HANOVER INSURANCE GROUP, INC.
Form 10-Q
August 07, 2009
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the quarterly period ended June 30, 2009

¨ **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 1-13754

THE HANOVER INSURANCE GROUP, INC.

(Exact name of registrant as specified in its charter)

Delaware	**04-3263626**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**

440 Lincoln Street, Worcester, Massachusetts 01653

(Address of principal executive offices) (Zip Code)

(508) 855-1000

(Registrant s telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x 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.

Large accelerated filer	x	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 x

The number of shares outstanding of the registrant s common stock was 50,860,359 as of August 1, 2009.

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PART I - FINANCIAL INFORMATION

ITEM 1 - FINANCIAL STATEMENTS

THE HANOVER INSURANCE GROUP, INC.

CONSOLIDATED STATEMENTS OF INCOME

(In millions)	(Unaudited) Quarter Ended June 30, 2009	2008	(Unaudited) Six Months Ended June 30, 2009	2008
REVENUES				
Premiums	**$ 630.0**	$ 619.3	**$ 1,262.0**	$ 1,237.0
Net investment income	**61.3**	63.8	**126.2**	128.4
Net realized investment losses:				
Total other-than temporary impairment losses on securities	**(18.1)**	(8.3)	**(34.6)**	(13.6)
Portion of loss recognized in other comprehensive income	**11.4**		**11.4**	
Net other than temporary impairment losses on securities recognized in earnings	**(6.7)**	(8.3)	**(23.2)**	(13.6)
Realized gains from sales and other	**3.1**	0.7	**13.5**	5.7
Total net realized investment losses	**(3.6)**	(7.6)	**(9.7)**	(7.9)
Fees and other income	**8.7**	9.5	**16.8**	17.4
Total revenues	**696.4**	685.0	**1,395.3**	1,374.9
LOSSES AND EXPENSES				
Losses and loss adjustment expenses	**393.8**	385.4	**822.1**	765.5
Policy acquisition expenses	**144.8**	139.0	**287.9**	276.4
Gain on tender offer	**(34.3)**		**(34.3)**	
Other operating expenses	**95.5**	83.9	**189.7**	169.9
Total losses and expenses	**599.8**	608.3	**1,265.4**	1,211.8
Income before federal income taxes	**96.6**	76.7	**129.9**	163.1
Federal income tax expense:				
Current	**12.4**	19.4	**25.0**	41.7
Deferred	**21.1**	9.4	**21.6**	16.2
Total federal income tax expense	**33.5**	28.8	**46.6**	57.9
Income from continuing operations	**63.1**	47.9	**83.3**	105.2
Discontinued operations (See Notes 3 and 4):				
Gain (loss) from discontinued FAFLIC business (net of income tax (expense) benefit of $(1.7) for the quarter ended June 30, 2008 and $0.4 for the six months ended June 30, 2008), including loss on assets held-for-sale of $66.1 in 2008	**0.9**	(67.7)	**5.9**	(71.2)
Gain (loss) from operations of discontinued accident and health business (net of income tax expense of $0.1 for the quarter ended June 30, 2009)	**0.2**		**(3.1)**	
Income from operations of AMGRO (net of income tax benefit of $1.3 for the quarter and six months ended June 30, 2008), including gain on disposal of $11.1 in 2008		10.4		10.1

Gain (loss) on disposal of variable life and annuity business (net of income tax benefit of $0.5 for the quarter ended June 30, 2008 and $0.4 for the six months ended June 30, 2008)	**0.2**	(0.8)	**4.1**	5.4
Other discontinued operations				(1.2)
Net income (loss)	**$ 64.4**	$ (10.2)	**$ 90.2**	$ 48.3

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THE HANOVER INSURANCE GROUP, INC.

CONSOLIDATED STATEMENTS OF INCOME (CONTINUED)

	(Unaudited) Quarter Ended June 30,		(Unaudited) Six Months Ended June 30,	
	2009	**2008**	**2009**	**2008**
PER SHARE DATA				
Basic				
Income from continuing operations	**$ 1.23**	$ 0.93	**$ 1.63**	$ 2.04
Discontinued operations:				
Gain (loss) from discontinued FAFLIC business (net of income tax (expense) benefit of $(0.03) for the quarter ended June 30, 2008 and $0.01 for the six months ended June 30, 2008), including loss on assets held-for-sale of $1.27 in 2008	**0.02**	(1.31)	**0.12**	(1.38)
Gain (loss) from operations of discontinued accident and health business	**0.01**		**(0.06)**	
Income from operations of AMGRO (net of income tax benefit of $0.03 for the quarter and six months ended June 30, 2008), including gain on disposal of $0.21 in 2008		0.20		0.20
(Loss) gain on disposal of variable life insurance and annuity business (net of income tax benefit of $0.01 for the quarter and six months ended June 30, 2008)		(0.02)	**0.08**	0.10
Other discontinued operations				(0.02)
Net income (loss) per share	**$ 1.26**	$ (0.20)	**$ 1.77**	$ 0.94
Weighted average shares outstanding	**51.1**	51.3	**51.1**	51.5
Diluted				
Income from continuing operations	**$ 1.23**	$ 0.92	**$ 1.62**	$ 2.02
Discontinued operations:				
Gain (loss) from discontinued FAFLIC business (net of income tax (expense) benefit of $(0.03) for the quarter ended June 30, 2008 and $0.01 for the six months ended June 30, 2008), including loss on assets held-for-sale of $1.27 in 2008	**0.02**	(1.30)	**0.11**	(1.37)
Loss from operations of discontinued accident and health business			**(0.06)**	
Income from operations of AMGRO (net of income tax benefit of $0.03 for the quarter and six months ended June 30, 2008), including gain on disposal of $0.21 in 2008		0.20		0.20
(Loss) gain on disposal of variable life insurance and annuity business (net of income tax benefit of $0.01 for the quarter and six months ended June 30, 2008)		(0.02)	**0.08**	0.10
Other discontinued operations				(0.02)
Net income (loss) per share	**$ 1.25**	$ (0.20)	**$ 1.75**	$ 0.93
Weighted average shares outstanding	**51.4**	51.8	**51.4**	52.0

The accompanying notes are an integral part of these consolidated financial statements.

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THE HANOVER INSURANCE GROUP, INC.

CONSOLIDATED BALANCE SHEETS

(In millions, except per share data)	(Unaudited) June 30, 2009	December 31, 2008
ASSETS		
Investments:		
Fixed maturities, at fair value (amortized cost of $4,463.7 and $4,382.0)	**$ 4,403.6**	$ 4,140.9
Equity securities, at fair value (cost of $94.6 and $97.6)	**92.1**	76.2
Mortgage loans	**26.2**	31.1
Other long-term investments	**16.9**	18.4
Total investments	**4,538.8**	4,266.6
Cash and cash equivalents	**281.0**	397.7
Accrued investment income	**50.9**	52.3
Premiums, accounts and notes receivable, net	**605.7**	578.5
Reinsurance receivable on paid and unpaid losses, benefits and unearned premiums	**1,126.6**	1,129.6
Deferred policy acquisition costs	**272.3**	264.8
Deferred federal income taxes	**247.7**	285.6
Goodwill	**170.0**	169.9
Other assets	**323.4**	315.7
Assets of discontinued operations	**131.3**	1,769.5
Total assets	**$ 7,747.7**	$ 9,230.2
LIABILITIES		
Policy liabilities and accruals:		
Losses and loss adjustment expenses	**$ 3,127.7**	$ 3,201.3
Unearned premiums	**1,267.1**	1,246.3
Contractholder deposit funds and other policy liabilities	**1.6**	1.8
Total policy liabilities and accruals	**4,396.4**	4,449.4
Expenses and taxes payable	**623.2**	622.3
Reinsurance premiums payable	**65.1**	61.3
Long-term debt	**309.9**	531.4
Liabilities of discontinued operations	**132.0**	1,678.6
Total liabilities	**5,526.6**	7,343.0
Commitments and contingencies (Note 13)		
SHAREHOLDERS EQUITY		
Preferred stock, $0.01 par value, 20.0 million shares authorized, none issued		
Common stock, $0.01 par value, 300.0 million shares authorized, 60.5 million shares issued	**0.6**	0.6
Additional paid-in capital	**1,805.1**	1,803.8
Accumulated other comprehensive loss	**(173.0)**	(384.8)
Retained earnings	**1,073.3**	949.8
Treasury stock at cost (9.7 and 9.6 million shares)	**(484.9)**	(482.2)
Total shareholders equity	**2,221.1**	1,887.2

Total liabilities and shareholders equity	**$ 7,747.7**	$ 9,230.2

The accompanying notes are an integral part of these consolidated financial statements.

