

OneBeacon Insurance Group, Ltd.  
Form 10-Q  
August 02, 2007

# UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

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## FORM 10-Q

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

For the period ended June 30, 2007

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 1-33128

## ONEBEACON INSURANCE GROUP, LTD.

(Exact name of Registrant as specified in its charter)

**Bermuda**

(State or other jurisdiction of  
incorporation or organization)

**98-0503315**

(I.R.S. Employer  
Identification No.)

**601 Carlson Parkway**

**Minnetonka, Minnesota**

(Address of principal executive offices)

**55305**

(Zip Code)

Registrant's telephone number, including area code: **(952) 852-2431**

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act 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 is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Accelerated Filer

Non-accelerated filer

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

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As of August 1, 2007, 26,267,437 Class A common shares, par value of \$0.01 per share, and 71,754,738 Class B common shares, par value \$0.01 per share, were outstanding.

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ONEBEACON INSURANCE GROUP, LTD.

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**PART 1. FINANCIAL INFORMATION****ITEM 1. Financial Statements****ONEBEACON INSURANCE GROUP, LTD.****CONSOLIDATED BALANCE SHEETS**

	<b>June 30, 2007 (Unaudited)</b>	<b>December 31, 2006</b>
	<b>(\$ in millions, except share and per share amounts)</b>	
<b>Assets</b>		
Available-for-sale investments:		
Fixed maturity investments, at fair value (amortized cost \$3,461.1 and \$3,501.5)	\$ 3,483.8	\$ 3,539.7
Common equity securities, at fair value (cost \$591.4 and \$568.9)	758.4	737.1
Short-term investments, at amortized cost (which approximates fair value)	235.4	319.0
Held-to-maturity investments (assets held in trust):		
Fixed maturity investments, at amortized cost (estimated market value \$310.9 and \$304.0)	311.9	305.0
Short-term investments, at amortized cost (which approximates fair value)	0.1	33.8
Other investments (cost \$261.3 and \$229.5)	332.7	278.1
Total investments	5,122.3	5,212.7
Cash	43.3	41.5
Reinsurance recoverable on unpaid losses	1,023.4	1,032.6
Reinsurance recoverable on unpaid losses Berkshire Hathaway, Inc.	1,742.1	1,810.0
Reinsurance recoverable on paid losses	21.2	32.4
Premiums receivable	545.6	517.1
Securities lending collateral	385.3	528.8
Deferred acquisition costs	193.4	183.8
Deferred tax asset	12.5	61.2
Investment income accrued	36.2	34.8
Ceded unearned premiums	65.7	38.2
Accounts receivable on unsettled investment sales	20.7	6.7
Other assets	360.0	369.6
Total assets	\$ 9,571.7	\$ 9,869.4
<b>Liabilities</b>		
Loss and LAE reserves	\$ 4,696.6	\$ 4,837.7
Unearned premiums	1,004.5	985.2
Debt	757.6	759.5
Securities lending payable	385.3	528.8
Preferred stock subject to mandatory redemption:		
Held by Berkshire Hathaway Inc. (redemption value \$300.0)	259.2	242.3
Held by others (redemption value \$ and \$20.0)		20.0
Ceded reinsurance payable	90.4	71.9
Accounts payable on unsettled investment purchases	11.8	11.5
Other liabilities	505.0	635.3
Total liabilities	7,710.4	8,092.2
<b>Common shareholders equity</b>		
Common shares and paid-in surplus (par value \$0.01; authorized, 200,000,000 shares; issued and outstanding, 100,022,175 shares)	1,116.8	1,115.9
Retained earnings	554.9	474.4
Accumulated other comprehensive income, after-tax:		
Net unrealized gains on investments	167.9	173.1
Net unrealized foreign currency translation gains	18.4	11.8
Other comprehensive income items	3.3	2.0
Total common shareholders equity	1,861.3	1,777.2
Total liabilities and common shareholders equity	\$ 9,571.7	\$ 9,869.4

See Notes to Consolidated Financial Statements including Note 12 Commitments and Contingencies

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## ONEBEACON INSURANCE GROUP, LTD.

## CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME

(Unaudited)

	Three months ended June 30,		Six months ended June 30,	
	2007	2006	2007	2006
	(\$ in millions, except per share amounts)			
<b>Revenues</b>				
Earned premiums	\$ 465.0	\$ 531.9	\$ 933.9	\$ 1,038.7
Net investment income	54.6	53.0	105.2	99.2
Net realized investment gains	57.1	41.6	112.0	69.6
Net other revenues	2.4	6.3	5.5	11.8
Total revenues	579.1	632.8	1,156.6	1,219.3
<b>Expenses</b>				
Loss and LAE	283.1	338.4	571.3	676.1
Policy acquisition expenses	78.3	85.4	156.6	172.9
Other underwriting expenses	89.6	86.0	180.5	169.9
General and administrative expenses	2.7	1.9	5.1	6.5
Accretion of fair value adjustment to loss and LAE reserves	4.0	5.8	8.0	11.5
Interest expense on debt	11.3	11.5	22.7	22.8
Interest expense dividends on preferred stock subject to mandatory redemption	7.6	7.5	15.1	15.1
Interest expense accretion on preferred stock subject to mandatory redemption	8.7	6.9	17.0	13.3
Total expenses	485.3	543.4	976.3	1,088.1
<b>Pre-tax income</b>	93.8	89.4	180.3	131.2
Income tax provision	(31.5 )	(8.7 )	(57.5 )	(20.4 )
<b>Income from continuing operations before equity in earnings of unconsolidated affiliate</b>	62.3	80.7	122.8	110.8
Equity in earnings of unconsolidated affiliate		8.0		10.2
<b>Income from continuing operations</b>	62.3	88.7	122.8	121.0
Income from discontinued operations		1.6		0.4
<b>Net income</b>	62.3	90.3	122.8	121.4
Change in net unrealized gains and losses for investments held	22.1	(7.1 )	65.7	5.2
Recognition of net unrealized gains and losses for investments sold	(34.6 )	(26.2 )	(70.9 )	(37.3 )
Change in foreign currency translation	5.1	3.4	6.6	2.6
Change in other comprehensive income items	1.1	0.8	1.3	1.9
<b>Comprehensive net income</b>	\$ 56.0	\$ 61.2	\$ 125.5	\$ 93.8
<b>Basic and diluted earnings per share</b>				
Basic:				
Income from continuing operations	\$ 0.62	\$ 0.89	\$ 1.23	\$ 1.21
Income from discontinued operations		0.02		
Net income available to common shareholders	\$ 0.62	\$ 0.90	\$ 1.23	\$ 1.21
Diluted:				
Income from continuing operations	\$ 0.62	\$ 0.89	\$ 1.23	\$ 1.21
Income from discontinued operations		0.02		
Net income available to common shareholders	\$ 0.62	\$ 0.90	\$ 1.23	\$ 1.21
<b>Dividends declared per common share</b>	\$ 0.21	\$	\$ 0.42	\$

See Notes to Consolidated Financial Statements



**ONEBEACON INSURANCE GROUP, LTD.****CONSOLIDATED STATEMENTS OF COMMON SHAREHOLDERS EQUITY****(Unaudited)**

	<b>Common shareholders equity (\$ in millions)</b>	<b>Common shares and paid-in surplus</b>	<b>Retained earnings</b>	<b>Accum. other comprehensive income, after-tax</b>
Balances at January 1, 2007	\$ 1,777.2	\$ 1,115.9	\$ 474.4	\$ 186.9
Adjustment to adopt FIN 48	(0.3 )		(0.3 )	
Net income	122.8		122.8	
Accrued option expense	0.6	0.6		
Issuance of common shares	0.3	0.3		
Dividends	(42.0 )		(42.0 )	
Other comprehensive income, after-tax	2.7			2.7
Balances at June 30, 2007	\$ 1,861.3	\$ 1,116.8	\$ 554.9	\$ 189.6

	<b>Common shareholders equity (\$ in millions)</b>	<b>Common shares and paid-in surplus</b>	<b>Retained earnings</b>	<b>Accum. other comprehensive income, after-tax</b>
Balances at January 1, 2006	\$ 1,560.0	\$ 1,169.8	\$ 232.6	\$ 157.6
Adjustment to adopt SFAS No. 155, after-tax			7.1	(7.1 )
Net income	121.4		121.4	
Other comprehensive income, after-tax	(27.6 )			(27.6 )
Balances at June 30, 2006	\$ 1,653.8	\$ 1,169.8	\$ 361.1	\$ 122.9

See Notes to Consolidated Financial Statements



## ONEBEACON INSURANCE GROUP, LTD.

## CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

	Six months ended June 30, 2007                      2006 (\$ in millions)	
Cash flows from operations:		
Net income	\$ 122.8	\$ 121.4
Charges (credits) to reconcile net income to cash flows used for operations:		
Income from discontinued operations		(0.4 )
Net realized investment gains	(112.0 )	(69.6 )
Dividends paid on mandatorily redeemable preferred stock of subsidiaries	15.1	15.1
Other operating items:		
Net change in loss and LAE reserves	(141.1 )	(312.5 )
Net change in unearned premiums	19.3	54.6
Net change in ceded reinsurance payable	18.5	4.5
Net change in premiums receivable	(28.5 )	(43.0 )
Net change in reinsurance recoverable on paid and unpaid losses	88.3	144.3
Net change in other assets and liabilities	(110.9 )	(116.6 )
Net cash used for operating activities of continuing operations	(128.5 )	(202.2 )
Net cash used for operating activities of discontinued operations		(23.5 )
Net cash used for operations	(128.5 )	(225.7 )
Cash flows from investing activities:		
Net maturities, purchases and sales of short-term investments available-for-sale	85.3	(43.3 )
Maturities of investments held-to-maturity	33.8	
Sales of fixed maturity investments	937.2	813.6
Maturities of fixed maturity investments	261.7	306.0
Sales of common equity securities	192.7	138.2
Sales of other investments	16.1	2.2
Purchases of fixed maturity investments available-for-sale	(1,145.6 )	(763.2 )
Purchases of common equity securities	(136.2 )	(207.0 )
Purchases of other investments	(28.0 )	(30.2 )
Net change in unsettled investment purchases and sales	(13.7 )	9.6
Net acquisitions of property and equipment	(9.0 )	(7.1 )
Net cash provided from investing activities of continuing operations	194.3	218.8
Net cash provided from investing activities of discontinued operations		19.8
Net cash provided from investing activities	194.3	238.6
Cash flows from financing activities:		
Redemption of mandatorily redeemable preferred stock of subsidiary	(20.0 )	
Repayment of debt	(2.0 )	
Cash dividends paid to common shareholders	(26.9 )	
Dividends paid on mandatorily redeemable preferred stock of subsidiaries	(15.1 )	(15.1 )
Net cash used for financing activities of continuing operations	(64.0 )	(15.1 )
Net (decrease) increase in cash during period	1.8	(2.2 )
Cash balance at beginning of period	41.5	44.1
Cash balance at end of period	\$ 43.3	\$ 41.9
Supplemental cash flows information:		
Interest paid	\$ 22.1	\$ 22.3
Net Federal income taxes paid (received)	55.9	(18.1 )
Supplemental non-cash activities:		
Dividend declared, net yet paid	\$ 15.1	



## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### NOTE 1. Nature of Operations and Summary of Significant Accounting Policies

#### *Basis of presentation*

These interim consolidated financial statements include the accounts of OneBeacon Insurance Group, Ltd. (the Company or the Registrant) and its subsidiaries (collectively, OneBeacon) and have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP). The OneBeacon operating companies are U.S.-based property and casualty insurance writers, substantially all of which operate in a multi-company pool. OneBeacon offers a wide range of specialty, commercial and personal products and services sold primarily through select independent agencies and brokers.

OneBeacon was acquired by White Mountains Group, Ltd. (White Mountains) from Aviva plc (Aviva, formerly CGNU) in 2001 (the OneBeacon Acquisition). White Mountains is a holding company whose businesses provide property and casualty insurance, reinsurance and certain other products. During the fourth quarter of 2006, White Mountains sold 27.6 million or 27.6% of the Company's common shares in an initial public offering. Prior to the initial public offering, OneBeacon was a wholly-owned subsidiary of White Mountains. Within this report, the term OneBeacon is used to refer to one or more entities within the consolidated organization, as the context requires. The Company is a Bermuda exempted limited company with its headquarters located at the Bank of Butterfield Building, 42 Reid Street, 6th Floor, Hamilton HM 12, Bermuda. The Company's U.S. headquarters are located at 1 Beacon Lane, Canton, Massachusetts 02021, its principal executive office is located at 601 Carlson Parkway, Minnetonka, Minnesota 55305 and its registered office is located at Clarendon House, 2 Church Street, Hamilton HM 11, Bermuda. OneBeacon's reportable segments are Primary Insurance Operations, Affiliate Quota Shares, and Other Operations, as defined below.

OneBeacon's Primary Insurance Operations segment includes the results of substantially all of its insurance operations, with the exception of certain quota share arrangements with affiliates of White Mountains as described below.

During 2004 and 2005, OneBeacon entered into two quota share reinsurance arrangements with other subsidiaries of White Mountains. Under the Sirius Quota Share, OneBeacon ceded between 6% and 12% of business written, effective April 1, 2004, to Sirius International Insurance Corporation. Under the Esurance Quota Share, which was effective on January 1, 2005, OneBeacon assumed approximately 85% of business written by Esurance Insurance Company, which includes business written by its wholly-owned subsidiary, Esurance Property and Casualty Insurance Company. These quota share agreements were commuted during the fourth quarter of 2006 in connection with the Company's initial public offering.

OneBeacon's Other Operations segment consists of the Company and its intermediate holding companies.

