PROASSURANCE CORP
Form 10-Q
August 06, 2014
Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q
(Mark One)
ý Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the quarterly period ended June 30, 2014 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 ý 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 ý 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	ý	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 ý
As of July 28, 2014, there were 58,333,988 shares of the registrant’s common stock outstanding.

Table of Contents

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 loss reserve, 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 medical professional liability insurance entities that could remove or add sizable groups of physicians 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 Financial Accounting Standards Board, the Securities and Exchange Commission (SEC), the Public Company Accounting Oversight Board, or the New York Stock Exchange (NYSE) and 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 effects of changes in the healthcare delivery system, including but not limited to the Patient Protection and Affordable Care Act (the Healthcare Reform Act);
- consolidation of healthcare providers resulting in entities that are more likely to self-insure a substantial portion of their healthcare professional 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;
- 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;
the availability, integrity and security of our technology infrastructure;
the impact of a catastrophic event, as it relates to both our operations and our insured risks;

Table of Contents

- the impact of acts of terrorism and acts of war;
- the effects of terrorism related insurance legislation and law;
- assessments from guaranty funds;
- our ability to achieve continued growth through expansion into other states 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 and 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 adversely affect the integration of Eastern Insurance Holdings, Inc. (Eastern) into ProAssurance, include, but are not limited to, the following:

- the operations of ProAssurance and Eastern may not be integrated successfully, or such integration may take longer to accomplish than expected; and
- operating costs, customer loss and business disruption following the transaction, including adverse effects on relationships with employees, may be greater than expected.

Additional risks that could arise from our membership in the Lloyd's of London market (Lloyd's) and our participation in Lloyd's Syndicate 1729 (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 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.

Table of Contents

TABLE OF CONTENTS

PART I. FINANCIAL INFORMATION		
ITEM 1.	FINANCIAL STATEMENTS	
	CONDENSED CONSOLIDATED BALANCE SHEETS (UNAUDITED) - JUNE 30, 2014 AND DECEMBER 31, 2013	5
	CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN CAPITAL (UNAUDITED) - SIX MONTHS ENDED JUNE 30, 2014 AND 2013	6
	CONDENSED CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME (UNAUDITED) - THREE AND SIX MONTHS ENDED JUNE 30, 2014 AND 2013	7
	CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED) - SIX MONTHS ENDED JUNE 30, 2014 AND 2013	8
	NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)	10
ITEM 2.	MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS	38
ITEM 3.	QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK	74
ITEM 4.	CONTROLS AND PROCEDURES	77
PART II. OTHER INFORMATION		
ITEM 1.	LEGAL PROCEEDINGS	77
ITEM 1A.	RISK FACTORS	77
ITEM 2.	UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS	77
ITEM 6.	EXHIBITS	78
SIGNATURE		79

Table of Contents

ProAssurance Corporation and Subsidiaries
Condensed Consolidated Balance Sheets (Unaudited)
(In thousands, except share data)

	June 30, 2014	December 31, 2013
Assets		
Investments		
Fixed maturities, available for sale, at fair value; amortized cost, $3,147,334 and $3,026,256, respectively	$3,272,990	$3,118,049
Equity securities, trading, at fair value; cost, $258,377 and $203,308, respectively	301,114	253,541
Short-term investments	172,868	248,605
Business owned life insurance	55,272	54,374
Investment in unconsolidated subsidiaries	242,811	214,236
Other investments, $31,544 at fair value at June 30, 2014, otherwise at cost or amortized cost	93,478	52,240
Total Investments	4,138,533	3,941,045
Cash and cash equivalents	210,659	129,383
Restricted Cash	—	78,000
Premiums receivable	215,178	115,403
Receivable from reinsurers on paid losses and loss adjustment expenses	5,766	3,231
Receivable from reinsurers on unpaid losses and loss adjustment expenses	256,704	247,518
Prepaid reinsurance premiums	29,256	21,449
Deferred policy acquisition costs	43,335	28,207
Deferred tax asset	—	1,757
Real estate, net	40,394	41,010
Intangible assets	105,813	52,002
Goodwill	210,725	161,115
Other assets	141,331	329,979
Total Assets	$5,397,694	$5,150,099
Liabilities and Shareholders’ Equity		
Liabilities		
Policy liabilities and accruals		
Reserve for losses and loss adjustment expenses	$2,174,293	$2,072,822
Unearned premiums	363,172	255,463
Reinsurance premiums payable	28,931	34,321
Total Policy Liabilities	2,566,396	2,362,606
Deferred tax liability	32,023	—
Other liabilities	188,504	143,079
Long-term debt, at amortized cost	250,000	250,000
Total Liabilities	3,036,923	2,755,685
Shareholders’ Equity		
Common shares, par value $0.01 per share, 100,000,000 shares authorized, 62,283,343 and 62,096,787 shares issued, respectively	623	621
Additional paid-in capital	355,399	349,894
Accumulated other comprehensive income (loss), net of deferred tax expense (benefit) of $43,376 and $32,127, respectively	81,653	59,661
Retained earnings	2,076,742	2,015,603
Treasury shares, at cost, 3,601,764 shares and 900,281 shares, respectively	(153,646)	(31,365)
Total Shareholders’ Equity	2,360,771	2,394,414

Total Liabilities and Shareholders’ Equity	$5,397,694	$5,150,099

See accompanying notes.