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THE HANOVER INSURANCE GROUP, INC.

CONSOLIDATED STATEMENTS OF SHAREHOLDERS EQUITY

(In millions)	(Unaudited) Six Months Ended June 30, 2009	2008
PREFERRED STOCK		
Balance at beginning and end of period	**$**	$
COMMON STOCK		
Balance at beginning and end of period	**0.6**	0.6
ADDITIONAL PAID-IN CAPITAL		
Balance at beginning of period	**1,803.8**	1,822.6
Tax benefit from stock options		0.3
Employee and director stock-based awards	**1.3**	(22.7)
Balance at end of period	**1,805.1**	1,800.2
ACCUMULATED OTHER COMPREHENSIVE LOSS		
NET UNREALIZED (DEPRECIATION) APPRECIATION ON AVAILABLE FOR SALE SECURITIES AND DERIVATIVE INSTRUMENTS:		
Balance at beginning of period	**(276.1)**	5.5
Cumulative effect of change in accounting principle, adoption of FSP FAS 115-2 and FAS 124-2	**(33.3)**	
Balance at beginning of period, as adjusted	**(309.4)**	5.5
Net appreciation (depreciation) during the period:		
Net appreciation (depreciation) on available-for-sale securities and derivative instruments	**250.8**	(80.5)
Portion of other-than-temporary impairment losses recognized in other comprehensive income	**(11.4)**	
Benefit for deferred federal income taxes	**0.2**	2.2
	239.6	(78.3)
Balance at end of period	**(69.8)**	(72.8)
DEFINED BENEFIT PENSION AND POSTRETIREMENT PLANS:		
Balance at beginning of period	**(108.7)**	(25.9)
Amounts arising in the period	**(1.6)**	(0.8)
Amortization during the period:		
Amount recognized as net periodic benefit cost	**10.0**	(1.8)
(Provision) benefit for deferred federal income taxes	**(2.9)**	0.9
	5.5	(1.7)
Balance at end of period	**(103.2)**	(27.6)
Total accumulated other comprehensive loss	**(173.0)**	(100.4)

Retained Earnings		
Balance at beginning of period	**949.8**	946.9
Cumulative effect of change in accounting principle, adoption of FSP FAS 115-2 and FAS 124-2	**33.3**	
Balance at beginning of period, as adjusted	**983.1**	946.9
Net income	**90.2**	48.3
Treasury stock issued for less than cost	**(2.2)**	(6.9)
Recognition of share-based compensation	**2.2**	13.4
Balance at end of period	**1,073.3**	1,001.7
Treasury Stock		
Balance at beginning of period	**(482.2)**	(450.7)
Shares purchased at cost	**(7.1)**	(58.5)
Net shares reissued at cost under employee stock-based compensation plans	**4.4**	19.8
Balance at end of period	**(484.9)**	(489.4)
Total shareholders equity	**$ 2,221.1**	$ 2,212.7

The accompanying notes are an integral part of these consolidated financial statements.

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THE HANOVER INSURANCE GROUP, INC.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(In millions)	(Unaudited) Quarter Ended June 30, 2009	2008	(Unaudited) Six Months Ended June 30, 2009	2008
Net income (loss)	**$ 64.4**	$ (10.2)	**$ 90.2**	$ 48.3
Other comprehensive income (loss):				
Available-for-sale securities:				
Net appreciation (depreciation) during the period	**202.2**	(76.8)	**250.8**	(80.1)
Portion of other-than-temporary impairment losses recognized in other comprehensive income	**(11.4)**		**(11.4)**	
Benefit for deferred federal income taxes		1.0	**0.2**	2.1
Total available-for-sale securities	**190.8**	(75.8)	**239.6**	(78.0)
Derivative instruments:				
Net depreciation during the period		(0.1)		(0.4)
Benefit for deferred federal income taxes				0.1
Total derivative instruments		(0.1)		(0.3)
	190.8	(75.9)	**239.6**	(78.3)
Pension and postretirement benefits:				
Amounts arising in the period	**(1.0)**	(0.7)	**(1.6)**	(0.8)
Amortization recognized as net periodic benefit costs:				
Net actuarial loss	**6.8**	1.2	**13.6**	1.5
Prior service cost	**(1.4)**	(1.4)	**(2.8)**	(2.5)
Transition asset	**(0.4)**	(0.4)	**(0.8)**	(0.8)
Total amortization recognized as net periodic benefit costs	**5.0**	(0.6)	**10.0**	(1.8)
(Provision) benefit for deferred federal income taxes	**(1.4)**	0.5	**(2.9)**	0.9
Total pension and postretirement benefits	**2.6**	(0.8)	**5.5**	(1.7)
Other comprehensive income (loss)	**193.4**	(76.7)	**245.1**	(80.0)
Comprehensive income (loss)	**$ 257.8**	$ (86.9)	**$ 335.3**	$ (31.7)

The accompanying notes are an integral part of these consolidated financial statements.

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THE HANOVER INSURANCE GROUP, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

	(Unaudited) Six Months Ended June 30,	
(In millions)	**2009**	**2008**
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	**$ 90.2**	$ 48.3
Adjustments to reconcile net income to net cash (used in) provided by operating activities:		
Gain on disposal of variable life insurance and annuity business	**(4.1)**	(5.4)
(Gain) estimated loss from sale of FAFLIC	**(5.9)**	66.1
Gain on sale of AMGRO, Inc.		(11.1)
Gain on tender offer	**(34.3)**	
Net realized investment losses	**12.9**	15.3
Net amortization and depreciation	**5.1**	9.3
Stock-based compensation expense	**5.7**	6.1
Amortization of deferred benefit plan costs	**9.9**	(2.6)
Deferred federal income taxes	**21.6**	33.6
Change in deferred acquisition costs	**(7.4)**	(10.6)
Change in premiums and notes receivable, net of reinsurance premiums payable	**(22.5)**	42.5
Change in accrued investment income	**1.8**	1.6
Change in policy liabilities and accruals, net	**(47.5)**	(115.6)
Change in reinsurance receivable	**3.7**	71.2
Change in expenses and taxes payable	**(74.1)**	(91.2)
Other, net	**(0.2)**	5.9
Net cash (used in) provided by operating activities	**(45.1)**	63.4
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from disposals and maturities of available-for-sale fixed maturities	**1,335.9**	475.0
Proceeds from disposals of equity securities and other investments		10.1
Proceeds from mortgages sold, matured or collected	**4.9**	3.5
Proceeds from collections of installment finance and notes receivable		192.2
Proceeds from the sale of FAFLIC	**105.8**	
Cash transferred with sale of FAFLIC	**(108.1)**	
Net cash used to acquire Verlan Holdings, Inc		(26.3)
Purchase of available-for-sale fixed maturities	**(1,424.6)**	(420.2)
Purchase of equity securities and other investments	**(15.2)**	(12.3)
Capital expenditures	**(4.2)**	(6.0)
Disbursements to fund installment finance and notes receivable		(178.6)
Other investing items	**2.8**	0.7
Net cash (used in) provided by investing activities	**(102.7)**	38.1
CASH FLOWS FROM FINANCING ACTIVITIES		
Exercise of options	**0.4**	4.1
Change in collateral related to securities lending program	**30.7**	3.8
Repurchase of long-term debt	**(125.0)**	
Treasury stock purchased at cost	**(7.1)**	(58.5)
Other financing activities	**0.1**	0.1
Net cash used in financing activities	**(100.9)**	(50.5)

Net change in cash and cash equivalents	**(248.7)**	51.0
Net change in cash related to discontinued operations	**132.0**	47.1
Cash and cash equivalents, beginning of period	**397.7**	210.6
Cash and cash equivalents, end of period	**$ 281.0**	$ 308.7

The accompanying notes are an integral part of these consolidated financial statements.