All significant intercompany transactions have been eliminated in consolidation. These interim financial statements include all adjustments considered necessary by management to fairly present the financial position, results of operations and cash flows of OneBeacon. These interim financial statements may not be indicative of financial results for the full year and should be read in conjunction with the Company's 2006 Annual Report on Form 10-K. The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Refer to the Company's 2006 Annual Report on Form 10-K for a complete discussion regarding OneBeacon's significant accounting policies.

As part of a reorganization immediately preceding the initial public offering, OneBeacon sold certain consolidated subsidiaries to White Mountains on August 3, 2006 at GAAP book value. These subsidiaries have been classified as discontinued operations. Accordingly, the results of operations for these subsidiaries are presented net of tax, as income from discontinued operations in the consolidated statements of income and comprehensive income. Cash flows associated with the operating and investing activities of discontinued operations are aggregated and presented under separate captions in the consolidated statements of cash flows. There were no cash flows associated with financing activities for the discontinued operations.

***Recently Adopted Changes in Accounting Principles***

*Federal, State and Foreign Income Taxes*

While OneBeacon is subject to taxation in several jurisdictions, the majority of OneBeacon's subsidiaries file a consolidated tax return in the United States. Income earned or losses generated by companies outside the United States are generally subject to an overall effective tax rate lower than that imposed by the United States.

On January 1, 2007 ( Date of Adoption ) OneBeacon adopted FASB Interpretation No. 48, Accounting for Uncertainties in Income Taxes ( FIN 48 ). FIN 48 prescribes when the benefit of a given tax position should be recognized and how it should be measured. Under the new guidance, recognition is based upon whether or not a company determines that it is more likely than not that a tax position will be sustained upon examination based upon the technical merits of the position. In evaluating the more-likely-than-not recognition threshold, OneBeacon must presume that the tax position will be subject to examination by a taxing authority with full knowledge of all relevant information. If the recognition threshold is met, then the tax position is measured at the largest amount of benefit that is more than 50% likely of being realized upon ultimate settlement.

FIN 48 also addresses how interest and penalties should be accrued for uncertain tax positions, requiring that interest expense should be recognized in the first period interest would be accrued under the tax law. OneBeacon classifies all interest and penalties on unrecognized tax benefits as part of income tax expense. At the Date of Adoption, OneBeacon had accrued interest and penalties of \$3.3 million, net of federal benefit. In connection with the adoption of FIN 48, OneBeacon has recognized a \$0.3 million increase in the liability for unrecognized tax benefits, primarily as a result of increases in its estimates of accrued interest. The effect of adoption has been recorded as an adjustment to opening retained earnings.

At the Date of Adoption, OneBeacon had \$56.0 million of unrecognized tax benefits. If recognized, \$51.8 million would be recorded as a reduction to income tax expense. Because of the impact of deferred tax accounting, exposure for certain temporary differences would not affect the effective tax rate but would accelerate the payment of cash to the taxing authority to an earlier period. There have been no material changes to the above balances since the Date of Adoption.

With few exceptions, OneBeacon is no longer subject to U.S. federal, state or non-U.S. income tax examinations by tax authorities for years before 2003. The Internal Revenue Service (IRS) commenced an examination of OneBeacon's U.S. income tax returns for 2003 through 2004 in the second quarter of 2006 that is anticipated to be completed by the end of 2008. As of June 30, 2007 the IRS has not proposed any significant adjustments to taxable income. OneBeacon does not expect to receive any adjustments that would result in a material change to its financial position.

OneBeacon does not anticipate any significant changes to its total unrecognized tax benefits within the next twelve months.

***Recent Accounting Pronouncements***

*Fair Value Measurements*

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements ( SFAS 157 ). The Statement provides a revised definition of fair value and guidance on the methods used to measure fair value. The Statement also expands financial statement disclosure requirements for fair value information. The Statement establishes a fair value hierarchy that distinguishes between assumptions based on market data from independent sources ( observable inputs ) and a reporting entity's internal assumptions based upon the best information available when external market data is limited or unavailable ( unobservable inputs ). The fair value hierarchy in SFAS 157 prioritizes inputs within three levels. Quoted prices in active markets have the highest priority (Level 1) followed by observable inputs other than quoted prices (Level 2) and unobservable inputs having the lowest priority (Level 3). The Statement is effective for financial statements issued for fiscal years beginning after November 15, 2007. OneBeacon has not yet determined the effect of adoption on its financial condition, results of operations or cash flows.

*Fair Value Option*

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities* ( SFAS 159 ). The Statement allows companies to make an election, on an individual instrument basis, to report financial assets and liabilities at fair value. The election must be made at the inception of a transaction and may not be reversed. The election may also be made for existing financial assets and liabilities at the time of adoption. Unrealized gains and losses on assets or liabilities for which the fair value option has been elected are to be reported in earnings. The Statement requires additional disclosures for instruments for which the election has been made, including a description of management's reasons for making the election. The Statement is effective as of fiscal years beginning after November 15, 2007 and is to be adopted prospectively and concurrent with the adoption of SFAS 157. OneBeacon has not yet determined the effect of adoption on its financial condition, results of operations or cash flows.

**NOTE 2. Discontinued Operations**

In 2006 OneBeacon sold certain consolidated subsidiaries at GAAP book value to White Mountains. These subsidiaries are included in discontinued operations and comprise the following entities:

- White Mountains Advisors LLC an investment management subsidiary;
- White Mountains Management Company, Inc. and White Mountains Capital, Inc. both service companies;
- White Mountains Services Holdings and White Mountains Services, LLC these companies contain the remainder of mortgage banking run-off assets from the sale of substantially all the mortgage banking assets of White Mountains Services Corporation (formerly Source One Mortgage Services Corporation) to Citibank Mortgage, Inc. in 1999;
- Tuckerman Capital, L.P. and Tuckerman Capital II, L.P. both private equity fund investments;
- International American Group primarily consists of American Centennial Insurance Company and British Insurance Company of Cayman, two run-off insurance companies.

OneBeacon's net income from continuing operations excludes the results of operations for the above entities for all periods presented. Income from discontinued operations has been presented separately and is shown net of related income taxes.

**NOTE 3. Acquisitions and Dispositions**

On September 29, 2006, OneBeacon sold certain assets and the right to renew existing policies of Agri, a division of OneBeacon that provided commercial farm and ranch and commercial agricultural insurance products, for \$32.0 million in cash to QBE and recorded a pre-tax gain of \$30.4 million through net other revenues. In connection with this sale, OneBeacon entered into agreements under which, at the option of QBE, it will write the policies of Agri on a direct basis and cede 100% of this business to QBE.

On October 31, 2006, OneBeacon restructured its investment in Main Street America Holdings, Inc. ( MSA ). OneBeacon received a \$70 million cash dividend from MSA following which OneBeacon sold its 50% common stock investment in MSA to Main Street America Group, Inc. ( the MSA Group ) for (i) \$70.0 million in 9.0% non-voting cumulative perpetual preferred stock of the MSA Group and (ii) 4.9% of the common stock of the MSA Group. Effective October 31, 2006, OneBeacon accounts for its remaining investment in the MSA Group in accordance with SFAS No. 115, *Accounting for Certain Investments in Debt and Equity Securities*. Refer to the Company's 2006 Annual Report on Form 10-K. Prior to the sale, OneBeacon owned 50% of the total common shares outstanding of MSA and accounted for this investment using the equity method of accounting. These transactions resulted in a net after-tax realized gain of \$8.5 million.

**NOTE 4. Reserves for Unpaid Loss and LAE**

The following table summarizes the loss and LAE reserve activities of OneBeacon's insurance subsidiaries for the three and six months ended June 30, 2007 and 2006:

	Three months ended June 30, 2007 (in millions)		Six Months Ended June 30, 2007 2006	
Gross beginning balance	\$ 4,773.9	\$ 5,186.2	\$ 4,837.7	\$ 5,354.3
Less beginning reinsurance recoverable on unpaid losses	(2,820.5 )	(3,033.8 )	(2,842.6 )	(3,120.9 )
Net loss and LAE reserves	1,953.4	2,152.4	1,995.1	2,233.4
Loss and LAE incurred relating to:				
Current year losses	295.8	319.1	596.0	664.0
Prior year losses	(12.7 )	19.3	(24.7 )	12.1
Total incurred loss and LAE	283.1	338.4	571.3	676.1
Accretion of fair value adjustment to net loss and LAE reserves	4.0	5.8	8.0	11.5
Loss and LAE paid relating to:				
Current year losses	(124.6 )	(195.0 )	(200.6 )	(288.9 )
Prior year losses	(184.8 )	(227.3 )	(442.7 )	(557.8 )
Total loss and LAE payments	(309.4 )	(422.3 )	(643.3 )	(846.7 )
Net ending balance	1,931.1	2,074.3	1,931.1	2,074.3
Plus ending reinsurance recoverable on unpaid losses	2,765.5	2,967.5	2,765.5	2,967.5
Gross ending balance	\$ 4,696.6	\$ 5,041.8	\$ 4,696.6	\$ 5,041.8

During the six months ended June 30, 2007, OneBeacon experienced \$24.7 million of favorable development on prior accident year loss reserves primarily related to professional liability in specialty lines, property liability in commercial lines and automobile liability in personal lines. During the six months ended June 30, 2006, OneBeacon experienced \$12.1 million of adverse development on prior accident year loss reserves primarily related to hurricane Katrina in commercial lines, partially offset by favorable development in other lines.

In connection with purchase accounting for the OneBeacon Acquisition, loss and LAE reserves and the related reinsurance recoverables were adjusted to fair value on the balance sheets. The net reduction to loss and LAE reserves is being recognized through an income statement charge ratably with and over the period the claims are settled. Accordingly, OneBeacon recognized \$4.0 million and \$8.0 million of such charges for the three and six months ended June 30, 2007, respectively, \$5.8 million and \$11.5 million of such charges for the three and six months ended June 30, 2006, respectively.

**NOTE 5. Reinsurance**

In the normal course of business, OneBeacon's insurance subsidiaries seek to limit losses that may arise from catastrophes or other events by reinsuring with third party reinsurers. OneBeacon remains liable for risks reinsured even if the reinsurer does not honor its obligations under reinsurance contracts.

Effective, July 1, 2007, OneBeacon renewed its property catastrophe reinsurance program through June 30, 2008. The program provides coverage for OneBeacon property business including automobile physical damage, as well as terrorism coverage for non-TRIA events (excluding nuclear, biological, chemical and radiological). Under the program, the first \$150 million of losses resulting from a single catastrophe are retained by OneBeacon and \$650 million of the next \$700 million of losses resulting from the catastrophe are reinsured. Any loss above \$850 million would be retained by OneBeacon. In the event of a catastrophe, OneBeacon's property catastrophe reinsurance program is reinstated for the remainder of the original contract term by paying a reinstatement premium that is based on the percentage of coverage reinstated and the original property catastrophe coverage premium.

At June 30, 2007, OneBeacon had \$21.2 million of reinsurance recoverables on paid losses and \$2,994.6 million (gross of \$229.1 million in purchase accounting adjustments, as described in Note 4) that will become recoverable if claims are paid in accordance with current reserve estimates. The collectibility of balances due from OneBeacon's reinsurers is critical to OneBeacon's financial strength because reinsurance contracts do not relieve OneBeacon of its primary obligation to its policyholders. OneBeacon is selective with its reinsurers, placing reinsurance with only those reinsurers having a strong financial condition. OneBeacon monitors the financial strength of its reinsurers on an ongoing basis. As a result, uncollectible



amounts have historically not been significant. The following table provides a listing of OneBeacon's top reinsurers based upon recoverable amounts, the percentage of total reinsurance recoverables and the reinsurers' A.M. Best ratings.

(\$ in millions)	Balance at June 30, 2007	% of total	A.M. Best Rating(1)	
National Indemnity Company and General Reinsurance Corporation (2)	\$ 2,145.0	77	% A	++
Tokio Marine and Nichido Fire	58.7	2	% A	++
Munich Reinsurance America (formerly America Reinsurance Company)	52.4	2	% A	
Liberty Mutual and subsidiaries(3)	35.8	1	% A	
Swiss Re	21.0	1	% A	+

(1) A.M. Best ratings as detailed above are: A++ (Superior, which is the highest of fifteen ratings), A+ (Superior, which is the second highest of fifteen ratings) and A (Excellent, which is the third highest of fifteen ratings).

(2) Includes \$404.0 million of Third Party Recoverables, which NICO would pay under the terms of the NICO Cover if they are unable to collect from third party reinsurers. OneBeacon also has an additional \$363.0 million of Third Party Recoverables from various reinsurers, the majority of which are rated A or better by A.M. Best.

(3) At June 30, 2007, OneBeacon had assumed balances receivable and expenses receivable of approximately \$36.8 million under its renewal rights agreement with Liberty Mutual, which expired on October 31, 2003.

In connection with the OneBeacon Acquisition, Aviva caused OneBeacon to purchase two reinsurance contracts: a reinsurance contract with National Indemnity Company or NICO, for up to \$2.5 billion in old asbestos and environmental ( A&E ) claims and certain other exposures (the NICO Cover ) and an adverse development cover from General Reinsurance Corporation ( GRC ) for up to \$570.0 million, comprised of \$400.0 million of adverse development on losses occurring in years 2000 and prior (the GRC Cover ) in addition to \$170.0 million of reserves ceded as of the date of the OneBeacon Acquisition. The NICO Cover and GRC Cover, which were contingent on and occurred contemporaneously with the OneBeacon Acquisition, were put in place in lieu of a seller guarantee of loss and LAE reserves and are therefore accounted for as a seller guarantee under GAAP in accordance with Emerging Issues Task Force Technical Matter Document No. D-54 ( EITF Topic D-54 ).