Table of Contents

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

	Common Stock	Additional Paid-in Capital	Accumulated Other Comprehensive Income (Loss)	Retained Earnings	Treasury Stock	Total
Balance at December 31, 2013	$621	$349,894	$ 59,661	$2,015,603	$(31,365)	$2,394,414
Common shares reacquired	—	—	—	—	(122,281)	(122,281)
Common shares issued for compensation	—	2,685	—	—	—	2,685
Share-based compensation	—	5,641	—	—	—	5,641
Net effect of restricted and performance shares issued and stock options exercised	2	(2,821)	—	—	—	(2,819)
Dividends to shareholders	—	—	—	(35,534)	—	(35,534)
Other comprehensive income (loss)	—	—	21,992	—	—	21,992
Net income	—	—	—	96,673	—	96,673
Balance at June 30, 2014	$623	$355,399	$ 81,653	$2,076,742	$(153,646)	$2,360,771

	Common Stock	Additional Paid-in Capital	Accumulated Other Comprehensive Income (Loss)	Retained Earnings	Treasury Stock	Total
Balance at December 31, 2012	$619	$341,780	$ 145,380	$1,782,857	$(56)	$2,270,580
Common shares issued for compensation	—	2,805	—	—	—	2,805
Share-based compensation	—	4,708	—	—	—	4,708
Net effect of restricted and performance shares issued and stock options exercised	2	(3,448)	—	—	—	(3,446)
Dividends to shareholders	—	—	—	(30,842)	—	(30,842)
Other comprehensive income (loss)	—	—	(70,318)	—	—	(70,318)
Net income	—	—	—	163,301	—	163,301
Balance at June 30, 2013	$621	$345,845	$ 75,062	$1,915,316	$(56)	$2,336,788

See accompanying notes.

Table of Contents

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

	Three Months Ended June 30		Six Months Ended June 30	
	2014	2013	2014	2013
Revenues				
Net premiums earned	$176,303	$130,352	$348,032	$264,930
Net investment income	30,225	33,267	59,957	65,393
Equity in earnings (loss) of unconsolidated subsidiaries	719	(2,972)	2,470	(3,195)
Net realized investment gains (losses):				
Other-than-temporary impairment (OTTI) losses	—	(71)	(50)	(71)
Portion of OTTI losses recognized in (reclassified from) other comprehensive income before taxes	—	—	—	—
Net impairment losses recognized in earnings	—	(71)	(50)	(71)
Other net realized investment gains (losses)	13,046	8,542	15,840	35,222
Total net realized investment gains (losses)	13,046	8,471	15,790	35,151
Other income	2,154	1,687	4,249	3,500
Total revenues	222,447	170,805	430,498	365,779
Expenses				
Losses and loss adjustment expenses	104,052	77,379	200,104	138,266
Reinsurance recoveries	(5,139)	(6,770)	(11,683)	(10,031)
Net losses and loss adjustment expenses	98,913	70,609	188,421	128,235
Underwriting, policy acquisition and operating expenses	52,157	34,959	104,672	72,244
Segregated portfolio cells dividend expense	1,789	—	2,838	—
Interest expense	3,521	392	7,091	763
Total expenses	156,380	105,960	303,022	201,242
Gain on acquisition	—	—	—	35,492
Income before income taxes	66,067	64,845	127,476	200,029
Provision for income taxes				
Current expense (benefit)	14,389	16,441	22,294	24,215
Deferred expense (benefit)	1,736	(2,047)	8,509	12,513
Total income tax expense (benefit)	16,125	14,394	30,803	36,728
Net income	49,942	50,451	96,673	163,301
Other comprehensive income (loss), after tax, net of reclassification adjustments	11,247	(62,564)	21,992	(70,318)
Comprehensive income	$61,189	$(12,113)	$118,665	$92,983
Earnings per share:				
Basic	$0.84	$0.82	$1.60	$2.64
Diluted	$0.84	$0.81	$1.59	$2.63
Weighted average number of common shares outstanding:				
Basic	59,524	61,825	60,383	61,766
Diluted	59,742	62,046	60,615	62,005
Cash dividends declared per common share	$0.30	$0.25	$0.60	$0.50

See accompanying notes.