THE HANOVER INSURANCE GROUP, INC.

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

1. Basis of Presentation and Principles of Consolidation

The accompanying unaudited consolidated financial statements of The Hanover Insurance Group, Inc. (THG or the Company) have been prepared in accordance with generally accepted accounting principles for interim financial information and with the requirements of Form 10-Q.

The interim consolidated financial statements of THG include the accounts of The Hanover Insurance Company (Hanover Insurance), and Citizens Insurance Company of America (Citizens), THG s principal property and casualty companies; and certain other insurance and non-insurance subsidiaries. These legal entities conduct their operations through several business segments discussed in Note 10. All significant intercompany accounts and transactions have been eliminated. The Company s results of operations also included the results of First Allmerica Financial Life Insurance Company (FAFLIC) through December 31, 2008. On January 2, 2009, the Company sold FAFLIC to Commonwealth Annuity and Life Insurance Company (Commonwealth Annuity) a subsidiary of the Goldman Sachs Group, Inc. (Goldman Sachs). Accordingly, the FAFLIC business was classified as a discontinued operation in accordance with Statement of Financial Accounting Standards No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets* (Statement No. 144) and prior periods in the consolidated Statements of Income have been reclassified to conform to this presentation. Additionally, as of December 31, 2008, a portion of FAFLIC s accounts were classified as assets and liabilities of discontinued operations in the consolidated Balance Sheets (See Note 3 Discontinued Operations of FAFLIC Business).

The accompanying interim consolidated financial statements reflect, in the opinion of the Company's management, all adjustments necessary for a fair presentation of the financial position and results of operations. The results of operations for the six months ended June 30, 2009 are not necessarily indicative of the results to be expected for the full year. These financial statements should be read in conjunction with the Company s 2008 Annual Report on Form 10-K filed with the Securities and Exchange Commission.

The preparation of financial statements in conformity with generally accepted accounting principles requires the Company to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amount of revenues and expenses during the reporting period. Actual results could differ from those estimates. Certain prior year amounts have been reclassified to conform to current year presentation.

2. New Accounting Pronouncements

Recently Adopted Standards

In May 2009, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 165, *Subsequent Events* (Statement No. 165). Statement No. 165 is consistent with current auditing standards in defining a subsequent event. Additionally, it provides for disclosure regarding the existence and timing of a company s evaluation of its subsequent events. Statement No. 165 defines two types of subsequent events, recognized and non-recognized . Recognized subsequent events provide additional evidence about conditions that existed at the date of the balance sheet and are required to be reflected in the financial statements. Non-recognized subsequent events provide evidence about conditions that did not exist at the date of the balance sheet but arose after that date and, therefore; are not required to be reflected in the financial statements. However, certain non-recognized subsequent events may require disclosure to prevent the financial statements from being misleading. This statement is effective prospectively for interim or annual financial periods ending after June 15, 2009. The Company has adopted this statement as of April 1, 2009. The effect of adopting Statement No. 165 was not material to the Company s financial position or results of operations.

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In May 2008, the FASB issued Statement of Financial Accounting Standards No. 163, *Accounting for Financial Guarantee Insurance Contracts an interpretation of FASB Statement No. 60* (Statement No. 163). Statement No. 163 provides for changes to both the recognition and measurement of premium revenues and claim liabilities for financial guarantee insurance contracts that are within the scope of Statement of Financial Accounting Standards No. 60, *Accounting and Reporting by Insurance Enterprises* and that do not qualify as a derivative instrument in accordance with Statement of Financial Accounting Standards No. 133, *Accounting for Derivative Instruments and Hedging Activities*. This statement also expands the disclosure requirements related to financial guarantee insurance contracts to include such items as a company s method of tracking insured financial obligations with credit deterioration, financial information about the insured financial obligations, and management s policies for placing and monitoring the insured financial obligations. Statement No. 163 is effective for fiscal years beginning after December 15, 2008, except for certain disclosures related to the insured financial obligations, which were effective for the third quarter of 2008. The Company adopted Statement No. 163 on January 1, 2009. The Company does not have financial guarantee insurance products, and, accordingly the adoption of Statement No. 163 did not have an effect on the Company s results of operations or financial position.

In December 2007, the FASB issued Statement of Financial Accounting Standards No. 141 (revised 2007), *Business Combinations* (Statement No. 141(R)). This Statement requires the acquiring entity in a business combination to recognize all assets acquired and liabilities assumed in a transaction at the acquisition-date fair value, with certain exceptions. Additionally, the statement requires changes to the accounting treatment of acquisition related items, including, among other items, transaction costs, contingent consideration, restructuring costs, indemnification assets and tax benefits. Statement No. 141(R) also provides for a substantial number of new disclosure requirements. In April 2009, the FASB issued FSP FAS 141(R)-1, *Accounting for Assets Acquired and Liabilities Assumed in a Business Combination That Arise from Contingencies* (FSP FAS 141(R)-1). This FSP amends and clarifies Statement No. 141(R) to address application issues regarding initial recognition and measurement, subsequent measurement and accounting, and disclosure of assets and liabilities arising from contingencies in a business combination. Statement No. 141(R) and FSP FAS 141(R)-1 are effective for business combinations initiated on or after the first annual reporting period beginning after December 15, 2008. The Company adopted Statement No. 141(R) and FSP FAS 141(R)-1 effective January 1, 2009. The adoption of Statement No. 141(R) and FSP FAS 141(R)-1 did not have an effect on the Company s financial position or results of operations; however they will likely have an impact on the Company s accounting for future business combinations, but the effect is dependent upon acquisitions, if any, that are made in the future.

In December 2007, the FASB issued Statement of Financial Accounting Standards No. 160, *Noncontrolling Interests in Consolidated Financial Statements, an amendment of ARB No. 51* (Statement No. 160), which establishes new standards governing the accounting for and reporting of noncontrolling interests (previously referred to as minority interests). This statement establishes reporting requirements which include, among other things, that noncontrolling interests be reflected as a separate component of equity, not as a liability. It also requires that the interests of the parent and the noncontrolling interest be clearly identifiable. Additionally, increases and decreases in a parent s ownership interest that leave control intact shall be reflected as equity transactions, rather than step acquisitions or dilution gains or losses. This statement also requires changes to the presentation of information in the financial statements and provides for additional disclosure requirements. Statement No. 160 is effective for fiscal years beginning on or after December 15, 2008. The Company adopted Statement No. 160 as of January 1, 2009. The effect of adopting Statement No. 160 was not material to the Company s financial position or results of operations.

In February 2007, the FASB issued Statement of Financial Accounting Standards No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities Including an amendment of FASB Statement No. 115* (Statement No. 159). Statement No. 159 permits a company to choose, at specified election dates, to measure at fair value certain eligible financial assets and liabilities that are not currently required to be measured at fair value. The specified election dates include, but are not limited to, the date when an entity first recognizes the item, when an entity enters into a firm commitment or when changes in the financial instrument causes it to no longer qualify for fair value accounting under a different accounting standard. An entity may elect the fair value option for eligible items that exist at the effective date. At that date, the difference between the carrying amounts and the fair values of eligible items for which the fair value option is elected should be recognized as a cumulative effect adjustment to the opening balance of retained earnings. The fair value option may be elected for each entire financial instrument, but need not be applied to all similar instruments. Once the fair value option has been elected, it is irrevocable. Unrealized gains and losses on items for which the fair value option has been elected will be reported in earnings. Statement No. 159 was effective as of the beginning of fiscal years that begin after November 15, 2007. The Company did not elect to implement the fair value option for eligible financial assets and liabilities as of January 1, 2008.