Under the terms of the NICO Cover, NICO receives the economic benefit of reinsurance recoverables from certain of OneBeacon's third party reinsurers ( Third Party Reinsurers ) in existence at the time the NICO Cover was executed ( Third Party Recoverables ). As a result, the Third Party Recoverables serve to protect the \$2.5 billion limit of NICO coverage for the benefit of OneBeacon. OneBeacon estimates that on an incurred basis, net of Third Party Recoverables, as of June 30, 2007 it has used approximately \$2.1 billion of the coverage provided by NICO. Approximately \$915 million of these incurred losses have been paid by NICO through June 30, 2007. Since entering into the NICO Cover, \$37.5 million of the \$2.1 billion of utilized coverage from NICO related to uncollectible Third Party Recoverables. To the extent that actual experience differs from OneBeacon's estimate of ultimate A&E losses and Third Party Recoverables, future losses could utilize some or all of the protection remaining under the NICO Cover.

Pursuant to the GRC Cover, OneBeacon is not entitled to recover losses to the full contract limit if such losses are reimbursed by GRC more quickly than anticipated at the time the contract was signed. OneBeacon intends to only seek reimbursement from GRC for claims which result in payment patterns similar to those supporting its recoverables recorded pursuant to the GRC Cover. The economic cost of not submitting certain other eligible claims to GRC is primarily the investment spread between the rate credited by GRC and the rate achieved by OneBeacon on its own investments. This cost, if any, is expected to be small.



**NOTE 6. Investment Securities**

OneBeacon's net investment income is comprised primarily of interest income associated with OneBeacon's fixed maturity investments, dividend income from its equity investments and interest income from its short-term investments. Net investment income for the three and six months ended June 30, 2007 and 2006 consisted of the following:

	Three months ended June 30, 2007		Six months ended June 30, 2007	
	2006	2006	2006	2006
	(\$ in millions)			
<b>Investment income:</b>				
Fixed maturity investments	\$ 52.3	\$ 45.9	\$ 97.6	\$ 85.4
Short-term investments	3.6	2.7	8.1	5.0
Common equity securities	3.5	7.7	6.8	12.5
Other investments	0.6	0.6	1.2	3.4
Total investment income	60.0	56.9	113.7	106.3
Less investment expenses	(5.4 )	(3.9 )	(8.5 )	(7.1 )
Net investment income, pre-tax	\$ 54.6	\$ 53.0	\$ 105.2	\$ 99.2

The composition of net realized investment gains consisted of the following:

	Three months ended June 30, 2007		Six months ended June 30, 2007	
	2006	2006	2006	2006
	(\$ in millions)			
Fixed maturity investments	\$ 7.4	\$ 5.5	\$ 13.2	\$ 16.8
Common equity securities	38.3	27.3	78.9	38.7
Other investments	11.4	8.8	19.9	14.1
Net realized investment gains, pre-tax	\$ 57.1	\$ 41.6	\$ 112.0	\$ 69.6

The components of OneBeacon's ending net unrealized investment gains and losses on its investment portfolio were as follows:

	Six months ended June 30, 2007	Year ended December 31, 2006
	(\$ in millions)	
<b>Investment securities:(1)</b>		
Gross unrealized investment gains	\$ 266.6	\$ 255.3
Gross unrealized investment losses	(34.2 )	(18.8 )
Net unrealized gains from investment securities	232.4	236.5
Income taxes attributable to such gains	(81.3 )	(82.1 )
Total net unrealized investment gains, after-tax	\$ 151.1	\$ 154.4

(1) Does not include deferred gains and losses on sales of investments between OneBeacon and entities under White Mountains' common control of \$16.8 million and \$18.7 million, after-tax, as of June 30, 2007 and December 31, 2006, respectively.

In connection with the initial public offering, two irrevocable grantor trusts were established to economically defease the Company's mandatorily redeemable preferred stock. The assets of each trust are solely dedicated to payments of dividends and redemption amounts on the mandatorily redeemable preferred stock. The assets held in the trusts include fixed maturity and short-term investments which are classified and accounted for as held-to-maturity. During the second quarter of 2007, trust assets were utilized to redeem the \$20.0 million Zenith Insurance Company ( Zenith ) Preferred Stock ( Zenith Preferred Stock ). Refer to the Company's 2006 Annual Report on Form 10-K for a complete discussion of the economic defeasance of the



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Company's mandatorily redeemable preferred stock. The carrying value, gross unrealized investment gains and losses, and estimated market values of OneBeacon's fixed maturity held-to-maturity investments, carried at amortized cost, as of June 30, 2007 and December 31, 2006 were as follows:

	<b>June 30, 2007</b>				
	<b>Carrying value (\$ in millions)</b>	<b>Gross unrealized gains</b>	<b>Gross unrealized losses</b>	<b>Net foreign currency gains</b>	<b>Estimated market value</b>
U.S. Government obligations	\$ 311.9	\$	\$ (1.0 )	\$	\$ 310.9
Total fixed maturity investments	\$ 311.9	\$	\$ (1.0 )	\$	\$ 310.9

	<b>December 31, 2006</b>				
	<b>Carrying value (\$ in millions)</b>	<b>Gross unrealized gains</b>	<b>Gross unrealized losses</b>	<b>Net foreign currency gains</b>	<b>Estimated market value</b>
U.S. Government obligations	\$ 305.0	\$	\$ (1.0 )	\$	\$ 304.0
Total fixed maturity investments	\$ 305.0	\$	\$ (1.0 )	\$	\$ 304.0

The cost or amortized cost, gross unrealized investment gains and losses, and carrying values of OneBeacon's fixed maturity available-for-sale investments as of June 30, 2007 and December 31, 2006, were as follows:

	<b>June 30, 2007</b>				
	<b>Cost or amortized cost (\$ in millions)</b>	<b>Gross unrealized gains</b>	<b>Gross unrealized losses</b>	<b>Net foreign currency gains</b>	<b>Carrying value</b>
U.S. Government obligations	\$ 805.2	\$ 0.6	\$ (9.6 )	\$	\$ 796.2
Debt securities issued by industrial corporations	1,519.3	10.1	(14.4 )	2.1	1,517.1
Municipal obligations	8.1	0.3			8.4
Asset-backed securities	985.4		(3.5 )	16.5	998.4
Foreign government obligations	41.6	0.1	(0.7 )		41.0
Preferred stocks	101.5	13.2	(0.5 )	8.5	122.7
Total fixed maturity investments	\$ 3,461.1	\$ 24.3	\$ (28.7 )	\$ 27.1	\$ 3,483.8

	<b>December 31, 2006</b>				
	<b>Cost or amortized cost (\$ in millions)</b>	<b>Gross unrealized gains</b>	<b>Gross unrealized losses</b>	<b>Net foreign currency gains</b>	<b>Carrying value</b>
U.S. Government obligations	\$ 806.7	\$ 1.8	\$ (4.2 )	\$	\$ 804.3
Debt securities issued by industrial corporations	1,429.6	8.2	(8.4 )	10.7	1,440.1
Municipal obligations	8.2	0.4			8.6
Asset-backed securities	1,091.4	9.4	(3.7 )		1,097.1
Foreign government obligations	54.7		(0.6 )		54.1
Preferred stocks	110.9	17.1	(0.4 )	7.9	135.5
Total fixed maturity investments	\$ 3,501.5	\$ 36.9	\$ (17.3 )	\$ 18.6	\$ 3,539.7

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The cost or amortized cost, gross unrealized investment gains and losses, and carrying values of OneBeacon's common equity securities and other investments as of June 30, 2007 and December 31, 2006, were as follows:

	<b>June 30, 2007</b>				
	<b>Cost or amortized cost (\$ in millions)</b>	<b>Gross unrealized gains</b>	<b>Gross unrealized losses</b>	<b>Net foreign currency gains</b>	<b>Carrying value</b>
Common equity securities	\$ 591.4	\$ 170.4	\$ (5.0 )	\$ 1.6	\$ 758.4
Other investments	\$ 261.3	\$ 71.9	\$ (0.5 )	\$	\$ 332.7

	<b>December 31, 2006</b>				
	<b>Cost or amortized cost (\$ in millions)</b>	<b>Gross unrealized gains</b>	<b>Gross unrealized losses</b>	<b>Net foreign currency losses</b>	<b>Carrying value</b>
Common equity securities	\$ 568.9	\$ 169.2	\$ (0.9 )	\$ (0.1 )	\$ 737.1
Other investments	\$ 229.5	\$ 49.2	\$ (0.6 )	\$	\$ 278.1

**Impairment**

Temporary losses on investment securities are recorded as unrealized losses. Temporary losses do not impact net income and earnings per share but serve to reduce comprehensive net income and common shareholders' equity. Unrealized losses subsequently identified as other-than-temporary impairments are recorded as realized losses. Other-than-temporary impairments previously recorded as unrealized losses do not impact comprehensive net income and common shareholders' equity but serve to reduce net income and earnings per share.

OneBeacon's methodology of assessing other-than-temporary impairments is based on security-specific facts and circumstances as of the balance sheet date. As a result, subsequent adverse changes in an issuer's credit quality or subsequent weakening of market conditions that differ from expectations could result in additional other-than-temporary impairments. In addition, the sale of a fixed maturity security with a previously recorded unrealized loss would result in a realized loss. Either of these situations would adversely impact net income and earnings per share but would not impact comprehensive net income and common shareholders' equity.

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The following table presents an analysis of the continuous periods during which OneBeacon has held investment positions which were carried at an unrealized loss as of June 30, 2007 (excluding short-term investments):

	June 30, 2007			
	0-6 Months (in millions)	6-12 Months	> 12 Months	Total
<b>Fixed maturity investments:</b>				
Number of positions	137	9	107	253
Market value	\$ 1,490.1	\$ 71.6	\$ 575.0	\$ 2,136.7
Amortized cost	\$ 1,507.0	\$ 72.1	\$ 586.3	\$ 2,165.4
Unrealized loss	\$ (16.9 )	\$ (0.5 )	\$ (11.3 )	\$ (28.7 )
<b>Common equity securities:</b>				
Number of positions	11	2		13
Market value	\$ 43.8	\$ 26.4	\$	\$ 70.2
Amortized cost	\$ 45.4	\$ 29.8	\$	\$ 75.2
Unrealized loss	\$ (1.6 )	\$ (3.4 )	\$	\$ (5.0 )
<b>Other investments:</b>				
Number of positions	3		3	6
Market value	\$ 10.6	\$	\$ 18.4	\$ 29.0
Amortized cost	\$ 10.7	\$	\$ 18.8	\$ 29.5
Unrealized loss	\$ (0.1 )	\$	\$ (0.4 )	\$ (0.5 )
<b>Total:</b>				
Number of positions	151	11	110	272
Market value	\$ 1,544.5	\$ 98.0	\$ 593.4	\$ 2,235.9
Amortized cost	\$ 1,563.1	\$ 101.9	\$ 605.1	\$ 2,270.1
Unrealized loss	\$ (18.6 )	\$ (3.9 )	\$ (11.7 )	\$ (34.2 )
<b>% of total gross unrealized losses</b>	54	% 11	% 35	% 100

During the three and six months ended June 30, 2007 and 2006, OneBeacon did not recognize any material pre-tax other-than-temporary impairment charges. OneBeacon believes that the gross unrealized losses relating to its fixed maturity investments at June 30, 2007 resulted primarily from increases in market interest rates from the dates that certain investments within that portfolio were acquired as opposed to fundamental changes in the credit quality of the issuers of such securities. OneBeacon views these decreases in value as being temporary because it has the intent and ability to retain such investments until recovery. However, should OneBeacon determine that it no longer has the intent and ability to hold a fixed maturity investment that has an existing unrealized loss resulting from an increase in market interest rates until it recovers, this loss would be realized through the income statement at the time such determination is made. OneBeacon also believes that the gross unrealized losses recorded on its common equity securities and its other investments at June 30, 2007 resulted primarily from decreases in quoted market values from the dates that certain investments securities within that portfolio were acquired as opposed to fundamental changes in the issuer's financial performance and near term financial prospects. Therefore, these decreases are also viewed as being temporary. However, due to the inherent risk involved in investing in the equity markets, it is possible that the decrease in market value of these investments may ultimately prove to be other than temporary. At June 30, 2007, OneBeacon's investment portfolio did not include any individual investment securities with an after-tax unrealized loss of more than \$3.0 million for more than a six-month period.

**NOTE 7. Segment Information**

OneBeacon's segments consist of the following: (1) Primary Insurance Operations, (2) Affiliate Quota Shares and (3) Other Operations. OneBeacon has made its segment determination based on consideration of the following criteria: (i) the nature of the business activities of each of the Company's subsidiaries and affiliates; (ii) the manner in which the Company's subsidiaries and affiliates are organized and (iii) the existence of primary managers responsible for specific subsidiaries and affiliates. Significant intercompany transactions among OneBeacon's segments have been eliminated herein. Financial information for OneBeacon's segments follows:

	Primary Insurance Operations (\$ in millions)	Affiliate Quota Shares(1)	Other Operations	Total
<b>Three months ended June 30, 2007</b>				
Earned premiums	\$ 465.0	\$	\$	\$ 465.0
Net investment income	48.7		5.9	54.6
Net realized investment gains (losses)	56.9		0.2	57.1
Net other revenues	3.3		(0.9)	2.4
Total revenues	573.9		5.2	579.1
Loss and LAE	283.1			283.1
Policy acquisition expenses	78.3			78.3
Other underwriting expenses	89.6			89.6
General and administrative expenses	1.2		1.5	2.7
Accretion of fair value adjustment to loss and LAE reserves			4.0	4.0
Interest expense on debt	0.8		10.5	11.3
Interest expense-on preferred stock subject to mandatory redemption			16.3	16.3
Total expenses	453.0		32.3	485.3
Pre-tax income (loss)	\$ 120.9	\$	\$ (27.1)	\$ 93.8
<b>Three months ended June 30, 2006</b>				
Earned premiums	485.3	\$ 46.6	\$	\$ 531.9
Net investment income	50.6		2.4	53.0
Net realized investment gains (losses)	41.7		(0.1)	41.6
Net other revenues	2.3		4.0	6.3
Total revenues	579.9	46.6	6.3	632.8
Loss and LAE	295.7	42.7		338.4
Policy acquisition expenses	74.4	11.0		85.4
Other underwriting expenses	86.0			86.0
General and administrative expenses	0.9		1.0	1.9
Accretion of fair value adjustment to loss and LAE reserves			5.8	5.8
Interest expense on debt	0.8		10.7	11.5
Interest expense-on preferred stock subject to mandatory redemption			14.4	14.4
Total expenses	457.8	53.7	31.9	543.4
Pre-tax income (loss)	\$ 122.1	\$ (7.1)	\$ (25.6)	\$ 89.4

(1) The affiliate quota share agreements were commuted during the fourth quarter of 2006.