Table of Contents

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

	Six Months Ended June 30	
	2014	2013
Operating Activities		
Net income	$96,673	$163,301
Adjustments to reconcile income to net cash provided by operating activities:		
Depreciation and amortization, net of accretion	23,974	24,442
Gain on acquisition	—	(35,492)
Net realized investment gains	(15,790)	(35,151)
Share-based compensation	5,641	4,708
Deferred income taxes	8,509	12,513
Policy acquisition costs, net amortization (net deferral)	(4,535)	(4,245)
Other	(6,380)	(6,056)
Other changes in assets and liabilities, excluding effect of business combinations:		
Premiums receivable	(27,786)	(10,563)
Reinsurance related assets and liabilities	(17,128)	1,812
Other assets	(6,017)	(42,065)
Reserve for losses and loss adjustment expenses	(50,284)	(61,298)
Unearned premiums	27,441	2,469
Other liabilities	(5,184)	(26,647)
Net cash provided (used) by operating activities	29,134	(12,272)
Investing Activities		
Purchases of:		
Fixed maturities, available for sale	(365,421)	(307,439)
Equity securities, trading	(56,006)	(53,339)
Other investments	(19,535)	(3,805)
Funding of tax credit limited partnerships	(5,348)	(32,332)
Investment in unconsolidated subsidiaries	(16,603)	(3,190)
Proceeds from sales or maturities of:		
Fixed maturities, available for sale	342,347	373,186
Equity securities, trading	85,477	59,400
Other investments	10,288	1,364
Net sales or maturities (purchases) of short-term investments	99,244	(14,732)
Cash received in acquisitions	35,013	22,780
Unsettled security transactions, net	19,866	(3,102)
(Increase) decrease in restricted cash	78,000	—
Other	6,065	(3,571)
Net cash provided (used) by investing activities	213,387	35,220

Continued on following page.

Table of Contents

	Six Months Ended June 30	
	2014	2013
Financing Activities		
Repurchase of common stock	(119,593)	—
Dividends to shareholders	(36,223)	(15,320)
Other	(5,429)	(6,945)
Net cash provided (used) by financing activities	(161,245)	(22,265)
Increase (decrease) in cash and cash equivalents	81,276	683
Cash and cash equivalents at beginning of period	129,383	118,551
Cash and cash equivalents at end of period	$210,659	$119,234
Significant non-cash transactions		
Deposit transferred as consideration for acquisition	$205,244	$153,700

See accompanying notes.

Table of Contents
ProAssurance Corporation and Subsidiaries
Notes to Condensed Consolidated Financial Statements (Unaudited)
June 30, 2014

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 U.S. generally accepted accounting principles (GAAP) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. 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 three- and six-month periods ended June 30, 2014 are not necessarily indicative of the results that may be expected for the year ending December 31, 2014. The accompanying Condensed Consolidated Financial Statements should be read in conjunction with the Consolidated Financial Statements and Notes contained in ProAssurance’s December 31, 2013 report on Form 10-K. In connection with its preparation of the Condensed Consolidated Financial Statements, ProAssurance evaluated events that occurred subsequent to June 30, 2014 for recognition or disclosure in its financial statements and notes to financial statements.
ProAssurance operates in four reportable segments as follows: Specialty Property and Casualty (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 13 of the Notes to Condensed Consolidated Financial Statements.

Reclassifications

On January 1, 2014, ProAssurance began reporting unearned ceding commissions as an offset to deferred policy acquisition costs (DPAC) on the Condensed Consolidated Balance Sheet, and the December 31, 2013 Condensed Consolidated Balance Sheet has been conformed to the current presentation. Previously, unearned ceding commissions ($0.8 million at December 31, 2013) were reported in Unearned premiums. Also, ceding commission income earned for the three and six months ended June 30, 2014 and 2013 has been reported as an offset to DPAC amortization (see Note 6) which lowered DPAC amortization as previously reported for the three and six months ended June 30, 2013 by $1.5 million and $2.7 million, respectively. Total underwriting, policy acquisition and operating expense for the 2013 three- and six-month periods was not affected by the change in presentation.

Intangible Assets

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 and had a carrying value of $80.0 million at June 30, 2014 and $35.2 million at December 31, 2013. Intangible assets with an indefinite life, primarily state licenses, are not amortized and had carrying values of $25.8 million at June 30, 2014 and $16.8 million at December 31, 2013. Both amortizable and non-amortizable intangible assets increased during 2014 due to intangible assets purchased in the Eastern acquisition, see Note 2. Intangible assets are evaluated for impairment on an annual basis.
Amortization expense for intangible assets for the three and six months ended June 30, 2014 was $2.6 million and $5.2 million, respectively, and was $1.3 million and $2.6 million for the three and six months ended June 30, 2013, respectively. Aggregate amortization expense for intangible assets over the next five years is estimated to be $5.2 million for the remainder of 2014, $8.3 million for 2015, $8.0 million for 2016, $5.7 million for 2017 and $5.3 million for 2018.

Other Assets and Other Liabilities

At December 31, 2013, Other assets was principally comprised of a deposit with an intermediate third-party of $205 million, related to the completion of the Eastern Insurance Holdings, Inc. (Eastern) acquisition which closed on January 1, 2014. See Note 2.
At June 30, 2014, Other liabilities included $18.7 million in segregated portfolio cell (SPC) dividends payable related to our recently acquired Workers' Compensation segment. The SPC dividend payable represents the cumulative

undistributed earnings of segregated portfolio cells that are contractually payable to external preferred shareholders of the cells.

