that are carried at the current cash surrender value of the policies (original cost \$33 million). All insured individuals were management employees at the time the policies were acquired. The primary purpose of the program is to offset future employee benefit expenses through earnings on the cash value of the policies. ProAssurance is the owner and principal beneficiary of these policies.

**Other Investments**

Other investments at September 30, 2015 and December 31, 2014 were comprised as follows:

| (In thousands)                                 | September 30, 2015 | December 31, 2014 |
|--|--------------------|-------------------|
| Investments in LPs/LLCs, at cost               | \$58,381           | \$53,258          |
| Convertible securities, at fair value          | 29,480             | 28,958            |
| Other, principally FHLB capital stock, at cost | 3,549              | 3,841             |
|  | \$91,410           | \$86,057          |



Investments in convertible securities are carried at fair value as permitted by the accounting guidance for hybrid financial instruments, with changes in fair value recognized in income as a component of Net realized investment gains or losses during the period of change. Interest on convertible securities is recorded on an accrual basis based on contractual interest rates and is included in Net investment income.

FHLB capital stock is not marketable, but may be liquidated by terminating membership in the FHLB. The liquidation process can take up to five years.

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## Unconsolidated Subsidiaries

ProAssurance holds investments in unconsolidated subsidiaries, accounted for under the equity method. The investments include the following:

| (In thousands)                                       | September 30, 2015   | Carrying Value     |                   |
|--|----------------------|--------------------|-------------------|
|  | Percentage Ownership | September 30, 2015 | December 31, 2014 |
| Investment in LPs/LLCs:                              |                      |                    |                   |
| Qualified affordable housing tax credit partnerships | See below            | \$ 124,109         | \$ 133,143        |
| Other tax credit partnerships                        | See below            | 4,306              | —                 |
| All other LPs/LLCs                                   | < 25%                | 169,960            | 143,358           |
|  |                      | \$ 298,375         | \$ 276,501        |

Qualified affordable housing tax credit partnership interests held by ProAssurance generate investment returns by providing tax benefits to fund investors in the form of tax credits and project operating losses. The carrying value of these investments reflects our total commitments (both funded and unfunded) to the partnerships. ProAssurance's ownership percentage relative to two of the tax credit partnership interests is almost 100%; these interests had a carrying value of \$54.6 million at September 30, 2015. ProAssurance's ownership percentage relative to the remaining tax credit partnership interests is less than 20%; these interests had a carrying value of \$69.5 million at September 30, 2015. ProAssurance does not have the ability to exert control over the partnerships; all are accounted for using the equity method.

Other tax credit partnerships are comprised entirely of historic tax credits. The historic tax credits generate investment returns by providing benefits to fund investors in the form of tax credits, tax deductible project operating losses and positive cash flows. ProAssurance's ownership percentage relative to the tax credit partnerships is almost 100%. ProAssurance does not have the ability to exert control over the partnerships; the interests are accounted for using the equity method.

As discussed in additional detail in Note 2 of the Notes to Condensed Consolidated Financial Statements, ProAssurance holds interests in certain LPs/LLCs that are investment funds which measure fund assets at fair value on a recurring basis and the fund managers provide a NAV for the interest. The carrying value of these interests is based on the NAV provided, and is considered to approximate the fair value of the interests; such interests totaled \$156.9 million at September 30, 2015 and \$133.3 million at December 31, 2014. ProAssurance also holds interests in other LPs/LLCs where the carrying value is not considered to approximate the estimated fair value of the interest; such interests totaled \$13.1 million at September 30, 2015 and \$10.1 million at December 31, 2014.

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## Investments Held in a Loss Position

The following tables provide summarized information with respect to investments held in an unrealized loss position at September 30, 2015 and December 31, 2014, including the length of time the investment had been held in a continuous unrealized loss position.

| (In thousands)                                   | September 30, 2015 |                 |                     |                 |                     |                 |
|--|--------------------|-----------------|---------------------|-----------------|---------------------|-----------------|
|  | Total              |                 | Less than 12 months |                 | 12 months or longer |                 |
|  | Fair Value         | Unrealized Loss | Fair Value          | Unrealized Loss | Fair Value          | Unrealized Loss |
| Fixed maturities, available for sale             |                    |                 |                     |                 |                     |                 |
| U.S. Treasury obligations                        | \$8,791            | \$32            | \$2,931             | \$8             | \$5,860             | \$24            |
| U.S. Government-sponsored enterprise obligations | 1,463              | 6               | 1,463               | 6               | —                   | —               |
| State and municipal bonds                        | 48,882             | 1,132           | 44,184              | 948             | 4,698               | 184             |
| Corporate debt                                   | 471,107            | 27,280          | 400,127             | 15,316          | 70,980              | 11,964          |
| Residential mortgage-backed securities           | 71,621             | 553             | 62,177              | 418             | 9,444               | 135             |
| Agency commercial mortgage-backed securities     | 425                | 20              | —                   | —               | 425                 | 20              |
| Other commercial mortgage-backed securities      | 8,428              | 61              | 5,084               | 43              | 3,344               | 18              |
| Other asset-backed securities                    | 24,421             | 17              | 16,458              | 9               | 7,963               | 8               |
|  | \$635,138          | \$29,101        | \$532,424           | \$16,748        | \$102,714           | \$12,353        |
| Other investments                                |                    |                 |                     |                 |                     |                 |
| Investments in LPs/LLCs carried at cost          | \$33,534           | \$2,242         | \$33,534            | \$2,242         | \$—                 | \$—             |

| (In thousands)                                   | December 31, 2014 |                 |                     |                 |                     |                 |
|--|-------------------|-----------------|---------------------|-----------------|---------------------|-----------------|
|  | Total             |                 | Less than 12 months |                 | 12 months or longer |                 |
|  | Fair Value        | Unrealized Loss | Fair Value          | Unrealized Loss | Fair Value          | Unrealized Loss |
| Fixed maturities, available for sale             |                   |                 |                     |                 |                     |                 |
| U.S. Treasury obligations                        | \$61,209          | \$987           | \$46,869            | \$617           | \$14,340            | \$370           |
| U.S. Government-sponsored enterprise obligations | 6,268             | 100             | 2,775               | 44              | 3,493               | 56              |
| State and municipal bonds                        | 39,831            | 335             | 18,910              | 84              | 20,921              | 251             |
| Corporate debt                                   | 423,107           | 17,103          | 326,804             | 13,236          | 96,303              | 3,867           |
| Residential mortgage-backed securities           | 45,006            | 448             | 14,406              | 31              | 30,600              | 417             |
| Agency commercial mortgage-backed securities     | 4,783             | 59              | 70                  | —               | 4,713               | 59              |
| Other commercial mortgage-backed securities      | 13,860            | 99              | 7,005               | 28              | 6,855               | 71              |
| Other asset-backed securities                    | 62,577            | 205             | 59,176              | 109             | 3,401               | 96              |
|  | \$656,641         | \$19,336        | \$476,015           | \$14,149        | \$180,626           | \$5,187         |
| Other investments                                |                   |                 |                     |                 |                     |                 |
| Investments in LPs/LLCs carried at cost          | \$23,683          | \$3,948         | \$22,265            | \$3,711         | \$1,418             | \$237           |

As of September 30, 2015, excluding U.S. Government backed securities, there were 546 debt securities (20.2% of all available-for-sale fixed maturity securities held) in an unrealized loss position representing 404 issuers. The greatest

and second greatest unrealized loss position among those securities were approximately \$1.5 million and \$1.3 million, respectively. The securities were evaluated for impairment as of September 30, 2015.

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As of December 31, 2014, excluding U.S. Government backed securities, there were 588 debt securities (20.5% of all available-for-sale fixed maturity securities held) in an unrealized loss position representing 434 issuers. The greatest and second greatest unrealized loss position among those securities approximated \$1.7 million and \$0.7 million, respectively. The securities were evaluated for impairment as of December 31, 2014.

Each quarter, ProAssurance performs a detailed analysis for the purpose of assessing whether any of the securities it holds in an unrealized loss position have suffered an other-than-temporary impairment in value. A detailed discussion of the factors considered in the assessment is included in Note 1 of the Notes to Consolidated Financial Statements included in ProAssurance's December 31, 2014 Form 10-K.

Fixed maturity securities held in an unrealized loss position at September 30, 2015, excluding asset-backed securities, have paid all scheduled contractual payments and are expected to continue doing so. Expected future cash flows of asset-backed securities held in an unrealized loss position were estimated as part of the September 30, 2015 impairment evaluation using the most recently available six-month historical performance data for the collateral (loans) underlying the security or, if historical data was not available, sector based assumptions, and equaled or exceeded the current amortized cost basis of the security.

## Net Investment Income

Net investment income by investment category was as follows:

| (In thousands)                   | Three Months Ended |          | Nine Months Ended |          |
|----------------------------------|--------------------|----------|-------------------|----------|
|                                  | September 30       |          | September 30      |          |
|                                  | 2015               | 2014     | 2015              | 2014     |
| Fixed maturities                 | \$24,127           | \$28,442 | \$74,110          | \$85,402 |
| Equities                         | 3,506              | 2,661    | 9,974             | 7,479    |
| Short-term and Other investments | 515                | 2,793    | 1,417             | 4,723    |
| BOLI                             | 658                | 646      | 1,589             | 1,544    |
| Investment fees and expenses     | (1,864 )           | (1,712 ) | (4,889 )          | (6,360 ) |
| Net investment income            | \$26,942           | \$32,830 | \$82,201          | \$92,788 |

## Equity in Earnings (Loss) from Unconsolidated Subsidiaries

Equity in earnings (loss) from unconsolidated subsidiaries included losses from qualified affordable housing project tax credit investments of \$2.4 million and \$7.6 million for the three- and nine-month periods ended September 30, 2015, respectively, and \$2.5 million and \$6.5 million for the three- and nine-month periods ended September 30, 2014, respectively. The losses recorded reflect ProAssurance's allocable portion of partnership operating losses. ProAssurance recognized tax credits related to these qualified affordable housing investments that totaled \$4.6 million and \$13.9 million for the three- and nine-month periods ended September 30, 2015, respectively and \$4.6 million and \$13.4 million for the three- and nine-month periods ended September 30, 2014, respectively. Tax credits recognized reduced income tax expense in the respective periods.

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## Net Realized Investment Gains (Losses)

Realized investment gains and losses are recognized on the specific identification basis. The following table provides detailed information regarding net realized investment gains (losses):

| (In thousands)   | Three Months Ended |            | Nine Months Ended |            |
|--|--------------------|------------|-------------------|------------|
|  | September 30       |            | September 30      |            |
|  | 2015               | 2014       | 2015              | 2014       |
| Total OTTI losses:   |                    |            |                   |            |
| State and municipal bonds  | \$—                | \$—        | \$—               | \$(50 )    |
| Corporate debt   | (1,925 )           | (1,425 )   | (6,405 )          | (1,425 )   |
| Other investments  | (1,870 )           | —          | (1,870 )          | —          |
| Portion recognized in OCI:   |                    |            |                   |            |
| Corporate debt   | 385                | 268        | 2,174             | 268        |
| Net impairments recognized in earnings   | \$(3,410 )         | \$(1,157 ) | \$(6,101 )        | \$(1,207 ) |
| Gross realized gains, available-for-sale securities  | 2,739              | 736        | 10,379            | 3,711      |
| Gross realized (losses), available-for-sale securities                                     | (2,548 )           | (52 )      | (4,613 )          | (371 )     |
| Net realized gains (losses), trading securities  | 402                | 3,227      | 12,594            | 21,830     |
| Net realized gains (losses), Other investments   | (361 )             | 55         | 357               | 321        |
| Change in unrealized holding gains (losses), trading securities                            | (32,621 )          | (10,402 )  | (47,513 )         | (17,906 )  |
| Change in unrealized holding gains (losses), convertible securities, carried at fair value | (971 )             | (538 )     | (1,669 )          | 1,281      |
| Other  | 138                | —          | 946               | —          |
| Net realized investment gains (losses)   | \$(36,632 )        | \$(8,131 ) | \$(35,620 )       | \$7,659    |

ProAssurance recognized impairments in income totaling \$3.4 million and \$6.1 million for the three- and nine-month periods ended September 30, 2015, respectively. Impairments recognized in income related to corporate debt securities for the 2015 three-month period primarily consisted of an impairment associated with bonds ProAssurance intends to sell but also included two other credit-related impairments, one a preferred stock from a consumer-oriented issuer and the other a bond from an energy sector issuer. ProAssurance also recognized non-credit impairments for the three- and nine-month periods ended September 30, 2015, respectively, related to the latter two securities as the fair value of the impaired securities was less than the future cash flows expected to be received from the securities.

Impairments recognized for the 2015 nine-month period further included credit-related impairments of corporate debt securities totaling \$2.7 million recorded related to high-yield securities from three other issuers in the energy sector, and non-credit impairments related to these same securities of \$1.8 million.

ProAssurance also recognized a \$1.9 million impairment related to an investment fund that is accounted for using the cost method. The fund is focused on the energy sector and securities held have declined in value. An OTTI was recognized to reduce the carrying value of the investment to an amount which Management believes will be recoverable on the investment.

The holding loss recognized related to our equity trading securities of \$32.6 million for the 2015 three-month period primarily reflected unfavorable equity market performance during the third quarter 2015.

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The following table presents a roll forward of cumulative credit losses recorded in earnings related to impaired debt securities for which a portion of the OTTI was recorded in OCI.

| (In thousands)  | Three Months Ended |         | Nine Months Ended |         |
|---|--------------------|---------|-------------------|---------|
|   | September 30       |         | September 30      |         |
|   | 2015               | 2014    | 2015              | 2014    |
| Balance beginning of period   | \$2,630            | \$83    | \$232             | \$83    |
| Additional credit losses recognized during the period, related to securities for which:         |                    |         |                   |         |
| No OTTI has been previously recognized  | —                  | 149     | 1,830             | 149     |
| OTTI has been previously recognized   | 623                | —       | 1,484             | —       |
| Reductions due to:  |                    |         |                   |         |
| Securities sold during the period (realized)  | —                  | —       | (293              | ) —     |
| Balance September 30  | \$3,253            | \$232   | \$3,253           | \$232   |
| Other information regarding sales and purchases of available-for-sale securities is as follows: |                    |         |                   |         |
| (In millions)   | Three Months Ended |         | Nine Months Ended |         |
|   | September 30       |         | September 30      |         |
|   | 2015               | 2014    | 2015              | 2014    |
| Proceeds from sales (exclusive of maturities and paydowns)                                      | \$119.0            | \$24.8  | \$420.0           | \$147.3 |
| Purchases   | \$90.9             | \$146.5 | \$466.2           | \$511.9 |

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4. Income Taxes

ProAssurance estimates its annual effective tax rate at the end of each quarterly reporting period and uses this estimated rate to record the provision for income taxes in the interim financial statements. The provision for income taxes is different from that which would be obtained by applying the statutory Federal income tax rate to income before taxes primarily because a portion of ProAssurance's investment income is tax-exempt, because ProAssurance utilizes tax credit benefits transferred from tax credit partnership investments, and because no tax benefit is received related to the operating loss or the U.K. tax expense associated with our Lloyd's Syndicate segment.

ProAssurance had a liability for federal income taxes of \$1.7 million at September 30, 2015, carried as part of Other Liabilities. ProAssurance had a receivable for federal income taxes of \$1.1 million at December 31, 2014, carried as a part of Other Assets. The liability for unrecognized tax benefits was \$0.8 million at September 30, 2015 and \$0.6 million at December 31, 2014.

5. Deferred Policy Acquisition Costs

Policy acquisition costs that are primarily and directly related to the successful production of new and renewal insurance contracts, most significantly agent commissions, premium taxes, and underwriting salaries and benefits, are capitalized as policy acquisition costs and amortized to expense, net of ceding commissions earned, as the related premium revenues are earned.

Amortization of DPAC was \$21.1 million and \$60.0 million for the three and nine months ended September 30, 2015, respectively, and \$21.2 million and \$62.4 million for the three and nine months ended September 30, 2014, respectively.

6. Reserve for Losses and Loss Adjustment Expenses

The reserve for losses is established based on estimates of individual claims and actuarially determined estimates of future losses based on ProAssurance's past loss experience, available industry data and projections as to future claims frequency, severity, inflationary trends and settlement patterns. Estimating the reserve, particularly the reserve appropriate for liability exposures, is a complex process. Claims may be resolved over an extended period of time, often five years or more, and may be subject to litigation. Estimating losses requires ProAssurance to make and revise judgments and assessments regarding multiple uncertainties over an extended period of time. As a result, the reserve estimate may vary significantly from the eventual outcome. The assumptions used in establishing ProAssurance's reserve are regularly reviewed and updated by management as new data becomes available. Changes to estimates of previously established reserves are included in earnings in the period in which the estimate is changed.

During the three and nine months ended September 30, 2015, ProAssurance recognized favorable net loss development of \$36.2 million and \$104.8 million, respectively, related to prior accident years. The favorable net loss development primarily reflected reductions in the Company's estimates of claims severity related to the 2008 through 2012 accident years.

For the three and nine months ended September 30, 2014, ProAssurance recognized favorable net loss development of \$42.9 million and \$133.3 million, respectively, to reflect reductions in estimated claims severity related to the 2007 through 2012 accident years.

7. Commitments and Contingencies

ProAssurance is involved in various legal actions related to insurance policies and claims handling including, but not limited to, claims asserted by policyholders. These types of legal actions arise in the Company's ordinary course of business and, in accordance with GAAP for insurance entities, are considered as a part of the Company's loss reserving process, which is described in detail under the heading "Losses and Loss Adjustment Expenses" in the Accounting Policies section in Note 1 of the Notes to Consolidated Financial Statements in ProAssurance's 2014 Form 10-K.

ProAssurance has funding commitments primarily related to non-public investment entities totaling approximately \$130.4 million, expected to be paid as follows: \$31.3 million in 2015, \$96.0 million in 2016 and 2017 combined, \$2.3



million in 2018 and 2019 combined and \$0.8 million thereafter. Of these funding commitments, \$13.2 million are related to qualified affordable housing project tax credit investments and are expected to be paid as follows: \$11.7 million in 2015, \$0.5 million in 2016 and 2017 combined, \$0.3 million in 2018 and 2019 combined and \$0.7 million thereafter.

As a member of Lloyd's and a capital provider to Syndicate 1729, ProAssurance is required to provide capital, referred to as FAL. At September 30, 2015, ProAssurance was satisfying the FAL requirement with investment securities on deposit with Lloyd's with a carrying value of \$89.7 million (see Note 3 of the Notes to Condensed Consolidated Financial Statements).

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ProAssurance has issued an unconditional revolving credit agreement of up to £10 million to the Premium Trust Fund of Syndicate 1729 for the purpose of providing working capital. Advances under this Syndicate Credit Agreement bear interest at 8.5% annually, and may be repaid at any time but are repayable upon demand after December 31, 2016. As of September 30, 2015, the unused commitment under the Syndicate Credit Agreement approximated £1.5 million (approximately \$2.3 million as of September 30, 2015).

**8. Long-term Debt**

ProAssurance's outstanding long-term debt consisted of the following:

| (In thousands)   | September 30,<br>2015 | December 31,<br>2014 |
|--|-----------------------|----------------------|
| Senior notes due 2023, unsecured, interest at 5.3% annually  | \$250,000             | \$250,000            |
| Revolving Credit Agreement, outstanding borrowings fully secured, see Note 3, and carried at an interest rate of 0.78%. The interest rate on the borrowing is set at the time the borrowing is initiated or renewed. The current borrowing can be repaid or renewed in January 2016. If renewed, the interest rate will reset. | 100,000               | —                    |
|  | \$350,000             | \$250,000            |

**Revolving Credit Agreement**

During June 2015, ProAssurance amended certain terms of its Revolving Credit Agreement to include the following:

- (1) The available line of credit of \$200 million has been expanded to include an additional \$50 million accordion feature, which if subscribed successfully, would also be available for use.
- (2) All borrowings are required to be repaid prior to the expiration date which has been extended to June 19, 2020.
- (3) ProAssurance is required to pay a commitment fee, ranging from 12.5 to 25 basis points based on ProAssurance's credit ratings, on the average unused portion of the credit line during the term of the Revolving Credit Agreement.
- (4) Borrowing under the Revolving Credit Agreement may be secured or unsecured and accrues interest at a selected base rate, adjusted by a margin, which can vary from 0 to 163 basis points, based on ProAssurance's credit rating and whether the borrowing is secured or unsecured.

In addition, the financial covenants were amended to replace the original minimum net worth calculation with a requirement that ProAssurance maintain a net worth, excluding AOCI, of at least \$1.3 billion.

**Covenant Compliance**

There are no financial covenants associated with the Senior Notes due 2023.

The Revolving Credit Agreement contains customary representations, covenants and events constituting default, and remedies for default. The Revolving Credit Agreement also defines financial covenants regarding permitted leverage ratios. ProAssurance is currently in compliance with all covenants of the Agreement.

**Additional Information**

For additional information regarding ProAssurance's long-term debt, see Note 10 of the Notes to Consolidated Financial Statements included in ProAssurance's December 31, 2014 Form 10-K.

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9. Shareholders' Equity

At September 30, 2015 and December 31, 2014, ProAssurance had 100 million shares of authorized common stock and 50 million shares of authorized preferred stock. The Board has the authority to determine provisions for the issuance of preferred shares, including the number of shares to be issued, the designations, powers, preferences and rights, and the qualifications, limitations or restrictions of such shares. To date, the Board has not approved the issuance of preferred stock.

ProAssurance declared cash dividends of \$0.31 per share during each of the first three quarters of 2015 totaling \$50.4 million, which included the third quarter dividend of \$16.5 million that was paid in October 2015. ProAssurance declared cash dividends of \$0.30 per share during each of the first three quarters of 2014 totaling \$52.9 million, which included the third quarter dividend of \$17.3 million that was paid in October 2014.

At September 30, 2015, Board authorizations for the repurchase of common shares or the retirement of outstanding debt of \$116.4 million remained available for use, which included a \$100 million increase to the authorization approved by the Board in May 2015. ProAssurance repurchased approximately 3.6 million and 3.7 million shares during the nine months ended September 30, 2015 and 2014 at a total cost of \$165.2 million and \$167.2 million, respectively.

Share-based compensation expense was \$2.7 million and \$7.6 million for the three and nine months ended September 30, 2015, respectively, and \$2.4 million and \$8.0 million for the three and nine months ended September 30, 2014, respectively. Related tax benefits were \$0.9 million and \$2.7 million for the three and nine months ended September 30, 2015, respectively, and \$0.8 million and \$2.8 million for the three and nine months ended September 30, 2014, respectively.

ProAssurance awarded approximately 92,000 restricted share units and 106,500 base performance share units to employees in February 2015. The fair value of each unit awarded was estimated at \$42.73, equal to the market value of a ProAssurance common share on the date of grant less the estimated present value of dividends during the vesting period. All awards are charged to expense as an increase to equity over the service period (generally the vesting period) associated with the award. Restricted share units and performance share units vest in their entirety at the end of a three-year period following the grant date based on a continuous service requirement and, for performance share units, achievement of a performance objective. Partial vesting is permitted for retirees. A ProAssurance common share is issued for each unit once vesting requirements are met, except that units sufficient to satisfy required tax withholdings are paid in cash. The number of common shares issued for performance share units varies from 75% to 125% of base awards depending upon the degree to which stated performance objectives are achieved. ProAssurance issued approximately 28,000 and 116,000 common shares to employees in February 2015 related to restricted share units and performance share units, respectively, granted in 2012. Performance share units for the 2012 award were issued at levels ranging from 104% to 125%.

ProAssurance issued approximately 28,000 common shares to employees in February 2015 as bonus compensation, as approved by the Compensation Committee of the Board. The shares issued were valued at fair value (the market price of a ProAssurance common share on the date of award).

Other Comprehensive Income (Loss) and Accumulated Other Comprehensive Income (Loss)

For the three and nine months ended September 30, 2015 and September 30, 2014, OCI was primarily comprised of unrealized gains and losses, including non-credit impairment losses, arising during the period related to available-for-sale securities, less reclassification adjustments as shown in the table that follows, net of tax. For the nine months ended September 30, 2015, OCI also included losses related to unrecognized changes in defined benefit plan liabilities of \$1.0 million, net of tax, from the reestimation of two defined benefit plans assumed in the Eastern acquisition. Both plans are frozen as to the earning of additional benefits, but the unrecognized plan benefit liability is reestimated annually.

At September 30, 2015 and December 31, 2014, AOCI was primarily comprised of unrealized gains and losses from available-for-sale securities, including non-credit impairments recognized in OCI of \$0.9 million and \$0.5 million, respectively, net of tax. At September 30, 2015 AOCI also included losses of \$1.0 million related to unrecognized changes in defined benefit plan liabilities, net of tax. All tax effects were computed using a 35% rate. OCI and AOCI also included immaterial amounts of foreign currency translation adjustments.