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	Primary Insurance Operations (\$ in millions)	Affiliate Quota Shares(1)	Other Operations	Total
<b>Six months ended June 30, 2007</b>				
Earned premiums	\$ 933.9	\$	\$	\$ 933.9
Net investment income	94.4		10.8	105.2
Net realized investment gains (losses)	111.8		0.2	112.0
Net other revenues	6.6		(1.1 )	5.5
Total revenues	1,146.7		9.9	1,156.6
Loss and LAE	571.3			571.3
Policy acquisition expenses	156.6			156.6
Other underwriting expenses	180.5			180.5
General and administrative expenses	1.2		3.9	5.1
Accretion of fair value adjustment to loss and LAE reserves			8.0	8.0
Interest expense on debt	1.7		21.0	22.7
Interest expense-on preferred stock subject to mandatory redemption			32.1	32.1
Total expenses	911.3		65.0	976.3
Pre-tax income (loss)	\$ 235.4	\$	\$ (55.1 )	\$ 180.3
<b>Six months ended June 30, 2006</b>				
Earned premiums	\$ 965.4	\$ 73.3	\$	\$ 1,038.7
Net investment income	93.9		5.3	99.2
Net realized investment gains (losses)	69.9		(0.3 )	69.6
Net other revenues	4.6		7.2	11.8
Total revenues	1,133.8	\$ 73.3	12.2	1,219.3
Loss and LAE	599.4	76.7		676.1
Policy acquisition expenses	160.8	12.1		172.9
Other underwriting expenses	169.9			169.9
General and administrative expenses	1.6		4.9	6.5
Accretion of fair value adjustment to loss and LAE reserves			11.5	11.5
Interest expense on debt	1.4		21.4	22.8
Interest expense-on preferred stock subject to mandatory redemption			28.4	28.4
Total expenses	933.1	88.8	66.2	1,088.1
Pre-tax income (loss)	\$ 200.7	\$ (15.5 )	\$ (54.0 )	\$ 131.2
<b>June 30, 2007</b>				
Total investments	\$ 4,639.1	\$	\$ 483.2	\$ 5,122.3
Reinsurance recoverable on paid and unpaid losses	3,015.8		(229.1 )	2,786.7
Total assets	9,297.9		273.8	9,571.7
Loss and LAE reserves	4,951.1		(254.5 )	4,696.6
Total liabilities	6,937.8		772.6	7,710.4
Total equity	2,360.1		(498.8 )	1,861.3
<b>December 31, 2006</b>				
Total investments	\$ 4,806.9	\$	\$ 405.8	\$ 5,212.7
Reinsurance recoverable on paid and unpaid losses	3,112.1		(237.1 )	2,875.0
Total assets	9,729.2		140.2	9,869.4
Loss and LAE reserves	5,108.2		(270.5 )	4,837.7
Total liabilities	7,382.3		709.9	8,092.2
Total equity	2,346.9		(569.7 )	1,777.2

(1) The affiliate quota share agreements were commuted during the fourth quarter of 2006.

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The following tables provide net written premiums and earned insurance premiums for OneBeacon's Primary Insurance Operations by major underwriting unit and in total for the three and six months ended June 30, 2007 and 2006:

	Specialty (\$ in millions)	Commercial	Personal	Total(1)
<b>Three months ended June 30, 2007</b>				
Net written premiums	\$ 110.8	\$ 193.6	\$ 180.4	\$ 484.8
Earned premiums	108.2	176.4	180.5	465.0
<b>Three months ended June 30, 2006</b>				
Net written premiums	\$ 105.6	\$ 195.7	\$ 217.4	\$ 515.4
Earned premiums	108.0	171.0	209.7	485.3
	Specialty (\$ in millions)	Commercial	Personal	Total(1)
<b>Six months ended June 30, 2007</b>				
Net written premiums	\$ 207.6	\$ 364.2	\$ 353.2	\$ 925.1
Earned premiums	215.2	348.4	370.3	933.9
<b>Six months ended June 30, 2006</b>				
Net written premiums	\$ 207.6	\$ 362.5	\$ 419.8	\$ 989.8
Earned premiums	210.0	336.3	419.2	965.4

(1) Includes results from run-off.

**NOTE 8. Investment in Unconsolidated Affiliate**

OneBeacon's investments in unconsolidated affiliate represent operating investments in other companies in which OneBeacon has a significant voting and economic interest but does not control the entity.

On October 31, 2006, OneBeacon's investment in MSA was restructured. OneBeacon received a \$70 million cash dividend from MSA following which OneBeacon sold its 50% common stock investment in MSA to Main Street America Group, Inc. (the MSA Group) for (i) \$70.0 million in 9.0% non-voting cumulative perpetual preferred stock of the MSA Group and (ii) 4.9% of the common stock of the MSA Group. (See Note 3 Acquisitions and Dispositions). Effective October 31, 2006, OneBeacon accounts for its remaining investment in the MSA Group in accordance with SFAS 115. Prior to the sale, OneBeacon owned 50% of the total common shares outstanding of MSA and accounted for this investment using the equity method of accounting. These transactions resulted in a net after-tax realized gain of \$8.5 million.

Prior to the exchange of OneBeacon's common stock investment in MSA, the Company accounted for this investment using the equity method of accounting. For the three and six months ended June 30, 2006, the after-tax equity in earnings from MSA common stock was \$8.0 million and \$10.2 million, respectively, and the after-tax equity in unrealized investment losses was \$7.7 million and \$8.9 million, respectively.

**NOTE 9. Retirement Plans**

The components of net periodic benefit costs for the three and six months ended June 30, 2007 and 2006 were as follows:

	Three months ended		Six months ended	
	June 30, 2007	2006	June 30, 2007	2006
	(\$ in millions)		(\$ in millions)	
Service cost	\$ 0.6	\$ 0.3	\$ 1.1	\$ 0.5
Interest cost	6.6	6.9	13.2	13.8
Expected return on plan assets	(6.7)	(7.6)	(13.5)	(15.3)
Amortization of unrecognized loss	0.1		0.2	0.1
Net periodic pension cost before settlements, curtailments and special termination benefits	0.6	(0.4)	1.0	(0.9)
Special termination benefits expense(1)		0.3		1.6
Net periodic benefit cost	\$ 0.6	\$ (0.1)	\$ 1.0	\$ 0.7





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(1) Special termination benefits are additional payments made from the pension plan when a vested participant terminates employment due to a reduction in force.

The Company anticipates contributing \$2.9 million to the pension plans for 2007. As of June 30, 2007, \$1.7 million in contributions have been made. All of OneBeacon's year to date and expected pension contributions in 2007 relate to non-qualified pension plans, for which OneBeacon has established assets held in rabbi trusts.

See Note 14 Subsequent Events.

#### **NOTE 10. Employee Share-Based Incentive Compensation Plans**

OneBeacon's share-based compensation plans consist of performance shares and also stock options granted in connection with the initial public offering. OneBeacon's share-based compensation plans are designed to maximize shareholder value over long periods of time by aligning the financial interests of its management with those of its owners. Performance shares are payable only upon achievement of pre-defined business goals and are valued based on the market value of OneBeacon's common shares at the time awards are earned. See Performance Shares below. Performance shares are typically paid in cash, though, in some instances, they may be paid in common shares or may be deferred in accordance with the terms of the Company's deferred compensation plans. OneBeacon expenses the full cost of all its share-based compensation.

In December 2004, the FASB issued SFAS No. 123(R), Share-Based Payment (SFAS 123R), which is a revision to SFAS No. 123, Accounting for Stock Based Compensation (SFAS 123) and supersedes Accounting Principles Board Opinion (APB) No. 25, Accounting for Stock Issued to Employees (APB 25). Effective January 1, 2006, OneBeacon adopted SFAS 123R to account for its share-based compensation under the modified prospective method of adoption. Under this method of adoption, SFAS 123R applies to new grants of share-based awards, awards modified after the effective date and the remaining portion of the fair value of the unvested awards at the adoption date. The unvested portion of OneBeacon performance share awards, as well as new awards, such as the stock options granted in connection with the initial public offering, are subject to the fair value measurement and recognition requirements of SFAS 123R.

Prior to adoption of SFAS 123R, OneBeacon accounted for its share-based compensation plans under the recognition and measurement principles of APB 25, and related interpretations, and the disclosure provisions of SFAS 123. The accounting treatment for OneBeacon's performance share awards under APB 25 was identical to the method prescribed by SFAS 123, whereby the liability for performance share awards was measured each period based upon the current market price of the underlying common shares. Under APB 25, the liability for the compensation cost for performance share awards was measured each period based upon the current market price of the underlying common shares. Forfeitures were recognized as they occurred. Upon adoption of SFAS 123R an estimate of future forfeitures was incorporated into the determination of the compensation cost for performance shares. The effect of this change was immaterial.

#### **Performance Shares**

Prior to February 2007, the value of OneBeacon's performance shares was based upon the market price of an underlying White Mountains common share (WTM Performance Shares). In February 2007, all of OneBeacon's WTM Performance Shares outstanding were replaced with performance shares whose value is based upon the market price of an underlying OneBeacon common share (OB Performance Shares).

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The following summarizes performance share activity for OB Performance Shares for the three and six months ended June 30, 2007 and 2006:

	Three months ended June 30, 2007		2006	
	Target OB Performance Shares outstanding (\$ in millions )	Accrued expense	Target OB Performance Shares outstanding	Accrued expense
Beginning of period	1,114,645	\$ 6.0	\$	\$
Payments and deferrals				
New awards	23,674	0.1		
Forfeitures and net change in assumed forfeitures	(15,978 )	(0.1 )		
Expense recognized		4.1		
End of period	1,122,341	\$ 10.1	\$	\$

	Six months ended June 30, 2007		2006	
	Target OB Performance Shares outstanding (\$ in millions )	Accrued expense	Target OB Performance Shares outstanding	Accrued expense
Beginning of period		\$	\$	\$
Payments and deferrals				
New awards	908,460			
Forfeitures and net change in assumed forfeitures	(68,820 )	(0.3 )		
Transfers in (1)	282,701	4.1		
Expense recognized		6.3		
End of period	1,122,341	\$ 10.1	\$	\$

(1) In February 2007, OneBeacon's WTM Performance Shares were replaced with OB Performance Shares of an equivalent value.

The following summarizes performance share activity for WTM Performance Shares for the three and six months ended June 30, 2007 and 2006:

	Three months ended June 30, 2007		2006	
	Target WTM Performance Shares outstanding (\$ in millions )	Accrued expense	Target WTM Performance Shares outstanding	Accrued expense
Beginning of period		\$	51,027	\$ 14.4
Payments and deferrals				
New awards				
Forfeitures and net change in assumed forfeitures				
Transfers out (3)				
Expense recognized				
End of period		\$	51,027	\$ 14.4



	Six months ended June 30, 2007		2006	
	Target WTM Performance Shares outstanding (\$ in millions)	Accrued expense	Target WTM Performance Shares outstanding	Accrued expense
Beginning of period	16,470	\$ 7.8	44,700	\$ 24.8
Payments and deferrals (1) (2)	(4,400 )	(3.7 )	(12,600 )	(13.4 )
New awards			20,235	
Forfeitures and net change in assumed forfeitures			(1,308 )	(0.3 )
Transfers out (3)	(12,070 )	(4.1 )		
Expense recognized				3.3
End of period		\$	51,027	\$ 14.4

- (1) Performance share payments in 2006 for the 2003-2005 performance cycle were made at 142% of target.
- (2) Performance share payments in 2007 for the 2004-2006 performance cycle were made at 145% of target.
- (3) In February 2007, OneBeacon's WTM Performance Shares were replaced with OB Performance Shares of an equivalent value.

The following summarizes performance shares outstanding and accrued performance share expense at June 30, 2007 for each performance cycle:

Performance cycle:	Target OB Performance Shares outstanding (\$ in millions)	Accrued expense
2005-2007	117,363	\$ 3.3
2006-2008	161,216	3.5
2007-2009	872,681	3.4
Sub-total	1,151,260	10.2
Assumed forfeitures	(28,919 )	(0.1 )
Total at June 30, 2007	1,122,341	\$ 10.1

If 100% of the outstanding performance shares had been vested on June 30, 2007, the total additional compensation cost to be recognized would have been \$32.1 million, based on current accrual factors (common share price and payout assumptions).

All performance shares earned for the 2003-2005 and the 2004-2006 performance cycles were settled in cash or by deferral into certain non-qualified deferred compensation plans of the Company's subsidiaries.