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In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157, *Fair Value Measurements* (Statement No. 157). This statement creates a common definition of fair value to be used throughout generally accepted accounting principles. Statement No. 157 will apply whenever another standard requires or permits assets or liabilities to be measured at fair value, with certain exceptions. The standard establishes a hierarchy for determining fair value which emphasizes the use of observable market data whenever available. The statement also requires expanded disclosures which include the extent to which assets and liabilities are measured at fair value, the methods and assumptions used to measure fair value and the effect of fair value measures on earnings. In April 2009, the FASB issued FSP FAS No. 157-4, *Determining Fair Value when the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly* (FSP FAS No. 157-4). This FSP provides additional guidance for estimating fair value in accordance with Statement No. 157, when the volume and level of activity for the asset or liability have significantly decreased. The emphasis of the FSP is that fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between willing market participants, under current market conditions. This FSP also further clarifies the guidance to be considered when determining whether or not a transaction is orderly. The FSP was effective for interim and annual reporting periods ending after June 15, 2009. In October 2008, the FASB issued FSP FAS No. 157-3, *Determining the Fair Value of a Financial Asset When the Market for That Asset Is Not Active* (FSP FAS No. 157-3). This FSP clarifies how Statement No. 157 should be applied when valuing securities in markets that are not active. This Statement provides guidance on how companies may use judgment, in addition to market information, in certain circumstances to value assets which have inactive markets. This FSP is effective upon issuance, including prior periods that financial statements have not yet been issued. Statement No. 157 was effective for fiscal years beginning after November 15, 2007 and interim periods within those fiscal years. The difference between the carrying amounts and fair values of those financial instruments held at the date this statement is initially applied should be recognized as a cumulative effect adjustment to the opening balance of retained earnings for the fiscal year in which this statement is initially applied. Additionally, in February 2008, the FASB issued Staff Position FAS 157-2, *Effective Date of FASB Statement No. 157*, which delayed the effective date of Statement No. 157 for all non-recurring fair value measurements of nonfinancial assets and nonfinancial liabilities until the fiscal year beginning after November 15, 2008. As a result, the Company partially applied the provisions of Statement No. 157 upon adoption at January 1, 2008 and adopted the remaining provisions relating to certain nonfinancial assets and liabilities on January 1, 2009. The Company adopted FSP FAS No. 157-4 as of April 1, 2009. The effect of adopting Statement No. 157 and the related FSPs for both financial and non-financial assets and liabilities, was not material to the Company s financial position or results of operations. See further disclosure in Note 6 Fair Value.

Recently Issued Standards

In June 2009, the FASB issued Statement of Financial Accounting Standards No. 168, *The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles a replacement of FASB Statement No. 162* (Statement No. 168). Statement No. 168 establishes a single source of authoritative generally accepted accounting principles (GAAP) recognized by the FASB to be applied by nongovernmental entities. All guidance contained in the Codification carries an equal level of authority. Rules and interpretive releases of the Securities and Exchange Commission (SEC) under authority of federal securities laws are also sources of authoritative GAAP for SEC registrants. Accordingly, all other accounting literature will be deemed non-authoritative . Statement No. 168 is effective on a prospective basis for financial statements issued for interim and annual periods ending after September 15, 2009. The Company does not expect that the adoption of Statement No. 168 will have a material effect on its financial position or results of operations.

In June 2009, FASB issued Statement of Financial Accounting Standards No. 167, *Amendments to FASB Interpretation No. 46(R)* (Statement No. 167). Statement No. 167 amends FASB Interpretation No. 46R, *Consolidation of Variable Interest Entities an interpretation of ARB No. 51* (FIN 46R) to require an analysis to determine whether a company has a controlling financial interest in a variable interest entity. This analysis identifies the primary beneficiary of a variable interest entity as the enterprise that has a) the power to direct the activities of a variable interest entity that most significantly impact the entity s economic performance and b) the obligation to absorb losses of the entity that could potentially be significant to the variable interest entity or the right to receive benefits from the entity that could potentially be significant to the variable interest entity. The statement requires an ongoing assessment of whether a company is the primary beneficiary of a variable interest entity when the holders of the entity, as a group, lose power, through voting or similar rights, to direct the actions that most significantly affect the entity s economic performance. This statement also enhances disclosures about a company s involvement in variable interest entities. Statement No. 167 is effective as of the beginning of the first annual reporting period that begins after November 15, 2009. The Company does not expect the adoption of Statement No. 167 to have a material impact on its financial position or results of operations.

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In June 2009, the FASB issued Statement of Financial Accounting Standards No. 166, *Accounting for Transfers of Financial Assets an amendment of FASB Statement No. 140* (Statement No. 166). Statement No. 166 revises FASB Statement of Financial Accounting Standards No. 140, *Accounting for Transfers and Extinguishment of Liabilities a replacement of FASB Statement 125* (Statement No. 140) and requires additional disclosures about transfers of financial assets, including securitization transactions, and any continuing exposure to the risks related to transferred financial assets. It also eliminates the concept of a qualifying special-purpose entity , changes the requirements for derecognizing financial assets, and enhances disclosure requirements. Statement No. 166 is effective prospectively, for annual periods beginning after November 15, 2009, and interim and annual periods thereafter. The Company does not expect the adoption of Statement No. 166 will have a material impact on its financial position or results of operations.

3. Discontinued Operations of FAFLIC Business

On January 2, 2009, THG sold its remaining life insurance subsidiary, FAFLIC, to Commonwealth Annuity, a subsidiary of Goldman Sachs. Approval was obtained from the Massachusetts Division of Insurance for a pre-close dividend from FAFLIC consisting of designated assets with a statutory book value of approximately $130 million. Total proceeds from the sale, including the dividend, were approximately $230 million, net of transaction costs. Additionally, coincident with the sale transaction, Hanover Insurance and FAFLIC entered into a reinsurance contract whereby Hanover Insurance assumed FAFLIC s discontinued accident and health insurance business. THG has also indemnified Commonwealth Annuity for certain litigation, regulatory matters and other liabilities related to the pre-closing activities of the business transferred.

The Company accounted for the disposal of its FAFLIC business as a discontinued operation in accordance with Statement of Financial Accounting Standards No. 144, *Accounting for the Impairment or Disposal of Long-lived Assets* (Statement No. 144). For the year ended December 31, 2008, the Company recognized a $77.3 million loss associated with the sale transaction.

The following table summarizes the results for this discontinued business for the periods indicated:

	(Unaudited) Quarter Ended June 30,		**(Unaudited) Six Months Ended June 30,**	
(In millions)	**2009**	**2008**	**2009**	**2008**
Gain (loss) from discontinued FAFLIC business	**$ 0.9**	$ (67.7)	**$ 5.9**	$ (71.2)

For the quarter ended June 30, 2009, the Company recognized income from discontinued operations of $0.9 million, primarily resulting from the Company s release of sale-related accruals. Net losses of $67.7 million in the second quarter of 2008 primarily reflect the Company s preliminary estimate of the loss associated with the sale transaction of $66.1 million. In addition, these losses include net realized investment losses of $2.7 million, primarily resulting from the sale of fixed maturity securities and from impairments and a $1.7 million tax expense; partially offset by favorable results, primarily attributable to the traditional line of business. Total revenues associated with the FAFLIC business in the second quarter of 2008 were $17.8 million. This business also generated income before taxes of $0.1 million during that period.

For the six months ended June 30, 2009, the Company recognized income from discontinued operations of $5.9 million, primarily resulting from a change in the Company s estimate of indemnification liabilities related to the sale and the aforementioned release of sale-related accruals. Net losses of $71.2 million in the first six months of 2008 primarily reflect the Company s preliminary estimate of the loss associated with the sale transaction, net realized investment losses of $7.4 million, primarily resulting from impairments and the sale and intercompany transfer of investment assets. These losses were partially offset by favorable results, primarily attributable to both the traditional and retirement lines of business. Total revenues associated with the FAFLIC business in the first six months of 2008 were $39.9 million. This business also generated a loss before taxes of $5.5 million during that period.

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In connection with the sales transaction, the Company agreed to indemnify Commonwealth Annuity for certain legal, regulatory and other matters that existed as of the sale. Accordingly, the Company established a gross liability in accordance with FASB Interpretation No. 45, *Guarantor s Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others* (FIN 45) of $9.9 million. As of June 30, 2009, the Company s total gross FIN 45 liability was $2.9 million. The Company regularly reviews and updates its FIN 45 liability for legal and regulatory matter indemnities. Although the Company believes its current estimate for its FIN 45 liability is appropriate, there can be no assurance that these estimates will not materially increase in the future. Adjustments to this reserve are recorded in the results of the Company in the period in which they are determined.

