

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

FORM 10-Q
(Mark One)

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

Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the transition period from _____ to _____

Commission file number 0-16533

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

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

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

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

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

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

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

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

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

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

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Glossary of Terms and Acronyms

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

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

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Forward-Looking Statements

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

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

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

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

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

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

the impact of acts of terrorism and acts of war;

the effects of terrorism-related insurance legislation and laws;

assessments from guaranty funds;

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

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

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

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

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

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

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

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

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

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

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

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

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

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

See accompanying notes.

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

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

	Common 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	—	—	—	—	(167,242)	(167,242)
Common shares issued for compensation	—	2,679	—	—	229	2,908
Share-based compensation	—	8,022	—	—	—	8,022
Net effect of restricted and performance shares issued and stock options exercised	2	(2,816)	—	—	—	(2,814)
Dividends to shareholders	—	—	—	(52,873)	—	(52,873)
Other comprehensive income (loss)	—	—	7,346	—	—	7,346
Net income	—	—	—	131,451	—	131,451
Balance at September 30, 2014	\$623	\$357,779	\$ 67,007	\$2,094,181	\$(198,378)	\$2,321,212
See accompanying notes.						

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

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

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

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

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

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ProAssurance Corporation and Subsidiaries

Notes to Condensed Consolidated Financial Statements (Unaudited)

September 30, 2015

1. Basis of Presentation

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

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

Other Liabilities

Other liabilities consisted of the following:

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

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

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

Accounting Changes Adopted

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

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

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

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

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Notes to Condensed Consolidated Financial Statements (Unaudited)

September 30, 2015

Accounting Changes Not Yet Adopted

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

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

Revenue from Contracts with Customers

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

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

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

Simplifying the Presentation of Debt Issuance Costs

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

Amendments to the Consolidation Analysis

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

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

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

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Notes to Condensed Consolidated Financial Statements (Unaudited)

September 30, 2015

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

Disclosures about Short-Duration Contracts

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

Simplifying the Accounting for Measurement-Period Adjustments

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

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2. Fair Value Measurement

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

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

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

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(In thousands)	September 30, 2015			Total Fair Value
	Fair Value Measurements Level 1	Level 2	Using Level 3	
Assets:				
Fixed maturities, available for sale				
U.S. Treasury obligations	\$—	\$111,919	\$—	\$111,919
U.S. Government-sponsored enterprise obligations	—	26,000	—	26,000
State and municipal bonds	—	967,786	—	967,786
Corporate debt, multiple observable inputs	2,329	1,302,377	—	1,304,706
Corporate debt, limited observable inputs	—	—	7,820	7,820
Residential mortgage-backed securities	—	254,878	—	254,878
Agency commercial mortgage-backed securities	—	11,204	—	11,204
Other commercial mortgage-backed securities	—	39,134	—	39,134
Other asset-backed securities	—	96,464	6,268	102,732
Equity securities				
Financial	66,614	—	—	66,614
Utilities/Energy	41,686	—	—	41,686
Consumer oriented	55,320	—	23	55,343
Industrial	50,447	—	—	50,447
Bond funds	75,688	—	—	75,688
All other	15,071	13,037	—	28,108
Short-term investments	154,858			