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Amounts reclassified from AOCI to net income and the amounts of deferred tax expense (benefit) included in OCI were as follows:

| (In thousands)   | Three Months Ended<br>September 30 |            | Nine Months Ended<br>September 30 |           |
|--|------------------------------------|------------|-----------------------------------|-----------|
|  | 2015                               | 2014       | 2015                              | 2014      |
| Reclassifications from AOCI to net income,<br>available-for-sale securities: |                                    |            |                                   |           |
| Realized investment gains (losses)   | \$(1,348                           | ) \$(473   | ) \$1,535                         | \$2,133   |
| Tax effect (at 35%)  | 472                                | 166        | (537                              | ) (747    |
| Net reclassification adjustments   | \$(876                             | ) \$(307   | ) \$998                           | \$1,386   |
| Deferred tax expense (benefit) included in OCI                               | \$(2,555                           | ) \$(7,851 | ) \$(11,905                       | ) \$3,784 |

## 10. Variable Interest Entities

ProAssurance holds passive interests in a number of entities that are considered to be VIEs under GAAP guidance. ProAssurance's VIE interests principally consist of interests in LPs/LLCs formed for the purpose of achieving diversified equity and debt returns. ProAssurance's VIE interests carried as a part of Other investments totaled \$38.1 million at September 30, 2015 and \$33.3 million at December 31, 2014. ProAssurance's VIE interests carried as a part of Investment in unconsolidated subsidiaries totaled \$69.1 million at September 30, 2015 and \$65.0 million at December 31, 2014.

ProAssurance has not consolidated these VIEs because it has either very limited or no power to control the activities that most significantly affect the economic performance of these entities and is not the primary beneficiary of any of the entities. ProAssurance's involvement with each entity is limited to its direct ownership interest in the entity. ProAssurance has no arrangements with any of the entities to provide other financial support to or on behalf of the entity. At September 30, 2015, ProAssurance's maximum loss exposure relative to these investments was limited to the carrying value of ProAssurance's investment in the VIE.

## 11. Earnings Per Share

Diluted weighted average shares is calculated as basic weighted average shares plus the effect, calculated using the treasury stock method, of assuming that dilutive stock options have been exercised and that performance, restricted and purchase share units have vested. All outstanding stock options, performance, restricted and purchase share units had a dilutive effect for the three and nine months ended September 30, 2015 and 2014.

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12. Segment Information

ProAssurance operates in four segments that are organized around the nature of the products and services provided: Specialty P&C, Workers' Compensation, Lloyd's Syndicate, and Corporate. A description of each segment follows. Specialty P&C is primarily focused on professional liability insurance and medical technology liability insurance. The professional liability business primarily offers professional liability insurance to healthcare providers and institutions and to attorneys and their firms. Medical technology liability insurance is offered for medical technology and life sciences companies that manufacture or distribute products including entities conducting human clinical trials. The Specialty P&C segment cedes certain premium to the Lloyd's Syndicate segment under a quota share agreement with Syndicate 1729. As discussed below, Syndicate 1729 operating results are reported on a quarter delay. The ceded premium associated with the Syndicate 1729 reinsurance agreement has been reported within the Specialty P&C segment on a similar delay, as this results in the ceded premium being reported in the same period in which the Lloyd's Syndicate segment reports the corresponding assumed premium.

Workers' Compensation provides workers' compensation products primarily to employers with 1,000 or fewer employees. The segment also offers alternative market solutions whereby policies written are 100% ceded either to a captive insurer unaffiliated with ProAssurance or to SPCs operated by a wholly owned subsidiary of ProAssurance. The SPCs are fully or partially owned by the employer (or employer group, association or affiliate) insured by the policies ceded. Financial results (underwriting profit or loss, plus investment results) of the SPCs accrue to the owners of that cell.

Lloyd's Syndicate includes operating results from ProAssurance's 58% participation in Lloyd's of London Syndicate 1729. Syndicate 1729 underwrites risks over a wide range of property and casualty insurance and reinsurance lines in both the U.S and international markets. The results of this segment are reported on a quarter delay, except that investment results associated with investment assets solely allocated to Syndicate 1729 operations and certain U.S. paid administrative expenses are reported concurrently as that information is available on an earlier time frame. Corporate includes ProAssurance's U.S. investment operations, interest expense and U.S. income taxes, all of which are managed at the corporate level, non-premium revenues generated outside of our insurance entities, and corporate expenses.

The accounting policies of the segments are the same as those described in Note 1 of the Notes to Consolidated Financial Statements in ProAssurance's December 31, 2014 report on Form 10-K and Note 1 of the Notes to Condensed Consolidated Financial Statements. ProAssurance evaluates performance of its Specialty P&C and Workers' Compensation segments based on before tax underwriting profit or loss, which excludes investment performance. Performance of the Lloyd's Syndicate segment is evaluated based on underwriting profit or loss, plus investment results of investment assets solely allocated to Syndicate 1729 operations, net of U.K. income tax expense. Performance of the Corporate segment is evaluated based on the contribution made to consolidated after tax results. ProAssurance accounts for inter-segment transactions as if the transactions were to third parties at current market prices. Assets are not allocated to segments because investments and other assets are not managed at the segment level.

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Financial data by segment were as follows:

| (In thousands)   | Three Months Ended September 30, 2015 |                       |                   |              |                            | Consolidated |
|--|---------------------------------------|-----------------------|-------------------|--------------|----------------------------|--------------|
|  | Specialty P&C                         | Workers' Compensation | Lloyd's Syndicate | Corporate    | Inter-segment Eliminations |              |
| Net premiums earned                                      | \$ 115,593                            | \$ 54,577             | \$ 11,915         | \$—          | \$—                        | \$ 182,085   |
| Net investment income                                    | —                                     | —                     | 260               | 26,682       | —                          | 26,942       |
| Equity in earnings (loss) of unconsolidated subsidiaries | —                                     | —                     | —                 | (221 )       | —                          | (221 )       |
| Net realized gains (losses)                              | —                                     | —                     | 9                 | (36,641 )    | —                          | (36,632 )    |
| Other income   | 1,660                                 | 61                    | (283 )            | 1,559        | (238 )                     | 2,759        |
| Net losses and loss adjustment expenses                  | (63,974 )                             | (36,132 )             | (8,700 )          | —            | —                          | (108,806 )   |
| Underwriting, policy acquisition and operating expenses* | (26,251 )                             | (16,231 )             | (5,644 )          | (5,137 )     | 238                        | (53,025 )    |
| Segregated portfolio cells dividend (expense) income     | —                                     | 1,933                 | —                 | —            | —                          | 1,933        |
| Interest expense   | —                                     | —                     | —                 | (3,637 )     | —                          | (3,637 )     |
| Income tax benefit (expense)                             | —                                     | —                     | (132 )            | (990 )       | —                          | (1,122 )     |
| Segment operating results                                | \$ 27,028                             | \$ 4,208              | \$ (2,575 )       | \$ (18,385 ) | \$—                        | \$ 10,276    |
| Significant non-cash items                               |                                       |                       |                   |              |                            |              |
| Depreciation and amortization                            | \$ 1,964                              | \$ 1,416              | \$ 94             | \$ 6,272     | \$—                        | \$ 9,746     |
| (In thousands)   | Nine Months Ended September 30, 2015  |                       |                   |              |                            | Consolidated |
|  | Specialty P&C                         | Workers' Compensation | Lloyd's Syndicate | Corporate    | Inter-segment Eliminations |              |
| Net premiums earned                                      | \$ 343,065                            | \$ 159,436            | \$ 26,776         | \$—          | \$—                        | \$ 529,277   |
| Net investment income                                    | —                                     | —                     | 653               | 81,548       | —                          | 82,201       |
| Equity in earnings (loss) of unconsolidated subsidiaries | —                                     | —                     | —                 | 3,821        | —                          | 3,821        |
| Net realized gains (losses)                              | —                                     | —                     | 25                | (35,645 )    | —                          | (35,620 )    |
| Other income   | 4,533                                 | 361                   | 209               | 1,828        | (427 )                     | 6,504        |
| Net losses and loss adjustment expenses                  | (197,056 )                            | (102,545 )            | (18,283 )         | —            | —                          | (317,884 )   |
| Underwriting, policy acquisition and operating expenses* | (80,057 )                             | (47,421 )             | (13,187 )         | (17,670 )    | 427                        | (157,908 )   |
| Segregated portfolio cells dividend (expense) income     | —                                     | (1,481 )              | —                 | —            | —                          | (1,481 )     |
| Interest expense   | —                                     | —                     | —                 | (10,978 )    | —                          | (10,978 )    |
| Income tax benefit (expense)                             | —                                     | —                     | (752 )            | (15,932 )    | —                          | (16,684 )    |
| Segment operating results                                | \$ 70,485                             | \$ 8,350              | \$ (4,559 )       | \$ 6,972     | \$—                        | \$ 81,248    |
| Significant non-cash items                               |                                       |                       |                   |              |                            |              |
| Depreciation and amortization                            | \$ 6,107                              | \$ 4,285              | \$ 330            | \$ 17,527    | \$—                        | \$ 28,249    |

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| (In thousands)   | Three Months Ended September 30, 2014 |                       |                   |           |                            |              |
|--|---------------------------------------|-----------------------|-------------------|-----------|----------------------------|--------------|
|  | Specialty P&C                         | Workers' Compensation | Lloyd's Syndicate | Corporate | Inter-segment Eliminations | Consolidated |
| Net premiums earned                                      | \$ 123,791                            | \$ 49,792             | \$ 3,445          | \$ —      | \$ —                       | \$ 177,028   |
| Net investment income                                    | —                                     | —                     | 120               | 32,710    | —                          | 32,830       |
| Equity in earnings (loss) of unconsolidated subsidiaries | —                                     | —                     | —                 | 298       | —                          | 298          |
| Net realized gains (losses)                              | —                                     | —                     | —                 | (8,131 )  | —                          | (8,131 )     |
| Other income   | 1,071                                 | 179                   | (79 )             | 824       | (187 )                     | 1,808        |
| Net losses and loss adjustment expenses                  | (63,639 )                             | (33,046 )             | (2,537 )          | —         | —                          | (99,222 )    |
| Underwriting, policy acquisition and operating expenses* | (33,814 )                             | (14,785 )             | (2,584 )          | (3,189 )  | 187                        | (54,185 )    |
| Segregated portfolio cells dividend expense (income)     | —                                     | 483                   | —                 | —         | —                          | 483          |
| Interest expense   | —                                     | —                     | —                 | (3,606 )  | —                          | (3,606 )     |
| Income tax benefit (expense)                             | —                                     | —                     | —                 | (12,525 ) | —                          | (12,525 )    |
| Segment operating results                                | \$ 27,409                             | \$ 2,623              | \$ (1,635 )       | \$ 6,381  | \$ —                       | \$ 34,778    |
| Significant non-cash items                               |                                       |                       |                   |           |                            |              |
| Depreciation and amortization                            | \$ 2,334                              | \$ 1,602              | \$ 157            | \$ 5,757  | \$ —                       | \$ 9,850     |
| (In thousands)   | Nine Months Ended September 30, 2014  |                       |                   |           |                            |              |
|  | Specialty P&C                         | Workers' Compensation | Lloyd's Syndicate | Corporate | Inter-segment Eliminations | Consolidated |
| Net premiums earned                                      | \$ 374,704                            | \$ 143,960            | \$ 6,397          | \$ —      | \$ —                       | \$ 525,061   |
| Net investment income                                    | —                                     | —                     | 244               | 92,544    | —                          | 92,788       |
| Equity in earnings (loss) of unconsolidated subsidiaries | —                                     | —                     | —                 | 2,767     | —                          | 2,767        |
| Net realized gains (losses)                              | —                                     | —                     | —                 | 7,659     | —                          | 7,659        |
| Other income   | 4,167                                 | 503                   | (79 )             | 1,856     | (392 )                     | 6,055        |
| Net losses and loss adjustment expenses                  | (191,263 )                            | (91,975 )             | (4,405 )          | —         | —                          | (287,643 )   |
| Underwriting, policy acquisition and operating expenses* | (101,044 )                            | (45,379 )             | (5,999 )          | (6,826 )  | 392                        | (158,856 )   |
| Segregated portfolio cells dividend expense (income)     | —                                     | (2,355 )              | —                 | —         | —                          | (2,355 )     |
| Interest expense   | —                                     | —                     | —                 | (10,697 ) | —                          | (10,697 )    |
| Income tax benefit (expense)                             | —                                     | —                     | —                 | (43,328 ) | —                          | (43,328 )    |
| Segment operating results                                | \$ 86,564                             | \$ 4,754              | \$ (3,842 )       | \$ 43,975 | \$ —                       | \$ 131,451   |
| Significant non-cash items                               |                                       |                       |                   |           |                            |              |
| Depreciation and amortization                            | \$ 6,708                              | \$ 4,384              | \$ 329            | \$ 18,379 | \$ —                       | \$ 29,800    |

\* Beginning with the first quarter of 2015, the operating subsidiaries within the Specialty P&C and Workers' Compensation segments were charged a management fee by the Corporate segment for various management services provided to the subsidiary. Under the new arrangement, the expenses associated with such services are reported as expenses of the Corporate segment, and the management fees charged are reported as an offset to Corporate operating expenses. Prior to 2015, a substantial portion of expenses associated with corporate services were directly allocated to



the insurance subsidiaries included in the Specialty P&C segment.

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The following table provides detailed information regarding ProAssurance's gross premiums earned by product as well as a reconciliation to net premiums earned. All gross premiums earned are from external customers except as noted. ProAssurance's insured risks are primarily within the United States.

| (In thousands)                       | Three Months Ended September 30 |            | Nine Months Ended September 30 |            |
|--------------------------------------|---------------------------------|------------|--------------------------------|------------|
|                                      | 2015                            | 2014       | 2015                           | 2014       |
| <b>Specialty P&amp;C Segment</b>     |                                 |            |                                |            |
| Gross premiums earned:               |                                 |            |                                |            |
| Healthcare professional liability    | \$ 118,624                      | \$ 120,623 | \$ 349,511                     | \$ 361,179 |
| Legal professional liability         | 6,994                           | 7,145      | 21,433                         | 21,147     |
| Medical technology liability         | 8,800                           | 9,258      | 26,457                         | 27,043     |
| Other                                | 374                             | 420        | 1,145                          | 1,445      |
| Ceded premiums earned*               | (19,199                         | ) (13,655  | ) (55,481                      | ) (36,110  |
| Segment net premiums earned          | \$ 115,593                      | \$ 123,791 | \$ 343,065                     | \$ 374,704 |
| <b>Workers' Compensation Segment</b> |                                 |            |                                |            |
| Gross premiums earned:               |                                 |            |                                |            |
| Traditional business                 | \$ 43,525                       | \$ 42,345  | \$ 129,515                     | \$ 119,702 |
| Alternative market business          | 17,052                          | 14,345     | 48,667                         | 40,253     |
| Ceded premiums earned                | (6,000                          | ) (6,898   | ) (18,746                      | ) (15,995  |
| Segment net premiums earned          | \$ 54,577                       | \$ 49,792  | \$ 159,436                     | \$ 143,960 |
| <b>Lloyd's Syndicate Segment</b>     |                                 |            |                                |            |
| Gross premiums earned:               |                                 |            |                                |            |
| Property and casualty*               | \$ 12,973                       | \$ 4,085   | \$ 29,832                      | \$ 7,110   |
| Ceded premiums earned                | (1,058                          | ) (640     | ) (3,056                       | ) (713     |
| Segment net premiums earned          | \$ 11,915                       | \$ 3,445   | \$ 26,776                      | \$ 6,397   |
| Consolidated net premiums earned     | \$ 182,085                      | \$ 177,028 | \$ 529,277                     | \$ 525,061 |

\*Includes premium ceded from the Specialty P&C Segment to the Lloyd's Syndicate Segment of \$3.6 million and \$10.6 million for the three and nine months ended September 30, 2015 and \$1.1 million and \$1.6 million for the three and nine months ended September 30, 2014, respectively.

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ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.

The following discussion should be read in conjunction with the Condensed Consolidated Financial Statements and Notes to those statements which accompany this report. A glossary of insurance terms and phrases is available on the investor section of our website. Throughout the discussion, references to "ProAssurance," "PRA," "Company," "we," "us" and "our" refer to ProAssurance Corporation and its consolidated subsidiaries. The discussion contains certain forward-looking information that involves risks and uncertainties. As discussed under the heading "Forward-Looking Statements," our actual financial condition and operating results could differ significantly from these forward-looking statements.

ProAssurance Overview

We report our results in four distinct segments that are organized around the nature of the products and services provided: Specialty Property & Casualty, Workers' Compensation, Lloyd's Syndicate, and Corporate. Our Specialty P&C segment includes our professional liability business and our medical technology liability business. Our Workers' Compensation segment includes workers' compensation insurance for employers, groups and associations. Our Lloyd's Syndicate segment includes operating results from our 58% participation in Syndicate 1729. Syndicate 1729 underwrites risks over a wide range of property and casualty insurance and reinsurance lines in both the U.S. and international markets. Our Corporate segment includes our U.S. investment operations which are managed at the corporate level, non-premium revenues generated outside of our insurance entities, corporate expenses, interest and U.S. income taxes. Additional information regarding our segments is included in Note 12 of the Notes to Condensed Consolidated Financial Statements and in Part I of our 2014 Form 10-K.

Critical Accounting Estimates

Our Condensed Consolidated Financial Statements are prepared in conformity with GAAP. Preparation of these financial statements requires us to make estimates and assumptions that affect the amounts we report on those statements. We evaluate these estimates and assumptions on an ongoing basis based on current and historical developments, market conditions, industry trends and other information that we believe to be reasonable under the circumstances. There can be no assurance that actual results will conform to our estimates and assumptions; reported results of operations may be materially affected by changes in these estimates and assumptions.

Management considers the following accounting estimates to be critical because they involve significant judgment by management and the effect of those judgments could result in a material effect on our financial statements.

Reserve for Losses and Loss Adjustment Expenses

The largest component of our liabilities is our reserve for losses and loss adjustment expenses ("reserve for losses" or "reserve"), and the largest component of expense for our operations is incurred losses and loss adjustment expenses (also referred to as "losses and loss adjustment expenses," "incurred losses," "losses incurred," and "losses"). Incurred losses reported in any period reflect our estimate of losses incurred related to the premiums earned in that period as well as any changes to our previous estimate of the reserve required for prior periods.

As of September 30, 2015 our reserve is almost entirely comprised of long-tail exposures. The estimation of long-tailed losses is inherently difficult and is subject to significant judgment on the part of management. Due to the nature of our claims, our loss costs, even for claims with similar characteristics, can vary significantly depending upon many factors, including but not limited to the specific characteristics of the claim and the manner in which the claim is resolved. Long-tailed insurance is characterized by the extended period of time typically required to assess the viability of a claim, potential damages, if any, and to then reach a resolution of the claim. The claims resolution process may extend to more than five years. The combination of continually changing conditions and the extended time required for claim resolution results in a loss cost estimation process that requires actuarial skill and the application of significant judgment, and such estimates require periodic modification.

Our reserve is established by management after taking into consideration a variety of factors including premium rates, claims frequency, historical paid and incurred loss development trends, the expected effect of inflation, general economic trends, the legal and political environment, and the conclusions reached by our internal and consulting actuaries. We update and review the data underlying the estimation of our reserve for losses each reporting period and make adjustments to loss estimation assumptions that we believe best reflect emerging data. Both our internal and

consulting actuaries perform an in-depth review of our reserve for losses on at least a semi-annual basis using the loss and exposure data of our insurance subsidiaries.

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Our reserving process can be broadly grouped into two areas: the establishment of the reserve for the current accident year (the initial reserve) and the re-estimation of the reserve for prior accident years (development of prior accident years).

### Current Accident Year - Initial Reserve

Considerable judgment is required in establishing our initial reserve for any current accident year period, as there is limited data available upon which to base our case reserves. Our process for setting an initial reserve considers the unique characteristics of each product, but in general we rely heavily on the loss assumptions that were used to price business, as our pricing reflects our analysis of loss costs that we expect to incur relative to the insurance product being priced.

**Specialty P&C Segment.** Professional and medical technology liability loss costs are impacted by many factors, including but not limited to, the nature of the claim, including whether or not the claim is an individual or a mass tort claim, the personal situation of the claimant or the claimant's family, the outcome of jury trials, the legislative and judicial climate where any potential litigation may occur, general economic conditions and, for claims involving bodily injury, the trend of healthcare costs. Within our Specialty P&C segment, for our HCPL business (81% of our consolidated gross reserve for losses and loss adjustment expenses as of December 31, 2014), we set an initial reserve using the average loss ratio used in our pricing, plus an additional provision in consideration of the historical loss volatility we and others in the industry have experienced. For our HCPL business our target loss ratio during recent accident years has approximated 75% and the provision for loss volatility has ranged from 8 to 10 percentage points, producing an overall average initial loss ratio for our HCPL business of approximately 85%. We believe use of a provision for volatility appropriately considers the inherent risks and limitations of our rate development process and the historic volatility of professional liability losses (the industry has experienced accident year loss ratios as high as 163% and as low as 53% over the past 30 years) and produces a reasonable best estimate of the reserve required to cover actual ultimate unpaid losses. A similar practice is followed for our legal professional liability business (5% of our consolidated gross reserve for losses and loss adjustment expenses as of December 31, 2014).

The risks insured in our medical technology liability business (6% of our consolidated gross reserve for losses and loss adjustment expenses as of December 31, 2014) are more varied, and policies are individually priced based on the risk characteristics of the policy. Therefore, for this business we establish an initial reserve using our most recently developed actuarial estimates of losses expected to be incurred based on factors which include: results from prior analysis of similar business, industry indications, observed trends and judgment. The medical technology liability line of business exhibits similar volatility to HCPL, and the actuarial pricing estimate includes a provision for this volatility.

**Workers' Compensation Segment.** Many factors affect the ultimate losses incurred for our workers' compensation coverages (8% of our consolidated gross reserve for losses and loss adjustment expenses as of December 31, 2014), including, but not limited to, the type and severity of the injury, the age and occupation of the injured worker, the estimated length of disability, medical treatment and related costs, and the jurisdiction of the injury occurrence. We use various actuarial methodologies in developing our workers' compensation reserve combined with a review of the exposure base generally based upon payroll. For the current accident year, given the lack of seasoned information, the different actuarial methodologies produce results with significant variability; therefore, more emphasis is placed on supplementing results from the actuarial methodologies used with trends in exposure base, medical expense inflation, general inflation, severity, and claim counts, among other things, to select an expected loss ratio.

### Development of Prior Accident Years

We re-evaluate the reserve for prior accident years each period based on our most recently available claims data and currently available industry trend information. Changes to previously established reserve estimates are recognized in the current period if management's best estimate of ultimate losses differs from the estimate previously established. While management considers a variety of variables in determining its best estimate, in general, as claims age, our methodologies give more weight to actual loss costs which, for the majority of our reserves, continue to indicate that ultimate loss costs will be lower than our previous estimates. The discussion in our Critical Accounting Estimates section in Item 7 of our 2014 Form 10-K includes additional information regarding the methodologies used to evaluate our reserve.

Any change in our estimate of net ultimate losses for prior years is reflected in net income in the period in which such changes are made. In recent years such changes have reduced our estimate of net ultimate losses, resulting in a reduction of reported losses for the period and a corresponding increase in pre-tax income.

We recognized net favorable reserve development of \$36.2 million during the three months ended September 30, 2015, of which \$35.0 million related to our Specialty P&C segment and \$1.2 million related to our Workers' Compensation segment. During the nine months ended September 30, 2015, we recognized net favorable reserve development of \$104.8 million, of which \$100.4 million related to our Specialty P&C segment and \$4.4 million related to our Workers' Compensation segment. The net favorable development recognized within the Specialty P&C segment was primarily attributable to the favorable resolution of HCPL claims during the period and an evaluation of established case reserves and paid claims data that indicated

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that the actual severity trend associated with the remaining HCPL claims continues to be less than we had previously estimated. Net favorable development recognized within our Workers' Compensation segment includes amortization of the purchase accounting fair value adjustment of \$0.4 million and \$1.2 million for the three and nine months ended September 30, 2015, respectively; the remaining net favorable development of \$0.8 million and \$3.2 million for the three- and nine-month periods, respectively, was attributable to our SPCs which are evaluated at the cell level. Because a relatively small number of claims are open per cell, the closing of claims can affect the actuarial projections for the remaining open claims in the cell to an extent that indicates development should be recognized for the cell. Due to the size of our consolidated reserve for losses and the large number of claims outstanding at any point in time, even a small percentage adjustment to our total reserve estimate could have a material effect on our results of operations for the period in which the adjustment is made.

Use of Judgment

Even though the actuarial process is highly technical, it is also highly judgmental, both as to the selection of the data used in the various actuarial methodologies (e.g., initial expected loss ratios and loss development factors) and in the interpretation of the output of the various methods used. Each actuarial method generally returns a different value and for the more recent accident years the variations among the various methodologies can be significant. For each partition of our reserves, the results of the various methods, along with the supplementary statistical data regarding such factors as closed with and without indemnity ratios, claim severity trends, the expected duration of such trends, changes in the legal and legislative environment and the current economic environment, are used to develop a point estimate based upon management's judgment and past experience. The process of selecting the point estimate is based upon the judgment of management taking into consideration the actuarial methods and other environmental factors discussed previously. The series of selected point estimates is then combined to produce an overall point estimate for ultimate losses.