Included in Assets of discontinued operations as of December 31, 2008 were $1,710.4 million of assets that were included in the sale of FAFLIC. Included in Liabilities of discontinued operations as of December 31, 2008 were $1,627.6 million of liabilities that were included in the sale of FAFLIC. In accordance with Statement No. 144, the following table details the major assets and liabilities reflected in these captions.

(In millions)	December 31, 2008
Assets:	
Cash and investments	$ 1,182.2
Reinsurance recoverable	241.5
Separate account assets	263.4
Other assets	49.3
Valuation allowance	(26.0)
Total assets	$ 1,710.4
Liabilities:	
Policy liabilities	$ 1,305.6
Separate account liabilities	263.4
Trust instruments supported by funding obligations	15.0
Other liabilities	43.6
Total liabilities	$ 1,627.6

4. Other Significant Transactions

On June 29, 2009, the Company completed a cash tender offer to repurchase a portion of its 8.207% Series B Capital Securities (Capital Securities) that were issued by AFC Capital Trust I (the Trust) and a portion of its 7.625% Senior Debentures (Senior Debentures) due in 2025 that were issued by THG. As of that date, $69.3 million of Capital Securities were tendered at a price equal to $800 per $1,000 of face value. In addition, the Company accepted for tender a principal amount of $77.3 million of Senior Debentures. Depending on the time of tender, holders of the Senior Debentures accepted for purchase received a price ranging from $870 to $900 per $1,000 of face value. Separately, the Company held $65.0 million of Capital Securities previously repurchased at a discount in the open market prior to the tender offer. In conjunction with the completion of the tender offer, the Company announced plans to liquidate and terminate the Trust as permitted by the terms of the Trust documents. The Company assessed the remaining risks within the Trust as a result of the planned termination and determined that the previously unconsolidated Trust should be consolidated as of June 30, 2009 in accordance with FASB Interpretation No. 46, *Consolidation of Variable Interest Entities an Interpretation of ARB No. 51*. Including the repurchase of the Senior Debentures and the consolidation of the Trust, the Company recognized a pre-tax gain of $34.3 million in the quarter ended June 30, 2009. Subsequent to the completion of the tender offer, $165.7 million of the Capital Securities not held by the Company and $122.7 million principal amount of the Senior Debentures not held by the Company remained outstanding. The Company liquidated the Trust on July 30, 2009. Each holder of Capital Securities as of that date received a principal amount of our Series B 8.207% Junior Subordinated Deferrable Interest Debentures due February 3, 2027 equal to the liquidation amount of the Capital Securities held by such holder.

On November 28, 2008, the Company acquired AIX Holdings, Inc. (AIX) for approximately $100 million, subject to various terms and conditions. AIX is a specialty property and casualty insurer that underwrites and manages program business.

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On June 2, 2008, the Company completed the sale of its premium financing subsidiary, AMGRO Inc., to Premium Financing Specialists, Inc. The Company recorded a gain of $11.1 million related to this sale, which was reflected in the Consolidated Statement of Income as part of Discontinued Operations in the second quarter of 2008.

On March 14, 2008, the Company acquired all of the outstanding shares of Verlan for $29.0 million. Verlan, now referred to as Hanover Specialty Property, is a specialty company providing property insurance to small and medium-sized manufacturing and distribution companies that are highly protected fire risks.

On October 16, 2007, the Company s Board of Directors authorized a share repurchase program of up to $100 million. Under this repurchase authorization, the Company may repurchase its common stock from time to time, in varying amounts and prices and at such times deemed appropriate, subject to market conditions and other considerations. The Company is not required to purchase any specific number of shares or to make purchases by any certain date under this program. In the first six months of 2009, the Company repurchased 0.2 million shares at an aggregate cost of $7.1 million. Total repurchases under this program as of June 30, 2009 were 1.6 million shares at a cost of $67.3 million.

On December 30, 2005, the Company sold its variable life insurance and annuity business to Goldman Sachs, including the reinsurance of 100% of the variable business of FAFLIC. THG agreed to indemnify Goldman Sachs for certain litigation, regulatory matters and other liabilities related to the pre-closing activities of the business that was sold. The Company accounted for the disposal as a discontinued operation in accordance with Statement No. 144. In the first six months of 2008, the Company recognized a benefit of $5.4 million, including $5.8 million resulting from the release of liabilities associated with the estimated liabilities for certain contractual indemnities to Goldman Sachs recorded in accordance with FIN 45. The $4.1 million gain in the first six months of 2009 related to a further change in the Company s estimate of indemnification liabilities.

5. Investments

A. Fixed maturities and equity securities

The Company accounts for its investments in fixed maturities and equity securities, which are classified as available-for-sale. In April 2009, the FASB issued FSP FAS 115-2 and FAS 124-2, *Recognition and Presentation of Other-Than-Temporary Impairments* (FSP FAS No. 115-2). This FSP replaces current other-than-temporary impairment guidance for debt securities specific to a company s intent and ability to hold impaired securities. (See Other-than-temporary impairments Adoption of FSP FAS 115-2 below for a further discussion).

The amortized cost and fair value of available-for-sale fixed maturities and equity securities were as follows:

(In millions)	**(Unaudited) June 30, 2009**				
			Gross Unrealized Losses		
	Amortized Cost (1)	**Gross Unrealized Gains**	**Unrealized Losses**	**OTTI Unrealized Losses (2)**	**Fair Value**
U.S. Treasury securities and U.S. government and agency securities	**$ 255.7**	**$ 3.9**	**$ 3.4**	**$**	**$ 256.2**
States and political subdivisions	**784.3**	**13.8**	**18.5**	**3.7**	**775.9**
Foreign governments	**2.7**				**2.7**
Corporate fixed maturities	**2,278.2**	**81.7**	**92.1**	**32.4**	**2,235.4**
Residential mortgage-backed securities	**972.0**	**27.0**	**16.9**	**8.6**	**973.5**
Commercial mortgage-backed securities	**276.1**	**3.4**	**23.3**		**256.2**
Total fixed maturities, including assets of discontinued operations	**4,569.0**	**129.8**	**154.2**	**44.7**	**4,499.9**
Less: fixed maturities of discontinued operations	**(105.3)**	**(10.5)**	**(15.3)**	**(4.2)**	**(96.3)**
Total fixed maturities, excluding discontinued operations	**$ 4,463.7**	**$ 119.3**	**$ 138.9**	**$ 40.5**	**$ 4,403.6**
Equity securities, excluding discontinued operations	**$ 94.6**	**$ 7.0**	**$ 9.5**	**$**	**$ 92.1**

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(In millions)	December 31, 2008				
			Gross Unrealized Losses		
	Amortized Cost (1)	Gross Unrealized Gains	Unrealized Losses	OTTI Unrealized Losses	Fair Value (3)
U.S. Treasury securities and U.S. government and agency securities	$ 344.8	$ 11.6	$ 0.8	$	$ 355.6
States and political subdivisions	758.7	3.9	35.7		726.9
Foreign governments	4.6	0.2			4.8
Corporate fixed maturities	2,745.5	26.2	261.1		2,510.6
Residential mortgage-backed securities	1,097.5	23.2	21.9		1,098.8
Commercial mortgage-backed securities	480.1	0.9	50.0		431.0
Total fixed maturities, including assets of discontinued operations	5,431.2	66.0	369.5		5,127.7
Less: fixed maturities of discontinued operations (4)	(1,049.2)	(14.0)	(76.4)		(986.8)
Total fixed maturities, excluding discontinued operations	$ 4,382.0	$ 52.0	$ 293.1	$	$ 4,140.9
Equity securities, excluding discontinued operations	$ 97.6	$ 3.4	$ 24.8	$	$ 76.2

(1) Amortized cost for fixed maturities and cost for equity securities.

(2) Represents other-than-temporary impairments (OTTI) recognized in accumulated other comprehensive income, including cumulative effect of adoption of FSP FAS 115-2 of $33.3 million.

(3) Included $42.2 million of trust preferred capital securities of a THG affiliated entity that are designated as held-to-maturity and carried at amortized cost.