**Stock Options**

As described above, in connection with the initial public offering, OneBeacon issued options to acquire 1,420,000 common shares of the Company to certain members of management. The following summarizes option activity for the six months ended June 30, 2007:

	<b>2007 Options outstanding (\$ in millions)</b>	<b>Accrued expense</b>
Opening balance outstanding options	1,420,000	\$ 0.2
New awards		
Assumed forfeitures	(71,000 )	
Exercised		
Expense recognized		0.6
Balance at June 30, 2007	1,349,000	\$ 0.8

The options have a \$30.00 per share exercise price and vest in equal installments on each of the third, fourth and fifth anniversaries of their issuance. These options expire five and a half years from the anniversary of issuance. The compensation expense associated with the options is being recognized ratably over five years.

**NOTE 11. Income Taxes**

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OneBeacon's income tax provision related to pre-tax income from continuing operations for the six months ended June 30, 2007 and June 30, 2006 represented effective tax rates of 31.9% and 15.6%, respectively, which were lower than the U.S. statutory rate of 35%. The effective tax rate is lower for each of the periods due to income generated in jurisdictions other than the United States, partially offset by non-deductible dividends and accretion on the Berkshire Hathaway, Inc. ( Berkshire ) Preferred Stock ( Berkshire Preferred Stock ) and Zenith Preferred Stock. The effective tax rate for the first six months of 2006 also reflects tax benefits related to settlements of U.S. federal and state income tax audits for years prior to 2003.

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*NOTE 12. Commitments and Contingencies*



*Legal Contingencies*

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OneBeacon, and the insurance industry in general, is subject to litigation and arbitration in the normal course of business. Other than those items listed below, we are not a party to any material litigation or arbitration other than as routinely encountered in claims activity, none of which is expected by management to have a material adverse effect on our financial condition and/or cash flows.

In August 2005, OneBeacon asserted claims against Liberty Mutual in the Court of Common Pleas in Philadelphia, Pennsylvania (the *Court*) asserting breach of contract and negligence claims pursuant to agreements with Liberty Mutual (the *Liberty Agreements*). The contract claim was submitted to arbitration and the Court stayed the remaining claims pending resolution of the arbitration. The hearing commenced in November 2006 and a final determination is expected by the end of 2007.

In January 2006, Liberty Mutual initiated an arbitration proceeding (the *ULAE Arbitration*) against OneBeacon asserting it is owed approximately \$68 million in connection with unallocated loss adjustment expenses (*ULAE*), under the *Liberty Agreements*. OneBeacon believes that Liberty's calculation of ULAE is inconsistent with the terms of the *Liberty Agreements* and with standard industry definitions of ULAE. As of June 30, 2007, OneBeacon has recorded in its loss and LAE reserves an estimate of ULAE expenses due Liberty Mutual on a basis that it believes is consistent with the terms of the *Liberty Agreements* and with standard industry definitions of ULAE.

In September 2006, OneBeacon initiated an arbitration against Liberty Mutual (the *Reinsurance Arbitration*) seeking payment of approximately \$57 million relating to reinsurance arrangements under the *Liberty Agreements*. In January 2007, the *Reinsurance Arbitration* was consolidated into the *ULAE Arbitration*. In July 2007, the reinsurance payment issues in the *Reinsurance Arbitration* were favorably resolved.

As of June 30, 2007, OneBeacon believes its loss and LAE reserves are sufficient to cover reasonably anticipated outcomes of all disputes with Liberty Mutual.

Refer to the Company's 2006 Annual Report on Form 10-K, and in particular Item 3 *Legal Proceedings* for a brief description of all other non-routine legal proceedings. Damages sought by the claimants do not exceed 10% of the Company's current assets.

### *Guarantees*

Beginning in February 2006, OBIC, agreed to provide guarantees of the obligations of Galileo Weather Risk Management Ltd., or Galileo, to Galileo's counterparty in certain weather-related product transactions. Galileo is a subsidiary of White Mountains. The guarantees require OBIC to pay the full amount of Galileo's obligations to the counterparty in the event of Galileo's failure to pay these obligations. In the event of a payment, OBIC would be eligible to exercise all of the rights of the counterparty against Galileo. As of June 30, 2007 there was one outstanding guarantee with a principal value of \$5.0 million. In the event that the total guaranteed principal amount exceeds the lesser of 5% of OBIC's admitted assets of \$3.8 billion at December 31, 2006 or 25% of OBIC's statutory surplus of \$1.7 billion at December 31, 2006, OBIC would require the approval of the Pennsylvania Department of Insurance in order to make any further guarantees. OBIC has agreed, at White Mountains' option, to continue to make these guarantees available until October 2008 and will receive from Galileo

an annual fee of 25 basis points of the value at risk for providing the guarantees. Pursuant to a separation agreement entered into by OneBeacon and White Mountains in connection with the initial public offering, White Mountains has agreed that it will take appropriate steps to ensure that OBIC will not be called on to make payment on these guarantees.

### NOTE 13. Earnings per Share

Basic and diluted earnings per share amounts have been determined in accordance with SFAS No. 128, *Earnings per Share*. As of June 30, 2007, OneBeacon has 100,022,175 shares issued and outstanding. On October 18, 2006, OneBeacon executed a stock split and recapitalization that increased the common shares outstanding from 12,000 to 100,000,000 and reduced the par value from \$1.00 to \$0.01. The stock split and recapitalization have been reflected retroactively in these financial statements for all periods presented. In connection with the initial public offering, four common shares of the Company's common stock were awarded to each employee and deposited into participant ESOP accounts. A total of 13,292 shares were awarded. During the second quarter of 2007, 8,883 shares of the Company's common stock were awarded to certain members of the Company's board of directors, in lieu of cash, as compensation for services rendered during the first quarter of 2007. The earnings per share amounts have been determined assuming that the common shares were outstanding for all periods presented.

	Three months ended		Six months ended	
	June 30,	2006	June 30,	2006
	2007		2007	
<b>Basic earnings per share numerators (in millions):</b>				
Income from continuing operations	\$ 62.3	\$ 88.7	\$ 122.8	\$ 121.0
Income from discontinued operations, net of tax		1.6		0.4
Net income available to common shareholders	\$ 62.3	\$ 90.3	\$ 122.8	\$ 121.4
<b>Diluted earnings per share numerators (in millions):</b>				
Income from continuing operations	\$ 62.3	\$ 88.7	\$ 122.8	\$ 121.0
Income from discontinued operations, net of tax		1.6		0.4
Net income available to common shareholders	\$ 62.3	\$ 90.3	\$ 122.8	\$ 121.4
<b>Basic earnings per share (in dollars):</b>				
Net income from continuing operations	\$ 0.62	\$ 0.89	\$ 1.23	\$ 1.21
Income from discontinued operations, net of tax		0.02		
Net income available to common shareholders	\$ 0.62	\$ 0.90	\$ 1.23	\$ 1.21
<b>Diluted earnings per share (in dollars):</b>				
Income from continuing operations	\$ 0.62	\$ 0.89	\$ 1.23	\$ 1.21
Income from discontinued operations, net of tax		0.02		
Net income available to common shareholders	\$ 0.62	\$ 0.90	\$ 1.23	\$ 1.21

### NOTE 14. Subsequent Events

#### *Legal Contingencies*

In September 2006, OneBeacon initiated an arbitration against Liberty Mutual (the Reinsurance Arbitration) seeking payment of approximately \$57 million relating to reinsurance arrangements under the Liberty Agreements. In January 2007, the Reinsurance Arbitration was consolidated into the ULAE Arbitration. In July 2007, the reinsurance payment issues in the Reinsurance Arbitration were favorably resolved.

#### *Pension Plan*

OneBeacon sponsors a qualified, non-contributory, defined benefit pension plan (the Plan). The Plan participants include retirees, terminated vested employees and substantially all employees who were employed as of December 31, 2001 and remain actively employed with OneBeacon. The Plan was curtailed in the fourth quarter of 2002.

On July 11, 2007, the Company settled approximately 80% of Plan liabilities through the purchase of two group annuity contracts for \$398.5 million from Transamerica Life Insurance Company and Hartford Life Insurance Company (Hartford Life). Hartford Life will act as the lead administrator. In accordance with SFAS No. 88 Employers' Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits, the Company will recognize this partial settlement in the third quarter of 2007. Additionally, the remaining Plan liabilities, which are primarily attributable to Plan participants who remain actively employed by OneBeacon, will be re-measured during the third quarter of 2007.



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

The following discussion contains forward-looking statements. Statements that are not historical in nature are forward-looking statements. OneBeacon cannot promise that our expectations in such forward-looking statements will turn out to be correct. OneBeacon's actual results could be materially different from and worse than our expectations. See Forward-Looking Statements on page 41 for specific important factors that could cause actual results to differ materially from those contained in forward-looking statements.

The following discussion also includes four non-GAAP financial measures, adjusted book value per common share, adjusted book value per common share, including dividends, adjusted common shareholders' equity and adjusted common shareholders' equity, including dividends, that have been reconciled to their most comparable GAAP financial measures (see below and page 35). OneBeacon believes these measures to be useful supplements to the comparable GAAP measures in evaluating OneBeacon's financial performance.

**Adjusted Book Value Per Common Share for the Three and Six Months Ended June 30, 2007**

We ended the second quarter of 2007 with an adjusted book value per share of \$18.21 reflecting a 3.7% increase for the second quarter 2007 and 8.3% growth through June 30, 2007, including dividends. The following table presents our adjusted book value per common share and adjusted book value per common share, including dividends, and reconciles these non-GAAP financial measures to their most comparable GAAP measure.

	June 30, 2007	March 31, 2007	December 31, 2006
<b>Numerator</b>			
Common shareholders' equity	\$ 1,861.3	\$ 1,825.7	\$ 1,777.2
Remaining adjustment of subsidiary preferred stock to face value	(40.8)	(49.5)	(57.7)
Adjusted common shareholders' equity (1)	\$ 1,820.5	\$ 1,776.2	\$ 1,719.5
Dividends	42.0	21.0	0.0
Adjusted common shareholders' equity, including dividends (1)	\$ 1,862.5	\$ 1,797.2	\$ 1,719.5
<b>Denominator</b>			
Common shares outstanding	100.0	100.0	100.0
<b>Book value per common share</b>	<b>\$ 18.61</b>	<b>\$ 18.26</b>	<b>\$ 17.77</b>
<b>Adjusted book value per common share (1)</b>	<b>\$ 18.21</b>	<b>\$ 17.76</b>	<b>\$ 17.20</b>
<b>Adjusted book value per common share, including dividends (1) (2)</b>	<b>\$ 18.63</b>	<b>\$ 17.97</b>	<b>\$ 17.20</b>

(1) Represents a non-GAAP financial measure.

(2) Includes dividends of \$0.21 per common share paid quarterly beginning in March 2007.

**Results of Operations***Review of Consolidated Results*

A summary of our consolidated financial results for the three and six months ended June 30, 2007 and 2006 is as follows:

	Three months ended June 30, 2007 (\$ in millions)		Six months ended June 30, 2007	
	2006	2006	2006	2006
Net written premiums	\$ 484.8	\$ 565.9	\$ 925.1	\$ 1,097.0
<b>Revenues</b>				
Earned premiums	\$ 465.0	\$ 531.9	\$ 933.9	\$ 1,038.7
Net investment income	54.6	53.0	105.2	99.2
Net realized investment gains	57.1	41.6	112.0	69.6
Net other revenues	2.4	6.3	5.5	11.8
Total revenues	579.1	632.8	1,156.6	1,219.3
<b>Expenses</b>				
Loss and LAE	283.1	338.4	571.3	676.1
Policy acquisition expenses	78.3	85.4	156.6	172.9
Other underwriting expenses	89.6	86.0	180.5	169.9
General and administrative expenses	2.7	1.9	5.1	6.5
Accretion of fair value adjustment to loss and LAE reserves	4.0	5.8	8.0	11.5
Interest expense on debt	11.3	11.5	22.7	22.8
Interest expense dividends and accretion on preferred stock subject to mandatory redemption	16.3	14.4	32.1	28.4
Total expenses	485.3	543.4	976.3	1,088.1
<b>Pre-tax earnings from continuing operations</b>	93.8	89.4	180.3	131.2
Income tax provision	(31.5 )	(8.7 )	(57.5 )	(20.4 )
<b>Income from continuing operations before equity in earnings of unconsolidated affiliate</b>	62.3	80.7	122.8	110.8
Equity in earnings of unconsolidated affiliate		8.0		10.2
<b>Income from continuing operations</b>	62.3	88.7	122.8	121.0
Income from discontinued operations		1.6		0.4
<b>Net income</b>	62.3	90.3	122.8	121.4
Other comprehensive income	(6.3 )	(29.1 )	2.7	(27.6 )
<b>Comprehensive net income</b>	\$ 56.0	\$ 61.2	\$ 125.5	\$ 93.8

**Consolidated Results Three months ended June 30, 2007 versus three months ended June 30, 2006**

Our pre-tax income from continuing operations for the second quarter of 2007 was \$93.8 million, compared to pre-tax income from continuing operations of \$89.4 million for the second quarter of 2006 and our GAAP combined ratio was 97.0% for the second quarter 2007, compared to 95.8% for the second quarter of 2006.

The increase to our GAAP combined ratio was primarily due to an increase in our expense ratio. The second quarter of 2006 included the benefit of \$6.2 million from the favorable settlement of a state franchise tax audit and a \$5.0 million reduction in contingent commission accruals, which in total reduced our GAAP combined ratio by 2.1 points. In addition, the expense ratio increased in the second quarter of 2007, compared with the prior year period, as a result of our continued investments in specialized teams of people and lower earned premium than in the second quarter of 2006. Partially offsetting these variances, was a decrease to the loss and LAE ratio. Our results for the second quarter of 2007 included favorable development on prior accident year losses of \$12.7 million, compared with adverse development on prior accident year losses of \$13.8 million in the second quarter of 2006, which included adverse development of \$10.7 million on catastrophe losses, primarily related to Katrina. Partially offsetting these decreases was higher current accident year catastrophe losses in the second quarter of 2007.