Table of Contents
ProAssurance Corporation and Subsidiaries
Notes to Condensed Consolidated Financial Statements (Unaudited)
June 30, 2014

Accounting Policy Additions
The significant accounting policies adopted as a result of the acquisition of Eastern and commencement of our Lloyd's Syndicate operations effective January 1, 2014 and followed by ProAssurance in making estimates that materially affect financial reporting are as follows:
Earned But Unbilled Premiums (EBUB)
Workers' compensation premiums are determined based upon the payroll of the insured, the applicable premium rates and, where applicable, an experience based modification factor. 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 earned when billed. ProAssurance tracks, by policy, the amount of additional premium billed in final audit invoices as a percentage of payroll exposure and uses this information to estimate the probable additional amount that it has earned, but not yet billed, as of the balance sheet date. Changes to the EBUB estimate are included in Net premiums earned in the period recognized. As of June 30, 2014, ProAssurance carried earned but unbilled premiums of $2.6 million as a part of Premiums receivable.
Convertible Bond Securities
Investments in convertible bond 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 (losses) during the period of change. Interest on convertible bond securities is recorded on an accrual basis based on contractual interest rates and is included in Net investment income.
Foreign Currency
The functional currency of all ProAssurance foreign subsidiaries is the U.S. Dollar.
Accounting Changes Not Yet Adopted
Presentation of Financial Statements and Property, Plant and Equipment-Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity
Effective for fiscal years beginning after December 15, 2014, the Financial Accounting Standards Board (FASB) issued guidance which changes 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 that are not reported as discontinued operations. ProAssurance plans to adopt the guidance beginning January 1, 2015. Adoption of the guidance is expected to have no effect on ProAssurance's results of operations or financial position.
Investments-Equity Method and Joint Ventures-Accounting for Investments in Qualified Affordable Housing Projects
Effective for fiscal years beginning after December 15, 2014, the FASB issued guidance which permits but does not require qualified reporting entities to use a new accounting method, the proportional amortization method, for investments in qualified affordable housing projects. Under the new method the initial cost of an investment is amortized in proportion to the tax benefits received, and investment performance is recognized as a component of income tax expense (benefit) rather than as a component of investment income. ProAssurance is in the process of evaluating whether it meets the qualification requirements for using the new method and the effect that the use of the new method would have on its results of operations and financial position. If ProAssurance elects to adopt the guidance, the adoption will occur beginning January 1, 2015.
Compensation-Stock Compensation-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, 2016, 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, 2017. 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.

Accounting Changes Adopted

Liabilities-Obligations Resulting from Joint and Several Liability Arrangements

Effective for fiscal years beginning after December 15, 2013, the FASB revised guidance related to obligations resulting from joint and several liability arrangements. The new guidance requires an entity to recognize, measure and disclose obligations resulting from joint and several liability arrangements for which the total amount of the obligation is fixed at the reporting date, except for obligations already addressed within existing GAAP guidance, with retrospective application required for such arrangements existing at the beginning of the fiscal year of adoption. ProAssurance adopted the guidance on January 1, 2014. Adoption of this guidance had no effect on ProAssurance's results of operations or financial position.

Income Taxes-Presentation of Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists

Effective for fiscal years beginning after December 15, 2013, the FASB issued guidance related to the financial statement presentation of unrecognized tax benefits. The new guidance requires an entity to present unrecognized tax benefits as a reduction to a deferred tax asset resulting from a net operating loss carryforward, a similar tax loss, or tax credit carryforward except in circumstances where the relevant taxing authority does not permit offset or does not require offset and the entity does not intend to use the deferred tax asset for offset. The guidance requires prospective application for all unrecognized tax benefits that exist as of the effective date, but may be applied retrospectively. ProAssurance adopted the guidance prospectively on January 1, 2014. Adoption of this guidance had no material effect on ProAssurance's results of operations or financial position.

Table of Contents
ProAssurance Corporation and Subsidiaries
Notes to Condensed Consolidated Financial Statements (Unaudited)
June 30, 2014

2. Business Combinations
All entities acquired in 2014 were accounted for in accordance with GAAP relating to business combinations.
On January 1, 2014, ProAssurance completed the acquisition of Eastern by purchasing 100% of its outstanding common shares for cash of $205 million. Eastern is based in Lancaster, Pennsylvania and specializes in workers' compensation insurance and reinsurance products and services, including alternative market solutions. ProAssurance incurred expenses related to the purchase of approximately $1.9 million during the first six months of 2014 and approximately $0.9 million during the year ended December 31, 2013. These expenses were included as a part of operating expenses in the periods incurred.
The purchase consideration for Eastern was allocated to the assets acquired and liabilities assumed based on their estimated fair values on the acquisition date. Goodwill of $49.6 million was recognized equal to the excess of the purchase price over the net fair value of identifiable assets acquired and liabilities assumed. Factors contributing to the recognition of goodwill include strategic and synergistic benefits that are expected to be realized as a result of the acquisition. These benefits include insurance market diversification, expanded access to alternative markets, and opportunities to reach additional insureds in the healthcare market by being a single source provider of a suite of insurance products. None of the goodwill is expected to be tax deductible. The allocation of purchase consideration is shown in the table below.