(4) Fixed maturities of discontinued operations as of December 31, 2008 included our discontinued FAFLIC business and discontinued accident and health business. Due to the January 2, 2009 sale of FAFLIC, fixed maturities with an amortized cost of $949.9 million, gross unrealized gains of $12.2 million, gross unrealized losses of $60.7 million and fair value of $901.4 million transferred to the buyer.

The amortized cost and fair value by maturity periods for fixed maturities 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, or the Company may have the right to put or sell the obligations back to the issuers. Mortgage-backed securities are included in the category representing their stated maturity.

(In millions)	(Unaudited) June 30, 2009	
	Amortized Cost	Fair Value
Due in one year or less	**$ 126.5**	**$ 127.0**
Due after one year through five years	**1,494.8**	**1,496.7**
Due after five years through ten years	**1,370.6**	**1,350.0**
Due after ten years	**1,577.1**	**1,526.2**
Total fixed maturities, including assets of discontinued operations	**4,569.0**	**4,499.9**
Less: fixed maturities of discontinued operations	**(105.3)**	**(96.3)**
Total fixed maturities, excluding assets of discontinued operations	**$ 4,463.7**	**$ 4,403.6**

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B. Securities in a continuous unrealized loss position

The following tables provide information about the Company s fixed maturities and equity securities that have been continuously in an unrealized loss position at June 30, 2009 and December 31, 2008:

	(Unaudited) June 30, 2009					
	12 months or less		Greater than 12 months		Total	
(In millions)	Gross Unrealized Losses and OTTI	Fair Value	Gross Unrealized Losses and OTTI	Fair Value	Gross Unrealized Losses and OTTI (1)	Fair Value
Fixed Maturities:						
Investment Grade:						
U.S. Treasury securities and U.S. government and agency securities	$ 3.4	$ 116.0	$	$	$ 3.4	$ 116.0
States and political subdivisions	**7.1**	**198.9**	**11.4**	**149.1**	**18.5**	**348.0**
Corporate fixed maturities	**20.3**	**209.6**	**49.6**	**453.2**	**69.9**	**662.8**
Residential mortgage-backed securities	**5.0**	**184.4**	**10.5**	**97.5**	**15.5**	**281.9**
Commercial mortgage-backed securities	**4.9**	**51.9**	**18.4**	**143.5**	**23.3**	**195.4**
Total investment grade	**40.7**	**760.8**	**89.9**	**843.3**	**130.6**	**1,604.1**
Below Investment Grade (2):						
States and political subdivisions			**3.7**	**4.8**	**3.7**	**4.8**
Corporate fixed maturities	**41.6**	**176.5**	**13.0**	**55.8**	**54.6**	**232.3**
Residential mortgage-backed securities	**5.9**	**9.8**	**4.1**	**11.2**	**10.0**	**21.0**
Total below investment grade	**47.5**	**186.3**	**20.8**	**71.8**	**68.3**	**258.1**
Total fixed maturities	**88.2**	**947.1**	**110.7**	**915.1**	**198.9**	**1,862.2**
Equity securities:						
Perpetual preferred securities			**3.8**	**16.9**	**3.8**	**16.9**
Common equity securities	**0.1**	**1.7**	**5.6**	**51.6**	**5.7**	**53.3**
Total equity securities	**0.1**	**1.7**	**9.4**	**68.5**	**9.5**	**70.2**
Total fixed maturities and equity securities, including discontinued operations	**88.3**	**948.8**	**120.1**	**983.6**	**208.4**	**1,932.4**
Less: fixed maturities and equity securities of discontinued operations	**(12.0)**	**(43.9)**	**(7.5)**	**(12.0)**	**(19.5)**	**(55.9)**
Total fixed maturities and equity securities, excluding discontinued operations	**$ 76.3**	**$ 904.9**	**$ 112.6**	**$ 971.6**	**$ 188.9**	**$ 1,876.5**

(1) Includes $44.7 million unrealized loss related to FSP FAS 115-2, of which $33.3 million represents the cumulative effect of adoption.

(2) Substantially all below investment grade securities with an unrealized loss had been rated by the NAIC, Standard & Poor s, or Moody s at June 30, 2009.

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(In millions)	12 months or less Gross Unrealized Losses	12 months or less Fair Value	Greater than 12 months Gross Unrealized Losses	Greater than 12 months Fair Value	Total Gross Unrealized Losses	Total Fair Value
	(Unaudited) December 31, 2008					
Fixed Maturities:						
Investment Grade:						
U.S. Treasury securities and U.S. government and agency securities	$ 0.8	$ 75.8	$	$	$ 0.8	$ 75.8
States and political subdivisions	27.1	362.4	3.9	56.5	31.0	418.9
Corporate fixed maturities	110.3	1,273.7	91.0	422.0	201.3	1,695.7
Residential mortgage-backed securities	18.7	120.6	3.2	30.2	21.9	150.8
Commercial mortgage-backed securities	26.4	273.8	23.6	146.0	50.0	419.8
Total investment grade	183.3	2,106.3	121.7	654.7	305.0	2,761.0
Below Investment Grade (1):						
States and political subdivisions	4.7	6.9			4.7	6.9
Corporate fixed maturities	59.8	145.7			59.8	145.7
Residential mortgage-backed securities		1.5				1.5
Total below investment grade	64.5	154.1			64.5	154.1
Total fixed maturities	247.8	2,260.4	121.7	654.7	369.5	2,915.1
Equity securities:						
Perpetual preferred securities			13.4	28.5	13.4	28.5
Common equity securities	11.4	32.3			11.4	32.3
Total equity securities	11.4	32.3	13.4	28.5	24.8	60.8
Total fixed maturities and equity securities, including discontinued operations	259.2	2,292.7	135.1	683.2	394.3	2,975.9
Less: fixed maturities and equity securities of discontinued operations (2)	(42.0)	(420.7)	(34.4)	(200.3)	(76.4)	(621.0)
Total fixed maturities and equity securities, excluding discontinued operations	$ 217.2	$ 1,872.0	$ 100.7	$ 482.9	$ 317.9	$ 2,354.9

(1) Substantially all below investment grade securities with an unrealized loss had been rated by the NAIC, Standard & Poor s, or Moody s at December 31, 2008.

(2) Fixed maturities of discontinued operations as of December 31, 2008 included our discontinued FAFLIC business and discontinued accident and health business. Due to the January 2, 2009 sale of FAFLIC, fixed maturities with total gross unrealized losses of $60.7 million and fair value of $568.7 million transferred to the buyer.

The Company employs a systematic methodology to evaluate declines in fair value below amortized cost for all investments. The methodology utilizes a quantitative and qualitative process ensuring that available evidence concerning the declines in fair value below amortized cost is evaluated in a disciplined manner. In determining whether a decline in fair value below amortized cost is other-than-temporary, the Company evaluates the issuer s overall financial condition; the issuer s credit and financial strength ratings; the issuer s financial performance, including earnings trends, dividend payments and asset quality; any specific events which may influence the operations of the issuer including governmental actions such as the enactment of The Emergency Economic Stabilization Act of 2008 and receipt of related funds; a weakening of the general market conditions in the industry or geographic region in which the issuer operates; and with respect to fixed maturity investments,

any factors that might raise doubt about the issuer s ability to pay all amounts due according to the contractual terms and whether the Company expects to recover the entire amortized cost basis of the security; and with respect to equity securities, the Company s ability and intent to hold the investment for a period of time to allow for a recovery in value. The Company applies these factors to all securities.

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The following tables provide information on the Company s gross unrealized losses of fixed maturity securities by credit ratings, including ratings of securities with third party guarantees, as of June 30, 2009 and December 31, 2008.