Our total revenues decreased 8.5% in the second quarter of 2007 to \$579.1 million, compared to \$632.8 million in the second quarter of 2006, due principally to a 12.6% decrease in earned premiums in the second quarter of 2007. The



second quarter of 2006 included \$105.1 million of business assumed from the affiliate quota share agreement with Esurance, which was commuted in the fourth quarter of 2006, in connection with our initial public offering. Net realized investment gains increased to \$57.1 million in the second quarter of 2007, compared with \$41.6 million in the second quarter of 2006, mainly due to the sale of certain convertible fixed maturity and equity securities in industry sectors that experienced significant appreciation during our period of ownership, principally energy and natural resources.

Net other revenues decreased 61.9% in the second quarter of 2007 to \$2.4 million, compared to \$6.3 million in the second quarter of 2006. The 2006 period included \$2.9 million of interest income from loans receivable from affiliates of White Mountains. These loans were settled in connection with our initial public offering.

**The income tax provision related to pre-tax income from continuing operations for the three months ended June 30, 2007 and June 30, 2006 represented effective tax rates of 33.6% and 9.8%, respectively, which were lower than the U.S. statutory rate of 35%. The effective tax rate is lower for each of the periods due to income generated in jurisdictions other than the United States, partially offset by non-deductible dividends and accretion on the Berkshire Preferred Stock and Zenith Preferred Stock. The effective tax rate for the second quarter of 2006 also reflects tax benefits related to settlements of U.S. federal and state income tax audits for years prior to 2003.**

#### **Consolidated Results Six months ended June 30, 2007 versus six months ended June 30, 2006**

Our pre-tax income from continuing operations for the first six months of 2007 was \$180.3 million, compared to pre-tax income from continuing operations of \$131.2 million for the first six months of 2006 and our GAAP combined ratio was 97.3% for the first six months 2007, compared to 98.1% for the first six months of 2006.

The decrease to our GAAP combined ratio was primarily due to a decrease in our loss and LAE ratio. The first six months of 2007 included \$24.7 million of favorable development on prior accident year losses, compared with, \$12.1 million of adverse development on prior accident year losses in the first six months of 2006, which included \$15.8 million of adverse development on catastrophe losses, primarily related to Katrina. Partially offsetting these variances was an increase in our expense ratio. Included in the first six months of 2007 was \$9.1 million of office consolidation expenses associated with actions taken to optimize long-term occupancy costs, including our move to our new U.S. Headquarters in Canton, Massachusetts. The first six months of 2006 included the benefit of \$6.2 million from the favorable settlement of a state franchise tax audit and a \$5.0 million reduction in contingent commission accruals. In addition, the expense ratio increased in the first six months of 2007, compared with the prior year period, as a result of our continued investments in specialized teams of people and lower earned premium than in the first six months of 2006.

Our total revenues decreased 5.1% in the first six months of 2007 to \$1,156.6 million, compared to \$1,219.3 million in the first six months of 2006, due principally to a 10.1% decrease in earned premiums in the first six months of 2007. The first six months of 2006 included \$192.8 million of business assumed from the affiliate quota share agreement with Esurance, which was commuted in the fourth quarter of 2006, in connection with our initial public offering. Net realized investment gains increased 60.9% to \$112.0 million in the first six months of 2007, compared with \$69.6 million in the first six months of 2006, mainly due to the sale of certain convertible fixed maturity and equity securities in industry sectors that experienced significant appreciation during our period of ownership, principally energy and natural resources.

Net other revenues decreased 53.4% in the first six months of 2007 to \$5.5 million, compared to \$11.8 million in the first six months of 2006. The 2006 period included \$5.3 million of interest income from loans receivable from affiliates of White Mountains. These loans were settled in connection with our initial public offering.

**The income tax provision related to pre-tax income from continuing operations for the six months ended June 30, 2007 and June 30, 2006 represented effective tax rates of 31.9% and 15.6%, respectively, which were lower than the U.S. statutory rate of 35%. The effective tax rate is lower for each of the periods due to income generated in jurisdictions other than the United States, partially offset by non-deductible dividends and accretion on the Berkshire Preferred Stock and Zenith Preferred Stock. The effective tax rate for the first six months of 2006 also reflects tax benefits related to settlements of U.S. federal and state income tax audits for years prior to 2003.**



***Summary of Operations By Segment***

Our segments consist of the following: (1) Primary Insurance Operations, (2) Affiliate Quota Shares and (3) Other Operations. In the fourth quarter of 2006, within our Primary Insurance Operations segment, we began to include OneBeacon Specialty Property (OBSP) within commercial lines and AutoOne Insurance (AutoOne) within personal lines. Both OBSP and AutoOne were formerly reported in specialty lines. The reporting change was undertaken to better align the reported results of our underwriting units with their product and management structure. Prior periods have been reclassified to conform to the current presentation. The affiliate quota share agreements were commuted in the fourth quarter of 2006 in connection with our initial public offering.

Our investments are managed by our affiliate, White Mountains Advisors, LLC (WM Advisors), and by Prospector Partners, LLC (Prospector). A discussion of our consolidated investment operations is included after the discussion of operations by segment. Our segment information is presented in Note 7 Segment Information to our consolidated financial statements.

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Primary Insurance Operations

Financial results for our Primary Insurance Operations segment for the three and six months ended June 30, 2007 and 2006, were as follows:

	Three months ended June 30, 2007 (\$ in millions)		Six months ended June 30, 2007 2006	
Net written premiums	\$ 484.8	\$ 515.4	\$ 925.1	\$ 989.8
Earned premiums	\$ 465.0	\$ 485.3	\$ 933.9	\$ 965.4
Net investment income	48.7	50.6	94.4	93.9
Net realized investment gains	56.9	41.7	111.8	69.9
Net other revenues	3.3	2.3	6.6	4.6
Total revenues	573.9	579.9	1,146.7	1,133.8
Loss and LAE	283.1	295.7	571.3	599.4
Policy acquisition expenses	78.3	74.4	156.6	160.8
Other underwriting expenses	89.6	86.0	180.5	169.9
General and administrative expenses	1.2	0.9	1.2	1.6
Interest expense on debt	0.8	0.8	1.7	1.4
Total expenses	453.0	457.8	911.3	933.1
Pre-tax income	\$ 120.9	\$ 122.1	\$ 235.4	\$ 200.7

The following tables provide GAAP ratios, net written premiums and earned premiums by underwriting units for the three and six months ended June 30, 2006 and 2007:

	Three months ended June 30, 2007 Specialty Commercial Personal Total(2) (\$ in millions)			
<i>GAAP Ratios: (1)(3)(4)(5)</i>				
Loss and LAE	56.8	% 56.8	% 62.6	% 60.9
Expense	31.8	37.3	36.2	36.1
Total Combined	88.6	% 94.1	% 98.8	% 97.0
Net written premiums	\$ 110.8	\$ 193.6	\$ 180.4	\$ 484.8
Earned premiums	108.2	176.4	180.5	465.0

	Three months ended June 30, 2006 Specialty Commercial Personal Total(2) (\$ in millions)			
<i>GAAP Ratios: (1)(3)(4)(5)</i>				
Loss and LAE	58.3	% 58.2	% 61.3	% 60.9
Expense	30.9	37.5	29.1	33.1
Total Combined	89.2	% 95.7	% 90.4	% 94.0
Net written premiums	\$ 105.6	\$ 195.7	\$ 217.4	\$ 515.4
Earned premiums	108.0	171.0	209.7	485.3

	Six months ended June 30, 2007 Specialty Commercial Personal Total(2) (\$ in millions)			
<i>GAAP Ratios: (1)(3)(4)(5)</i>				
Loss and LAE	57.1	% 55.9	% 64.3	% 61.2
Expense	31.6	37.3	36.3	36.1
Total Combined	88.7	% 93.2	% 100.6	% 97.3
Net written premiums	\$ 207.6	\$ 364.2	\$ 353.2	\$ 925.1
Earned premiums	215.2	348.4	370.3	933.9



	Six months ended June 30, 2006				Personal	Total(2)		
	Specialty (\$ in millions)	Commercial						
<i>GAAP Ratios: (1)(3)(4)(5)</i>								
Loss and LAE	56.0	%	58.8	%	64.5	%	62.1	%
Expense	31.4		38.6		30.8		34.3	
Total Combined	87.4	%	97.4	%	95.3	%	96.4	%
Net written premiums	\$ 207.6		\$ 362.5		\$ 419.8		\$ 989.8	
Earned premiums	210.0		336.3		419.2		965.4	

(1) In the fourth quarter of 2006, we began to include OBSP within commercial lines and AutoOne within personal lines. Both OBSP and AutoOne were formerly reported in specialty lines. The reporting change was undertaken to better align the reported results of our underwriting units with their product and management structure. Prior periods have been reclassified to conform to the current presentation.

(2) Includes results from run-off. For the three months ended June 30, 2007, includes no net written premium from run-off and in the three months ended 2006, includes net written premium of \$(3.3) million from run-off. For the three months ended June 30, 2007 and 2006, includes earned premium of \$(0.1) million and \$(3.4) million, respectively, from run-off. The six months ended June 30, 2007, includes no net written or earned premium from run-off. For the six months ended June 30, 2006, includes net written premium of \$(0.1) million and earned premium of \$(0.1) million from run-off.

(3) Includes our long-term incentive compensation expense. For the three months ended June 30, 2007 and 2006, long-term incentive compensation expense increased our total GAAP combined ratio by 2.2 points and 2.1 points, respectively. For the six months ended June 30, 2007 and 2006, long-term incentive compensation expense increased our total GAAP combined ratio by 1.9 points and 1.6 points, respectively.

(4) Includes loss and LAE relating to catastrophes. For each of the three months ended June 30, 2007 and 2006, total calendar year incurred loss and LAE relating to catastrophes increased our loss and LAE and total combined ratios by 2.7 points, including development on prior accident year catastrophes which increased our loss and LAE and total combined ratios by 0.3 points and 2.2 points, respectively. For the six months ended June 30, 2007 and 2006, total calendar year incurred loss and LAE relating to catastrophes increased our loss and LAE and total combined ratios by 1.4 points and 2.9 points, respectively, including development on prior accident year catastrophes which increased (decreased) our loss and LAE and total combined ratios by (0.1) points and 1.6 points, respectively.

(5) Prior accident year development, including development on catastrophes, for the three months ended June 30, 2007 and 2006 increased (decreased) our loss and LAE and total combined ratios by (2.7) points and 4.0 points, respectively. Prior accident year development, including development on catastrophes, for the six months ended June 30, 2007 and 2006 increased (decreased) our loss and LAE and total combined ratios by (2.6) points and 2.5 points, respectively.

#### Primary Insurance Operations Three months ended June 30, 2007 versus three months ended June 30, 2006

*Specialty lines.* Net written premiums for specialty lines increased by 4.9% to \$110.8 million in the second quarter of 2007 as compared to \$105.6 million in the second quarter of 2006. Excluding the Agri business, to which the renewal rights were sold in the third quarter of 2006, net written premiums increased by 33.8%, compared to the second quarter of 2006, driven by \$14.7 million in net written premium in the Accident and Health (A&H) business which commenced operations in 2007, a \$6.5 million increase in net written premium at OneBeacon Professional Partners (OBPP) and a \$6.1 million increase in net written premium at International Marine Underwriters (IMU).

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The specialty lines combined ratio for the second quarter of 2007 was 88.6%, compared to 89.2% for the second quarter of 2006 due primarily to decreases in the loss and LAE ratio. The loss and LAE ratio decreased 1.5 points in the second quarter of 2007 to 56.8%, compared with 58.3% in the prior year period mainly due to a 6.2 point favorable change in prior accident year losses in the second quarter of 2007, compared to the second quarter of 2006, partially offset by a 4.7 point unfavorable change in current accident year losses compared to the prior year period. The increase in current accident year losses in the second quarter of 2007 is primarily due to an unfavorable change in current accident year losses at IMU, which had extraordinarily low case incurred loss activity in the second quarter of 2006 versus a normal flow of case incurred losses in the second quarter of 2007. The expense ratio for the second quarter of 2007 increased 0.9 points to 31.8%, compared

to 30.9% in the prior year period primarily due to costs associated with starting two new business in specialty lines, A&H and Government Risk Solutions.

*Commercial lines.* Net written premiums for commercial lines decreased by 1.1% to \$193.6 million in the second quarter of 2007, compared to \$195.7 million in the second quarter of 2006. This decrease was due to an \$11.1 million decrease in net written premiums in the middle market division compared to the prior year period, reflecting higher reinsurance costs, as well as lower premiums at OBSP. Partially offsetting this decrease was a \$9.0 million increase in net written premiums to \$36.1 million in the small business division principally driven by our small business package products.

The commercial lines combined ratio for the second quarter of 2007 was 94.1%, compared to 95.7% in the second quarter of 2006 due primarily to a decreased loss and LAE ratio, as well as a slight decrease in the expense ratio. The loss and LAE ratio decreased to 56.8% compared to 58.2% in the second quarter of 2006, primarily due to the impact of adverse development on prior accident year catastrophe losses in the second quarter of 2006. The second quarter of 2006 included 6.5 points of prior accident year development on catastrophe losses primarily related to hurricane Katrina at OBSP. The second quarter of 2007 included 2.4 points of favorable development on prior accident year losses. Partially offsetting these decreases were higher current accident year non-catastrophe losses in the second quarter of 2007, compared with the prior year period. The expense ratio decreased to 37.3% from 37.5% in the second quarter of 2006 primarily due to lower policy acquisition expenses as a result of an internal study on the deferral rate of policy acquisition costs. The second quarter of 2006 included the benefit of 1.6 points related to the favorable settlement of a state franchise tax audit.