(In thousands)	
Fixed maturities, available for sale	$107,131
Equity securities, trading	65,945
Cash and short-term investments	58,944
Other investments	42,133
Premiums receivable	71,989
Receivable from reinsurers on paid and unpaid losses and LAE	18,942
Intangible assets	59,000
Deferred policy acquisition costs (see discussion below)	10,593
Other assets	19,225
Reserve for losses and loss adjustment expenses	(151,755)
Unearned premiums	(80,268)
Ceded balances payable	(9,507)
Segregated portfolio cells dividends payable	(15,866)
Deferred tax liabilities, net	(12,835)
Other liabilities	(28,038)
Fair value of net assets acquired	$155,633
Goodwill	49,610
Total purchase consideration	$205,243

Intangible assets acquired included the following:

(In millions)	Estimated Fair Value on Acquisition Date	Estimated Useful Life	
Agency relationships	$27.0	15	
Policyholder relationships	8.0	15	
Trade names	8.0	15	
Non-compete agreements	7.0	3	
Total intangibles subject to amortization	$50.0	13	*
Insurance license agreements	$9.0	Indefinite	

* Reflects the weighted average estimated useful life of acquired intangible assets that are subject to amortization.

ProAssurance's fair value estimate of the value of business acquired (VOBA), calculated as the present value of future earnings expected from the insurance contracts acquired, approximated the carrying value of Eastern's asset for deferred policy acquisition costs as of the acquisition date. Consequently, Eastern's asset for deferred policy acquisition costs was recognized in the purchase price allocation, as listed above, in lieu of recognizing an intangible asset for VOBA.

ProAssurance Corporation and Subsidiaries
Notes to Condensed Consolidated Financial Statements (Unaudited)
June 30, 2014

ProAssurance believes that all contractual cash flows related to acquired receivables will be collected. The fair value of the reserve for losses and loss adjustment expenses and related reinsurance recoverables were based on three components: an actuarial estimate of the expected future net cash flows, a reduction to those cash flows for the time value of money determined utilizing the U.S. Treasury Yield Curve, and a risk margin adjustment to reflect the net present value of profit that an investor would demand in return for the assumption of the development risk associated with the reserve. The fair value of the reserve, including the risk margin adjustment, exceeded the undiscounted loss reserve previously established by Eastern by $9.3 million; this fair value adjustment will be amortized over the average expected life of the reserve of 6 years as a reduction to loss expenses.

The following table provides Pro Forma Consolidated Results for the three and six months ended June 30, 2014 and 2013 as if the Eastern transaction had occurred on January 1, 2013. ProAssurance Actual Consolidated Results have been adjusted by the following, net of related tax effects, to reflect the Pro Forma Consolidated Results below.

- For the three and six months ended June 30, 2013, the ProAssurance 2013 Actual Consolidated Results, which did not include Eastern, have been adjusted to include Eastern's 2013 operating results. ProAssurance Actual Consolidated Results for the three and six months ended June 30, 2014 included Eastern's operating results (Revenue of $52.1 million and $100.4 million, respectively, and Net income of $3.6 million and $5.4 million, respectively).
- Certain costs included in ProAssurance actual results for the three and six months ended June 30, 2014 have been reported in the Pro Forma Consolidated Results as if the costs had been incurred for the three and six months ended June 30, 2013. Such costs include direct transaction costs and certain compensation costs directly related to the integration of Eastern operations.
- Actual Consolidated Results for the three and six months ended June 30, 2013, were reduced to reflect amortization of intangible assets and debt security premiums and discounts recorded as a part of the Eastern purchase price allocation.

	Three Months Ended June 30, 2014		Six Months Ended June 30, 2014	
(In thousands)	ProAssurance Pro Forma Consolidated Results	ProAssurance Actual Consolidated Results	ProAssurance Pro Forma Consolidated Results	ProAssurance Actual Consolidated Results
Revenue	$222,447	$222,447	$430,498	$430,498
Net income	$49,997	$49,942	$97,693	$96,673

	Three Months Ended June 30, 2013		Six Months Ended June 30, 2013	
(In thousands)	ProAssurance Pro Forma Consolidated Results	ProAssurance Actual Consolidated Results	ProAssurance Pro Forma Consolidated Results	ProAssurance Actual Consolidated Results
Revenue	$217,643	$170,805	$456,782	$365,779
Net income	$52,538	$50,451	$167,197	$163,301

Table of Contents
ProAssurance Corporation and Subsidiaries
Notes to Condensed Consolidated Financial Statements (Unaudited)
June 30, 2014

3. 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 June 30, 2014 and December 31, 2013, including financial instruments for which ProAssurance has elected fair value, 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.