Given the potential for unanticipated volatility for long-tailed lines of business, we are cautious in giving full credibility to emerging trends that, when more fully mature, may lead to the recognition of either favorable or adverse development of our losses. There may be trends, both positive and negative, reflected in the numerical data both within our own information and in the broader marketplace that mitigate or reverse as time progresses and additional data becomes available. This is particularly true for our HCPL business which has historically exhibited significant volatility as previously discussed.

HCPL. Over the past several years the most influential factor affecting the analysis of our HCPL reserves and the related development recognized has been the change, or lack thereof, in the severity of claims. The severity trend is an explicit component of our pricing models, whereas in our reserving process the severity trend's impact is implicit. Our estimate of this trend and our expectations about changes in this trend impact a variety of factors, from the selection of expected loss ratios to the ultimate point estimates established by management.

Because of the implicit and wide-ranging nature of severity trend assumptions on the loss reserving process it is not practical to specifically isolate the impact of changing severity trends. However, because severity is an explicit component of our HCPL pricing process we can better isolate the impact that changing severity can have on our loss costs and loss ratios as regards our pricing models for this business component. Our current HCPL pricing models assume a severity trend of 2% to 3% in most states and products. If the severity trend were to be higher by 1 percentage point, the impact would be an increase in our expected loss ratio for this business of 3.2 percentage points, based on current claim disposition patterns. An increase in the severity trend of 3 percentage points would result in a 10.1 percentage point increase in our expected loss ratio. Due to the long-tailed nature of our claims and the previously discussed historical volatility of loss costs, selection of a severity trend assumption is a subjective process that is inherently likely to prove inaccurate over time. Given the long tail and volatility, we are generally cautious in making changes to the severity assumptions within our pricing models. Also of note is that all open claims and accident years are generally impacted by a change in the severity trend, which compounds the effect of such a change. For the 2004 to 2009 accident years, both our internal and consulting actuaries observed an unprecedented reduction in the frequency of HCPL claims (or number of claims per exposure unit) that cannot be attributed to any single factor. We believe that much of the reduction in claim frequency is the result of a decline in the filing of non-meritorious lawsuits that have historically been dismissed or otherwise resulted in no payment of indemnity on

behalf of our insureds. With fewer non-meritorious claims being filed we expect that the claims that are filed have the potential for greater average losses, or greater severity. As a result, we cannot be certain as to the impact this decline will ultimately have on the average cost of claims, and this has complicated the selection of an appropriate severity trend for our pricing model for these lines. It has also made it more challenging to factor severity into the various actuarial methodologies we use to evaluate our reserve. Based on the weighted average of payments, typically 85% of our HCPL claims are resolved after eight years for a given accident year. Due to this long tail, we continue to be uncertain of the full impact of the observed decline in frequency and whether the expected increase in severity will materialize.



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Although we remain uncertain regarding the ultimate severity trend to project into the future due to the long-tailed nature of our business, we have given consideration to observed loss costs in setting our rates. For our HCPL business this practice has resulted in rate reductions in recent years. For example, on average, excluding our podiatry business acquired in 2009, we have gradually reduced the premium rates we charge on our standard physician renewal business (our largest HCPL line) by approximately 17% from the beginning of 2006 to September 30, 2015. Loss ratios for the current accident years have thus remained fairly constant because expected loss reductions have been reflected in our rates.

Workers' Compensation. Severity has not historically been an influential factor affecting our workers' compensation analysis of reserves, as claims are typically resolved more quickly than the industry norm. As previously mentioned, the determination and calculation of loss development factors requires considerable judgment. In particular the selection of tail factors requires considerable judgment as they are determined in the absence of direct loss development history and thus require reliance upon industry data which may not be representative of the Company's data and experience.

Investment Valuations

We record the majority of our investments at fair value as shown in the table below. At September 30, 2015 the distribution of our investments based on GAAP fair value hierarchies (levels) was as follows:

|                          | Distribution by GAAP Fair Value Hierarchy |         |         |                 | September 30,                |
|--------------------------|---|---------|---------|-----------------|------------------------------|
|                          | Level 1                                   | Level 2 | Level 3 | Not Categorized | 2015<br>Total<br>Investments |
| Investments recorded at: |   |         |         |                 |                              |
| Fair value               | 12%                                       | 76%     | 1%      | 4%              | 93%                          |
| Other valuations         |   |         |         |                 | 7%                           |
| Total Investments        |   |         |         |                 | 100%                         |

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. All of our fixed maturity and equity security investments are carried at fair value. Our short-term securities are carried at amortized cost, which approximates fair value.

Because of the number of securities we own and the complexity of developing accurate fair values, we utilize multiple independent pricing services to assist us in establishing the fair value of individual securities. The pricing services provide fair values based on exchange traded prices, if available. If an exchange traded price is not available, the pricing services, if possible, provide a fair value that is based on multiple broker/dealer quotes or that has been developed using pricing models. Pricing models vary by asset class and utilize currently available market data for securities comparable to ours to estimate a fair value for our security. The pricing services scrutinize market data for consistency with other relevant market information before including the data in the pricing models. The pricing services disclose the types of pricing models used and the inputs used for each asset class. Determining fair values using these pricing models requires the use of judgment to identify appropriate comparable securities and to choose a valuation methodology that is appropriate for the asset class and available data.

The pricing services provide a single value per instrument quoted. We review the values provided for reasonableness each quarter by comparing market yields generated by the supplied value versus market yields observed in the market place. We also compare yields indicated by the provided values to appropriate benchmark yields and review for values that are unchanged or that reflect an unanticipated variation as compared to prior period values. We utilize a primary pricing service for each security type and compare provided information for consistency with alternate pricing services, known market data and information from our own trades, considering both values and valuation trends. We also review weekly trades versus the prices supplied by the services. If a supplied value appears unreasonable, we discuss the valuation in question with the pricing service and make adjustments if deemed necessary. To date, our review has not resulted in any changes to the values supplied by the pricing services. The pricing services do not provide a fair value unless an exchange traded price or multiple observable inputs are available. As a result, the pricing services may provide a fair value for a security in some periods but not others, depending upon the level of

recent market activity for the security or comparable securities.

Level 1 Investments

Fair values for a majority of our equity securities, a portion of our convertible securities and our short-term securities are determined using exchange traded prices. There is little judgment involved when fair value is determined using an exchange traded price. In accordance with GAAP, for disclosure purposes we classify securities valued using an exchange traded price as Level 1 securities.

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## Level 2 Investments

Most fixed income securities do not trade daily, and thus exchange traded prices are generally not available for these securities. However, market information (often referred to as observable inputs or market data, including but not limited to, last reported trade, non-binding broker quotes, bids, benchmark yield curves, issuer spreads, two sided markets, benchmark securities, offers and recent data regarding assumed prepayment speeds, cash flow and loan performance data) is available for most of our fixed income securities. We determine fair value for a large portion of our fixed income securities using available market information. In accordance with GAAP, for disclosure purposes we classify securities valued based on multiple market observable inputs as Level 2 securities.

## Level 3 Investments

When a pricing service does not provide a value for one of our fixed maturity securities, management estimates fair value using either a single non-binding broker quote or pricing models that utilize market based assumptions which have limited observable inputs. The process involves significant judgment in selecting the appropriate data and modeling techniques to use in the valuation process. For disclosure purposes we classify securities valued using limited observable inputs as Level 3 securities.

## Fair Values Not Categorized

We hold interests in certain LPs/LLCs that are investment funds which measure fund assets at fair value on a recurring basis and provide us with a NAV for our interest. As a practical expedient, we consider the NAV provided to approximate the fair value of the interest. In accordance with GAAP, we do not categorize these investments within the fair value hierarchy.

## Investments - Other Valuation Methodologies

Certain of our investments, in accordance with GAAP for the type of investment, are measured using methodologies other than fair value. At September 30, 2015 these investments represented approximately 7% of total investments and are detailed in the following table. Additional information about these investments is provided in Notes 2 and 3 of the Notes to Condensed Consolidated Financial Statements.

| (In millions)                                     | Carrying Value | GAAP Measurement Method |
|---|----------------|-------------------------|
| Other investments:                                |                |                         |
| Investments in LPs                                | \$58.4         | Cost                    |
| Other, principally FHLB capital stock             | 3.5            | Cost                    |
| Total other investments                           | 61.9           |                         |
| Investment in unconsolidated subsidiaries:        |                |                         |
| Investments in tax credit partnerships            | 128.4          | Equity                  |
| Equity method LPs/LLCs                            | 13.1           | Equity                  |
| Total investment in unconsolidated subsidiaries   | 141.5          |                         |
| BOLI  | 56.7           | Cash surrender value    |
| Total investments - Other valuation methodologies | \$260.1        |                         |

## Investment Impairments

We evaluate our investments on at least a quarterly basis for declines in fair value that represent OTTI. We consider an impairment to be an OTTI if we intend to sell the security or if we believe we will be required to sell the security before we fully recover the amortized cost basis of the security. Otherwise, we consider various factors in our evaluation, as discussed below.

For debt securities, we consider whether we expect to fully recover the amortized cost basis of the security, based upon consideration of some or all of the following:

- third party research and credit rating reports;
- the current credit standing of the issuer, including credit rating downgrades;
- the extent to which the decline in fair value is attributable to credit risk specifically associated with the security or its issuer;



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our internal assessments and those of our external portfolio managers regarding specific circumstances surrounding a security, which can cause us to believe the security is more or less likely to recover its value than other securities with a similar structure;

for asset-backed securities, the origination date of the underlying loans, the remaining average life, the probability that credit performance of the underlying loans will deteriorate in the future, and our assessment of the quality of the collateral underlying the loan;

failure of the issuer of the security to make scheduled interest or principal payments;

any changes to the rating of the security by a rating agency; and

recoveries or additional declines in fair value subsequent to the balance sheet date.

In assessing whether we expect to recover the cost basis of debt securities, particularly asset-backed securities, we must make a number of assumptions regarding the cash flows that we expect to receive from the security in future periods. These judgments are subjective in nature and may subsequently be proved to be inaccurate.

We evaluate our cost method interests in LPs/LLCs for OTTI by considering whether there has been a decline in fair value below the recorded value, which involves assumptions and estimates. We receive a report from each of the LPs/LLCs at least quarterly which provides us a NAV for our interest. The NAV is based on the fair values of securities held by the LP/LLC as determined by the LP/LLC manager. We consider the most recent NAV provided, the performance of the LP/LLC relative to the market, the stated objectives of the LP/LLC, the cash flows expected from the LP/LLC and audited financial statements of the entity, if available, in considering whether an OTTI exists. Our investments in tax credit partnerships are evaluated for OTTI by considering both qualitative and quantitative factors which include: whether cash flows, primarily tax benefits, currently expected from the investment equal or exceed the carrying value of the investment, whether currently expected cash flows are less than those expected at the time the investment was acquired, and our ability and intent to hold the investment until the recovery of its carrying value.

We also evaluate our holdings of FHLB securities for impairment. We consider the current capital status of the FHLB, whether the FHLB is in compliance with regulatory minimum capital requirements, and the FHLB's most recently reported operating results.

### Deferred Policy Acquisition Costs

Policy acquisition costs (primarily commissions, premium taxes and underwriting salaries) which are directly related to the successful acquisition of new and renewal premiums are capitalized as deferred policy acquisition costs and charged to expense, net of ceding commissions earned, as the related premium revenue is recognized. We evaluate the recoverability of our deferred policy acquisition costs at the segment level each reporting period, and any amounts estimated to be unrecoverable are charged to expense in the current period. As of September 30, 2015 we have not determined that any amounts are unrecoverable.

### Estimation of Taxes / Tax Credits

For interim periods, we determine our provision for income taxes based on our current estimate of our annual effective tax rate. Items which are unusual, infrequent, or that cannot be reliably estimated are considered in the effective tax rate in the period in which the item is included in income. In calculating our estimated annual effective tax rate, we include the estimated benefit of tax credits for the annual period based on the most recently available information provided by the tax credit partnership; the actual amounts of credits provided by the tax credit partnerships may prove to be different than our estimates. The effect of such differences is recognized in the period identified.

### Deferred Taxes

Deferred federal income taxes arise from the recognition of temporary differences between the bases of assets and liabilities determined for financial reporting purposes and the bases determined for income tax purposes. Our temporary differences principally relate to our loss reserve, unearned premiums, compensation recognition, deferred policy acquisition costs, unrealized investment gains (losses), intangibles, and basis differences on investment assets. Deferred tax assets and liabilities are measured using the enacted tax rates expected to be in effect when such benefits are realized. We review our deferred tax assets quarterly for impairment. If we determine that it is more likely than not that some or all of a deferred tax asset will not be realized, a valuation allowance is recorded to reduce the carrying

value of the asset. In assessing the need for a valuation allowance, management is required to make certain judgments and assumptions about our future operations based on historical experience and information as of the measurement period regarding reversal of existing temporary differences,

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carryback capacity, future taxable income (including its capital and operating characteristics) and tax planning strategies. We did not have any valuation allowances as of September 30, 2015.

Unrecognized Tax Benefits

We evaluate tax positions taken on tax returns and recognize positions in our financial statements when it is more likely than not that we will sustain the position upon resolution with a taxing authority. If recognized, the benefit is measured as the largest amount of benefit that has a greater than fifty percent probability of being realized. We review uncertain tax positions each period, considering changes in facts and circumstances, such as changes in tax law, interactions with taxing authorities and developments in case law, and make adjustments as we consider necessary. Adjustments to our unrecognized tax benefits may affect our income tax expense, and settlement of uncertain tax positions may require the use of cash.

Goodwill

Management evaluates the carrying value of goodwill at the segment (or reporting unit) level annually as of October 1st. If, at any time during the year, events occur or circumstances change that would more likely than not reduce the fair value below the carrying value, we also evaluate goodwill at that time.

The goodwill impairment assessment requires evaluating qualitative factors or performing a quantitative assessment to determine if a reporting unit's carrying value is likely to exceed its fair value. For our assessment performed as of October 1, 2014, we elected to evaluate qualitative factors and concluded, based on the evaluation, that it was more likely than not that the fair value of each reporting unit exceeded the carrying value of the unit and deemed it unnecessary to perform further testing. Additional information regarding our goodwill evaluation at the segment level is included in Note 1 of the Notes to Consolidated Financial Statements included in ProAssurance's December 31, 2014 Form 10-K. Note 12 of the Notes to Condensed Consolidated Financial Statements provides additional information regarding our segments.

Intangibles

Intangible assets with definite lives are amortized over the estimated useful life of the asset. Amortizable intangible assets primarily consist of agency and policyholder relationships, renewal rights and trade names. Intangible assets with an indefinite life, primarily state licenses, are not amortized. Intangible assets are evaluated for impairment on an annual basis. Additional information regarding intangible assets is included in Note 1 of the Notes to Consolidated Financial Statements included in ProAssurance's December 31, 2014 Form 10-K.

Audit Premium

Workers' compensation premiums are determined based upon the payroll of the insured, applicable premium rates and an experience based modification factor, where applicable. An audit of the policyholders' records is conducted after policy expiration to make a final determination of applicable premiums. Audit premium due from or due to a policyholder as a result of an audit is reflected in net premiums written and earned when billed. We track, by policy, the amount of additional premium billed in final audit invoices as a percentage of payroll exposure and use this information to estimate the probable additional amount of EBUB premium as of the balance sheet date. We include changes to the EBUB premium estimate in net premiums written and earned in the period recognized.

Accounting Changes

We are not aware of any accounting changes not yet adopted as of September 30, 2015 that would have a material effect on our results of operations or financial position. Note 1 of the Notes to Condensed Consolidated Financial Statements provides additional detail regarding accounting changes.

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## Liquidity and Capital Resources and Financial Condition

## Overview

ProAssurance Corporation is a holding company and is a legal entity separate and distinct from its subsidiaries. The holding company has no substantial external revenues other than its investment revenues, and dividends from its operating subsidiaries represent a significant source of funds for its obligations, including debt service and shareholder dividends. At September 30, 2015, we held cash and liquid investments of approximately \$130.2 million outside our insurance subsidiaries that were available for use without regulatory approval or other restriction. Our holding company also has an additional \$100 million in permitted borrowings under its Revolving Credit Agreement, and an accordion feature, which if subscribed successfully, would allow another \$50 million in available funds as discussed in this section under the heading "Debt."

To date during 2015, our insurance subsidiaries have paid dividends to us of \$310.7 million, including \$170.0 million that was paid in October 2015. Of the total dividends paid, \$161.9 million were extraordinary dividends. In the aggregate, our domestic insurance subsidiaries would be permitted to pay dividends of approximately \$19.0 million over the remainder of 2015 without the prior approval of state insurance regulators, but we do not currently plan to pay the remaining permitted dividends. The payment of any dividend requires prior notice to the insurance regulator in the state of domicile, and the regulator may reduce or prevent the dividend if, in its judgment, payment of the dividend would have an adverse effect on the surplus of the insurance subsidiary. We make the decision to pay dividends from an insurance subsidiary based on the capital needs of that subsidiary, and may pay less than the permitted dividend and may also request permission to pay an additional amount (an extraordinary dividend).

## Operating Activities and Related Cash Flows

The principal components of our operating cash flows are the excess of premiums collected and net investment income over losses paid and operating costs, including income taxes. Timing delays exist between the collection of premiums and the payment of losses associated with the premiums. Premiums are generally collected within the twelve-month period after the policy is written, while our claim payments are generally paid over a more extended period of time. Likewise, timing delays exist between the payment of claims and the collection of any associated reinsurance recoveries.

Operating cash flows compare as follows:

| (In millions)  | Operating Cash Flow            |              |
|--|--------------------------------|--------------|
|  | Nine Months Ended September 30 |              |
|  | 2015                           | 2014         |
| Cash provided by operating activities                          | \$105.5                        | \$101.1      |
| Change in Operating Cash Flows                                 | 2015 vs 2014                   | 2014 vs 2013 |
| Cash provided by operating activities, prior year              | \$101.1                        | \$24.0       |
| Increase (decrease) in operating cash flows attributable to:   |                                |              |
| Premium receipts   | (0.6 )                         | (14.6 )      |
| Payments to reinsurers   | 6.3                            | (9.9 )       |
| Losses paid, net of reinsurance recoveries                     | 9.7                            | 9.1          |
| Cash received from investments                                 | (14.4 )                        | (11.8 )      |
| Federal and state income tax payments                          | (13.8 )                        | 84.6         |
| Acquisition costs  | 2.2                            | —            |
| Effect of Eastern acquisition on 2014 net operating cash flows | —                              | 22.0         |
| Cash flows produced by Lloyd's Syndicate operations            | 13.8                           | (1.3 )       |
| Other amounts not individually significant, net                | 1.2                            | (1.0 )       |
| Cash provided by operating activities, current year            | \$105.5                        | \$101.1      |

Premium receipts. The decrease in premium receipts for 2015 was attributable to lower premium volume for our Specialty P&C segment, the effect of which was almost entirely offset by the effect of higher premium volume for our Workers' Compensation segment. The reduction in premium receipts for 2014 reflected lower premium volume within



our Specialty P&C segment as compared to 2013.

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Payments to reinsurers. Payments to reinsurers (increased) decreased as compared to the prior period as shown below:

| (In millions)   | Nine Months Ended September 30 |              |
|---|--------------------------------|--------------|
|   | 2015 vs 2014                   | 2014 vs 2013 |
| Change in payments to reinsurers, exclusive of Syndicate 1729 | \$12.5                         | \$(6.3)      |
| Change in reinsurance paid to Syndicate 1729                  | (6.2)                          | (3.6)        |
|   | \$6.3                          | \$(9.9)      |

Exclusive of the effect of our quota share reinsurance agreement with Syndicate 1729, payments to reinsurers decreased in 2015 as compared to 2014 but increased in 2014 as compared to 2013. The 2015 decrease is primarily due to cash flows associated with premium settlements on certain of our excess of loss reinsurance arrangements. These cash flows can vary widely from period to period depending upon the terms of the particular contracts for which settlement is due and the amount of losses determined to be reimbursable under those contracts. The 2014 increase was primarily attributable to expansion of our shared risks arrangements. Payments to Syndicate 1729 increased in 2015 due to an additional quarter of activity as compared to 2014 and increased in 2014 as compared to 2013 because 2014 was the initial year of the reinsurance program. Net operating cash flows of our Syndicate 1729 operations reflects the receipt of these payments, but are reported pro rata (58%) and on a one quarter delay.

Losses paid, net of reinsurance recoveries. The timing of our net loss payments varies from period to period because the process for resolving claims is complex and occurs at an uneven pace depending upon the circumstances of the individual claim.

Cash received from investments. Receipts from fixed income securities have declined due to both lower yields and a smaller fixed income portfolio. Also, the timing of dividend receipts and income distributions from our investment LPs/LLCs is uneven.

Federal and state income tax payments. Net tax payments (increased) decreased as compared to the prior period as shown below:

| (In millions)   | Nine Months Ended September 30 |              |
|---|--------------------------------|--------------|
|   | 2015 vs 2014                   | 2014 vs 2013 |
| The effect of refunds received from the favorable resolution of an IRS examination of \$30.5 million in 2014 as compared to a protective tax payment made related to the exam of \$20.6 million in 2013 | \$(30.5)                       | \$51.2       |
| Change in amount of tax payments made for the prior tax year  | (3.0)                          | 29.1         |
| Change in amount of estimated tax payments for the current tax year   | 17.0                           | 7.4          |
| Change in amount of excess tax benefits associated with share-based compensation  | 1.2                            | 0.6          |
| Refunds received related to Eastern's pre-acquisition period  | 1.5                            | (3.7)        |
|   | \$(13.8)                       | \$84.6       |

Acquisition Costs. During 2014 we paid transaction costs of \$2.2 million related to the acquisition of Eastern and the start-up of Lloyd's Syndicate 1729.

Effect of Eastern acquisition on 2014 net operating cash flows. Net cash flows from the operations acquired in the Eastern transaction increased 2014 operating cash flows as compared to 2013. Because Eastern results are included in both the 2015 and 2014 operating cash flows, there is no similar effect for the 2015 versus 2014 comparison.

Cash flows produced by Lloyd's Syndicate Operations. This represents our 58% share of Syndicate 1729 operating cash flows, reported on a one quarter delay. Because Syndicate 1729 did not commence active operations until January 2014, the 2014 nine-month period includes only two quarters of activity while the 2015 nine-month period reflects three quarters of activity.

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## Reinsurance

Within our Specialty P&C segment, we use insurance and reinsurance (collectively, “reinsurance”) to provide capacity to write larger limits of liability, to provide reimbursement for losses incurred under the higher limit coverages we offer, to provide protection against losses in excess of policy limits. We also use risk sharing reinsurance arrangements, which provide custom insurance solutions for large customer groups, and have a quota share arrangement with Lloyd's Syndicate 1729 established to provide an initial premium base for Syndicate 1729. Within our Workers' Compensation segment, we use reinsurance to reduce our net liability on individual risks, to mitigate the effect of significant loss occurrences (including catastrophic events), to stabilize underwriting results, and to increase underwriting capacity by decreasing leverage. The purchase of reinsurance does not relieve us from the ultimate risk on our policies, but it does provide reimbursement for certain losses we pay. We pay our reinsurers a premium in exchange for reinsurance of the risk. For many of our reinsurance arrangements, the premium due to the reinsurer is determined by the loss experience of the business reinsured, subject to certain minimum and maximum amounts. Until all loss amounts are known, we estimate the premium due to the reinsurer. Changes to the estimate of premium owed under reinsurance agreements related to prior periods are recorded in the period in which the change in estimate occurs and can have a significant effect on net premiums earned.

We generally reinsure risks under treaties (our excess of loss reinsurance arrangements) pursuant to which the reinsurers agree to assume all or a portion of all risks that we insure above our individual risk retention levels, up to the maximum individual limits offered. These arrangements are negotiated and renewed annually. Renewal dates for our professional liability, medical technology liability and workers' compensation treaties are October 1, January 1 and May 1, respectively. As of October 1, 2015 our professional liability treaty renewed with more favorable terms and pricing than the previous agreement. Our workers' compensation and medical technology liability treaties also renewed at a more favorable rate than the previous agreements upon the latest renewal of each. The significant terms of our excess of loss reinsurance arrangements are detailed in the following table.

## Excess of Loss Reinsurance Agreements

| Professional Liability                                  | Medical Technology Liability | Workers' Compensation - Traditional |
|---|------------------------------|-------------------------------------|
| (1) Historically, retention has ranged from 5% to 32.5% |                              |                                     |
| (2) Historically, retention has been as high as \$2M    |                              |                                     |

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Large professional liability risks that are above the limits of our basic reinsurance treaties are reinsured on a facultative basis, whereby the reinsurer agrees to insure a particular risk up to a designated limit. We also have in place a number of risk sharing arrangements that apply to the first \$1 million of losses for certain large healthcare systems and other healthcare provider associations.

During the three and nine months ended September 30, 2015, we wrote workers' compensation policies in our alternative market business generating premium of approximately \$15.7 million and \$48.9 million, respectively, under custom programs whereby the policies written are fully reinsured under 100% quota share agreements to the SPCs of our wholly owned subsidiary, Eastern Re, domiciled in the Cayman Islands, net of a ceding commission. The remaining premium written in our alternative market business of \$1.3 million and \$4.9 million for the 2015 three- and nine-month periods is 100% ceded to an unaffiliated captive insurer.