*Personal lines.* Net written premiums for personal lines decreased by 17.0% to \$180.4 million in the second quarter of 2007, compared to \$217.4 million in the second quarter of 2006. The decrease was principally attributable to reduced writings at AutoOne due to significant declines in New York's assigned risk pool and increased market competition in the voluntary market. With respect to the New York assigned risk pool, market trends indicate that assigned risk volumes are expected to decline to approximately \$150 million in 2007, down from \$240 million in 2006, \$383 million in 2005 and \$629 million in 2004. The Company expects a reduction in AutoOne's premium volume reflective of these trends. In traditional personal lines, net written premiums decreased 4.5% due to an increasingly competitive auto market and also state-mandated rate decreases in Massachusetts along with higher reinsurance costs.

The personal lines combined ratio for the second quarter of 2007 was 98.8%, compared to 90.4% for the second quarter of 2006. The increase in the combined ratio was due to increases in the both the loss and LAE and expense ratios. The expense ratio increased to 36.2%, compared to 29.1% in the second quarter of 2006. The 2006 period included the benefit of 2.4 points from a reduction of contingent commission accruals and 1.7 points related to the favorable settlement of a state franchise tax audit. The second quarter of 2007 included the adverse effect of spreading certain fixed costs over a lower premium base. The loss and LAE ratio increased to 62.6%, compared to 61.3% for the second quarter of 2006, mainly due to higher than average large loss activity and higher catastrophes in the second quarter of 2007, as compared to the prior year. The second quarter of 2007 included 3.3 points of current accident year catastrophe losses, compared with 0.3 points of catastrophe losses in the second quarter of 2006.

*Run-off.* For the second quarter of 2007, run-off generated an underwriting loss of \$10.8 million, compared to an underwriting loss of \$9.9 million in the second quarter of 2006.

#### **Primary Insurance Operations Six months ended June 30, 2007 versus six months ended June 30, 2006**

*Specialty lines.* Net written premiums for specialty lines were \$207.6 million for both the first six months of 2007 and 2006. Excluding the Agri business, to which the renewal rights were sold in the third quarter of 2006, net written premiums increased by 26.6%, compared to the first six months of 2006 due to a \$16.6 million increase in net written premiums in specialty liability products at OBPP, \$14.7 million in net written premiums in the Accident and Health (A&H) business which commenced operations in 2007 and a \$10.9 million increase in net written premiums at IMU.

The specialty lines combined ratio for the first six months of 2007 was 88.7%, compared to 87.4% for the first six months of 2006 due primarily to an increased loss and LAE ratio. The loss and LAE ratio increased 1.1 points in the first six months of 2007 to 57.1%, compared with 56.0% in the prior year period mainly due to an additional 1.8 points of unfavorable large non-catastrophe current accident year losses in the Agri run-off business. The first six months of 2007 included 6.3 points of favorable development on prior accident year losses, compared to 2.6 points

of favorable development on prior accident years in the first six months of 2006. The unfavorable change in the current accident year losses is also related to the mix shift in our portfolio as the Agri business runs

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off. Our other specialty lines businesses carry a higher loss ratio, but lower expense ratio than the Agri book. The expense ratio increased 0.2 points to 31.6%, essentially flat when compared to the first six months of 2006.

*Commercial lines.* Net written premiums for commercial lines increased by 0.5% to \$364.2 million in the first six months of 2007, compared to \$362.5 million in the first six months of 2006. This increase was due to an \$18.7 million increase in net written premiums to \$69.8 million in the small business division principally driven by our small business package products. Partially offsetting this increase was a \$17.0 million decrease in net written premiums in the middle market division to \$294.4 million compared to the prior year period, reflecting the more competitive market place, as well as lower premiums at OBSP.

The commercial lines combined ratio for the first six months of 2007 was 93.2%, compared to 97.4% in the first six months of 2006 due to decreases in both the loss and LAE ratio and the expense ratio. The loss and LAE ratio decreased to 55.9% compared to 58.8% in the first six months of 2006, primarily due to more favorable development on prior accident year losses in the first six months of 2007, partially offset by a 4.0 point increase in the current accident year loss ratio. The first six months of 2007 included 3.2 points of net favorable development on prior accident year losses, as compared to the first six months of 2006 which included 3.7 points of net adverse development on prior accident year losses, driven by adverse development on hurricane Katrina losses at OBSP. The expense ratio decreased to 37.3% from 38.6% in the first six months of 2006 primarily due to lower policy acquisition expenses as described above.

*Personal lines.* Net written premiums for personal lines decreased by 15.9% to \$353.2 million in the first six months of 2007, compared to \$419.8 million in the first six months of 2006. The decrease was principally attributable to reduced writings at AutoOne due to significant declines in New York's assigned risk pool and increased competition in the voluntary market, as described above. The Company expects a reduction in AutoOne's premium volume reflective of these trends. In traditional personal, lines net written premium decreased 4.0% due to an increasingly competitive auto market and also state-mandated rate decreases in Massachusetts along with higher reinsurance costs.

The personal lines combined ratio for the first six months of 2007 was 100.6%, compared to 95.3% for the first six months of 2006. The increase in the combined ratio was due to an increased expense ratio. The expense ratio increased to 36.3%, compared to 30.8% in the first six months of 2006. The 2006 period included the benefit of 1.2 points from a reduction of contingent commission accruals and 0.8 point related to the favorable settlement of a state franchise tax audit. The first six months of 2007 included the adverse effect of spreading certain fixed costs over a lower premium base. The loss and LAE ratio decreased to 64.3% for the first six months of 2007, compared to 64.5% for the first six months of 2006. The first six months of 2007 included 1.0 point of favorable development on prior accident years, compared to the first six months of 2006 which included 2.1 points of adverse development on prior accident years. Offsetting this decrease, was higher than average large loss activity in the first six months of 2007, as well as 1.2 points of higher catastrophe losses as compared to the first six months of 2006.

*Run-off.* For the first six months of 2007, run-off generated an underwriting loss of \$20.1 million, compared to an underwriting loss of \$20.2 million in the first six months of 2006.

#### *Affiliate Quota Shares*

During 2004 and 2005, we entered into two quota share reinsurance arrangements with other subsidiaries of White Mountains. Under the Esurance Quota Share, which was effective on January 1, 2005, we assumed approximately 85% of business written by Esurance Insurance Company, which includes business written by its wholly owned subsidiary. Under the Sirius Quota Share, we ceded between 6% and 12% of business written, effective April 1, 2004, to Sirius International Insurance Corporation.

The affiliate quota shares were entered into primarily for White Mountains' capital management purposes and were therefore excluded from the information used by White Mountains' Board of Directors to measure our financial performance. The affiliate quota share agreements were commuted in the fourth quarter of 2006 in connection with our initial public offering.



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A summary of results from our Affiliate Quota Shares segment for the three months ended June 30, 2006 is as follows:

	Three months ended June 30, 2006 (\$ in millions)		Six months ended June 30, 2006	
	Esurance Quota Share	Sirius Quota Share	Esurance Quota Share	Sirius Quota Share
Net written premiums	\$ 109.0	\$ (58.5 )	\$ 226.7	\$ (119.5 )
Earned premiums	105.1	(58.5 )	192.8	(119.5 )
Total revenues	105.1	(58.5 )	192.8	(119.5 )
Loss and LAE	73.1	(30.4 )	137.3	(60.6 )
Policy acquisition expenses	32.9	(21.9 )	56.9	(44.8 )
Total expenses	106.0	(52.3 )	194.2	(105.4 )
Pre-tax income (loss)	\$ (0.9 )	\$ (6.2 )	\$ (1.4 )	\$ (14.1 )

*Other Operations*

Our Other Operations segment consists of OneBeacon Insurance Group, Ltd. and our intermediate subsidiary holding companies. Our Other Operations segment primarily consists of financing activities, purchase accounting adjustments relating to our acquisition by White Mountains in 2001 and other assets and general and administrative expenses incurred at the holding company level. This segment also includes entities that prior to the initial public offering employed persons associated with White Mountains' holding company operations.

The purchase accounting adjustments relating to the OneBeacon Acquisition were made to reflect the estimated fair value of our assets acquired and liabilities assumed on the date of the acquisition. The purchase accounting adjustments are primarily comprised of an adjustment to our loss and LAE reserves and related reinsurance recoverables to record them at fair value, an adjustment to record the cost of our investments at fair value and an allocation of the excess of acquired net assets over the purchase price to our non-current, non-financial assets, primarily its property, plant and equipment.

The Other Operations segment results are affected by purchase accounting over time as the fair value adjustments made at our acquisition unwind. Accordingly, net investment income and/or net realized investment gains and losses are affected as the difference between the amortized cost and the fair value of our investment portfolio is amortized into investment income, or recorded as net realized investment gains and losses as the investments are sold; the fair value adjustment to net loss and LAE reserves is expensed through income as our net loss and LAE reserves at the time of the OneBeacon Acquisition are settled; and the portion of the carrying value of property, plant and equipment that was written off in purchase accounting is recorded as net other revenues when it is sold to third parties.

A summary of results from our Other Operations segment for the three and six months ended June 30, 2006 and 2007 are as follows:

	Three months ended June 30, 2007 (\$ in millions)		Six months ended June 30, 2007	
	2007	2006	2007	2006
Net investment income	\$ 5.9	\$ 2.4	\$ 10.8	\$ 5.3
Net realized investment gains (loss)	0.2	(0.1 )	0.2	(0.3 )
Net other revenues	(0.9 )	4.0	(1.1 )	7.2
Total revenues	5.2	6.3	9.9	12.2
General and administrative expenses	1.5	1.0	3.9	4.9
Accretion of fair value adjustment to loss and LAE reserves	4.0	5.8	8.0	11.5
Interest expense on debt	10.5	10.7	21.0	21.4
Interest expense dividends and accretion on preferred stock	16.3	14.4	32.1	28.4
Total expenses	32.3	31.9	65.0	66.2
Pre-tax loss	\$ (27.1 )	(25.6 )	\$ (55.1 )	\$ (54.0 )



**Other Operations Results Three months ended June 30, 2007 versus three months ended June 30, 2006**

Our Other Operations segment reported a pre-tax loss of \$27.1 million for the second quarter 2007, compared to a pre-tax loss of \$25.6 million for the second quarter of 2006. Fluctuations in revenues and expenses between the second quarter of 2007 compared to the second quarter of 2006 essentially offset.

**Other Operations Results Six months ended June 30, 2007 versus six months ended June 30, 2006**

Our Other Operations segment reported a pre-tax loss of \$55.1 million for the first six months 2007, compared to a pre-tax loss of \$54.0 million for the first six months of 2006. Fluctuations in revenues and expenses between the first six months of 2007 compared to the first six months of 2006 essentially offset.

**Summary of Investment Results****Investment Returns**

A summary of our consolidated pre-tax investment results for the three and six months ended June 30, 2007 and 2006 is as follows:

	Three months ended June 30, 2007		Six months ended June 30, 2007 (\$ in millions)	
	2006		2006	
Gross investment income (1)	\$ 60.0	\$ 56.9	\$ 113.7	\$ 106.3
Net realized investment gains	57.1	41.6	112.0	69.6
Net change in unrealized gains (losses) on investments (2), (3)	(10.2 )	(31.2 )	3.2	(38.4 )
Total GAAP pre-tax investment results	\$ 106.9	\$ 67.3	\$ 228.9	\$ 137.5

(1) The three and six months ended June 30, 2007 includes \$4.1 million and \$8.3 million, respectively, of net investment income for assets held in trust.

(2) Does not include results of our investment in MSA during the period it was recorded under the equity method.

(3) The six months ended June 30, 2006 includes the impact of the adoption of SFAS No. 155.

Gross investment returns versus typical benchmarks for the three and six months ended June 30, 2007 and 2006 are as follows:

	Three months ended June 30, 2007(1)		Six months ended June 30, 2007(1)	
	2006		2006	
Fixed maturity investments	0.8	%	1.4	%
Short-term investments	1.2		2.6	
Total fixed income	0.8		2.5	
Lehman U.S. Aggregate Index	(0.4 )		1.2	(0.7 )
Common stock	6.1		11.3	10.3
Other investments	9.1	(4.0 )	14.7	5.0
Total equities	7.0		12.3	8.8
S&P 500 Index (total return)	6.3		7.0	2.7
Total consolidated portfolio	2.1	%	1.5	%

(1) Includes \$4.1 million and \$8.3 million, respectively of net investment income for assets held in trust, for the three and six months ended June 30, 2007.



## **Investment Returns Three months ended June 30, 2007 versus three months ended June 30, 2006**

### **Overview**

Our total pre-tax investment results were \$106.9 million, a return of 2.1% for the second quarter of 2007 versus \$67.3 million, a return of 1.5%, for the second quarter of 2006. Gross investment income for the second quarter of 2007 was \$60.0 million, an increase of 5.4%, compared to \$56.9 million during the second quarter of 2006. Net realized investment gains were \$57.1 million in the second quarter of 2007, an increase of 37.3%, compared to \$41.6 million in the second quarter of 2006, mainly due to the sale of certain convertible fixed maturity and equity securities in industry sectors that experienced significant appreciation during the period of our ownership, principally energy and natural resources. The change in net unrealized investment gains was a decrease of \$10.2 million for the second quarter of 2007, compared to a decrease of \$31.2 million in the second quarter of 2006.