	(Unaudited) June 30, 2009									
(In millions)	AAA	AA	A	BBB	Total investment grade	BB	B	CCC and below	Total below investment grade	Total
U.S. Treasury securities and U.S. government and agency securities	$ 3.4	$	$	$	$ 3.4	$	$	$	$	$ 3.4
States and political subdivisions	2.2	3.1	4.1	9.1	18.5		3.7		3.7	22.2
Corporate fixed maturities	0.3	7.0	26.5	36.1	69.9	28.9	10.9	14.8	54.6	124.5
Residential mortgage-backed securities	7.3	2.6	0.2	5.4	15.5	3.8	3.0	3.2	10.0	25.5
Commercial mortgage-backed securities	11.1	3.0	9.2		23.3					23.3
Total fixed maturities, including discontinued operations	24.3	15.7	40.0	50.6	130.6	32.7	17.6	18.0	68.3	198.9
Less: losses included in discontinued operations	(0.2)	(1.7)	(0.1)	(7.9)	(9.9)	(2.2)	(3.7)	(3.7)	(9.6)	(19.5)
Total fixed maturities, excluding discontinued operations	$ 24.1	$ 14.0	$ 39.9	$ 42.7	$ 120.7	$ 30.5	$ 13.9	$ 14.3	$ 58.7	$ 179.4

	(Unaudited) December 31, 2008									
(In millions)	**AAA**	**AA**	**A**	**BBB**	**Total investment grade**	**BB**	**B**	**CCC and below**	**Total below investment grade**	**Total**
U.S. Treasury securities and U.S. government and agency securities	$ 0.8	$	$	$	$ 0.8	$	$	$	$	$ 0.8
States and political subdivisions	3.2	11.4	11.3	5.1	31.0	3.2	1.5		4.7	35.7
Corporate fixed maturities	0.5	2.5	79.7	118.6	201.3	15.0	26.3	18.5	59.8	261.1
Residential mortgage-backed securities	19.4	2.5			21.9					21.9
Commercial mortgage-backed securities	32.9	6.3	10.8		50.0					50.0
Total fixed maturities, including discontinued operations	56.8	22.7	101.8	123.7	305.0	18.2	27.8	18.5	64.5	369.5
Less: losses included in discontinued operations (1)	(17.3)	(2.2)	(19.8)	(28.9)	(68.2)	(2.3)	(3.8)	(2.1)	(8.2)	(76.4)
Total fixed maturities, excluding discontinued operations	$ 39.5	$ 20.5	$ 82.0	$ 94.8	$ 236.8	$ 15.9	$ 24.0	$ 16.4	$ 56.3	$ 293.1

(1) Fixed maturities of discontinued operations as of December 31, 2008 included our discontinued FAFLIC business and discontinued accident and health business. Due to the January 2, 2009 sale of FAFLIC, fixed maturities with total gross unrealized losses of $60.7 million transferred to the buyer.

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C. Other-than-temporary impairments

Adoption of FSP FAS 115-2

On April 1, 2009, the Company adopted FSP FAS 115-2. FSP FAS 115-2 modifies the assessment of other-than-temporary impairments on debt securities, as well as the method of recording and reporting other-than-temporary impairments.

Under the new guidance, if a company intends to sell or more likely than not will be required to sell the debt security before recovery of its amortized cost basis, the amortized cost of the security is reduced to its fair value, with a corresponding charge to earnings. If a company does not intend to sell the debt security, or more likely than not, will not be required to sell it, the FSP requires that the company separate the other-than-temporary impairment into the portion which represents the credit loss and the amount related to all other factors. The amount of the estimated loss attributable to credit is recognized in earnings and the amount related to non-credit factors is recognized in other comprehensive income, net of applicable taxes.

The FSP also requires a cumulative effect adjustment upon adoption to reclassify the non-credit component of previously recognized impairments from retained earnings to other comprehensive income. The Company reviewed previously recognized OTTI recorded through realized losses on securities held at April 1, 2009, which was approximately $121 million, and determined that $33.3 million of these OTTI were related to non-credit factors, such as interest rates and market conditions. Accordingly, the Company increased the amortized cost basis of these debt securities and recorded a cumulative effect adjustment of $33.3 million within shareholders equity. The cumulative effect adjustment had no effect on total shareholders equity as it increased retained earnings and reduced accumulated other comprehensive income.

Current period other-than-temporary impairments

For the first six months of 2009, other-than-temporary impairments on fixed maturities and equity securities were $34.6 million, of which $23.2 million was recognized in earnings and the remaining $11.4 million was recorded as unrealized losses in accumulated other comprehensive income, net of taxes.

For the three months ended June 30, 2009, other-than-temporary impairments on fixed maturities and equity securities were $18.1 million, of which $6.7 million was recognized in earnings and the remaining $11.4 million was recorded as unrealized losses in accumulated other comprehensive income, net of taxes. Of the OTTI recognized in earnings, $2.6 million was estimated credit losses on debt securities for which a portion of the impairment was recognized in other comprehensive income and $4.1 million were losses for which the entire difference between amortized cost and fair value was charged to earnings.

The methodology and significant inputs used to measure the amount of credit losses in the quarter ended June 30, 2009 are as follows:

Corporate bonds ($1.7 million) the Company utilized a financial model that derives expected cash flows based on probability-of-default factors by credit rating and asset duration and loss-given-default factors based on security type. These factors are based on historical data provided by an independent third-party rating agency;

Municipals ($0.6 million) the Company utilized cash flow estimates based on bond specific facts and circumstances that may include the political subdivision s taxing authority, the issuer s ability to adjust user fees or other sources of revenue to satisfy its debt obligations and the ability to access insurance or guarantees;

Asset-backed securities, including commercial and residential mortgage backed securities ($0.3 million) the Company utilized cash flow estimates based on bond specific facts and circumstances that include collateral characteristics, expectations of delinquency and default rates, loss severity, prepayment speeds and structural support, including subordination and guarantees.

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The following table summarizes the cumulative amounts related to the Company s credit loss portion of the other-than-temporary impairment losses on debt securities held as of June 30, 2009 for which the non-credit portion of the loss is included in other comprehensive income:

(In millions)	
Cumulative credit loss as of April 1, 2009 (1)	**$ 17.3**
New credit losses	**2.6**
Cumulative credit losses as of June 30, 2009 (1)	**$ 19.9**

(1) Excludes other-than-temporary impairment losses on securities held that the Company intends to sell, or it is more likely than not that the Company will be required to sell the security, before the recovery of the amortized cost basis.

D. Proceeds from voluntary sales

The proceeds from voluntary sales of available-for-sale securities and the gross realized gains and gross realized losses on those sales were as follows:

	(Unaudited) Quarter Ended June 30, 2009			**(Unaudited) Six Months Ended June 30, 2009**		
(In millions)	**Proceeds from voluntary sales**	**Gross gains**	**Gross losses**	**Proceeds from voluntary sales**	**Gross gains**	**Gross losses**
Fixed maturities	**$ 614.7**	**$ 7.4**	**$ 5.1**	**$ 996.6**	**$ 23.1**	**$ 10.0**
Equity securities						

6. Fair Value

Effective January 1, 2008, the Company adopted Statement No. 157 as it relates to its financial assets and liabilities. Statement No. 157 provides for a standard definition of fair value to be used in new and existing pronouncements, including Statement of Financial Accounting Standards No. 107, *Disclosures about Fair Value of Financial Instruments*. This statement requires disclosure of fair value information about certain financial instruments (insurance contracts, real estate, goodwill and taxes are excluded) for which it is practicable to estimate such values, whether or not these instruments are included in the balance sheet. The fair values presented for certain financial instruments are estimates which, in many cases, may differ significantly from the amounts that could be realized upon immediate liquidation.

Statement No. 157 defines fair value as the price that would be received to sell an asset or paid to transfer a liability, i.e., exit price, in an orderly transaction between market participants and also establishes a hierarchy for determining fair value, which emphasizes the use of observable market data whenever available. The three broad levels defined by the hierarchy are as follows, with the highest priority given to Level 1 as these are the most reliable, and the lowest priority given to Level 3:

Level 1 Quoted prices in active markets for identical assets.

Level 2 Quoted prices for similar assets in active markets, quoted prices for identical or similar assets in markets that are not active, or other inputs that are observable or can be corroborated by observable market data, including model-derived valuations.

Level 3 Unobservable inputs that are supported by little or no market activity.

When more than one level of input is used to determine fair value, the financial instrument is classified as Level 1, 2 or 3 according to the lowest level input that has a significant impact on the fair value measurement.

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The following methods and assumptions were used to estimate the fair value of each class of financial instruments and have not changed during the period:

Cash and Cash Equivalents

For these short-term investments, the carrying amount approximates fair value.