Each SPC has preferred shareholders and the underwriting profit or loss of each cell accrues fully to these preferred shareholders. We participate as a preferred shareholder in certain SPCs. Our ownership interest in the SPCs for which we participate is generally 50%, but we have ownership interests as low as 25% and as high as 82.5%.

Each SPC has in place its own reinsurance arrangements, which are illustrated in the table below.

Segregated Portfolio Cell Reinsurance

Per Occurrence Coverage

Aggregate Coverage

(1) ProAssurance assumes 100% of aggregate losses in excess of an aggregate attachment point with a maximum loss limit of \$100K.

(2) The attachment point is based on a percentage of premium (average is 89%) and varies by cell.

Each SPC maintains a loss fund initially equal to the difference between premium assumed by the cell and the ceding commission. The external owners of each cell provide a letter of credit to us that is equal to the difference between the loss fund of the SPC (amount of funds available to pay losses after deduction of ceding commission) and the aggregate attachment point of the reinsurance.

Within our Lloyd's Syndicate segment, Syndicate 1729 purchases reinsurance to limit its liability on individual risks and to protect against catastrophic loss. The level of reinsurance that the Syndicate purchases is dependent on a number of factors, including its underwriting risk appetite for catastrophic exposure, the specific risks inherent in each line or class of business written and the pricing, coverage and terms and conditions available from the reinsurance market. Both quota share reinsurance and excess of loss reinsurance is utilized to manage the net loss exposure. The Syndicate may still be exposed to loss that exceeds the level of reinsurance purchased, as well as to reinstatement premiums triggered by losses exceeding specified levels.

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For all of our segments, we make a determination of the amount of insurance risk we choose to retain based upon numerous factors, including our risk tolerance and the capital we have to support it, the price and availability of reinsurance, the volume of business, our level of experience with a particular set of claims and our analysis of the potential underwriting results. We purchase excess of loss reinsurance to limit the amount of risk we retain and we do so from a number of companies to mitigate concentrations of credit risk. We utilize reinsurance brokers to assist us in the placement of these reinsurance programs and in the analysis of the credit quality of our reinsurers. The determination of which reinsurers we choose to do business with is based upon an evaluation of their then-current financial strength, rating and stability. However, the financial strength of our reinsurers, and their corresponding ability to pay us, may change in the future due to forces or events we cannot control or anticipate.

**Litigation**

We are involved in various legal actions related to insurance policies and claims handling including, but not limited to, claims asserted against us by policyholders. These types of legal actions arise in the ordinary course of business and, in accordance with GAAP for insurance entities, are generally considered as a part of our loss reserving process, which is described in detail in our Critical Accounting Estimates section under the heading "Reserve for Losses and Loss Adjustment Expenses." We also have other direct actions against the Company unrelated to our claims activity which we evaluate and account for as a part of our other liabilities. For these corporate legal actions, we evaluate each case separately and establish what we believe is an appropriate reserve based on GAAP guidance related to contingent liabilities. As of September 30, 2015 there were no material reserves established for corporate legal actions.

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## Investing Activities and Related Cash Flows

## Investment Exposures

The following table provides summarized information regarding our investments as of September 30, 2015:

| (\$ in thousands)                    | Carrying Value | Included in Carrying Value: |                   | Average Rating * | % Total Investments |
|--------------------------------------|----------------|-----------------------------|-------------------|------------------|---------------------|
|                                      |                | Unrealized Gains            | Unrealized Losses |                  |                     |
| Fixed Maturities, Available for Sale |                |                             |                   |                  |                     |
| Government                           |                |                             |                   |                  |                     |
| U.S. Treasury                        | \$ 111,919     | \$ 2,536                    | \$ (33 )          | AAA              | 3 %                 |
| U.S. Government-sponsored enterprise | 26,000         | 1,257                       | (5 )              | AAA              | 1 %                 |
| Total government                     | 137,919        | 3,793                       | (38 )             | AAA              | 4 %                 |
| State and Municipal Bonds            |                |                             |                   |                  |                     |
| Pre-refunded                         |                |                             |                   |                  |                     |
| General obligation                   | 176,290        | 6,073                       | (20 )             | AA               | 5 %                 |
| Special revenue                      | 196,114        | 9,127                       | (9 )              | AA+              | 5 %                 |
| Total state and municipal bonds      | 595,382        | 24,072                      | (1,102 )          | AA               | 16 %                |
| Corporate Debt                       | 967,786        | 39,272                      | (1,131 )          | AA               | 26 %                |
| Corporate Debt                       |                |                             |                   |                  |                     |
| Financial                            |                |                             |                   |                  |                     |
| Consumer oriented                    | 403,971        | 9,575                       | (1,032 )          | A                | 11 %                |
| Utilities/Energy                     | 267,560        | 7,592                       | (2,662 )          | BBB+             | 7 %                 |
| Industrial                           | 260,119        | 7,856                       | (14,355 )         | BBB+             | 7 %                 |
| Other                                | 368,972        | 8,197                       | (9,182 )          | BBB+             | 10 %                |
| Total corporate debt                 | 11,904         | 228                         | (49 )             | A+               | <1%                 |
| Securities backed by:                | 1,312,526      | 33,448                      | (27,280 )         | A-               | 35 %                |
| Agency mortgages                     |                |                             |                   |                  |                     |
| Non-agency mortgages                 | 252,378        | 7,825                       | (550 )            | AAA              | 7 %                 |
| Agency commercial mortgages          | 2,500          | 5                           | (3 )              | AA-              | <1%                 |
| Other commercial mortgages           | 11,204         | 279                         | (20 )             | AAA              | <1%                 |
| Automobile loans                     | 39,134         | 601                         | (62 )             | AAA              | 1 %                 |
| Other asset loans                    | 49,947         | 177                         | (10 )             | AAA              | 1 %                 |
| Total asset-backed securities        | 52,785         | 448                         | (7 )              | AA+              | 1 %                 |
| Total fixed maturities               | 407,948        | 9,335                       | (652 )            | AAA              | 10 %                |
| Equity Securities, Trading           |                |                             |                   |                  |                     |
| Financial                            | 2,826,179      | 85,848                      | (29,101 )         | A+               | 75 %                |
| Utilities/Energy                     | 66,614         | —                           | —                 |                  | 2 %                 |
| Industrial                           | 41,686         | —                           | —                 |                  | 1 %                 |
| Consumer oriented                    | 50,447         | —                           | —                 |                  | 1 %                 |
| Bond funds                           | 55,343         | —                           | —                 |                  | 1 %                 |
| All Other                            | 75,688         | —                           | —                 |                  | 2 %                 |
| Total equities                       | 28,108         | —                           | —                 |                  | 1 %                 |
| Short-Term Investments               | 317,886        | —                           | —                 |                  | 8 %                 |
| BOLI                                 | 158,057        | —                           | —                 |                  | 4 %                 |
|                                      | 56,748         | —                           | —                 |                  | 2 %                 |

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| (\$ in thousands)  | Carrying Value | Included in Carrying Value: |                   | Average Rating * | % Total Investments |
|--|----------------|-----------------------------|-------------------|------------------|---------------------|
|  |                | Unrealized Gains            | Unrealized Losses |                  |                     |
| Investment in Unconsolidated Subsidiaries                          |                |                             |                   |                  |                     |
| Investment in qualified affordable housing tax credit partnerships | 124,109        | —                           | —                 | 3                | %                   |
| Investment in historic tax credits                                 | 4,306          | —                           | —                 | <1%              |                     |
| Investments in LPs/LLCs, equity method                             | 169,960        | —                           | —                 | 5                | %                   |
| Total investment in unconsolidated subsidiaries                    | 298,375        | —                           | —                 | 8                | %                   |
| Other Investments  |                |                             |                   |                  |                     |
| Investments in LPs/LLCs, cost method                               | 58,381         | —                           | —                 | 2                | %                   |
| Convertible securities, at fair value                              | 29,480         | —                           | —                 | 1                | %                   |
| FHLB capital stock and other                                       | 3,549          | —                           | —                 | <1%              |                     |
| Total other investments  | 91,410         | —                           | —                 | 3                | %                   |
| Total Investments  | \$3,748,655    | \$ 85,848                   | \$(29,101 )       | 100              | %                   |

\* A weighted average rating is calculated using available ratings from Standard & Poor's, Moody's and Fitch. The table presents the Standard & Poor's rating that is equivalent to the computed average.

We provide detailed information regarding our investment holdings in a Quarterly Investment Supplement located under the Financial Information header on the Investor Relations page of our website which can be reached directly at <http://www.proassurance.com/investorrelations/supplemental.aspx>, or through links at Proassurance.com.

We manage our investments to ensure that we will have sufficient liquidity to meet our obligations, taking into consideration the timing of cash flows from our investments, including interest payments, dividends and principal payments, as well as the expected cash flows to be generated by our operations. In addition to the interest and dividends we will receive, we anticipate that between \$80 million and \$90 million of our investments will mature (or be paid down) each quarter of the next four quarters and be available, if needed, to meet our cash flow requirements. The primary outflow of cash at our insurance subsidiaries is related to paid losses and operating costs, including income taxes. The payment of individual claims cannot be predicted with certainty; therefore, we rely upon the history of paid claims in estimating the timing of future claims payments. To the extent that we may have an unanticipated shortfall in cash we may either liquidate securities or borrow funds under existing borrowing arrangements through our Revolving Credit Agreement and the FHLB system. Currently, \$100 million remains available for use through the Revolving Credit Agreement, and its accordion feature, if subscribed successfully, would make another \$50 million available. See additional discussion in this section under the heading "Debt." Given the duration of our investments, we do not foresee a shortfall that would require us to meet operating cash needs through additional borrowings. Additional information regarding the Revolving Credit Agreement is detailed in Note 8 of the Notes to Condensed Consolidated Financial Statements.

Our investment portfolio continues to be primarily composed of high quality fixed income securities with approximately 93% of our fixed maturities being investment grade securities as determined by national rating agencies. The weighted average effective duration of our fixed maturity securities at September 30, 2015 was 3.6 years; the weighted average effective duration of our fixed maturity securities combined with our short-term securities was 3.4 years.

As a member of Lloyd's and an investor in Syndicate 1729, we are required to provide capital, referred to as FAL, to support Syndicate 1729. At September 30, 2015, we satisfied our FAL requirement with securities held at Lloyd's, consisting of fixed maturities and short term investments having fair values of \$89.3 million and \$0.4 million, respectively; see also Note 3 of the Notes to Condensed Consolidated Financial Statements.

We have provided operating funds to Syndicate 1729 in the form of a £10 million unconditional revolving credit agreement. As of September 30, 2015, the unused commitment under the Syndicate Credit Agreement approximated £1.5 million (\$2.3 million as of September 30, 2015).

The carrying value of our investments in qualified affordable housing project tax credit partnerships was approximately \$124.1 million at September 30, 2015 and \$133.1 million at December 31, 2014. In accordance with

GAAP guidance for this type of investment, the carrying value reflects our total commitments (both funded and unfunded) to the partnerships, less amortization, since our initial investment. We fund these investments based on funding schedules maintained by the partnerships. As of September 30, 2015, approximately \$13.2 million of our total commitments to the tax credit partnerships had not yet been funded. The unfunded commitments are expected to be paid over a period of more than 6 years with \$11.7 million expected to be paid in 2015.



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We also hold investments in historic tax credit partnerships, which had a carrying value of \$4.3 million as of September 30, 2015. For historic tax credit investments the carrying value reflects our funded commitments only. As of September 30, 2015, we had unfunded commitments to historic tax credit partnerships of approximately \$14.6 million. The unfunded commitments are expected to be paid over a period of approximately 2 years.

At September 30, 2015 and December 31, 2014 the carrying value of our investment fund LPs/LLCs totaled \$228.3 million and \$196.6 million, respectively. We had unfunded commitments to investment fund LPs/LLCs at September 30, 2015 which approximately \$102.6 million; unfunded commitments are not reflected in the carrying value of these investments. The unfunded commitments are expected to be paid over a period of approximately 4 years as requested by the fund managers.

Financing Activities and Related Cash Flows

Treasury Shares

We repurchased approximately 3.6 million common shares, having a total cost of approximately \$165.2 million, during the nine months ended September 30, 2015 (including approximately 0.9 million shares at a total cost of \$41.9 million during the three months ended September 30, 2015). During the nine months ended September 30, 2014 we repurchased approximately 3.7 million shares, having a total cost of approximately \$167.2 million (including approximately 1.0 million shares at a total cost of \$45.0 million during the three months ended September 30, 2014). In May 2015 our Board increased its authorization for the repurchase of common shares or the retirement of outstanding debt by \$100 million. Our total share repurchases through October 31, 2015, primarily conducted through our 10b5-1 plans, totaled approximately 3.6 million common shares at a cost of approximately \$167.5 million. As of October 31, 2015 our remaining Board authorization was approximately \$114.0 million.

Shareholder Dividends

Our Board of Directors declared cash dividends of \$0.31 per share during each of the first three quarters of 2015 and \$0.30 per share during each of the first three quarters of 2014. Dividends paid in the first quarter of 2015 included a special dividend of \$2.65 per share declared in the fourth quarter of 2014; no special dividends were paid in the first quarter of 2014. Any decision to pay future cash dividends is subject to the Board's final determination after a comprehensive review of financial performance, future expectations and other factors deemed relevant by the Board.

Debt

At September 30, 2015 our long-term debt included \$250 million of outstanding unsecured senior notes. The notes bear interest at 5.3% annually and are due in 2023 although they may be redeemed in whole or part prior to maturity. There are no financial covenants associated with these notes.

Additional information regarding our long-term debt is provided in Note 8 of the Notes to Condensed Consolidated Financial Statements.

We have available a Revolving Credit Agreement which may be used for general corporate purposes, including, but not limited to, short-term working capital, share repurchases as authorized by the Board, and support for other activities we enter into in the normal course of business. On June 19, 2015 we executed an amendment to our Revolving Credit Agreement which expanded the permitted borrowings from \$200 million to \$250 million by adding an accordion feature, which, if subscribed to successfully, would make another \$50 million available and extended the expiration to June 2020. In addition, the amendment included other revisions related to pricing and financial covenants, which can be found in more detail in Note 8 of the Notes to Condensed Consolidated Financial Statements. At September 30, 2015 we had borrowed \$100 million under the Revolving Credit Agreement, on a fully secured basis. The borrowing at September 30, 2015 is repayable or renewable in January 2016, but repayment can be deferred until expiration of the Revolving Credit Agreement. We are in compliance with the financial covenants of the Agreement.

We are a member of a number of FHLBs. Through membership, we have access to secured cash advances which can be used for liquidity purposes or other operational needs. To date, we have not established a FHLB line of credit or materially utilized our membership.

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Results of Operations – Three and Nine Months Ended September 30, 2015 Compared to Three and Nine Months Ended September 30, 2014

Selected consolidated financial data for each period is summarized in the table below.

| (\$ in thousands, except per share data)                | Three Months Ended September 30 |           |             | Nine Months Ended September 30 |           |             |
|---|---------------------------------|-----------|-------------|--------------------------------|-----------|-------------|
|   | 2015                            | 2014      | Change      | 2015                           | 2014      | Change      |
| <b>Revenues:</b>  |                                 |           |             |                                |           |             |
| Net premiums written                                    | \$213,110                       | \$200,909 | \$12,201    | \$581,855                      | \$568,575 | \$13,280    |
| Net premiums earned                                     | \$182,085                       | \$177,028 | \$5,057     | \$529,277                      | \$525,061 | \$4,216     |
| Net investment result                                   | 26,721                          | 33,128    | (6,407 )    | 86,022                         | 95,555    | (9,533 )    |
| Net realized investment gains (losses)                  | (36,632 )                       | (8,131 )  | (28,501 )   | (35,620 )                      | 7,659     | (43,279 )   |
| Other income  | 2,759                           | 1,808     | 951         | 6,504                          | 6,055     | 449         |
| Total revenues  | 174,933                         | 203,833   | (28,900 )   | 586,183                        | 634,330   | (48,147 )   |
| <b>Expenses:</b>  |                                 |           |             |                                |           |             |
| Losses and loss adjustment expenses                     | 119,824                         | 106,486   | 13,338      | 350,739                        | 306,591   | 44,148      |
| Reinsurance recoveries                                  | (11,018 )                       | (7,264 )  | (3,754 )    | (32,855 )                      | (18,948 ) | (13,907 )   |
| Net losses and loss adjustment expenses                 | 108,806                         | 99,222    | 9,584       | 317,884                        | 287,643   | 30,241      |
| Underwriting, policy acquisition and operating expenses | 53,025                          | 54,185    | (1,160 )    | 157,908                        | 158,856   | (948 )      |
| Segregated portfolio cells dividend expense (income)    | (1,933 )                        | (483 )    | (1,450 )    | 1,481                          | 2,355     | (874 )      |
| Interest expense  | 3,637                           | 3,606     | 31          | 10,978                         | 10,697    | 281         |
| Total expenses  | 163,535                         | 156,530   | 7,005       | 488,251                        | 459,551   | 28,700      |
| Income before income taxes                              | 11,398                          | 47,303    | (35,905 )   | 97,932                         | 174,779   | (76,847 )   |
| Income taxes  | 1,122                           | 12,525    | (11,403 )   | 16,684                         | 43,328    | (26,644 )   |
| Net income  | \$10,276                        | \$34,778  | \$(24,502 ) | \$81,248                       | \$131,451 | \$(50,203 ) |
| Operating income  | \$34,151                        | \$40,131  | \$(5,980 )  | \$104,553                      | \$126,020 | \$(21,467 ) |
| <b>Earnings per share:</b>                              |                                 |           |             |                                |           |             |
| Basic   | \$0.19                          | \$0.59    | \$(0.40 )   | \$1.47                         | \$2.20    | \$(0.73 )   |
| Diluted   | \$0.19                          | \$0.59    | (0.40 )     | \$1.46                         | \$2.19    | \$(0.73 )   |
| <b>Operating earnings per share:</b>                    |                                 |           |             |                                |           |             |
| Basic   | \$0.63                          | \$0.68    | \$(0.05 )   | \$1.89                         | \$2.11    | \$(0.22 )   |
| Diluted   | \$0.63                          | \$0.68    | \$(0.05 )   | \$1.88                         | \$2.10    | \$(0.22 )   |
| Net loss ratio  | 59.8                            | % 56.0    | % 3.8       | 60.1                           | % 54.8    | % 5.3       |
| Underwriting expense ratio                              | 29.1                            | % 30.6    | % (1.5 )    | 29.8                           | % 30.3    | % (0.5 )    |
| Combined ratio  | 88.9                            | % 86.6    | % 2.3       | 89.9                           | % 85.1    | % 4.8       |
| Operating ratio   | 74.1                            | % 68.1    | % 6.0       | 74.4                           | % 67.4    | % 7.0       |
| Effective tax rate                                      | 9.8                             | % 26.5    | % (16.7 )   | 17.0                           | % 24.8    | % (7.8 )    |
| Return on equity*                                       | 2.0                             | % 5.9     | % (3.9 )    | 5.2                            | % 7.4     | % (2.2 )    |

\* Annualized

In all tables that follow, the abbreviation "nm" indicates that the information or the percentage change is not meaningful.

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## Revenues

Our consolidated net premiums earned were as follows:

| (\$ in thousands)     | Three Months Ended September 30 |            |            | Nine Months Ended September 30 |            |            |             |         |
|-----------------------|---------------------------------|------------|------------|--------------------------------|------------|------------|-------------|---------|
|                       | 2015                            | 2014       | Change     | 2015                           | 2014       | Change     |             |         |
| Net Premiums Earned   |                                 |            |            |                                |            |            |             |         |
| Specialty P&C         | \$ 115,593                      | \$ 123,791 | \$(8,198 ) | (6.6 %)                        | \$ 343,065 | \$ 374,704 | \$(31,639 ) | (8.4 %) |
| Workers' Compensation | 54,577                          | 49,792     | 4,785      | 9.6 %                          | 159,436    | 143,960    | 15,476      | 10.8 %  |
| Lloyd's Syndicate     | 11,915                          | 3,445      | 8,470      | >100%                          | 26,776     | 6,397      | 20,379      | >100%   |
| Consolidated total    | \$ 182,085                      | \$ 177,028 | \$ 5,057   | 2.9 %                          | \$ 529,277 | \$ 525,061 | \$ 4,216    | 0.8 %   |

Consolidated net premiums earned increased during both the three- and nine-month periods in 2015 as compared to 2014 due to an increase in net premiums earned for both our Workers' Compensation and Lloyd's segments, which was substantially offset by a decrease in net premiums earned for our Specialty P&C segment.

Our net investment result, which includes both net investment income and earnings from unconsolidated subsidiaries, decreased \$6.4 million or 19.3% for the 2015 three-month period and decreased \$9.5 million or 10.0% for the 2015 nine-month period, primarily due to reduced earnings on our fixed income portfolio, due both to a smaller portfolio and lower yields.

Net realized investment gains (losses) decreased \$28.5 million and \$43.3 million for the 2015 three- and nine-month periods, respectively, as compared to 2014. The decrease for both periods was primarily attributable to losses on our trading securities during 2015, particularly in the third quarter. We recognized impairments in earnings of \$3.4 million and \$6.1 million for the 2015 three- and nine-month periods and \$1.2 million for both the three- and nine-month periods of 2014.

## Expenses

The following table shows our net loss ratio by segment:

| (\$ in millions)                     | Three Months Ended September 30 |        |        | Nine Months Ended September 30 |        |        |
|--------------------------------------|---------------------------------|--------|--------|--------------------------------|--------|--------|
|                                      | 2015                            | 2014   | Change | 2015                           | 2014   | Change |
| Current accident year net loss ratio |                                 |        |        |                                |        |        |
| Consolidated ratio                   | 79.6 %                          | 80.3 % | (0.7 ) | 79.9 %                         | 80.2 % | (0.3 ) |
| Specialty P&C                        | 85.6 %                          | 85.6 % | —      | 86.7 %                         | 85.8 % | 0.9    |
| Workers' Compensation                | 68.4 %                          | 67.6 % | 0.8    | 67.1 %                         | 65.9 % | 1.2    |
| Lloyd's Syndicate                    | 73.0 %                          | 73.6 % | (0.6 ) | 68.3 %                         | 68.9 % | (0.6 ) |
| Calendar year net loss ratio         |                                 |        |        |                                |        |        |
| Consolidated ratio                   | 59.8 %                          | 56.0 % | 3.8    | 60.1 %                         | 54.8 % | 5.3    |
| Specialty P&C                        | 55.3 %                          | 51.4 % | 3.9    | 57.4 %                         | 51.0 % | 6.4    |
| Workers' Compensation                | 66.2 %                          | 66.4 % | (0.2 ) | 64.3 %                         | 63.9 % | 0.4    |
| Lloyd's Syndicate                    | 73.0 %                          | 73.6 % | (0.6 ) | 68.3 %                         | 68.9 % | (0.6 ) |

## Favorable net loss development, prior accident years

|                       |         |         |          |          |          |           |
|-----------------------|---------|---------|----------|----------|----------|-----------|
| Consolidated          | \$ 36.2 | \$ 42.9 | \$(6.7 ) | \$ 104.8 | \$ 133.3 | \$(28.5 ) |
| Specialty P&C         | \$ 35.0 | \$ 42.3 | \$(7.3 ) | \$ 100.4 | \$ 130.4 | \$(30.0 ) |
| Workers' Compensation | \$ 1.2  | \$ 0.6  | \$ 0.6   | \$ 4.4   | \$ 2.9   | \$ 1.5    |
| Lloyd's Syndicate     | \$ —    | \$ —    | \$ —     | \$ —     | \$ —     | \$ —      |

Our consolidated current accident year net loss ratio decreased 0.7 and 0.3 percentage points for the 2015 three- and nine-month periods, respectively, as compared to 2014 with the decline being driven by a greater impact in 2015 of lower loss ratios in our Lloyd's segment.



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Our consolidated calendar year net loss ratio is lower than our consolidated current accident year net loss ratio due to the recognition of net favorable loss development in our Specialty P&C and Workers' Compensation segments as shown in the previous table.

Our underwriting expense ratio reflected the following:

|   | Three Months Ended September 30 |        |           | Nine Months Ended September 30 |        |           |
|---|---------------------------------|--------|-----------|--------------------------------|--------|-----------|
|   | 2015                            | 2014   | Change    | 2015                           | 2014   | Change    |
| Underwriting Expense Ratio, as reported |                                 |        |           |                                |        |           |
| Consolidated                            | 29.1                            | % 30.6 | % (1.5 )  | 29.8                           | % 30.3 | % (0.5 )  |
| Specialty P&C                           | 22.7                            | % 27.3 | % (4.6 )  | 23.3                           | % 27.0 | % (3.7 )  |
| Workers' Compensation                   | 29.7                            | % 29.7 | % —       | 29.7                           | % 31.5 | % (1.8 )  |
| Lloyd's Syndicate                       | 47.4                            | % 75.0 | % (27.6 ) | 49.2                           | % 93.8 | % (44.6 ) |
| Corporate*                              | 2.8                             | % 1.8  | % 1.0     | 3.3                            | % 1.3  | % 2.0     |

\* There are no net premiums earned associated with the Corporate segment. Ratio shown is the contribution of the Corporate segment to the consolidated ratio (Corporate expenses divided by consolidated net premium earned).