Table of Contents
ProAssurance Corporation and Subsidiaries
Notes to Condensed Consolidated Financial Statements (Unaudited)
June 30, 2014

	June 30, 2014			
	Fair Value Measurements Using			Total
(In thousands)	Level 1	Level 2	Level 3	Fair Value
Assets:				
Fixed maturities, available for sale				
U.S. Treasury obligations	$—	$172,430	$—	$172,430
U.S. Government-sponsored enterprise obligations	—	43,411	—	43,411
State and municipal bonds	—	1,119,707	7,148	1,126,855
Corporate debt, multiple observable inputs	—	1,442,569	—	1,442,569
Corporate debt, limited observable inputs:				
Other corporate debt, NRSRO ratings available	—	—	11,893	11,893
Other corporate debt, NRSRO ratings not available	—	—	2,651	2,651
Residential mortgage-backed securities	—	301,907	—	301,907
Agency commercial mortgage-backed securities	—	18,257	—	18,257
Other commercial mortgage-backed securities	—	63,967	—	63,967
Other asset-backed securities	—	83,090	5,960	89,050
Equity securities				
Financial	80,486	—	—	80,486
Utilities/Energy	27,944	—	—	27,944
Consumer oriented	63,117	—	—	63,117
Industrial	55,858	—	—	55,858
Bond funds	39,044	—	—	39,044
All other	34,665	—	—	34,665
Short-term investments	169,273	3,595	—	172,868
Financial instruments carried at fair value, classified as a part of:				
Investment in unconsolidated subsidiaries	—	—	101,342	101,342
Other investments	6,505	25,039	—	31,544
Total assets	$476,892	$3,273,972	$128,994	$3,879,858

Table of Contents
ProAssurance Corporation and Subsidiaries
Notes to Condensed Consolidated Financial Statements (Unaudited)
June 30, 2014

	December 31, 2013			
	Fair Value Measurements Using			Total
(In thousands)	Level 1	Level 2	Level 3	Fair Value
Assets:				
Fixed maturities, available for sale				
U.S. Treasury obligations	$—	$170,714	$—	$170,714
U.S. Government-sponsored enterprise obligations	—	32,768	—	32,768
State and municipal bonds	—	1,147,328	7,338	1,154,666
Corporate debt, multiple observable inputs	—	1,346,977	—	1,346,977
Corporate debt, limited observable inputs:				
Other corporate debt, NRSRO ratings available	—	—	11,449	11,449
Other corporate debt, NRSRO ratings not available	—	—	2,727	2,727
Residential mortgage-backed securities	—	235,614	—	235,614
Agency commercial mortgage-backed securities	—	27,475	—	27,475
Other commercial mortgage-backed securities	—	61,390	—	61,390
Other asset-backed securities	—	67,455	6,814	74,269
Equity securities				
Financial	81,536	—	—	81,536
Utilities/Energy	32,350	—	—	32,350
Consumer oriented	66,461	—	—	66,461
Industrial	57,262	—	—	57,262
All other	15,932	—	—	15,932
Short-term investments	248,605			248,605
Financial instruments carried at fair value, classified as a part of:				
Investment in unconsolidated subsidiaries	—	—	72,062	72,062
Total assets	$502,146	$3,089,721	$100,390	$3,692,257

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. If a value did not appear reasonable, the valuation was discussed with the service that provided the value and would have been adjusted, if necessary. No such adjustments were necessary in 2014 or 2013.

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 recent significant economic or geographic events or ratings changes affecting the security's fair value.

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 by an outside vendor based upon a widely distributed, loan-specific listing of average bid and ask prices published daily by an investment industry group. The publisher of the listing derived the averages from data received from multiple market-makers for bank loans.

Residential and commercial mortgage backed securities. Agency pass-through securities were valued using a matrix, considering the issuer type, coupon rate and longest cash flows outstanding. The matrix was developed daily based on 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. Valuations of Alt-A mortgages included a review of collateral performance data, which is generally updated monthly.

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. Valuations of subprime home equity loans used the same valuation methodology as previously described for Alt-A mortgages.

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 primarily of convertible bond securities. Convertible bonds were valued using a pricing model that incorporated selected dealer quotes as well as real-time market data including 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.
- Exclusive of Investments in unconsolidated subsidiaries, which are valued at net asset value (NAV), 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.

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. At June 30, 2014, 100% of the securities were rated; the average rating was A.

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 having like terms and payment features that are of comparable credit quality. Assessments of credit quality were based on NRSRO ratings, if available, or were subjectively determined by management if not available. At June 30, 2014, the average rating of rated securities 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.

Table of Contents

ProAssurance Corporation and Subsidiaries
Notes to Condensed Consolidated Financial Statements (Unaudited)
June 30, 2014

Investment in unconsolidated subsidiaries consisted of limited partnership (LP) and limited liability company (LLC) interests valued using the NAV provided by the LP/LLC, which approximated the fair value of the interest. Such interests include the following:

	Unfunded Commitments	Fair Value	
(In thousands)	June 30, 2014	June 30, 2014	December 31, 2013
Investments in LPs/LLCs:			
Secured debt fund (1)	$20,600	$19,562	$13,233
Long equity fund (2)	None	7,123	6,574
Long/Short equity funds (3)	None	29,305	28,385
Non-public equity funds (4)	$79,230	33,509	23,870
Multi-strategy fund of funds (5)	None	8,165	—
Structured credit fund (6)	None	3,678	—
		$101,342	$72,062

(1) The LP is structured to provide income and capital appreciation primarily through investments in senior secured debt. Redemptions are not allowed. Income and capital are to be periodically distributed at the discretion of the LP over an anticipated time frame that spans from 7 to 9 years.