Fixed Maturities

Level 1 securities generally include U.S. Treasury issues and other securities that are highly liquid and for which quoted market prices are available. Level 2 securities are valued using pricing for similar securities and pricing models that incorporate observable inputs including, but not limited to yield curves and issuer spreads. Level 3 securities include issues for which little observable data can be obtained, primarily due to the illiquid nature of the securities, and for which significant inputs used to determine fair value are based on the Company s own assumptions. Non-binding broker quotes are also included in Level 3.

The Company utilizes a third party pricing service for the valuation of the majority of its fixed maturity securities and receives one quote per security. When quoted market prices in an active market are available, they are provided by the pricing service as the fair value and such values are classified as Level 1. Since fixed maturities other than U.S. Treasury securities generally do not trade on a daily basis, the pricing service prepares estimates of fair value measurements for other securities using pricing applications which include available relevant market information, benchmark curves, benchmarking of like securities, sector groupings and prepayment assumptions, when necessary. Inputs into these applications include, but are not limited to benchmark yields, reported trades, broker/dealer quotes, issuer spreads, bid offers and reference data. Generally, all prices provided by the pricing service, except quoted market prices, are reported as Level 2.

The Company holds privately placed corporate bonds and certain other bonds that do not have an active market and for which the pricing service cannot provide fair values. The Company determines fair values for these securities using either matrix pricing or broker quotes. The Company will use observable market data to the extent it is available, but is also required to use a certain amount of unobservable judgment due to the illiquid nature of the securities involved. Additionally, the Company may obtain non-binding broker quotes which are reported as Level 3.

Equity Securities

Level 1 includes publicly traded securities valued at quoted market prices. Level 3 consists of common stock of private companies for which observable inputs are not available.

The Company utilizes a third party pricing service for the valuation of the majority of its equity securities and receives one quote for each equity security. When quoted market prices in an active market are available, they are provided by the pricing service as the fair value and such values are classified as Level 1. Generally, all prices provided by the pricing service, except quoted market prices, are reported as Level 2. Occasionally, the Company may obtain non-binding broker quotes which are reported as Level 3.

Mortgage Loans

Fair values are estimated by discounting the future contractual cash flows using the current rates at which similar loans would be made to borrowers with similar credit ratings.

Policy Loans

The carrying amount reported in the Consolidated Balance Sheets approximates fair value since policy loans have no defined maturity dates and are inseparable from the insurance contracts. Policy loans were included in discontinued operations at December 31, 2008 and were sold on January 2, 2009.

Derivative Instruments

These Level 3 valuations are derived from the counterparties internally developed models which do not necessarily represent observable market data. Derivatives were included in discontinued operations at December 31, 2008 and were sold on January 2, 2009.

Separate Account Assets

The Company s separate accounts are invested in variable insurance trust funds which have a daily net asset value obtainable from an active market. Separate accounts were included in discontinued operations at December 31, 2008 and were sold on January 2, 2009.

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Investment Contracts (Without Mortality Features)

Fair values for liabilities under guaranteed investment type contracts are estimated using discounted cash flow calculations using current interest rates for similar contracts with maturities consistent with those remaining for the contracts being valued. Liabilities under supplemental contracts without life contingencies are estimated based on current fund balances while other individual contract funds represent the present value of future policy benefits. Other liabilities are based on current surrender values. These contracts were included in discontinued operations at December 31, 2008 and were sold on January 2, 2009.

Legal Indemnities

Fair values are estimated using probability-weighted discounted cash flow analyses.

Trust Instruments Supported by Funding Obligations

Fair values are estimated using discounted cash flow calculations using current interest rates for similar contracts with maturities consistent with those remaining for the contracts being valued. Trust instruments supported by funding obligations were included in discontinued operations at December 31, 2008 and were sold on January 2, 2009.

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Long-term Debt

The fair value of long-term debt was estimated based on quoted market prices. If a quoted market price is not available, fair values are estimated using independent pricing sources.

The estimated fair values of the financial instruments were as follows:

(In millions)	(Unaudited) June 30, 2009		December 31, 2008	
	Carrying Value	*Fair Value*	*Carrying Value*	*Fair Value*
Financial Assets				
Cash and cash equivalents	**$ 280.7**	**$ 280.7**	$ 529.5	$ 529.5
Fixed maturities	**4,499.9**	**4,499.9**	5,156.2	5,156.2
Equity securities	**92.1**	**92.1**	47.8	47.8
Mortgage loans	**26.2**	**27.9**	31.1	33.1
Policy loans			111.1	111.1
Total financial assets, including financial assets of discontinued operations	**4,898.9**	**4,900.6**	5,875.7	5,877.7
Less: financial assets of discontinued operations	**(96.0)**	**(96.0)**	(1,229.8)	(1,229.8)
Total financial assets of continuing operations	**$ 4,802.9**	**$ 4,804.6**	$ 4,645.9	$ 4,647.9
Financial Liabilities				
Derivative instruments	**$**	**$**	$ 0.2	$ 0.2
Supplemental contracts without life contingencies	**3.3**	**3.3**	18.5	18.5
Dividend accumulations			81.1	81.1
Other individual contract deposit funds			5.5	5.5
Other group contract deposit funds			25.4	25.3
Legal indemnities	**9.0**	**9.0**	11.3	11.3
Trust instruments supported by funding obligations			15.0	15.9
Long-term debt	**309.9**	**250.4**	531.4	325.8
Total financial liabilities, including financial liabilities of discontinued operations	**322.2**	**262.7**	688.4	483.6
Less: financial liabilities of discontinued operations			(138.9)	(139.7)
Total financial liabilities of continuing operations	**$ 322.2**	**$ 262.7**	$ 549.5	$ 343.9

The Company performs a review of the fair value hierarchy classifications and of prices received from its third party pricing service on a quarterly basis. The Company reviews the pricing services policy describing its processes, practices and inputs, including various financial models used to value securities. Also, the Company reviews the portfolio pricing. Securities with changes in prices that exceed a defined threshold are verified to independent sources such as Bloomberg. If upon review, the Company is not satisfied with the validity of a given price, a pricing challenge would be submitted to the pricing service along with supporting documentation for its review. The Company does not adjust quotes or prices obtained from the pricing service unless the pricing service agrees with the Company s challenge. During the six months ended June 30, 2009, the Company did not adjust any prices received from brokers or its pricing service.

Changes in the observability of valuation inputs may result in a reclassification of certain financial assets or liabilities within the fair value hierarchy. Reclassifications related to Level 3 of the fair value hierarchy are reported as transfers in or out of Level 3 as of the beginning of the period in which the reclassification occurs. As previously discussed, the Company utilizes a third party pricing service for the valuation of the majority of its fixed maturities and equity securities. The pricing service has indicated that it will only produce an estimate of fair value if there is objectively verifiable information to produce a valuation. If the pricing service discontinues pricing an investment, the Company will use

observable market data to the extent it is available, but may also be required to make assumptions for market based inputs that are unavailable due to market conditions.

During the six months ended June 30, 2009, the Company transferred certain assets that were previously classified as Level 3 into Level 2, primarily as a result of assessing the significance of unobservable inputs on the fair value measurement.

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The Company currently holds fixed maturity securities and equity securities, and prior to January 2, 2009 also held separate account assets, for which fair value is determined on a recurring basis. The following tables present for each hierarchy level, the Company s assets that were measured at fair value at June 30, 2009 and December 31, 2008.

	(Unaudited) Fair Value at June 30, 2009			
(In millions)	**Total**	**Level 1**	**Level 2**	**Level 3**
Fixed maturities:				
U.S. Treasury securities and U.S. government and agency securities	**$ 256.2**	**$ 79.6**	**$ 176.6**	**$**
States and political subdivisions	**775.9**		**757.5**	**18.4**
Foreign governments	**2.7**		**2.7**	
Corporate fixed maturities	**2,235.4**		**2,193.8**	**41.6**
Residential mortgage-backed securities	**973.5**		**973.5**	
Commercial mortgage-backed securities	**256.2**		**245.6**	**10.6**
Total fixed maturities	**4,499.9**	**79.6**	**4,349.7**	**70.6**
Equity securities	**89.9**	**76.9**	**11.8**	**1.2**

Total investment assets at fair value, including assets of discontinued operations