The decline in our 2015 consolidated expense ratio reflects both higher earned premium and lower expenses during 2015. The increase in earned premium is attributable to our Lloyd's Syndicate and Workers' Compensation segments while the reduction in expenses primarily reflects discrete expenses, primarily in our Corporate and Workers' Compensation segments, of approximately \$2.5 million and \$2.9 million incurred in the three- and nine-month periods of 2014, respectively, but not 2015. Cost shifts between segments and between operating expense and ULAE are the primary reason that our Corporate segment expense ratios increased and our Specialty P&C segment expense ratio decreased in 2015, although the increase to the Corporate segment was partially offset by the effect of 2014 discrete expenses, as previously discussed. The Lloyd's Syndicate segment expense ratio has decreased in 2015 as compared to 2014 as operations of this segment were in a start-up phase during 2014.

#### Taxes

Our effective tax rate was 9.8% for the three months ended September 30, 2015, as compared to 26.5% for the same respective period in 2014, and was 17.0% for the nine months ended September 30, 2015, as compared to 24.8% for the same respective period in 2014. The reduction to the ratio for both the three and nine months ended September 30, 2015, was primarily due to the combined effect of higher tax credits and lower pre-tax income.

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## Operating Ratio and ROE

Our operating ratio (calculated as our combined ratio, less our investment income ratio) increased by 6.0 and 7.0 percentage points in the three- and nine-month periods ending September 30, 2015, respectively. These increases principally reflected a higher net loss ratio due to a lower amount of prior year favorable development.

ROE was 2.0% and 5.2% for the 2015 three- and nine-month periods, respectively, and was 5.9% and 7.4% for the same respective periods of 2014.

## Book Value per Share

We believe our commitment to share repurchases and the declaration of dividends are currently our most effective uses of capital even though, in the short-term, dividends and share repurchases above book value dampen growth in book value per share. Our book value per share at September 30, 2015 as compared to December 31, 2014 is shown in the following table.

|  | Book Value Per Share |
|--|----------------------|
| Book Value Per Share at December 31, 2014  | \$38.17              |
| Increase (decrease) to book value per share during the nine months ended September 30, 2015 attributable to: |                      |
| Dividends declared   | (0.93 )              |
| Repurchase of shares   | (0.51 )              |
| Capital management activities  | (1.44 )              |
| Net income   | 1.47                 |
| Decrease in accumulated other comprehensive income   | (0.40 )              |
| Other  | (0.04 )              |
| Book Value Per Share at September 30, 2015   | \$37.76              |

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## Non-GAAP Financial Measures

Operating income is a non-GAAP financial measure that is widely used to evaluate performance within the insurance sector. In calculating operating income, we have excluded the after-tax effects of net realized investment gains or losses, guaranty fund assessments or recoupments and the effect of confidential settlements that do not reflect normal operating results. We believe operating income presents a useful view of the performance of our insurance operations, but should be considered in conjunction with net income computed in accordance with GAAP.

The following table is a reconciliation of Net income to Operating income:

|  | Three Months Ended |          | Nine Months Ended |           |
|--|--------------------|----------|-------------------|-----------|
|  | September 30       |          | September 30      |           |
| (In thousands, except per share data)                  | 2015               | 2014     | 2015              | 2014      |
| Net income   | \$10,276           | \$34,778 | \$81,248          | \$131,451 |
| Items excluded in the calculation of operating income: |                    |          |                   |           |
| Net realized investment (gains) losses                 | 36,632             | 8,131    | 35,620            | (7,659 )  |
| Guaranty fund assessments (recoupments)                | 99                 | 104      | 234               | 147       |
| Effect of confidential settlements, net                | —                  | —        | —                 | (843 )    |
| Pre-tax effect of exclusions                           | 36,731             | 8,235    | 35,854            | (8,355 )  |
| Tax effect, at 35%                                     | (12,856 )          | (2,882 ) | (12,549 )         | 2,924     |
| Operating income                                       | \$34,151           | \$40,131 | \$104,553         | \$126,020 |
| Per diluted common share:                              |                    |          |                   |           |
| Net income   | \$0.19             | \$0.59   | \$1.46            | \$2.19    |
| Effect of exclusions                                   | 0.44               | 0.09     | 0.42              | (0.09 )   |
| Operating income per diluted common share              | \$0.63             | \$0.68   | \$1.88            | \$2.10    |

Note: The 35% rate above is the annual expected incremental tax rate associated with the taxable or tax deductible items listed. We record the provision for income taxes in our interim financial statements based upon our estimated annual effective tax rate.

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## Segment Operating Results - Specialty Property &amp; Casualty

Our Specialty P&C segment focuses on professional liability insurance and medical technology liability insurance as discussed in Note 12 of the Notes to Condensed Consolidated Financial Statements. Specialty P&C segment operating results reflect pre-tax underwriting profit or loss from these insurance lines, exclusive of investment results, which are included in our Corporate segment. Segment operating results for the three and nine months ended September 30, 2015 were \$27.0 million and \$70.5 million, respectively, as compared to \$27.4 million and \$86.6 million for the same respective periods of 2014, and included the following:

| (\$ in thousands)                                       | Three Months Ended September 30 |           |                    | Nine Months Ended September 30 |           |                     |
|---|---------------------------------|-----------|--------------------|--------------------------------|-----------|---------------------|
|   | 2015                            | 2014      | Change             | 2015                           | 2014      | Change              |
| Net premiums written                                    | \$140,846                       | \$142,733 | \$(1,887) (1.3 %)  | \$361,564                      | \$379,428 | \$(17,864) (4.7 %)  |
| Net premiums earned                                     | \$115,593                       | \$123,791 | \$(8,198) (6.6 %)  | \$343,065                      | \$374,704 | \$(31,639) (8.4 %)  |
| Net losses and loss adjustment expenses                 | \$63,974                        | \$63,639  | \$335 0.5 %        | \$197,056                      | \$191,263 | \$5,793 3.0 %       |
| Underwriting, policy acquisition and operating expenses | \$26,251                        | \$33,814  | \$(7,563) (22.4 %) | \$80,057                       | \$101,044 | \$(20,987) (20.8 %) |
| Net loss ratio  | 55.3%                           | 51.4%     | 3.9                | 57.4%                          | 51.0%     | 6.4                 |
| Underwriting expense ratio                              | 22.7%                           | 27.3%     | (4.6 )             | 23.3%                          | 27.0%     | (3.7 )              |

## Premiums Written

Changes in our premium volume within our Specialty P&C segment are driven by four primary factors: (1) the amount of new business, (2) our retention of existing business, (3) the premium charged for business that is renewed, which is affected by rates charged and by the amount and type of coverage an insured chooses to purchase, and (4) the timing of premium written through multi-period policies. In addition, premium volume may periodically be affected by shifts in the timing of renewals between periods. The healthcare professional liability market, which accounts for a majority of the revenues in this segment, remains challenging as physicians continue joining hospitals or larger group practices and are thus no longer purchasing insurance in the standard market. In addition, some competitors have chosen to compete primarily on price; both factors impact our ability to write new business and retain existing business.

Gross, ceded and net premiums written were as follows:

| (\$ in thousands)            | Three Months Ended September 30 |           |                   | Nine Months Ended September 30 |           |                    |
|------------------------------|---------------------------------|-----------|-------------------|--------------------------------|-----------|--------------------|
|                              | 2015                            | 2014      | Change            | 2015                           | 2014      | Change             |
| Gross premiums written       | \$160,516                       | \$163,134 | \$(2,618) (1.6 %) | \$416,656                      | \$429,730 | \$(13,074) (3.0 %) |
| Less: Ceded premiums written | 19,670                          | 20,401    | (731 ) (3.6 %)    | 55,092                         | 50,302    | 4,790 9.5 %        |
| Net premiums written         | \$140,846                       | \$142,733 | \$(1,887) (1.3 %) | \$361,564                      | \$379,428 | \$(17,864) (4.7 %) |



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## Gross Premiums Written

Gross premiums written by component were as follows:

| (\$ in thousands)                | Three Months Ended September 30 |           |            | Nine Months Ended September 30 |           |           |             |          |
|----------------------------------|---------------------------------|-----------|------------|--------------------------------|-----------|-----------|-------------|----------|
|                                  | 2015                            | 2014      | Change     | 2015                           | 2014      | Change    |             |          |
| Professional liability           |                                 |           |            |                                |           |           |             |          |
| Physicians (1):                  |                                 |           |            |                                |           |           |             |          |
| Twelve month term                | \$111,364                       | \$115,698 | \$(4,334 ) | (3.7 %)                        | \$270,168 | \$289,533 | \$(19,365 ) | (6.7 %)  |
| Twenty-four month term           | 7,760                           | 5,311     | 2,449      | 46.1 %                         | 25,256    | 17,648    | 7,608       | 43.1 %   |
| Total Physicians                 | 119,124                         | 121,009   | (1,885 )   | (1.6 %)                        | 295,424   | 307,181   | (11,757 )   | (3.8 %)  |
| Healthcare facilities (2)        | 9,757                           | 9,291     | 466        | 5.0 %                          | 30,426    | 28,932    | 1,494       | 5.2 %    |
| Other healthcare providers (3)   | 10,249                          | 10,203    | 46         | 0.5 %                          | 25,016    | 26,458    | (1,442 )    | (5.5 %)  |
| Legal professionals (4)          | 5,877                           | 7,097     | (1,220 )   | (17.2 %)                       | 23,048    | 23,095    | (47 )       | (0.2 %)  |
| Tail coverages (5)               | 6,107                           | 4,630     | 1,477      | 31.9 %                         | 16,440    | 15,132    | 1,308       | 8.6 %    |
| Total professional liability     | 151,114                         | 152,230   | (1,116 )   | (0.7 %)                        | 390,354   | 400,798   | (10,444 )   | (2.6 %)  |
| Medical technology liability (6) | 9,124                           | 10,473    | (1,349 )   | (12.9 %)                       | 25,193    | 27,561    | (2,368 )    | (8.6 %)  |
| Other                            | 278                             | 431       | (153 )     | (35.5 %)                       | 1,109     | 1,371     | (262 )      | (19.1 %) |
| Total                            | \$160,516                       | \$163,134 | \$(2,618 ) | (1.6 %)                        | \$416,656 | \$429,730 | \$(13,074 ) | (3.0 %)  |

(1) Physician policies were our greatest source of premium revenues in both 2015 and 2014. The decline in twelve month term policies was primarily due to the non-renewal of a few large policies in 2015, timing differences related to the renewal of certain other policies, and, for the nine-month period, the shifting of certain policies from a twelve month term to a twenty-four month term during 2015. We offer twenty-four month term policies to our physician insureds in one selected jurisdiction. The increase in twenty-four month premium as compared to 2014, was primarily due to the normal cycle of renewals (policies subject to renewal in 2015 were previously written in 2013 rather than in 2014) and to a lesser degree, for the nine-month period, the renewal of certain twelve month term policies as twenty-four month term as mentioned above.

(2) Our healthcare facilities premium (which includes hospitals, surgery centers and other facilities) increased during the 2015 nine-month period, principally due to one large policy written during the first quarter 2015.

(3) Our other healthcare providers are primarily dentists, chiropractors and allied health professionals. The decline in premiums for the 2015 nine-month period was primarily attributable to retention losses.

(4) Our legal professionals policies are offered principally through agent and brokerage arrangements.

(5) We offer extended reporting endorsement or "tail" coverage to insureds who discontinue their claims-made coverage with us, and we also periodically offer "tail" coverage through custom policies. The amount of tail coverage premium written can vary widely from period to period.

(6) Our medical technology liability business is marketed throughout the United States; coverage is offered on a primary basis, within specified limits, to manufacturers and distributors of medical technology and life sciences products including entities conducting human clinical trials. In addition to the previously listed factors that affect our premium volume, our medical technology liability premium volume is impacted by the sales volume of insureds. The decline during the 2015 nine-month period primarily related to the non-renewal of several large policies which together approximated \$2.3 million, \$0.6 million of which occurred during the 2015 three-month period. The non-renewal of these policies was largely attributable to certain insureds merging with larger entities who are not insured by us as well as price competition. The effect of the non-renewals was offset by new business written during the period.

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New business written by component on a direct basis was as follows:

| (In millions)                | Three Months Ended September 30 |        | Nine Months Ended September 30 |        |
|------------------------------|---------------------------------|--------|--------------------------------|--------|
|                              | 2015                            | 2014   | 2015                           | 2014   |
| Physicians                   | \$4.9                           | \$5.7  | \$15.9                         | \$14.1 |
| Healthcare facilities        | 1.7                             | 2.4    | 4.5                            | 4.4    |
| Other healthcare providers   | 0.5                             | 0.9    | 1.7                            | 2.3    |
| Legal professionals          | 1.0                             | 1.2    | 3.6                            | 3.4    |
| Medical technology liability | 1.1                             | 1.4    | 2.9                            | 4.0    |
| Total                        | \$9.2                           | \$11.6 | \$28.6                         | \$28.2 |

We calculate our retention rate as annualized renewed premium divided by all annualized premium subject to renewal. Retention rates are affected by a number of factors. We may lose insureds to competitors or to alternative insurance mechanisms such as risk retention groups or self-insurance entities (often when physicians join hospitals or large group practices) or due to pricing or other issues. We may choose not to renew an insured as a result of our underwriting evaluation. Insureds may also terminate coverage because they have left the practice of medicine for various reasons, principally for retirement but also for personal reasons or due to disability or death.

Retention by component was as follows:

|                                 | Three Months Ended September 30 |      | Nine Months Ended September 30 |      |   |
|---------------------------------|---------------------------------|------|--------------------------------|------|---|
|                                 | 2015                            | 2014 | 2015                           | 2014 |   |
| Physicians, standard lines only | 89                              | % 90 | % 88                           | % 89 | % |
| Healthcare facilities           | 86                              | % 84 | % 84                           | % 82 | % |
| Other healthcare providers      | 86                              | % 85 | % 87                           | % 81 | % |
| Legal professionals             | 69                              | % 80 | % 79                           | % 82 | % |
| Medical technology liability*   | 85                              | % 83 | % 82                           | % 87 | % |

\* See Gross Premiums Written section above for further explanation of YTD retention decline in 2015.

The pricing of our business includes the effects of filed rates, surcharges and discounts. We continue to base our pricing on expected losses, as indicated by our historical loss data and available industry loss data. We are committed to a rate structure that will allow us to fulfill our obligations to our insureds, while generating competitive returns for our shareholders.

Changes in renewal pricing by component was as follows:

|                               | Three Months Ended   | Nine Months Ended    |   |
|-------------------------------|----------------------|----------------------|---|
|                               | September 30<br>2015 | September 30<br>2015 |   |
| Physicians                    | 1                    | % 1                  | % |
| Healthcare facilities*        | (2)                  | % 1                  | % |
| Other healthcare providers    | 3                    | % 3                  | % |
| Legal professionals           | 9                    | % 3                  | % |
| Medical technology liability* | (3)                  | %—                   | % |

\* The changes in renewal pricing shown for healthcare facilities and medical technology liability lines of business are reflective of changes in our exposure base, deductibles, self-insurance retention limits and other policy terms.

#### Ceded Premiums Written

Ceded premiums represent the amounts owed to our reinsurers for their assumption of a portion of our losses. Through our current excess of loss reinsurance arrangements we retain the first \$1 million in risk insured by us and cede any coverages in excess of this amount. For our medical technology liability coverages, we also retain 20% of the next \$9 million of risk for coverages in excess of \$1 million. We pay our reinsurers a ceding premium in exchange for their accepting the risk, the ultimate amount of which is determined by the loss experience of the business ceded, subject to certain minimum and maximum amounts.



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Ceded premiums written for the three and nine months ended September 30, 2015 and 2014 were comprised as follows:

| (\$ in thousands)  | Three Months Ended September 30 |          |                  | Nine Months Ended September 30 |           |                    |
|--|---------------------------------|----------|------------------|--------------------------------|-----------|--------------------|
|  | 2015                            | 2014     | Change           | 2015                           | 2014      | Change             |
| Excess of loss reinsurance arrangements  | \$7,956                         | \$8,382  | \$(426 ) (5.1 %) | \$22,461                       | \$24,406  | \$(1,945 ) (8.0 %) |
| Premium ceded to Syndicate 1729 (1)  | 4,790                           | 4,974    | (184 ) (3.7 %)   | 14,196                         | 9,847     | 4,349 44.2 %       |
| Other shared risk arrangements (2)   | 7,947                           | 7,837    | 110 1.4 %        | 20,831                         | 19,319    | 1,512 7.8 %        |
| Other ceded premiums written   | 1,777                           | 2,365    | (588 ) (24.9 %)  | 6,039                          | 6,870     | (831 ) (12.1 %)    |
| Reduction in premiums owed under reinsurance agreements, prior accident years, net (3) | (2,800 )                        | (3,157 ) | 357 11.3 %       | (8,435 )                       | (10,140 ) | 1,705 16.8 %       |
| Total ceded premiums written   | \$19,670                        | \$20,401 | \$(731 ) (3.6 %) | \$55,092                       | \$50,302  | \$4,790 9.5 %      |

As previously discussed, we are a 58% participant in Syndicate 1729 and record our pro rata share of its operating results in our Lloyd's Syndicate segment on a quarter delay. We also record this agreement within the Specialty P&C segment on a quarter delay as the amounts are not material and this permits the cession to be reported by both the Lloyd's Syndicate segment and the Specialty P&C segment in the same reporting period. Premium ceded to Syndicate 1729 reported for the 2015 three-month period in the table above reflected cessions that occurred during the second quarter 2015 and premium reported for the 2015 nine-month period reflected cessions that occurred during the first and second quarters of 2015 and in the fourth quarter of 2014. Premium ceded to Syndicate 1729 (1) reported for the 2014 three-month period in the table above reflected cessions that occurred during the second quarter 2014 and ceded premium reported for the 2014 nine-month period reflected cessions that occurred during the first and second quarters of 2014. The related ceding commission income, recorded as an offset to DPAC, was \$1.3 million and \$3.8 million for the three- and nine-month periods of 2015, respectively and \$1.3 million and \$2.7 million for the three- and nine-month periods of 2014, respectively. The 2015 third quarter cession of \$10.5 million and the related ceding commission income of \$2.8 million will be recorded in the fourth quarter of 2015.

Eliminations of the inter-segment portion (58% of the Specialty P&C cession) of the transactions are also recorded on a quarter delay.

We have entered into various shared risk arrangements, including quota share, fronting, and captive arrangements, (2) with certain large healthcare systems and other insurance entities. These arrangements include our Ascension Health and CAPAssurance Programs.

Given the length of time that it takes to resolve our claims, many years may elapse before all losses recoverable under a reinsurance arrangement are known. As a part of the process of estimating our loss reserve we also make estimates regarding the amounts recoverable under our reinsurance arrangements. As previously discussed, the (3) premiums ultimately ceded under our excess of loss reinsurance arrangements are subject to the losses ceded under the arrangements. In both 2015 and 2014, on a net basis, we reduced our estimate of expected losses and associated recoveries for prior year ceded losses, as well as our estimate of ceded premiums owed to reinsurers. Changes to estimates of premiums ceded related to prior accident years are fully earned in the period the change in estimates occur.

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## Ceded Premiums Ratio

As shown in the table below, our ceded premiums ratio was affected in both 2015 and 2014 by revisions to our estimate of premiums owed to reinsurers related to coverages provided in prior accident years.

|  | Three Months Ended<br>September 30 |         |        | Nine Months Ended<br>September 30 |         |        |
|--|------------------------------------|---------|--------|-----------------------------------|---------|--------|
|  | 2015                               | 2014    | Change | 2015                              | 2014    | Change |
| Ceded premiums ratio, as reported  | 12.3 %                             | 12.5 %  | (0.2 ) | 13.2 %                            | 11.7 %  | 1.5    |
| Less the effect of reduction in premiums owed under reinsurance agreements, prior accident years (as previously discussed) | (1.7 %)                            | (1.9 %) | 0.2    | (2.0 %)                           | (2.4 %) | 0.4    |
| Ratio, current accident year   | 14.0 %                             | 14.4 %  | (0.4 ) | 15.2 %                            | 14.1 %  | 1.1    |

The increase in the current accident year ceded premiums ratio for the 2015 nine-month period was primarily attributable to three quarters of ceded premium written under the quota share arrangement with Syndicate 1729 recorded during the nine-month period compared with two quarters of ceded premium written recorded during the 2014 nine-month period, as there was no premium recorded during the the first quarter in 2014 due to results being reported on a quarter delay.

## Net Premiums Earned

Net premiums earned were as follows:

| (\$ in thousands)           | Three Months Ended September 30 |           |            | Nine Months Ended September 30 |           |             |
|-----------------------------|---------------------------------|-----------|------------|--------------------------------|-----------|-------------|
|                             | 2015                            | 2014      | Change     | 2015                           | 2014      | Change      |
| Gross premiums earned       | \$134,792                       | \$137,446 | \$(2,654 ) | \$398,546                      | \$410,814 | \$(12,268 ) |
| Less: Ceded premiums earned | 19,199                          | 13,655    | 5,544      | 55,481                         | 36,110    | 19,371      |
| Net premiums earned         | \$115,593                       | \$123,791 | \$(8,198 ) | \$343,065                      | \$374,704 | \$(31,639 ) |

Net premiums earned consist of gross premiums earned less the portion of earned premiums that we cede to our reinsurers for their assumption of a portion of our losses. Because premiums are generally earned pro rata over the entire policy period, fluctuations in premiums earned tend to lag those of premiums written. Generally, our policies carry a term of one year, but as discussed above, we write certain policies with a twenty-four month term, and certain of our medical technology liability policies carry a multi-year term. Tail coverage premiums are generally 100% earned in the period written because the policies insure only incidents that occurred in prior periods and are not cancellable. Additionally, ceded premium changes due to changes to estimates of premiums owed under reinsurance agreements for prior accident years are fully earned in the period of change.

The decrease in gross premiums earned in 2015 primarily reflected the pro rata effect of lower physician premiums written during the preceding twelve months. The increase in ceded premiums earned primarily reflected the \$6.2 million and \$18.4 million in premiums ceded under the quota share arrangement with Syndicate 1729 during the 2015 three- and nine-month periods, respectively, as compared to \$1.9 million and \$2.7 million for the same respective periods of 2014. As discussed above, there was no Syndicate 1729 cession recorded during the first quarter of 2014 due to results being reported on a quarter delay. In addition, for the 2015 three- and nine-month periods, prior accident year ceded premiums reductions were \$0.4 million and \$1.7 million lower than for the 2014 three- and nine-month periods, respectively (see discussion under the heading "Ceded Premiums Written").

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## Losses and Loss Adjustment Expenses

The determination of calendar year losses involves the actuarial evaluation of incurred losses for the current accident year and the actuarial re-evaluation of incurred losses for prior accident years, including an evaluation of the reserve amounts required for losses in excess of policy limits.

Accident year refers to the accounting period in which the insured event becomes a liability of the insurer. For claims-made policies, which represent over 90% of the premiums written in our Specialty P&C segment, the insured event generally becomes a liability when the event is first reported to the insurer. For occurrence policies the insured event becomes a liability when the event takes place. We believe that measuring losses on an accident year basis is the best measure of the underlying profitability of the premiums earned in that period, since it associates policy premiums earned with the estimate of the losses incurred related to those policy premiums.

The following table summarizes calendar year net loss ratios by separating losses between the current accident year and all prior accident years. Additionally, the table shows our current accident year net loss ratio was affected by revisions to our estimate of premiums owed to reinsurers related to coverages provided in prior accident years. Our current accident year net loss ratios for the three and nine months ended September 30, 2015 and 2014 compare as follows:

|  | Net Loss Ratios (1)             |          |          |                                |          |        |
|--|---------------------------------|----------|----------|--------------------------------|----------|--------|
|  | Three Months Ended September 30 |          |          | Nine Months Ended September 30 |          |        |
|  | 2015                            | 2014     | Change   | 2015                           | 2014     | Change |
| Calendar year net loss ratio   | 55.3                            | % 51.4   | % 3.9    | 57.4                           | % 51.0   | % 6.4  |
| Less impact of prior accident years on the net loss ratio                                  | (30.3                           | %) (34.2 | %) 3.9   | (29.3                          | %) (34.8 | %) 5.5 |
| Current accident year net loss ratio   | 85.6                            | % 85.6   | % —      | 86.7                           | % 85.8   | % 0.9  |
| Less estimated ratio increase (decrease) attributable to:                                  |                                 |          |          |                                |          |        |
| Ceded premium reductions, prior accident years (2)   | (2.1                            | %) (2.2  | %) 0.1   | (2.2                           | %) (2.4  | %) 0.2 |
| Current accident year net loss ratio, excluding the effect of prior year ceded premium (3) | 87.7                            | % 87.8   | % (0.1 ) | 88.9                           | % 88.2   | % 0.7  |

(1) Net losses as specified divided by net premiums earned.

Reductions to premiums owed under reinsurance agreements for prior accident years increased net premiums earned (the denominator of the current accident year ratio) in both 2015 and 2014. See the discussion in the (2) Premiums section for our Specialty P&C segment under the heading "Ceded Premiums Written" for additional information.