(2) The LP 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 redemptions of the investors' existing capital balance with 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 from 4 to 12 years.

(5) The LLC is 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) The LP seeks 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 LPs/LLCs.

Table of Contents

ProAssurance Corporation and Subsidiaries
Notes to Condensed Consolidated Financial Statements (Unaudited)
June 30, 2014

Quantitative Information Regarding Level 3 Valuations
Quantitative Information about Level 3 Fair Value Measurements

(In millions)	Fair Value at June 30, 2014	December 31, 2013	Valuation Technique	Unobservable Input	Range (Weighted Average)
Assets:					
State and municipal bonds	$7.1	$7.3	Market Comparable Securities	Comparability Adjustment	0% - 10% (5%)
			Discounted Cash Flows	Comparability Adjustment	0% - 10% (5%)
Corporate debt with limited observable inputs	$14.5	$14.2	Market Comparable Securities	Comparability Adjustment	0% - 5% (2.5%)
			Discounted Cash Flows	Comparability Adjustment	0% - 5% (2.5%)
Other asset-backed securities	$6.0	$6.8	Market Comparable Securities	Comparability Adjustment	0% - 5% (2.5%)
			Discounted Cash Flows	Comparability Adjustment	0% - 5% (2.5%)

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.

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.

June 30, 2014
Level 3 Fair Value Measurements – Assets

(In thousands)	U.S. Government-sponsored Enterprise Obligations	State and Municipal Bonds	Corporate Debt	Asset-backed Securities	Investment in Unconsolidated Subsidiaries	Total
Balance March 31, 2014	$999	$7,490	$12,381	$7,226	$ 91,907	$120,003
Total gains (losses) realized and unrealized:						
Included in earnings, as a part of:						
Net investment income	—	(4)	16	—	—	12
Equity in earnings of unconsolidated subsidiaries	—	—	—	—	3,231	3,231
Net realized investment gains (losses)	—	—	—	—	—	—
Included in other comprehensive income	2	(26)	(2)	25	—	(1)
Purchases	—	—	2,499	1,175	6,939	10,613
Sales	—	—	(350)	(61)	(735)	(1,146)
Transfers in	—	1,549	—	—	—	1,549

Transfers out	(1,001)	(1,861)	—	(2,405)	—	(5,267)
Balance June 30, 2014	$—	$7,148	$14,544	$5,960	$ 101,342	$128,994
Change in unrealized gains (losses) included in earnings for the above period for Level 3 assets held at period-end	$—	$—	$—	$—	$ 3,231	$3,231

20

Table of Contents

ProAssurance Corporation and Subsidiaries
Notes to Condensed Consolidated Financial Statements (Unaudited)
June 30, 2014

	June 30, 2014 Level 3 Fair Value Measurements – Assets					
(In thousands)	U.S. Government-sponsored Enterprise Obligations	State and Municipal Bonds	Corporate Debt	Asset-backed Securities	Investment in Unconsolidated Subsidiaries	Total
Balance December 31, 2013	$—	$7,338	$14,176	$6,814	$ 72,062	$100,390
Total gains (losses) realized and unrealized:						
Included in earnings, as a part of:						
Net investment income	—	(6)	32	—	—	26
Equity in earnings of unconsolidated subsidiaries	—	—	—	—	6,096	6,096
Net realized investment gains (losses)	—	(95)	3	—	—	(92)
Included in other comprehensive income	1	42	667	69	—	779
Purchases	1,000	1,861	2,499	3,340	25,375	34,075
Sales	—	(257)	(808)	(61)	(2,191)	(3,317)
Transfers in	—	2,119	—	305	—	2,424
Transfers out	(1,001)	(3,854)	(2,025)	(4,507)	—	(11,387)
Balance June 30, 2014	$—	$7,148	$14,544	$5,960	$ 101,342	$128,994
Change in unrealized gains (losses) included in earnings for the above period for Level 3 assets held at period-end	$—	$—	$—	$—	$ 6,096	$6,096

	June 30, 2013 Level 3 Fair Value Measurements – Assets					
(In thousands)	U.S. Government-sponsored Enterprise Obligations	State and Municipal Bonds	Corporate Debt	Asset-backed Securities	Investment in Unconsolidated Subsidiaries	Total
Balance March 31, 2013	$—	$7,175	$9,662	$7,076	$ 47,540	$71,453
Total gains (losses) realized and unrealized:						
Included in earnings, as a part of:						
Net investment income	—	—	—	(1)	—	(1)
Equity in earnings of unconsolidated subsidiaries	—	—	—	—	433	433
Net realized investment gains (losses)	—	(44)	—	—	—	(44)
Included in other comprehensive income	—	—	(293)	(97)	—	(390)
Purchases	—	—	3,595	—	5,543	9,138