The current accident year net loss ratio reflected the effect of loss increases attributable to changes in the mix of (3) our risk exposures in 2015 and for the three-month period this increase was more than offset by the effect of a lower allocation of compensation costs to ULAE, as discussed in this section under the heading "Underwriting, Policy Acquisition and Operating Expenses."

We recognized net favorable loss development related to our previously established reserves of \$35.0 million and \$100.4 million during the three and nine months ended September 30, 2015, respectively, and \$42.3 million and \$130.4 million during the same respective periods of 2014. We re-evaluate our previously established reserve each quarter based on our most recently available claims data and currently available industry trend information.

Development recognized during the three and nine months ended September 30, 2015 principally related to accident years 2008 through 2012. Development recognized during the 2014 three- and nine-month periods principally related to accident years 2007 through 2012.

A detailed discussion of factors influencing our recognition of loss development is included in our Critical Accounting Estimates section under the heading "Reserve for Losses and Loss Adjustment Expenses" and in our 2014 Form 10-K under the same heading. Assumptions used in establishing our reserve are regularly reviewed and updated by management as new data becomes available. Any adjustments necessary are reflected in the then current operations.

Due to the size of our reserve, even a small percentage adjustment to the assumptions can have a material effect on our results of operations for the period in which the change is made, as was the case in both 2015 and 2014.

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## Underwriting, Policy Acquisition and Operating Expenses

Specialty P&C underwriting, policy acquisition and operating expenses were \$26.3 million and \$80.1 million for the 2015 three- and nine-month periods and \$33.8 million and \$101.0 million for the 2014 three- and nine-month periods, respectively.

Segment underwriting, policy acquisition and operating expenses were comprised as follows:

| (\$ in millions)  | Three Months Ended September 30 |         |                   | Nine Months Ended September 30 |          |                    |
|---|---------------------------------|---------|-------------------|--------------------------------|----------|--------------------|
|   | 2015                            | 2014    | Change            | 2015                           | 2014     | Change             |
| Specialty P&C segment:  |                                 |         |                   |                                |          |                    |
| DPAC amortization   | \$ 11.2                         | \$ 13.7 | \$(2.5 ) (18.2 %) | \$ 35.0                        | \$ 42.4  | \$(7.4 ) (17.5 %)  |
| Management fees   | 2.2                             | —       | 2.2 nm            | 5.5                            | —        | 5.5 nm             |
| Expenses allocated from the Corporate segment                 | —                               | 6.5     | (6.5 ) nm         | —                              | 17.1     | (17.1 ) nm         |
| ULAE portion of expenses allocated from the Corporate segment | —                               | (1.6 )  | 1.6 nm            | —                              | (5.3 )   | 5.3 nm             |
| Net allocation from the Corporate segment                     | —                               | 4.9     | (4.9 ) nm         | —                              | 11.8     | (11.8 ) nm         |
| Other underwriting and operating expenses                     | 12.9                            | 15.2    | (2.3 ) (15.1 %)   | 39.6                           | 46.8     | (7.2 ) (15.4 %)    |
| Total   | \$ 26.3                         | \$ 33.8 | \$(7.5 ) (22.4 %) | \$ 80.1                        | \$ 101.0 | \$(20.9 ) (20.8 %) |

DPAC amortization decreased \$2.5 million and \$7.4 million during the three and nine months ended September 30, 2015 primarily due to increased ceding commission income of \$1.4 million and \$4.6 million, respectively, almost all of which resulted from a quota share reinsurance arrangement with Syndicate 1729, as previously discussed. The remaining decrease is primarily attributable to the reduction in gross earned premium in 2015 as compared to 2014. Management fees, as discussed in the following paragraph, are intercompany charges from the Corporate segment pursuant to a management agreement that became effective in the first quarter of 2015. No management fees were charged to the Specialty P&C segment in 2014.

Other underwriting and operating expenses decreased due to changes in the amount of expense charged to the Specialty P&C segment by the Corporate segment for certain services. Prior to implementation of the management agreement (see Management fees above) the cost of certain services was directly allocated from the Corporate segment to the Specialty P&C segment, both to operating expense and to ULAE. There were no similar allocations in 2015 as these costs are now charged to the segment via the management fee. Also, corporate restructuring initiatives undertaken over the course of 2014 shifted certain costs, primarily compensation costs, from the Specialty P&C segment to the Corporate segment. See our operating expense discussion in Corporate segment Results of Operations for a comparative analysis of Specialty P&C segment and Corporate segment underwriting and operating expense on a combined basis.

## Underwriting Expense Ratio (the Expense Ratio)

The underwriting expense ratio for the Specialty P&C segment reflects a decrease in 2015 as compared to 2014, as shown below:

|                            | Three Months Ended September 30 |        |        | Nine Months Ended September 30 |        |        |
|----------------------------|---------------------------------|--------|--------|--------------------------------|--------|--------|
|                            | 2015                            | 2014   | Change | 2015                           | 2014   | Change |
| Underwriting expense ratio | 22.7 %                          | 27.3 % | (4.6 ) | 23.3 %                         | 27.0 % | (3.7 ) |



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The change in the ratio is principally attributable to the following:

| (In percentage points)  | Increase (decrease), 2015 versus<br>2014 |                                      |
|---|--|--------------------------------------|
|   | Comparative<br>three-month<br>periods    | Comparative<br>nine-month<br>periods |
| Estimated ratio increase (decrease) attributable to:  |  |                                      |
| Net earned premium reductions during 2015, as well as the<br>2015 decline in DPAC amortization          | (0.2                                     | ) 0.3                                |
| Management fee  | 1.9                                      | 1.6                                  |
| Effect of expense reductions, primarily attributable to<br>expense allocation changes and restructuring | (6.3                                     | ) (5.6 )                             |
| Net increase/(decrease) in ratio  | (4.6                                     | ) (3.7 )                             |

The reduction to the ratio in 2015 was primarily due to the implementation of the new management agreement and the shifting of certain expenses to the Corporate segment, as previously discussed. Net earned premium declined in 2015 but the effect of the decline was more than offset for the three months and substantially offset for the nine months by the effect of lower DPAC amortization. As previously discussed, the reduction to DPAC amortization during 2015 was primarily attributable to ceding commissions earned relative to the quota share reinsurance arrangement with Syndicate 1729.

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## Segment Operating Results - Workers' Compensation

Our Workers' Compensation segment provides traditional workers' compensation insurance products to employers with 1,000 or fewer employees and alternative market solutions, as discussed in Note 12 of the Notes to Condensed Consolidated Financial Statements. Segment operating results reflect pre-tax underwriting profit or loss, exclusive of investment results which are included in our Corporate segment. Segment operating results for the three and nine months ended September 30, 2015 were \$4.2 million and \$8.4 million, respectively, as compared to \$2.6 million and \$4.8 million for the same respective periods of 2014, and included the following:

| (\$ in thousands)                                       | Three Months Ended September 30 |          |                    | Nine Months Ended September 30 |           |                  |
|---|---------------------------------|----------|--------------------|--------------------------------|-----------|------------------|
|   | 2015                            | 2014     | Change             | 2015                           | 2014      | Change           |
| Net premiums written                                    | \$56,244                        | \$54,287 | \$1,957 3.6 %      | \$178,060                      | \$164,984 | \$13,076 7.9 %   |
| Net premiums earned                                     | \$54,577                        | \$49,792 | \$4,785 9.6 %      | \$159,436                      | \$143,960 | \$15,476 10.8 %  |
| Net losses and loss adjustment expenses                 | \$36,132                        | \$33,046 | \$3,086 9.3 %      | \$102,545                      | \$91,975  | \$10,570 11.5 %  |
| Underwriting, policy acquisition and operating expenses | \$16,231                        | \$14,785 | \$1,446 9.8 %      | \$47,421                       | \$45,379  | \$2,042 4.5 %    |
| SPC dividend expense (income)                           | \$(1,933 )                      | \$(483 ) | \$(1,450)(300.2 %) | \$1,481                        | \$2,355   | \$(874 )(37.1 %) |
| Net loss ratio  | 66.2                            | %66.4    | %(0.2 )            | 64.3                           | %63.9     | %0.4             |
| Underwriting expense ratio                              | 29.7                            | %29.7    | %—                 | 29.7                           | %31.5     | %(1.8 )          |

## Premiums Written

Our workers' compensation premium volume is driven by four primary factors: (1) the amount of new business written, (2) audit premium, (3) retention of our existing book of business, and (4) premium rates charged on our renewal book of business.

Gross, ceded and net premiums written were as follows:

| (\$ in thousands)            | Three Months Ended September 30 |          |                   | Nine Months Ended September 30 |           |                |
|------------------------------|---------------------------------|----------|-------------------|--------------------------------|-----------|----------------|
|                              | 2015                            | 2014     | Change            | 2015                           | 2014      | Change         |
| Gross premiums written       |                                 |          |                   |                                |           |                |
| Traditional business         | \$44,849                        | \$46,666 | \$(1,817 )(3.9 %) | \$142,159                      | \$136,752 | \$5,407 4.0 %  |
| Alternative market business  | 16,939                          | 13,641   | 3,298 24.2 %      | 53,805                         | 44,378    | 9,427 21.2 %   |
| Segment results              | 61,788                          | 60,307   | 1,481 2.5 %       | 195,964                        | 181,130   | 14,834 8.2 %   |
| Less: Ceded premiums written |                                 |          |                   |                                |           |                |
| Traditional business         | 2,379                           | 3,361    | (982 )(29.2 %)    | 7,749                          | 7,912     | (163 )(2.1 %)  |
| Alternative market business  | 3,165                           | 2,659    | 506 19.0 %        | 10,155                         | 8,234     | 1,921 23.3 %   |
| Segment results              | 5,544                           | 6,020    | (476 )(7.9 %)     | 17,904                         | 16,146    | 1,758 10.9 %   |
| Net premiums written         |                                 |          |                   |                                |           |                |
| Traditional business         | 42,470                          | 43,305   | (835 )(1.9 %)     | 134,410                        | 128,840   | 5,570 4.3 %    |
| Alternative market business  | 13,774                          | 10,982   | 2,792 25.4 %      | 43,650                         | 36,144    | 7,506 20.8 %   |
| Segment results              | \$56,244                        | \$54,287 | \$1,957 3.6 %     | \$178,060                      | \$164,984 | \$13,076 7.9 % |

Our traditional workers' compensation insurance products include guaranteed cost, dividend, deductible, and retrospectively-rated policies. Our alternative market business is 100% ceded to either the SPCs at our wholly owned Cayman Islands reinsurance subsidiary, Eastern Re, or to an unaffiliated captive insurer. As of September 30, 2015, there were 21 (18 active) SPCs at Eastern Re and 3 active alternative market programs with the unaffiliated captive

insurer.

Additional information regarding the structure of the SPCs is included in the Underwriting, Policy Acquisition and Operating Expense section that follows.

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## Gross Premiums Written

Gross premiums written in our traditional and alternative market business for the three and nine months ended September 30, 2015 and 2014 are reflected in the table on the previous page. Gross premiums written increased in both the three- and nine-month periods of 2015 primarily reflecting new business, renewal rates and audit premium when compared to the same periods in 2014. The increase in the 2015 three-month period was partially offset by a decrease in the renewal retention rate, as compared to the same period in 2014. Our alternative market business added a new SPC in the second quarter 2015 with \$0.4 million and \$0.6 million in premiums written for the three and nine months ended September 30, 2015, respectively.

New business, audit premium, retention and renewal price changes for both the traditional business and the alternative market business for 2015 and 2014 are shown in the table below:

| (\$ in millions)               | Three Months Ended September 30<br>2015 |                                   |                    |   | 2014                    |                                   |                    |   |
|--------------------------------|---|-----------------------------------|--------------------|---|-------------------------|-----------------------------------|--------------------|---|
|                                | Traditional<br>Business                 | Alternative<br>Market<br>Business | Segment<br>Results |   | Traditional<br>Business | Alternative<br>Market<br>Business | Segment<br>Results |   |
| New business                   | \$7.9                                   | \$2.6                             | \$10.5             |   | \$10.3                  | \$2.3                             | \$12.6             |   |
| Audit premium (including EBUB) | \$1.9                                   | \$0.2                             | \$2.1              |   | \$1.9                   | \$0.3                             | \$2.2              |   |
| Retention rate (1)             | 77                                      | %85                               | %79                | % | 83                      | %90                               | %85                | % |
| Change in renewal pricing (2)  | —                                       | %2                                | %1                 | % | 2                       | %3                                | %2                 | % |
| (\$ in millions)               | Nine Months Ended September 30<br>2015  |                                   |                    |   | 2014                    |                                   |                    |   |
|                                | Traditional<br>Business                 | Alternative<br>Market<br>Business | Segment<br>Results |   | Traditional<br>Business | Alternative<br>Market<br>Business | Segment<br>Results |   |
| New business                   | \$23.7                                  | \$7.2                             | \$30.9             |   | \$29.4                  | \$7.0                             | \$36.4             |   |
| Audit premium (including EBUB) | \$4.5                                   | \$0.5                             | \$5.0              |   | \$2.8                   | \$0.2                             | \$3.0              |   |
| Retention rate (1)             | 81                                      | %89                               | %83                | % | 82                      | %87                               | %83                | % |
| Change in renewal pricing (2)  | 2                                       | %2                                | %2                 | % | 2                       | %1                                | %2                 | % |

(1) We calculate our workers' compensation retention rate as annualized expiring renewed premium divided by all annualized expiring premium subject to renewal. Our retention rate can be impacted by various factors, including price or other competitive issues, insureds being acquired, or a decision not to renew based on our underwriting evaluation. The renewal retention rate decreased by approximately 6 percentage points during the 2015 three-month period when compared to the same three-month period in 2014 primarily reflecting increased competition, two account conversions from guaranteed cost to large deductible, and an increase in non-renewed accounts with premium of at least \$0.1 million. The deductible account conversions contributed 1 percentage point to the decrease in the retention rate.

(2) The pricing of our business includes an assessment of the underlying policy exposure and the effects of current market conditions. We continue to base our pricing on expected losses, as indicated by our historical loss data. Renewal pricing was approximately 1 percentage point during the 2015 three-month period, compared to 2 points for the same period in 2014. The decrease in renewal pricing from 2014 to 2015 is primarily attributable to the impact of increased competition.

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## Ceded Premiums Written

Ceded premiums written reflect our external reinsurance programs and alternative market business ceded to an unaffiliated captive insurance company.

Ceded premiums written for the three and nine months ended September 30, 2015 and 2014 were as follows:

| (\$ in thousands)                                  | Three Months Ended September 30 |         |         |        |    | Nine Months Ended September 30 |          |         |       |    |
|--|---------------------------------|---------|---------|--------|----|--------------------------------|----------|---------|-------|----|
|  | 2015                            | 2014    | Change  |        |    | 2015                           | 2014     | Change  |       |    |
| Premiums ceded to external reinsurers              |                                 |         |         |        |    |                                |          |         |       |    |
| Traditional business                               | \$2,636                         | \$2,611 | \$25    | 1.0    | %  | \$7,289                        | \$8,125  | \$(836) | (10.3 | %) |
| Alternative market business                        | 1,876                           | 1,891   | (15)    | (0.8   | %) | 5,299                          | 4,271    | 1,028   | 24.1  | %  |
| Segment results                                    | 4,512                           | 4,502   | 10      | 0.2    | %  | 12,588                         | 12,396   | 192     | 1.5   | %  |
| Return premium estimate under external reinsurance |                                 |         |         |        |    |                                |          |         |       |    |
| Traditional business                               | (257                            | )750    | (1,007  | (134.3 | %) | 460                            | (213     | )673    | >100% |    |
| Alternative market business                        | —                               | —       | —       | nm     |    | —                              | —        | —       | nm    |    |
| Segment results                                    | (257                            | )750    | (1,007  | (134.3 | %) | 460                            | (213     | )673    | >100% |    |
| Premiums ceded to an unaffiliated captive insurer  |                                 |         |         |        |    |                                |          |         |       |    |
| Traditional business                               | —                               | —       | —       | nm     |    | —                              | —        | —       | nm    |    |
| Alternative market business                        | 1,289                           | 768     | 521     | 67.8   | %  | 4,856                          | 3,963    | 893     | 22.5  | %  |
| Segment results                                    | 1,289                           | 768     | 521     | 67.8   | %  | 4,856                          | 3,963    | 893     | 22.5  | %  |
| Total ceded premiums written                       |                                 |         |         |        |    |                                |          |         |       |    |
| Traditional business                               | 2,379                           | 3,361   | (982    | (29.2  | %) | 7,749                          | 7,912    | (163    | (2.1  | %) |
| Alternative market business                        | 3,165                           | 2,659   | 506     | 19.0   | %  | 10,155                         | 8,234    | 1,921   | 23.3  | %  |
| Segment results                                    | \$5,544                         | \$6,020 | \$(476) | (7.9   | %) | \$17,904                       | \$16,146 | \$1,758 | 10.9  | %  |

We retain the first \$0.5 million in risk insured by us on our traditional business and cede losses in excess of this amount on each loss occurrence under our primary external reinsurance contract. The traditional external reinsurance contract contains a return premium provision under which we estimate return premium based on the underlying loss experience of policies covered under the contract. Changes in the return premium estimate reflect the loss experience under the reinsurance contract for the three and nine months ended September 30, 2015 and 2014. In our alternative market business, the risk retention for each loss occurrence ranges from \$0.3 million to \$0.35 million based on the alternative market program. We cede 100% of premiums written under three alternative market programs to an unaffiliated captive insurer.

Premiums ceded to external reinsurers in our traditional business decreased during the nine-month period of 2015, which primarily reflected a reduction in reinsurance rates. The \$1.0 million increase in the return premium for the 2015 three-month period, primarily reflected favorable loss experience on prior contract years, partially offset by 2015 severity-related claim activity. The \$0.7 million decrease in the return premium estimate for the nine-month period of 2015 primarily reflected 2015 traditional ceded incurred losses of \$4.0 million, partially offset by favorable loss experience on prior contract years. The increase in premiums ceded to the unaffiliated captive insurer during the three- and nine-month periods of 2015 primarily reflected a new alternative market program that became effective in the fourth quarter of 2014.

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## Ceded Premiums Ratio

Ceded premiums ratio was as follows:

|   | Three Months Ended September 30 |                             |                 |                      |                             |                 |
|---|---------------------------------|-----------------------------|-----------------|----------------------|-----------------------------|-----------------|
|   | 2015                            |                             |                 | 2014                 |                             |                 |
|   | Traditional Business            | Alternative Market Business | Segment Results | Traditional Business | Alternative Market Business | Segment Results |
| Ceded premiums ratio, as reported                     | 5.3%                            | 18.7%                       | 9.0%            | 7.2%                 | 19.5%                       | 10.0%           |
| Less the effect of:                                   |                                 |                             |                 |                      |                             |                 |
| Return premium estimated under external reinsurance   | (0.6%)                          | —%                          | (0.4%)          | 1.6%                 | —%                          | 1.2%            |
| Premiums ceded to unaffiliated captive insurer (100%) | —%                              | 7.6%                        | 2.1%            | —%                   | 5.6%                        | 1.3%            |
| Ceded premiums ratio, less the effects of above       | 5.9%                            | 11.1%                       | 7.3%            | 5.6%                 | 13.9%                       | 7.5%            |
|   | Nine Months Ended September 30  |                             |                 |                      |                             |                 |
|   | 2015                            |                             |                 | 2014                 |                             |                 |
|   | Traditional Business            | Alternative Market Business | Segment Results | Traditional Business | Alternative Market Business | Segment Results |
| Ceded premiums ratio, as reported                     | 5.5%                            | 18.9%                       | 9.1%            | 5.8%                 | 18.6%                       | 8.9%            |
| Less the effect of:                                   |                                 |                             |                 |                      |                             |                 |
| Return premium estimated under external reinsurance   | 0.3%                            | —%                          | 0.2%            | (0.2%)               | —%                          | (0.1%)          |
| Premiums ceded to unaffiliated captive insurer (100%) | —%                              | 9.0%                        | 2.5%            | —%                   | 8.9%                        | 2.2%            |
| Ceded premiums ratio, less the effects of above       | 5.2%                            | 9.9%                        | 6.4%            | 6.0%                 | 9.7%                        | 6.8%            |

We cede premiums related to our traditional business on an earned premium basis, whereas alternative market premiums are ceded on a written premium basis. The increase in the traditional ceded premiums ratio for the 2015 three-month period primarily reflected a decrease in gross premiums written (the denominator of the ratio above) while there was an increase in gross premiums earned for the same comparative periods. Because our reinsurance for the traditional business is contractually based on earned premium, an increase in gross earned premium increases ceded premiums written.

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## Net Premiums Earned

Net premiums earned for the three and nine months ended September 30, 2015 and 2014 were as follows:

| (\$ in thousands)                  | Three Months Ended September 30 |          |         | Nine Months Ended September 30 |      |                                     |
|------------------------------------|---------------------------------|----------|---------|--------------------------------|------|-------------------------------------|
|                                    | 2015                            | 2014     | Change  | 2015                           | 2014 | Change                              |
| <b>Gross premiums earned</b>       |                                 |          |         |                                |      |                                     |
| Traditional business               | \$43,525                        | \$42,345 | \$1,180 | 2.8                            | %    | \$129,515 \$119,702 \$9,813 8.2 %   |
| Alternative market business        | 17,052                          | 14,345   | 2,707   | 18.9                           | %    | 48,667 40,253 8,414 20.9 %          |
| Segment results                    | 60,577                          | 56,690   | 3,887   | 6.9                            | %    | 178,182 159,955 18,227 11.4 %       |
| <b>Less: Ceded premiums earned</b> |                                 |          |         |                                |      |                                     |
| Traditional business               | 2,378                           | 3,453    | (1,075) | (31.1)                         | %    | 8,302 7,308 994 13.6 %              |
| Alternative market business        | 3,622                           | 3,445    | 177     | 5.1                            | %    | 10,444 8,687 1,757 20.2 %           |
| Segment results                    | 6,000                           | 6,898    | (898)   | (13.0)                         | %    | 18,746 15,995 2,751 17.2 %          |
| <b>Net premiums earned</b>         |                                 |          |         |                                |      |                                     |
| Traditional business               | 41,147                          | 38,892   | 2,255   | 5.8                            | %    | 121,213 112,394 8,819 7.8 %         |
| Alternative market business        | 13,430                          | 10,900   | 2,530   | 23.2                           | %    | 38,223 31,566 6,657 21.1 %          |
| Segment results                    | \$54,577                        | \$49,792 | \$4,785 | 9.6                            | %    | \$159,436 \$143,960 \$15,476 10.8 % |

Net premiums earned consist of gross premiums earned less the portion of earned premiums that we cede to our reinsurers for their assumption of a portion of our losses. Our workers' compensation policies are twelve-month policies and premiums are earned on a pro rata basis over the policy period. Net premiums earned also include premium adjustments related to the audit of our insureds' payrolls. Payroll audits are conducted subsequent to the end of the policy period and any related adjustments are recorded in the current period. In addition, we record an estimate for EBUB and evaluate the estimate on a quarterly basis.

The increase in net premiums earned during the 2015 three- and nine-month periods primarily reflects the pro rata effects of growth in net premiums written over the past twelve months. In addition, we increased the EBUB estimate by \$0.3 million and \$0.5 million during the 2015 three- and nine-month periods compared to an increase of \$0.8 million and \$0.4 million for the same periods in 2014, respectively. The increase in the EBUB estimate reflects the increase in audit premium recognized during the first nine months of 2015.