Sales	—	(2,106)	(249)	(18)	(8,967)	(11,340)
Transfers in	—	—	—	—	—	—
Transfers out	—	—	(1,356)	(2,281)	—	(3,637)
Balance June 30, 2013	$—	$5,025	$11,359	$4,679	$ 44,549	$65,612
Change in unrealized gains (losses) included in earnings for the above period for Level 3 assets held at period-end	$—	$—	$—	$—	$ 433	$433

21

Table of Contents
ProAssurance Corporation and Subsidiaries
Notes to Condensed Consolidated Financial Statements (Unaudited)
June 30, 2014

	June 30, 2013 Level 3 Fair Value Measurements – Assets					
(In thousands)	U.S. Government-sponsored Enterprise Obligations	State and Municipal Bonds	Corporate Debt	Asset-backed Securities	Investment in Unconsolidated Subsidiaries	Total
Balance December 31, 2012	$—	$7,175	$15,191	$4,035	$ 33,739	$60,140
Total gains (losses) realized and unrealized:						
Included in earnings, as a part of:						
Net investment income	—	—	(102)	(17)	—	(119)
Equity in earnings of unconsolidated subsidiaries	—	—	—	—	2,281	2,281
Net realized investment gains (losses)	—	(44)	(69)	—	—	(113)
Included in other comprehensive income	—	—	(293)	(97)	—	(390)
Purchases	—	—	7,470	1,356	18,621	27,447
Sales	—	(2,106)	(865)	(18)	(10,092)	(13,081)
Transfers in	—	—	—	1,701	—	1,701
Transfers out	—	—	(9,973)	(2,281)	—	(12,254)
Balance June 30, 2013	$—	$5,025	$11,359	$4,679	$ 44,549	$65,612
Change in unrealized gains (losses) included in earnings for the above period for Level 3 assets held at period-end	$—	$—	$—	$—	$ 2,281	$2,281

Transfers

There were no transfers between the Level 1 and Level 2 categories during the three and six months ended June 30, 2014 or 2013.

Transfers shown in the preceding Level 3 Tables were as of the end of the period and were to or from Level 2, unless otherwise noted.

All transfers during the three and six months ended June 30, 2014 and June 30, 2013 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.

Table of Contents

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.

	June 30, 2014		December 31, 2013	
(In thousands)	Carrying Value	Fair Value	Carrying Value	Fair Value
Financial assets:				
BOLI	$55,272	$55,272	$54,374	$54,374
Investment in unconsolidated subsidiaries	3,328	3,328	—	—
Other investments	61,934	62,647	52,240	51,833
Other assets	21,740	21,690	17,940	17,940
Financial liabilities:				
Senior notes due 2023	$250,000	$272,503	$250,000	$262,500
Other liabilities	14,346	14,337	13,303	13,303

The fair value of the BOLI was equal to the cash surrender value associated with the policies on the valuation date.

Investment in unconsolidated subsidiaries consisted of an interest in an investment fund LP accounted for using the equity method. The fair value was estimated to approximate our initial capital contribution which occurred in 2014 and represented an arm's length transaction between market participants.

Other investments listed in the table above include interests in certain investment fund LPs/LLCs accounted for using the cost method, investments in Federal Home Loan Bank (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 NAVs provided by the LP/LLC managers. 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 of the underlying securities. 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.

Table of Contents
ProAssurance Corporation and Subsidiaries
Notes to Condensed Consolidated Financial Statements (Unaudited)
June 30, 2014

4. Investments
Available-for-sale securities at June 30, 2014 and December 31, 2013 included the following:

	June 30, 2014			
(In thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Fixed maturities				
U.S. Treasury obligations	$166,819	$6,193	$(582)	$172,430
U.S. Government-sponsored enterprise obligations	41,579	2,000	(168)	43,411
State and municipal bonds	1,077,118	51,048	(1,311)	1,126,855
Corporate debt	1,400,060	61,069	(4,016)	1,457,113
Residential mortgage-backed securities	292,899	10,076	(1,068)	301,907
Agency commercial mortgage-backed securities	18,041	270	(54)	18,257
Other commercial mortgage-backed securities	61,962	2,089	(84)	63,967
Other asset-backed securities	88,856	437	(243)	89,050
	$3,147,334	$133,182	$(7,526)	$3,272,990

	December 31, 2013			
(In thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Fixed maturities				
U.S. Treasury obligations	$166,115	$6,118	$(1,519)	$170,714
U.S. Government-sponsored enterprise obligations	30,942	2,251	(425)	32,768
State and municipal bonds	1,116,060	46,533	(7,927)	1,154,666
Corporate debt	1,321,838	53,059	(13,744)	1,361,153
Residential mortgage-backed securities	230,861	7,608	(2,855)	235,614
Agency commercial mortgage-backed securities	27,268	343	(136)	