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## Losses and Loss Adjustment Expenses

The following table summarizes calendar year net loss ratios by separating losses between the current accident year and all prior accident years. The components of the calendar year loss ratio were as follows:

|  | Net Loss Ratios                 |                             |                 |                      |                             |                 |                      |                             |                 | Change |      |      |     |      |   |      |   |
|--|---------------------------------|-----------------------------|-----------------|----------------------|-----------------------------|-----------------|----------------------|-----------------------------|-----------------|--------|------|------|-----|------|---|------|---|
|  | Three Months Ended September 30 |                             |                 |                      |                             |                 |                      |                             |                 |        |      |      |     |      |   |      |   |
|  | 2015                            |                             |                 | 2014                 |                             |                 |                      |                             |                 |        |      |      |     |      |   |      |   |
|  | Traditional Business            | Alternative Market Business | Segment Results | Traditional Business | Alternative Market Business | Segment Results | Traditional Business | Alternative Market Business | Segment Results |        |      |      |     |      |   |      |   |
| Calendar year net loss ratio   | 65.6                            | % 68.2                      | % 66.2          | % 64.9               | % 71.8                      | % 66.4          | % 0.7                | (3.6                        | )               | (0.2   | )    |      |     |      |   |      |   |
| Less impact of prior accident years on the net loss ratio                              | (0.9                            | %)                          | (6.2            | %)                   | (2.2                        | %)              | (1.1                 | %)                          | (1.8            | %)     | (1.2 | %)   | 0.2 | (4.4 | ) | (1.0 | ) |
| Current accident year net loss ratio   | 66.5                            | % 74.4                      | % 68.4          | % 66.0               | % 73.6                      | % 67.6          | % 0.5                | 0.8                         |                 | 0.8    |      |      |     |      |   |      |   |
| Less impact of audit premium on loss ratio   | —                               | % (1.2                      | %)              | (0.3                 | %)                          | —               | % (0.7               | %)                          | (0.1            | %)     | —    | (0.5 | )   | (0.2 | ) |      |   |
| Current accident year net loss ratio, excluding the effect of audit and return premium | 66.5                            | % 75.6                      | % 68.7          | % 66.0               | % 74.3                      | % 67.7          | % 0.5                | 1.3                         |                 | 1.0    |      |      |     |      |   |      |   |

|  | Net Loss Ratios                |                             |                 |                      |                             |                 |                      |                             |                 | Change |      |      |   |      |   |      |   |
|--|--------------------------------|-----------------------------|-----------------|----------------------|-----------------------------|-----------------|----------------------|-----------------------------|-----------------|--------|------|------|---|------|---|------|---|
|  | Nine Months Ended September 30 |                             |                 |                      |                             |                 |                      |                             |                 |        |      |      |   |      |   |      |   |
|  | 2015                           |                             |                 | 2014                 |                             |                 |                      |                             |                 |        |      |      |   |      |   |      |   |
|  | Traditional Business           | Alternative Market Business | Segment Results | Traditional Business | Alternative Market Business | Segment Results | Traditional Business | Alternative Market Business | Segment Results |        |      |      |   |      |   |      |   |
| Calendar year net loss ratio   | 65.5                           | % 60.4                      | % 64.3          | % 65.0               | % 60.1                      | % 63.9          | % 0.5                | 0.3                         |                 | 0.4    |      |      |   |      |   |      |   |
| Less impact of prior accident years on the net loss ratio                              | (1.0                           | %)                          | (8.5            | %)                   | (2.8                        | %)              | (1.0                 | %)                          | (5.5            | %)     | (2.0 | %)   | — | (3.0 | ) | (0.8 | ) |
| Current accident year net loss ratio   | 66.5                           | % 68.9                      | % 67.1          | % 66.0               | % 65.6                      | % 65.9          | % 0.5                | 3.3                         |                 | 1.2    |      |      |   |      |   |      |   |
| Less impact of audit premium on loss ratio   | —                              | % (0.9                      | %)              | (0.2                 | %)                          | —               | % (0.4               | %)                          | —               | %      | —    | (0.5 | ) | (0.2 | ) |      |   |
| Current accident year net loss ratio, excluding the effect of audit and return premium | 66.5                           | % 69.8                      | % 67.3          | % 66.0               | % 66.0                      | % 65.9          | % 0.5                | 3.8                         |                 | 1.4    |      |      |   |      |   |      |   |

We recognized net favorable prior year development related to our previously established reserve of \$1.2 million and \$4.4 million, respectively, for the three and nine months ended September 30, 2015 and \$0.6 million and \$2.9 million for the same respective periods of 2014. The net favorable prior year development included \$0.4 million and \$1.2 million for both the three and nine months ended September 30, 2015 and 2014, respectively, related to amortization



of the purchase accounting fair value adjustment for our traditional business. Favorable prior year development for our alternative market business was \$0.8 million and \$3.2 million for the three and nine months ended September 30, 2015, respectively, and \$0.2 million and \$1.7 million for the same respective periods of 2014.

Within our alternative market business, audit premium from insureds results in a decrease in the net loss ratio, whereas audit premium returned to insureds results in an increase in the net loss ratio. We recognized audit premium in our alternative market business during both 2015 and 2014 and the effect of that premium on the current accident year net loss ratio is reflected in the table above.

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## Underwriting, Policy Acquisition and Operating Expenses

Underwriting, policy acquisition and operating expenses include commissions, premium taxes and underwriting salaries, which are capitalized and deferred over the related workers' compensation policy period, net of external ceding commissions earned. The capitalization of these costs can vary as they are subject to the success rate of our contract acquisition efforts. These expenses also include management fees charged by the Corporate segment, which represent intercompany charges pursuant to a management agreement that became effective in the first quarter of 2015. No management fees were charged to the Workers' Compensation segment in 2014.

The table below provides a comparison of underwriting, policy acquisition and operating expenses for the three and nine months ended September 30, 2015 and 2014:

| (\$ in thousands)                                       | Three Months Ended September 30 |          |         |      | Nine Months Ended September 30 |          |         |      |    |
|---|---------------------------------|----------|---------|------|--------------------------------|----------|---------|------|----|
|   | 2015                            | 2014     | Change  |      | 2015                           | 2014     | Change  |      |    |
| Traditional business                                    | \$12,001                        | \$11,458 | \$543   | 4.7  | % \$35,367                     | \$35,492 | \$(125) | (0.4 | %) |
| Alternative market business                             | 4,230                           | 3,327    | 903     | 27.1 | % 12,054                       | 9,887    | 2,167   | 21.9 | %  |
| Underwriting, policy acquisition and operating expenses | \$16,231                        | \$14,785 | \$1,446 | 9.8  | % \$47,421                     | \$45,379 | \$2,042 | 4.5  | %  |

The following table highlights certain discrete events affecting expenses in 2015 when compared to the same three- and nine-month periods in 2014:

| (In thousands)               | Expense Increase (Decrease) |                   |
|------------------------------|-----------------------------|-------------------|
|                              | 2015 vs 2014                |                   |
|                              | Three Months Ended          | Nine Months Ended |
| One-time professional fees   | \$—                         | \$(661)           |
| Transaction-related expenses | \$(146)                     | \$(2,055)         |

There were a nominal amount of transaction-related expenses incurred during the nine months ended September 30, 2015.

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## Underwriting Expense Ratio (the Expense Ratio)

Our expense ratio for the three and nine months ended September 30, 2015 and 2014, including the impact of audit premium, management fee and certain discrete items, was as follows:

|   | Underwriting Expense Ratio      |        |             |        |          |         |             |        |             | Change |          |         |             |        |          |         |        |
|---|---------------------------------|--------|-------------|--------|----------|---------|-------------|--------|-------------|--------|----------|---------|-------------|--------|----------|---------|--------|
|   | Three Months Ended September 30 |        |             |        |          |         | 2014        |        |             |        |          |         |             |        |          |         |        |
|   | 2015                            |        | Alternative |        | Segment  |         | 2014        |        | Alternative |        | 2014     | 2015    | 2014        | 2015   |          |         |        |
|   | Traditional                     | Market | Business    | Market | Business | Results | Traditional | Market | Business    | Market | Business | Results | Traditional | Market | Business | Results |        |
| Underwriting expense ratio, as reported                   | 29.2                            | %      | 31.5        | %      | 29.7     | %       | 29.5        | %      | 30.5        | %      | 29.7     | %       | (0.3        | )      | 1.0      | —       |        |
| Less estimated ratio increase (decrease) attributable to: |                                 |        |             |        |          |         |             |        |             |        |          |         |             |        |          |         |        |
| Transaction-related expenses                              | —                               | %      | —           | %      | —        | %       | 0.4         | %      | —           | %      | 0.3      | %       | (0.4        | )      | —        | (0.3 )  |        |
| One-time professional fees                                | —                               | %      | —           | %      | —        | %       | —           | %      | —           | %      | —        | %       | —           |        | —        | —       |        |
| Amortization of intangible assets                         | 3.2                             | %      | —           | %      | 2.4      | %       | 3.3         | %      | —           | %      | 2.6      | %       | (0.1        | )      | —        | (0.2 )  |        |
| Management fees   | 1.1                             | %      | —           | %      | 0.8      | %       | —           | %      | —           | %      | —        | %       | 1.1         |        | —        | 0.8     |        |
| Impact of audit premium                                   | (1.6                            | %)     | (0.5        | %)     | (1.3     | %)      | (2.2        | %)     | (0.9        | %)     | (1.9     | %)      | 0.6         |        | 0.4      | 0.6     |        |
| Impact of return premium estimate                         | (0.2                            | %)     | —           | %      | (0.1     | %)      | 0.5         | %      | —           | %      | 0.4      | %       | (0.7        | )      | —        | (0.5 )  |        |
| Underwriting expense ratio, less listed effects           | 26.7                            | %      | 32.0        | %      | 27.9     | %       | 27.5        | %      | 31.4        | %      | 28.3     | %       | (0.8        | )      | 0.6      | (0.4 )  |        |
|   | Underwriting Expense Ratio      |        |             |        |          |         |             |        |             |        |          |         |             |        |          |         |        |
|   | Nine Months Ended September 30  |        |             |        |          |         |             |        |             |        |          |         |             |        |          |         |        |
|   | 2015                            |        | Alternative |        | Segment  |         | 2014        |        | Alternative |        | Segment  |         | Change      |        |          |         |        |
|   | Traditional                     | Market | Business    | Market | Business | Results | Traditional | Market | Business    | Market | Business | Results | Traditional | Market | Business | Results |        |
| Underwriting expense ratio, as reported                   | 29.2                            | %      | 31.5        | %      | 29.7     | %       | 31.6        | %      | 31.3        | %      | 31.5     | %       | (2.4        | )      | 0.2      | (1.8 )  |        |
| Less estimated ratio increase (decrease) attributable to: |                                 |        |             |        |          |         |             |        |             |        |          |         |             |        |          |         |        |
| Transaction-related expenses                              | —                               | %      | —           | %      | —        | %       | 1.8         | %      | —           | %      | 1.4      | %       | (1.8        | )      | —        | (1.4 )  |        |
| One-time professional fees                                | —                               | %      | —           | %      | —        | %       | 0.6         | %      | —           | %      | 0.5      | %       | (0.6        | )      | —        | (0.5 )  |        |
| Amortization of intangible assets                         | 3.2                             | %      | —           | %      | 2.4      | %       | 3.5         | %      | —           | %      | 2.7      | %       | (0.3        | )      | —        | (0.3 )  |        |
| Management fees   | 1.2                             | %      | —           | %      | 0.9      | %       | —           | %      | —           | %      | —        | %       | 1.2         |        | —        | 0.9     |        |
| Impact of audit premium                                   | (1.3                            | %)     | (0.5        | %)     | (1.1     | %)      | (0.9        | %)     | (0.2        | %)     | (0.8     | %)      | (0.4        | )      | (0.3     | )       | (0.3 ) |
| Impact of return premium estimate                         | 0.1                             | %      | —           | %      | 0.1      | %       | (0.1        | %)     | —           | %      | (0.1     | %)      | 0.2         |        | —        | 0.2     |        |
| Underwriting expense ratio, less listed effects           | 26.0                            | %      | 32.0        | %      | 27.4     | %       | 26.7        | %      | 31.5        | %      | 27.8     | %       | (0.7        | )      | 0.5      | (0.4 )  |        |

The decrease in the traditional business expense ratio for the 2015 three- and nine-month periods primarily reflects the growth in net premiums earned and prudent expense management. The alternative markets expense ratio primarily reflects ceding commissions charged to each program.

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## Segregated Portfolio Cell Dividend Expense (Income)

Our Workers' Compensation segment provides turn-key workers' compensation alternative market solutions that include program design, fronting, claims administration, risk management, SPC rental, asset management and SPC management services. The asset management and SPC management services are outsourced to a third party.

Alternative market customers include individual companies, groups and associations. SPC dividend expense (income) for each period represents the profit or loss attributable to the alternative market business ceded to the SPCs of Eastern Re, net of any participation we have taken in the SPCs.

The SPCs are segregated pools of assets and liabilities that provide an insurance facility for a defined set of risks.

Assets of each SPC are solely for the benefit of that individual cell and each SPC is solely responsible for the liabilities of that individual cell. Assets of one SPC are statutorily protected from the creditors of the others. We participate to a varying degree in the results of selected SPCs. Our ownership interest in the SPCs in which we participate is generally 50%, but we have ownership interests as low as 25% and as high as 82.5%. Under the SPC structure, the net operating results of each cell, net of our participation, are due to the external owners of that cell.

SPC dividend expense (income) was as follows:

| (\$ in thousands)                           | Three Months Ended September 30 |         |           | Nine Months Ended September 30 |         |         |           |          |
|---|---------------------------------|---------|-----------|--------------------------------|---------|---------|-----------|----------|
|   | 2015                            | 2014    | Change    | 2015                           | 2014    | Change  |           |          |
| SPC net operating results - profit/(loss)   | \$(1,909)                       | \$(598) | \$(1,311) | (219.2 %)                      | \$1,901 | \$3,297 | \$(1,396) | (42.3 %) |
| Less: Eastern participation - profit/(loss) | 24                              | (115)   | 139       | >100%                          | 420     | 942     | (522)     | (55.4 %) |
| SPC dividend expense (income)               | \$(1,933)                       | \$(483) | \$(1,450) | (300.2 %)                      | \$1,481 | \$2,355 | \$(874)   | (37.1 %) |

SPC dividend expense (income) for the three- and nine-month periods of 2015 primarily reflected an increase in the SPC loss ratio and a decrease in net realized gains when compared to the same 2014 period.

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## Segment Operating Results - Lloyd's Syndicate

Through a wholly owned and consolidated subsidiary (the Corporate Member), we are a corporate member of Lloyd's of London. Our Corporate Member is the majority (58%) capital provider to Syndicate 1729, which began writing and reinsuring property and casualty business as of January 1, 2014. The remaining capital for Syndicate 1729 is provided by unrelated third parties, including private names and other corporate members.

Syndicate 1729 covers a range of property and casualty insurance and reinsurance lines, and has a maximum underwriting capacity of £75 million for the 2015 underwriting year, of which £43.2 million (\$65.3 million based on September 30, 2015 exchange rates) is our allocated underwriting capacity as a Corporate Member. We are meeting our FAL requirement for the 2015 calendar year with investment securities held at Lloyd's which at September 30, 2015 had a fair value of \$89.7 million, as discussed in Note 3 of the Notes to Condensed Consolidated Financial Statements. We have also provided a £10 million credit facility to the Trustees of Syndicate 1729 to provide initial operating funds, £8.5 million of which had been advanced at September 30, 2015. See related discussion under the heading "Investment Exposures" in Liquidity and Capital Resources and Financial Condition and in Note 7 of the Notes to Condensed Consolidated Financial Statements.

Our Lloyd's Syndicate segment results includes both our 58% participation in the operating results of Syndicate 1729 and 100% of the operating results of our wholly owned subsidiaries that support Syndicate 1729. We report results from our Syndicate 1729 involvement on a quarter delay, except that investment results associated with our FAL investments and certain U.S. paid administrative expenses are reported concurrently as that information is available on an earlier time frame. Due to the reporting delay and because Syndicate 1729 did not commence active operations until January 2014, the 2014 nine-month period includes only two quarters of Syndicate 1729 activity while the 2015 nine-month period reflects three quarters of activity. Segment operating results for the three and nine months ended September 30, 2015 were net losses of \$2.6 million and \$4.6 million, respectively, as compared to net losses of \$1.6 million and \$3.8 million for the same respective periods of 2014, and included the following:

| (\$ in thousands)                                       | Three Months Ended September |         | Nine Months Ended September |          |   |
|---|------------------------------|---------|-----------------------------|----------|---|
|   | 30<br>2015                   | 2014    | 30<br>2015                  | 2014     |   |
| Net premiums written                                    | \$16,019                     | \$3,889 | \$42,231                    | \$24,163 |   |
| Net premiums earned                                     | \$11,915                     | \$3,445 | \$26,776                    | \$6,397  |   |
| Net investment income                                   | \$260                        | \$120   | \$653                       | \$244    |   |
| Net losses and loss adjustment expenses                 | \$8,700                      | \$2,537 | \$18,283                    | \$4,405  |   |
| Underwriting, policy acquisition and operating expenses | \$5,644                      | \$2,584 | \$13,187                    | \$5,999  |   |
| Income tax expense                                      | \$132                        | \$—     | \$752                       | \$—      |   |
| Net loss ratio  | 73.0                         | % 73.6  | % 68.3                      | % 68.9   | % |
| Underwriting expense ratio                              | 47.4                         | % 75.0  | % 49.2                      | % 93.8   | % |

Net premiums written increased \$12.1 million and \$18.1 million for the 2015 three- and nine-month periods, respectively, and included casualty, property, and property reinsurance coverages. The increase for the three-month period was primarily attributable to new business and the increase for the nine-month period primarily reflected the additional quarter of activity in 2015, as previously discussed. As discussed in our Specialty P&C segment operating results, Syndicate 1729 has entered into a quota share reinsurance agreement with one of our Specialty P&C wholly owned insurance subsidiaries and pays a ceding commission related to the amount assumed. Our Specialty P&C segment also reports this ceding arrangement on the same one quarter delay as the effect of doing so is not material. Net premiums written in the above table included \$0.1 million and \$14.9 million for the 2015 three- and nine-month periods and \$2.9 million and \$19.0 million for the 2014 three- and nine-month periods attributable to our 58% participation in this arrangement. For premium assumed, we include in written premium an estimate of all premium to be earned over the entire period covered by the reinsurance agreement, generally one year, in the quarter in which the reinsurance agreement becomes effective. In subsequent quarters, adjustments are made to the estimate and reflected in written premium in that quarter.



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Net premiums earned consist of gross premiums earned less the portion of earned premiums that we cede to our reinsurers for their assumption of a portion of our losses. Because premiums are generally earned pro rata over the entire policy period, fluctuations in premiums earned tend to lag those of premiums written. Policies written to date primarily carry a term of one year. Net earned premium reported for the three- and nine-month periods ended September 30, 2015 included premium assumed from a ProAssurance subsidiary of approximately \$3.6 million and \$10.7 million, respectively, and approximately \$1.1 million and \$1.6 million for the three- and nine-month periods ended September 30, 2014, respectively. The 2015 increase in net premiums earned reflects the effect of there being no active Syndicate operations prior to January 1, 2014 and, for the comparative nine-month periods, the reporting delay.

The net loss ratio decreased 0.6 percentage points for both the 2015 three- and nine-month periods, which primarily reflects variations in the mix of risk insured. Losses for each period were primarily recorded using the loss assumptions by risk category incorporated into the business plan submitted to Lloyd's for Syndicate 1729 with some adjustment, in 2015, to give consideration to actual loss experience incurred to date. The assumptions used in the business plan were consistent with loss results reflected in Lloyd's historical data for similar risks. We expect loss ratios to fluctuate from quarter to quarter as Syndicate 1729 writes more business and the book begins to mature. Underwriting expenses were \$5.6 million and \$13.2 million for the three and nine months ended September 30, 2015 and \$2.6 million and \$6.0 million for the three and nine months ended September 30, 2014, respectively. The improvement in the 2015 expense ratio reflects the increase in net premiums earned and we anticipate a continued reduction to the ratio as the level of net premiums earned is expected to grow.

Net investment income for the 2015 and 2014 three- and nine-month periods was primarily attributable to interest earned on the FAL investments. Our FAL investments are primarily short-term investments and investment-grade corporate debt securities.

Operating results of this segment are subject to income tax under U.K. tax law. Tax expense incurred in 2015 includes both our estimated U.K. tax liability for the 2014 tax year (determined during the second quarter of 2015) and an accrual of our 2015 U.K. tax liability. The subsidiaries of this segment generated U.K. tax income primarily because certain expenses recognized for GAAP reporting purposes are not deductible for U.K. tax purposes.



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## Segment Operating Results - Corporate

Segment operating results for our Corporate segment for the 2015 three- and nine-month periods was a loss of \$18.4 million and income of \$7.0 million, respectively. Corporate segment operating results for the 2014 three- and nine-month periods included \$6.4 million and \$44.0 million of income, respectively. Results included the following:

| (\$ in thousands)   | Three Months Ended September 30 |            |                      | Nine Months Ended September 30 |          |                      |
|---|---------------------------------|------------|----------------------|--------------------------------|----------|----------------------|
|   | 2015                            | 2014       | Change               | 2015                           | 2014     | Change               |
| Net investment income   | \$26,682                        | \$32,710   | \$(6,028 ) (18.4 %)  | \$81,548                       | \$92,544 | \$(10,996) (11.9 %)  |
| Equity in earnings (loss) of unconsolidated subsidiaries  | \$(221 )                        | \$298      | \$(519 ) (174.2 %)   | \$3,821                        | \$2,767  | \$1,054 38.1 %       |
| Total net realized investment gains (losses)  | \$(36,641)                      | \$(8,131 ) | \$(28,510) (350.6 %) | \$(35,645)                     | \$7,659  | \$(43,304) (565.4 %) |
| Operating expense   | \$5,137                         | \$3,189    | \$1,948 61.1 %       | \$17,670                       | \$6,826  | \$10,844 >100%       |
| Interest expense  | \$3,637                         | \$3,606    | \$31 0.9 %           | \$10,978                       | \$10,697 | \$281 2.6 %          |
| Income taxes  | 990                             | \$12,525   | \$(11,535) (92.1 %)  | \$15,932                       | \$43,328 | \$(27,396) (63.2 %)  |
| Net Investment Income, Equity in Earnings (Loss) of Unconsolidated Subsidiaries, Net Realized Investment Gains (Losses) |                                 |            |                      |                                |          |                      |

## Net Investment Income

Net investment income is primarily derived from the income earned by our fixed maturity securities and also includes dividend income from equity securities, income from our short-term and cash equivalent investments, earnings from other investments and increases in the cash surrender value of BOLI contracts. Investment fees and expenses are deducted from investment income.

Net investment income by investment category was as follows:

| (\$ in thousands)                | Three Months Ended September 30 |          |                     | Nine Months Ended September 30 |          |                     |
|----------------------------------|---------------------------------|----------|---------------------|--------------------------------|----------|---------------------|
|                                  | 2015                            | 2014     | Change              | 2015                           | 2014     | Change              |
| Fixed maturities                 | \$23,853                        | \$28,302 | \$(4,449 ) (15.7 %) | \$73,374                       | \$85,132 | \$(11,758) (13.8 %) |
| Equities                         | 3,506                           | 2,661    | 845 31.8 %          | 9,974                          | 7,479    | 2,495 33.4 %        |
| Short-term and Other investments | 511                             | 2,793    | (2,282 ) (81.7 %)   | 1,406                          | 4,723    | (3,317 ) (70.2 %)   |
| BOLI                             | 658                             | 646      | 12 1.9 %            | 1,589                          | 1,544    | 45 2.9 %            |
| Investment fees and expenses     | (1,846 )                        | (1,692 ) | (154 ) (9.1 %)      | (4,795 )                       | (6,334 ) | 1,539 24.3 %        |
| Net investment income            | \$26,682                        | \$32,710 | \$(6,028 ) (18.4 %) | \$81,548                       | \$92,544 | \$(10,996) (11.9 %) |

## Fixed Maturities

The decrease in our income from fixed maturity securities for both three- and nine-month periods of 2015 was due both to lower average investment balances and to lower yields. We reduced the size of our fixed portfolio over the last year in order to repurchase stock, pay dividends and invest in other asset classes. On an overall basis our average investment in fixed securities was approximately 11% and 8% lower for the three- and nine-month periods of 2015, respectively, as compared to the same period in 2014.

Average yields for our fixed maturity portfolio were as follows:

|                                     | Three Months Ended September 30 |      | Nine Months Ended September 30 |      |
|-------------------------------------|---------------------------------|------|--------------------------------|------|
|                                     | 2015                            | 2014 | 2015                           | 2014 |
| Average income yield                | 3.5%                            | 3.7% | 3.4%                           | 3.7% |
| Average tax equivalent income yield | 4.0%                            | 4.2% | 4.0%                           | 4.3% |

## Equities

Income from our equity portfolio increased approximately 31.8% and 33.4% for the 2015 three- and nine-month periods, respectively, as compared to the same periods in 2014. This reflects the addition of a bond fund to this category, an increase in the size of the equity portfolio, and changes in the mix of equities owned.



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## Short-term Investments and Other Invested Assets

Income from our other invested assets decreased for the 2015 three- and nine-month periods, principally due to lower distributions from our interests in LPs that we account for using the cost method.

## Investment Fees and Expenses

Investment fees and expenses were relatively flat for the 2015 three-month period but decreased \$1.5 million for the 2015 nine-month period. The decrease reflected lower portfolio management fees, due to various factors including a smaller portfolio and reduced performance payments.

## Equity in Earnings (Loss) of Unconsolidated Subsidiaries

Equity in earnings (loss) of unconsolidated subsidiaries is derived from our investment interests accounted for under the equity method. Results were as follows:

| (\$ in thousands)  | Three Months Ended September 30 |          |        | Nine Months Ended September 30 |          |          |
|--|---------------------------------|----------|--------|--------------------------------|----------|----------|
|  | 2015                            | 2014     | Change | 2015                           | 2014     | Change   |
| Investment LPs/LLCs                                      | \$3,219                         | \$2,760  | \$459  | \$12,425                       | \$9,255  | \$3,170  |
| Tax credit partnerships                                  | (3,440 )                        | (2,462 ) | (978 ) | (8,604 )                       | (6,488 ) | (2,116 ) |
| Equity in earnings (loss) of unconsolidated subsidiaries | 16.6 %                          | <(100%)  |        | 34.3 %                         | 38.1 %   |          |

We hold interests in certain LPs/LLCs that generate earnings from trading portfolios, secured debt, debt securities, multi-strategy funds and private equity investments. The performance of the LPs is affected by the volatility of equity and credit markets.

Our tax credit investments are designed to generate returns by providing tax benefits in the form of tax credits and tax-deductible project operating losses. The increase in tax credit partnership losses for the three- and nine-month periods of 2015 reflects new investments in historic tax credit partnerships. The nine-month period also reflects an increase to partnership losses from the re-estimation of inception-to-date results for certain partnership interests during the first quarter of 2015. We account for our tax credit investments on the equity method and record our allocable portion of the operating losses of the underlying properties based on estimates provided by the partnership. We adjust our estimate of our allocable portion of operating losses periodically as actual operating results of the underlying properties become available.

The tax benefits received from our tax credit partnerships, which are not reflected in our investment results above, reduced our tax expenses in 2015 and 2014 as follows:

| (In millions)                            | Three Months Ended September 30 |       | Nine Months Ended September 30 |        |
|--|---------------------------------|-------|--------------------------------|--------|
|  | 2015                            | 2014  | 2015                           | 2014   |
| Tax credits recognized during the period | \$6.3                           | \$4.6 | \$16.7                         | \$13.4 |
| Tax benefit of amortization              | \$1.2                           | \$0.9 | \$3.0                          | \$2.3  |

During 2015, we began investing in historic tax credit partnerships. Tax credits provided by the underlying projects of these partnerships are typically available in the tax year in which the project is put into active service, whereas the tax credits provided by qualified affordable housing tax credit partnerships are provided over approximately a ten year period. The increase in the amount of tax credits recognized in 2015 is primarily due to our investment in historic tax credit partnerships.

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## Non-GAAP Financial Measure – Tax Equivalent Investment Result

We believe that to fully understand our investment returns it is important to consider the current tax benefits associated with certain investments as the tax benefit received represents a portion of the return provided by our tax-exempt bonds, BOLI, common and preferred stocks, and tax credit partnership investments (our tax-preferred investments). We impute a pro forma tax-equivalent result by estimating the amount of fully-taxable income needed to achieve the same after-tax result as is currently provided by our tax-preferred investments. We believe this better reflects the economics behind our decision to invest in certain asset classes that are either taxed at lower rates and/or result in reductions to our current federal income tax expense. Our pro forma tax-equivalent investment result is shown in the table that follows as is a reconciliation of our tax equivalent result to our GAAP net investment result.

| (In thousands)  | Three Months Ended<br>September 30 |          | Nine Months Ended<br>September 30 |           |
|---|------------------------------------|----------|-----------------------------------|-----------|
|   | 2015                               | 2014     | 2015                              | 2014      |
| GAAP net investment result:   |                                    |          |                                   |           |
| Net investment income   | \$26,682                           | \$32,710 | \$81,548                          | \$92,544  |
| Equity in earnings (loss) of unconsolidated subsidiaries                                  | (221                               | ) 298    | 3,821                             | 2,767     |
| GAAP net investment result  | \$26,461                           | \$33,008 | \$85,369                          | \$95,311  |
| Pro forma tax-equivalent investment result  | \$40,950                           | \$45,077 | \$125,297                         | \$130,860 |
| Reconciliation of pro forma and GAAP tax-equivalent investment result:                    |                                    |          |                                   |           |
| Pro forma tax-equivalent investment result  | \$40,950                           | \$45,077 | \$125,297                         | \$130,860 |
| Less taxable equivalent adjustments, calculated using the 35% federal statutory tax rate: |                                    |          |                                   |           |
| State and municipal bonds   | 3,572                              | 4,070    | 11,069                            | 12,699    |
| BOLI  | 354                                | 348      | 855                               | 831       |
| Dividends received  | 863                                | 499      | 2,273                             | 1,354     |
| Tax credit partnerships   | 9,700                              | 7,152    | 25,731                            | 20,665    |
| GAAP net investment result  | \$26,461                           | \$33,008 | \$85,369                          | \$95,311  |

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## Net Realized Investment Gains (Losses)

The following table provides detailed information regarding our net realized investment gains (losses).

| (In thousands)  | Three Months Ended |            | Nine Months Ended |            |
|---|--------------------|------------|-------------------|------------|
|   | September 30       |            | September 30      |            |
|   | 2015               | 2014       | 2015              | 2014       |
| OTTI losses, total:   |                    |            |                   |            |
| State and municipal bonds   | \$—                | \$—        | \$—               | \$(50 )    |
| Corporate debt  | (1,925 )           | (1,425 )   | (6,405 )          | (1,425 )   |
| Other investments   | (1,870 )           | —          | (1,870 )          | —          |
| Portion recognized in Other Comprehensive Income:   |                    |            |                   |            |
| Corporate debt  | 385                | 268        | 2,174             | 268        |
| Net impairments recognized in earnings  | \$(3,410 )         | \$(1,157 ) | \$(6,101 )        | \$(1,207 ) |
| Gross realized gains, available-for-sale securities   | 2,729              | 736        | 10,354            | 3,711      |
| Gross realized (losses), available-for-sale securities  | (2,548 )           | (52 )      | (4,613 )          | (371 )     |
| Net realized gains (losses), trading securities   | 403                | 3,227      | 12,594            | 21,830     |
| Net realized gains (losses), other investments  | (361 )             | 55         | 1,167             | 321        |
| Change in unrealized holding gains (losses), trading securities   | (32,620 )          | (10,402 )  | (47,513 )         | (17,906 )  |
| Change in unrealized holding gains (losses), convertible securities, carried at fair value as a part of Other investments | (971 )             | (538 )     | (1,669 )          | 1,281      |
| Other   | 137                | —          | 136               | —          |
| Net realized investment gains (losses)  | \$(36,641 )        | \$(8,131 ) | \$(35,645 )       | \$7,659    |

We recognized impairments in income totaling \$3.4 million and \$6.1 million for the three and nine months ended September 30, 2015, respectively. Impairments recognized in income related to corporate debt for the 2015 three-month period primarily consisted of a \$0.9 million impairment associated with bonds we intend to sell but also included two other credit-related impairments. One impairment related to preferred stock from a consumer-oriented issuer which has experienced declines in its revenue stream that may not be reversible. The other impairment related to a bond from an energy sector issuer that we expect to restructure debt within a few years. We recognized non-credit impairments related to the latter two impairments as the fair value of the impaired securities was less than the future cash flows expected to be received from the securities. Impairments recognized for the nine-month period further include credit-related impairments of corporate debt securities totaling \$2.7 million, recorded related to high-yield securities from three other issuers in the energy sector, and non-credit impairments related to these same securities of \$1.8 million.

We also recognized a \$1.9 million impairment related to an investment fund that is accounted for using the cost method. The fund is focused on the energy sector and securities held have declined in value. An OTTI was recognized to reduce the carrying value of the investment to an amount which we believe will be recoverable on the investment. The holding loss recognized related to our equity trading securities of \$32.6 million for the three months ended September 30, 2015 primarily reflected unfavorable equity market performance during the third quarter of 2015; however, approximately \$4.0 million of the loss was attributable to a decline in the value of holdings of an inflation indexed fund, due to lower inflation expectations.

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## Operating Expenses

Corporate segment operating expenses were \$5.1 million and \$17.7 million for the three and nine months ended September 30, 2015, respectively, and \$3.2 million and \$6.8 million for the three and nine months ended September 30, 2014, respectively.

The increase in operating expenses as compared to 2014 reflects the effects of a corporate restructuring process during 2014 and the implementation of a management fee charged by the Corporate segment to the Specialty P&C and Workers' Compensation segments in 2015. As a part of our restructuring process in 2014, there were shifts in the recording of certain expenses between segments, with the net effect being an increase to Corporate expenses and a decrease to Specialty P&C expenses. Also, beginning with the first quarter of 2015, the operating subsidiaries within our Specialty P&C and Workers' Compensation segments are charged a management fee by the Corporate segment for services provided to these subsidiaries. The management fee is based on the extent to which services are provided to the subsidiary and the amount of premium written by the subsidiary. Under the new arrangement, the expenses associated with such services are reported as expenses of the Corporate segment, and the management fees charged are reported as an offset to Corporate operating expenses. Prior to 2015, a substantial portion of expenses associated with services provided to other segments were directly allocated to the insurance subsidiaries included in the Specialty P&C segment. Expenses were not allocated to the subsidiaries within the Workers' Compensation segment during 2014 as these subsidiaries were newly acquired.

Due to these changes to our reporting of expenses by segment, we believe a comparison of Corporate and Specialty P&C expenses on a combined basis is more meaningful than a separate analysis by segment. The table below compares underwriting and operating expenses reported by the Corporate and Specialty P&C segments on a combined basis for the three and nine months ended September 30, 2015 and 2014.

| (\$ in millions)  | Three Months Ended September 30 |        |          | Nine Months Ended September 30 |         |           |
|---|---------------------------------|--------|----------|--------------------------------|---------|-----------|
|   | 2015                            | 2014   | Change   | 2015                           | 2014    | Change    |
| Underwriting, policy acquisition and operating expense:       |                                 |        |          |                                |         |           |
| Corporate Segment:  |                                 |        |          |                                |         |           |
| Operating expenses  | \$9.3                           | \$9.7  | \$(0.4 ) | \$28.9                         | \$23.9  | \$5.0     |
| Operating expenses allocated to Specialty P&C segment         | —                               | (6.5 ) | 6.5      | —                              | (17.1 ) | 17.1      |
| Management fee offset   | (4.2 )                          | —      | (4.2 )   | (11.2 )                        | —       | (11.2 )   |
| Segment Total   | \$5.1                           | \$3.2  | \$1.9    | \$17.7                         | \$6.8   | \$10.9    |
| Specialty P&C segment:  |                                 |        |          |                                |         |           |
| DPAC amortization   | 11.2                            | 13.7   | (2.5 )   | 35.0                           | 42.4    | (7.4 )    |
| Management fees   | 2.2                             | —      | 2.2      | 5.5                            | —       | 5.5       |
| Expenses allocated from the Corporate segment                 | —                               | 6.5    | (6.5 )   | —                              | 17.1    | (17.1 )   |
| ULAE portion of expenses allocated from the Corporate segment | —                               | (1.6 ) | 1.6      | —                              | (5.3 )  | 5.3       |
| Net allocation from the Corporate segment                     | —                               | 4.9    | (4.9 )   | —                              | 11.8    | (11.8 )   |
| Other underwriting and operating expenses                     | 12.9                            | 15.2   | (2.3 )   | 39.6                           | 46.8    | (7.2 )    |
| Segment Total   | \$26.3                          | \$33.8 | \$(7.5 ) | \$80.1                         | \$101.0 | \$(20.9 ) |
| Corporate and Specialty P&C expenses, combined                | \$31.4                          | \$37.0 | \$(5.6 ) | \$97.8                         | \$107.8 | \$(10.0 ) |

Corporate and Specialty P&C  
expenses, combined, exclusive of  
DPAC amortization, management \$22.2 \$24.9 \$(2.7 ) (10.8 %) \$68.5 \$70.7 \$(2.2 ) (3.1 %)  
fees and allocations identified  
above

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On a combined basis, exclusive of any effect from DPAC amortization, management fees and allocations, there was a \$2.7 million and a \$2.2 million decrease in expenses for the 2015 three- and nine-month periods, respectively, as compared to 2014. The 2015 decreases were attributable to various factors, most significantly: the comparative effect of a reserve established during 2014 related to discontinued operations of an acquired entity, higher costs for technology enhancement during 2014, and lower amortization due to certain intangible assets becoming fully amortized. These reductions to expense were partially offset by higher compensation expense in the Corporate segment during 2015 due to restructuring which shifted costs to operating expense from ULAE, and, for the nine-month period only, a recovery received during 2014 related to the settlement of litigation.

**Interest Expense**

Interest expense increased during the three and nine months ended September 30, 2015 as compared to the same periods in 2014 primarily due to a \$100 million secured borrowing under our Revolving Credit Agreement in January 2015.

Interest expense was composed of the following:

| (In thousands)   | Three Months Ended<br>September 30 |         |          | Nine Months Ended<br>September 30 |          |          |
|--|------------------------------------|---------|----------|-----------------------------------|----------|----------|
|  | 2015                               | 2014    | Change   | 2015                              | 2014     | Change   |
| Senior notes due 2023  | \$3,357                            | \$3,467 | \$(110 ) | \$10,071                          | \$10,186 | \$(115 ) |
| Revolving credit agreement (including fees and amortization) | 271                                | 129     | 142      | 879                               | 376      | 503      |
| Other  | 9                                  | 10      | (1 )     | 28                                | 135      | (107 )   |
|  | \$3,637                            | \$3,606 | \$31     | \$10,978                          | \$10,697 | \$281    |

**Taxes**

Tax expense allocated to our Corporate segment includes U.S. tax only. The U.K. tax expense incurred by the U.K. based subsidiaries of our Lloyd's Syndicate segment is allocated to that segment. Consolidated tax expense reflects tax expense of both segments, as shown in the table below:

| (In thousands)                               | Three Months Ended<br>September 30 |          | Nine Months Ended<br>September 30 |          |
|--|------------------------------------|----------|-----------------------------------|----------|
|  | 2015                               | 2014     | 2015                              | 2014     |
| Corporate segment income tax expense         | \$990                              | \$12,525 | \$15,932                          | \$43,328 |
| Lloyd's Syndicate segment income tax expense | 132                                | —        | 752                               | —        |
| Consolidated income tax expense              | \$1,122                            | \$12,525 | \$16,684                          | \$43,328 |

Factors affecting our consolidated effective tax rate include the following:

|                    | Three Months Ended<br>September 30 |         |    |  | Nine Months Ended<br>September 30 |         |    |  |
|--------------------|------------------------------------|---------|----|--|-----------------------------------|---------|----|--|
|                    | 2015                               | 2014    |    |  | 2015                              | 2014    |    |  |
| Statutory rate     | 35.0                               | % 35.0  | %  |  | 35.0                              | % 35.0  | %  |  |
| Tax-exempt income* | (5.4                               | %) (4.5 | %) |  | (6.3                              | %) (4.9 | %) |  |
| Tax credits        | (19.4                              | %) (7.2 | %) |  | (13.0                             | %) (6.9 | %) |  |
| Non-U.S. loss      | 4.2                                | % 0.4   | %  |  | 0.7                               | % 0.4   | %  |  |
| Other              | (4.6                               | %) 2.8  | %  |  | 0.6                               | % 1.2   | %  |  |
| Effective tax rate | 9.8                                | % 26.5  | %  |  | 17.0                              | % 24.8  | %  |  |

\* Includes tax-exempt interest, dividends received deduction, and cash surrender value of BOLI.

We estimate our annual effective tax rate at the end of each quarterly reporting period, which is used to record the provision for income taxes in our interim financial statements. Our effective tax rates for both 2015 and 2014 were different from the statutory Federal income tax rate primarily due to the following:

- a portion of our investment income was tax-exempt.
- we utilized tax credits transferred to us from our tax credit partnership investments.
- we did not recognize a tax benefit related to the operating loss or the U.K. tax expense associated with our Lloyd's Syndicate segment.



The increased effect of tax-exempt income and the tax credits was primarily because the total amount of pre-tax income declined in 2015 as compared to 2014, but the effect of the tax credits also reflects an increased amount of credits. Tax credits

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recognized for the three- and nine-month periods ended September 30, 2015 were \$6.3 million and \$16.7 million, respectively, as compared to \$4.6 million and \$13.4 million for the 2014 three- and nine-month periods. The increased effect of other items primarily reflects the effect of the lower pre-tax income in 2015.

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## ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.

We believe that we are principally exposed to three types of market risk related to our investment operations. These risks are interest rate risk, credit risk and equity price risk. We have limited exposure to foreign currency risk as we issue few insurance contracts denominated in currencies other than the U.S. dollar and we have few monetary assets or obligations denominated in foreign currencies.

## Interest Rate Risk

Our fixed maturities portfolio is exposed to interest rate risk. Fluctuations in interest rates have a direct impact on the market valuation of these securities. As interest rates rise, market values of fixed income portfolios fall and vice versa. Certain of the securities are held in an unrealized loss position; we do not intend to sell and believe we will not be required to sell any of the debt securities held in an unrealized loss position before its anticipated recovery.

The following table summarizes estimated changes in the fair value of our available-for-sale fixed maturity securities for specific hypothetical changes in interest rates by asset class at September 30, 2015 and December 31, 2014. There are principally two factors that determine interest rates on a given security: market interest rates and credit spreads. As different asset classes can be affected in different ways by movements in those two factors, we have broken out our portfolio by asset class in the following table.

|  | Interest Rate Shift in Basis Points |         |         |         |         |
|--|-------------------------------------|---------|---------|---------|---------|
|  | September 30, 2015                  |         |         |         |         |
|  | (200)                               | (100)   | Current | 100     | 200     |
| Fair Value (in millions):                        |                                     |         |         |         |         |
| U.S. Treasury obligations                        | \$117                               | \$116   | \$112   | \$108   | \$105   |
| U.S. Government-sponsored enterprise obligations | 27                                  | 27      | 26      | 25      | 25      |
| State and municipal bonds                        | 1,015                               | 1,000   | 968     | 933     | 898     |
| Corporate debt                                   | 1,385                               | 1,360   | 1,312   | 1,263   | 1,217   |
| Asset-backed securities                          | 416                                 | 416     | 408     | 395     | 380     |
| All fixed maturity securities                    | \$2,960                             | \$2,919 | \$2,826 | \$2,724 | \$2,625 |
| Duration:  |                                     |         |         |         |         |
| U.S. Treasury obligations                        | 3.29                                | 3.24    | 3.18    | 3.11    | 3.05    |
| U.S. Government-sponsored enterprise obligations | 2.49                                | 2.46    | 2.47    | 2.70    | 2.71    |
| State and municipal bonds                        | 3.46                                | 3.53    | 3.60    | 3.68    | 3.76    |
| Corporate debt                                   | 3.72                                | 3.74    | 3.79    | 3.73    | 3.66    |
| Asset-backed securities                          | 1.62                                | 1.82    | 2.85    | 3.64    | 3.96    |
| All fixed maturity securities                    | 3.31                                | 3.36    | 3.55    | 3.67    | 3.70    |
|  | December 31, 2014                   |         |         |         |         |
| Fair Value (in millions):                        |                                     |         |         |         |         |
| U.S. Treasury obligations                        | \$176                               | \$172   | \$167   | \$161   | \$156   |
| U.S. Government-sponsored enterprise obligations | 41                                  | 40      | 40      | 38      | 37      |
| State and municipal bonds                        | 1,114                               | 1,097   | 1,063   | 1,024   | 985     |
| Corporate debt                                   | 1,503                               | 1,468   | 1,417   | 1,365   | 1,316   |
| Asset-backed securities                          | 468                                 | 467     | 458     | 447     | 432     |
| All fixed maturity securities                    | \$3,302                             | \$3,244 | \$3,145 | \$3,035 | \$2,926 |
| Duration:  |                                     |         |         |         |         |
| U.S. Treasury obligations                        | 3.56                                | 3.50    | 3.43    | 3.36    | 3.30    |
| U.S. Government-sponsored enterprise obligations | 2.53                                | 2.49    | 2.80    | 3.08    | 3.12    |
| State and municipal bonds                        | 3.40                                | 3.49    | 3.60    | 3.73    | 3.85    |
| Corporate debt                                   | 3.71                                | 3.73    | 3.82    | 3.76    | 3.70    |
| Asset-backed securities                          | 1.51                                | 1.69    | 2.36    | 3.08    | 3.47    |
| All fixed maturity securities                    | 3.30                                | 3.30    | 3.50    | 3.60    | 3.70    |



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Computations of prospective effects of hypothetical interest rate changes are based on numerous assumptions, including the maintenance of the existing level and composition of fixed income security assets, and should not be relied on as indicative of future results.

Certain shortcomings are inherent in the method of analysis presented in the computation of the fair value of fixed rate instruments. Actual values may differ from the projections presented should market conditions vary from assumptions used in the calculation of the fair value of individual securities, including non-parallel shifts in the term structure of interest rates and changing individual issuer credit spreads.

Our cash and short-term investment portfolio at September 30, 2015 was carried on a cost basis which approximates its fair value. Our portfolio lacks significant interest rate sensitivity due to its short duration.

**Credit Risk**

We have exposure to credit risk primarily as a holder of fixed income securities. We control this exposure by emphasizing investment grade credit quality in the fixed income securities we purchase.

As of September 30, 2015, 93% of our fixed maturity securities were rated investment grade as determined by NRSROs, such as Fitch, Moody's and Standard & Poor's. We believe that this concentration in investment grade securities reduces our exposure to credit risk on our fixed income investments to an acceptable level. However, investment grade securities, in spite of their rating, can rapidly deteriorate and result in significant losses. Ratings published by the NRSROs are one of the tools used to evaluate the credit worthiness of our securities. The ratings reflect the subjective opinion of the rating agencies as to the credit worthiness of the securities, and therefore, we may be subject to additional credit exposure should the rating prove to be unreliable.

We also have exposure to credit risk related to our receivables from reinsurers. Our receivables from reinsurers (with regard to both paid and unpaid losses) approximated \$247 million at September 30, 2015 and \$244 million at December 31, 2014. We monitor the credit risk associated with our reinsurers using publicly available financial and rating agency data.

**Equity Price Risk**

At September 30, 2015 the fair value of our equity investments, excluding our equity investments in bond investment funds as discussed in the following paragraph, was \$242 million. These equity securities are subject to equity price risk, which is the potential for loss in fair value due to a decline in equity prices. The weighted average beta of this group of securities was 0.94. Beta measures the price sensitivity of an equity security or group of equity securities to a change in the broader equity market, in this case the S&P 500 Index. If the value of the S&P 500 Index increased by 10%, the fair value of these securities would be expected to increase by 9.4% to \$265 million. Conversely, a 10% decrease in the S&P 500 Index would imply a decrease of 9.4% in the fair value of these securities to \$219 million. The selected hypothetical changes of plus or minus 10% do not reflect what could be considered the best or worst case scenarios and are used for illustrative purposes only.

Our equity investments include equity investments in certain bond investment funds which are not significantly subject to equity price risk, and thus we have excluded these investments from the above analysis.

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## ITEM 4. CONTROLS AND PROCEDURES.

The Chief Executive Officer and Chief Financial Officer of the Company participated in management's evaluation of our disclosure controls and procedures (as defined in SEC Rule 13a-15(e)) as of September 30, 2015. ProAssurance's disclosure controls and procedures are designed to reasonably assure that information required to be disclosed by us in reports we file or submit under the Exchange Act is accumulated and communicated to our management as appropriate to allow timely decisions regarding disclosure and is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures are effective.

## Changes in Internal Control over Financial Reporting

There have been no significant changes in our internal controls over financial reporting that have materially affected, or are reasonably likely to materially affect, those controls during the quarter.

## PART II. OTHER INFORMATION

## ITEM 1. LEGAL PROCEEDINGS.

See Note 7 of the Notes to Condensed Consolidated Financial Statements.

## ITEM 1A. RISK FACTORS.

There are no changes to the "Risk Factors" in Part 1, Item 1A of the 2014 Form 10-K.

## ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS.

(a) Not applicable.

(b) Not applicable.

(c) Information required by Item 703 of Regulation S-K.

| Period                 | Total Number of Shares Purchased | Average Price Paid per Share | Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs | Approximate Dollar Value of Shares that May Yet Be Purchased Under the Plans or Programs * (In thousands) |
|------------------------|----------------------------------|------------------------------|--|---|
| July 1 – 31, 2015      | 347,437                          | \$47.58                      | 347,437  | \$141,704   |
| August 1 – 31, 2015    | 261,810                          | \$48.58                      | 261,810  | \$128,980   |
| September 1 – 30, 2015 | 257,562                          | \$48.96                      | 257,562  | \$116,364   |
| Total                  | 866,809                          | \$48.29                      | 866,809  |   |

Under its current plan begun in November 2010, the ProAssurance Board of Directors has authorized \$600 million \* for the repurchase of common shares or the retirement of outstanding debt, including \$100 million authorized in May 2015. This is ProAssurance's only plan for the repurchase of common shares, and the plan has no expiration date.

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ITEM 6. EXHIBITS

| Exhibit<br>Number | Description   |
|-------------------|---|
| 31.1              | Certification of Principal Executive Officer of ProAssurance as required under SEC rule 13a-14(a).  |
| 31.2              | Certification of Principal Financial and Accounting Officer of ProAssurance as required under SEC rule 13a-14(a).   |
| 32.1              | Certification of Principal Executive Officer of ProAssurance as required under SEC Rule 13a-14(b) and Section 1350 of Chapter 63 of Title 18 of the United States Code, as amended (18 U.S.C. 1350).                |
| 32.2              | Certification of Principal Financial and Accounting Officer of ProAssurance as required under SEC Rule 13a-14(b) and Section 1350 of Chapter 63 of Title 18 of the United States Code, as amended (18 U.S.C. 1350). |
| 101.INS           | XBRL Instance Document  |
| 101.SCH           | XBRL Taxonomy Extension Schema Document   |
| 101.CAL           | XBRL Taxonomy Extension Calculation Linkbase Document   |
| 101.DEF           | XBRL Taxonomy Extension Definition Linkbase Document  |
| 101.LAB           | XBRL Taxonomy Extension Labels Linkbase Document  |
| 101.PRE           | XBRL Taxonomy Extension Presentation Linkbase Document  |

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SIGNATURE

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.

PROASSURANCE CORPORATION

November 4, 2015

/s/ Edward L. Rand, Jr.

Edward L. Rand, Jr.

Chief Financial Officer

(Duly authorized officer and principal financial officer)

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