### **Fixed income**

Our fixed income portfolio returned 0.8% in the second quarter of 2007, compared to 1.4 % in the second quarter of 2006. During the 2007 period, we maintained a high quality fixed maturity portfolio with a relatively short duration of approximately 2.5 years which performed consistent with its characteristics and better than the longer-duration Lehman U.S. Aggregate Index benchmark.

### **Equities**

Our equity portfolio returned 7.0% in the second quarter of 2007, compared to 1.9% in the second quarter of 2006. Our common stock portfolio returned 6.1% and 3.8%, for the second quarter of 2007 and 2006, respectively. The common stock portfolio performed 0.2 percentage points worse than the S&P 500 benchmark for the second quarter of 2007, compared with 2.4 percentage points better than the S&P 500 benchmark for the second quarter of 2006.

## **Investment Returns Six months ended June 30,2007 versus six months ended June 30, 2006**

### **Overview**

Our total pre-tax investment results were \$228.9 million, a return of 4.4% for the first six months of 2007, compared to \$137.5 million, a return of 3.0%, for the first six months of 2006. Gross investment income for the first six months of 2007 was \$113.7 million, an increase of 7.0%, compared to \$106.3 million for the first six months of 2006. Net realized investment gains were \$112 million for the first six months of 2007, an increase of 60.9% from the first six months of 2006, mainly due to the sale of certain convertible fixed maturity and equity securities in industry sectors that experienced significant appreciation during the period of our ownership, principally energy and natural resources. The change in net unrealized investment gains was \$3.2 million in the first six months of 2007, compared to a decrease of \$38.4 million in the first six months of 2006.

### **Fixed income**

Our fixed income portfolio returned 2.5% for the first six months of 2007, compared to 1.5 % for the first six months of 2006. During the 2007 period, we maintained a high quality fixed maturity portfolio with a relatively short duration of approximately 2.5 years which performed consistent with its characteristics and better than the longer-duration Lehman U.S. Aggregate Index benchmark.

### **Equities**

Our equity portfolio returned 12.3% for the first six months of 2007 versus 8.8% for the first six months of 2006. Our common stock portfolio returned 11.3% and 10.3% for the first six months of 2007 and 2006, respectively, or 4.3 and 7.6 percentage points better than the S&P 500 benchmark, respectively.

### **Impairment**

See Note 6 Investment Securities of the accompanying consolidated financial statements for our analysis of impairment losses on investment securities.



## Non-GAAP Financial Measures

This report includes four non-GAAP financial measures that have been reconciled to their most comparable GAAP financial measures. OneBeacon believes these measures to be useful supplements to the comparable GAAP measures in evaluating OneBeacon's financial performance. In addition, certain of these non-GAAP financial measures have been adjusted to exclude the impacts of economically defeasing the Company's mandatorily redeemable preferred stock. As described in more detail in the Company's Annual Report on Form 10-K for the year ended December 31, 2006, in connection with its initial public offering, the Company created two irrevocable grantor trusts and funded them with assets sufficient to make the remaining dividend and redemption payments for \$20.0 million of preferred stock that was redeemed in June 2007 and \$300.0 million of preferred stock that will be redeemed in May of 2008. The Company created and funded these trusts to appropriately capitalize and leverage the Company in preparation for and in connection with its initial public offering. Having completed these actions, OneBeacon believes that presentation of certain of the non-GAAP financial measures as described below, adjusted to exclude the impact of the economic defeasance of the preferred stock as of and for the respective periods, is a useful supplement to understanding the Company's earnings and profitability.

**Adjusted book value per common share** is a non-GAAP financial measure which is derived by excluding the impact of economically defeasing the Company's mandatorily redeemable preferred stock from book value per common share, the most closely comparable GAAP measure. For the reason stated above, OneBeacon believes that adjusted book value per common share is a useful supplement to understanding the Company's earnings and profitability. The reconciliation of book value per common share to adjusted book value per common share is included on page 24.

**Adjusted book value per common share, including dividends** is a non-GAAP financial measure which is derived by adding back the impact of dividends paid to adjusted book value per common share (a non-GAAP financial measure described above). OneBeacon believes that adjusted book value per common share, including dividends is a useful supplement to understanding the Company's earnings and profitability. The reconciliation of book value per common share to adjusted book value per common share, including dividends is included on page 24.

**Adjusted common shareholders' equity**, which is used in calculating adjusted book value per common share (a non-GAAP financial measure described above), is derived by excluding the impact of economically defeasing the Company's mandatorily redeemable preferred stock from common shareholders' equity, the most closely comparable GAAP measure. The reconciliation of common shareholders' equity to adjusted common shareholders' equity is included on page 24.

**Adjusted common shareholders' equity, including dividends**, which is used in calculating adjusted book value per common share, including dividends (a non-GAAP financial measure described above), is derived by adding back the impact of dividends paid to adjusted common shareholders' equity (a non-GAAP financial measure described above). The reconciliation of common shareholders' equity to adjusted common shareholders' equity is included on page 24.

## Liquidity and Capital Resources

### *Operating cash and short-term investments*

Our sources and uses of cash are as follows:

*Holding company level.* The primary sources of cash for OneBeacon Insurance Group, Ltd. and certain of our intermediate holding companies are expected to be dividends and tax sharing payments received from our insurance operating subsidiaries, financing activities and net investment income and proceeds from sales and maturities of holding company investments. The primary uses of cash are expected to be interest payments on our debt obligations, dividend payments on our preferred shares and our common shares, purchases of investments, payments made to tax authorities and holding company operating expenses.

*Operating subsidiary level.* The primary sources of cash for our operating subsidiaries are expected to be premium

collections, financing activities, net investment income and proceeds from sales and maturities of investments. The primary uses of cash are expected to be claim payments, policy acquisition costs, debt obligations, operating expenses, the purchase of investments and dividends and tax sharing payments made to parent holding companies.

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Insurance companies typically collect premiums on policies that they write prior to paying claims made under those policies. During periods of premium growth, insurance companies typically experience positive cash flow from operations, as premium receipts typically exceed claim payments. When this happens, positive cash flow from operations is usually offset by negative cash flow from investing activities, as the positive operating cash flow is used to purchase investments. Conversely, during periods of premium decline, insurance companies typically experience negative cash flow from operations, even during periods in which they report GAAP net income, as the claims that they pay exceed the premiums that they collect. When this happens, negative cash flow from operations is typically offset by positive cash flow from investing activities, as invested assets are sold to fund current claim payments.

Both internal and external forces influence our financial condition, results of operations and cash flows. Claim settlements, premium levels and investment returns may be impacted by changing rates of inflation and other economic conditions. In many cases, significant periods of time, ranging up to several years or more, may lapse between the occurrence of an insured loss, the reporting of the loss to us and the settlement of the liability for that loss. The exact timing of the payment of claims and benefits cannot be predicted with certainty. Our operating subsidiaries maintain portfolios of invested assets with varying maturities and a substantial amount of short-term investments to provide adequate liquidity for the payment of claims.

Management believes that our cash balances, cash flows from operations and cash flows from investments are adequate to meet expected cash requirements for the foreseeable future on both a holding company and operating subsidiary level.

#### *Dividend Capacity*

Under the insurance laws of the states and jurisdictions under which our operating subsidiaries are domiciled, an insurer is restricted with respect to the timing or the amount of dividends it may pay without prior approval by regulatory authorities. Accordingly, there can be no assurance regarding the amount of such dividends that may be paid by such subsidiaries in the future.

Generally, our regulated insurance operating subsidiaries have the ability to pay dividends during any 12-month period without the prior approval of regulatory authorities in an amount equal to the greater of prior year statutory net income or 10% of prior year end statutory surplus, subject to the availability of unassigned funds. As a result, based on 2006 statutory net income, our top tier regulated insurance operating subsidiaries have the ability to pay an aggregate of approximately \$234 million of dividends during 2007 without prior approval of regulatory authorities, subject to the availability of unassigned funds.

During the first six months of 2007, OneBeacon Insurance Group LLC (OneBeacon LLC), the direct parent of our operating insurance subsidiaries, paid \$140.0 million of dividends to Fund American Companies, Inc. (Fund American), its parent.

In addition, Fund American's ability to declare or pay dividends is limited by the terms of the Series A Preferred Stock issued to Berkshire. Fund American may not, in certain circumstances, declare or pay any dividend or distribution to any other class or series of stock without the consent of the holders of a majority of outstanding shares of the Berkshire Preferred Stock. Under the terms of a Keep-Well Agreement dated November 30, 2004 between White Mountains and Fund American (the Keep-Well), White Mountains has agreed to return to Fund American up to approximately \$1.1 billion if some or all of that amount is required by Fund American to meet its obligations under the terms of the Berkshire Preferred Stock. Under the Keep-Well, White Mountains must make any required contributions to Fund American prior to making any distributions to its shareholders. The aggregate amount of distributions that White Mountains may make to its shareholders is limited; the limit increases or decreases by an amount equal to White Mountains' consolidated net income or loss over the remaining life of the Keep-Well. The Keep-Well will expire when all obligations of the Berkshire Preferred Stock, which is redeemable in May 2008, have been satisfied. See

Management's Discussion of Financial Condition and Results of Operations Economic Defeasance for a discussion of the creation and funding of an irrevocable grantor trust to economically defease the Berkshire Preferred Stock.

### **Economic Defeasance**

In connection with our initial public offering, two of our subsidiaries, Fund American and Fund American Enterprises, each established an irrevocable grantor trust. The assets of each trust are solely dedicated to the satisfaction of the payment of dividends and redemption amounts on, respectively, \$300 million liquidation preference of Fund American's Berkshire Preferred Stock, and \$20 million liquidation preference of Fund American Enterprises' Zenith Preferred Stock. Fund American and Fund American Enterprises funded their respective trust with cash and purchased a portfolio of fixed maturity securities issued by the U.S. government and government-sponsored enterprises, the scheduled interest and principal payments are sufficient to pay when due all amounts required under the terms of the Berkshire Preferred Stock and the Zenith Preferred Stock, respectively (including the mandatory redemption of the Berkshire Preferred Stock in May 2008 and the redemption of the Zenith Preferred Stock, which was exercised in June 2007). The creation and funding of the trusts does not legally defease the preferred stock nor create any additional rights for the holders of the Berkshire Preferred Stock and the Zenith Preferred Stock either in the trusts or otherwise, although the assets in the trusts remain segregated from Fund American's and Fund American Enterprises' other general assets and are not available to Fund American or Fund American Enterprises for any use other than the payment of the Berkshire Preferred Stock and the Zenith Preferred Stock, respectively. The assets of each trust remain subject to the claims of Fund American's and Fund American Enterprises' creditors, respectively, in the event that either Fund American or Fund American Enterprises becomes insolvent. White Mountains Capital, Inc., a subsidiary of White Mountains, serves as the trustee for both irrevocable grantor trusts. In the second quarter of 2007, the Zenith Preferred Stock was redeemed for \$20.0 million. The assets held in the trusts as of June 30, 2007 and December 31, 2006, include \$311.9 million and \$305.0 million, respectively, of fixed maturity investment and \$0.1 million and \$33.8 million, respectively, of short-term investments. Pre-tax net investment income earned on these investments totaled \$4.1 million and \$8.3 million, respectively, for the three and six months ended June 30, 2007.

## Financing

The following table summarizes our capital structure as of June 30, 2007 and December 31, 2006:

	As of June 30, 2007 (\$ in millions)		As of December 31, 2006	
Senior Notes, carrying value	\$ 698.8		\$ 698.7	
Other debt	58.8		60.8	
Total debt	757.6		759.5	
Preferred stock subject to mandatory redemption	259.2		262.3	
Total common shareholders' equity	1,861.3		1,777.2	
Total capital	\$ 2,878.1		\$ 2,799.0	
Ratio of debt and preferred stock subject to mandatory redemption to total capital	35.3	%	36.5	%
Ratio of debt to total capital excluding preferred stock subject to mandatory redemption (1)	28.9	%	29.9	%

(1) The calculation of total capital excludes the preferred stock subject to mandatory redemption because it was economically defeased in connection with our initial public offering.

We believe that our strong financial position provides us with the flexibility and capacity to obtain funds externally as needed through debt or equity financing on both a short-term and long-term basis.

The 5.875% Senior Notes due 2013 of our subsidiary Fund American, which we refer to as the Senior Notes, are currently rated Baa2 (Medium Grade, the ninth highest of twenty-one ratings) with a stable outlook by Moody's, BBB (Adequate, the ninth highest of twenty-two ratings) with a stable outlook by Standard & Poor's, bbb (Very Good, the ninth highest of twenty-two ratings) with a stable outlook by A.M. Best and BBB (Good, the ninth highest of twenty-three ratings) with a stable outlook by Fitch.

In connection with our purchase of land and an office building in Canton, Massachusetts, which is now our U.S. headquarters, we entered into a \$40.8 million mortgage note to fund renovations. As of December 31, 2006, we had fully drawn on the facility.

White Mountains currently provides an irrevocable and unconditional guarantee as to the payment of principal and interest (the Guarantee) on the Senior Notes. In consideration of this Guarantee, we have agreed to pay a specified fee to White Mountains in the amount of 25 basis points per annum on the outstanding principal amount of the Senior Notes. We have further agreed that if White Mountains' voting interest in us ceases to represent more than 50% of all our voting securities, we will redeem, exchange or otherwise modify the Senior Notes in order to fully and permanently eliminate White Mountains' obligations under the Guarantee (the Guarantee Elimination). White Mountains has agreed to provide written notice to us when its voting interest in us has been reduced below 50%. We will have 180 days from the receipt of such notification to complete the Guarantee Elimination. If the Guarantee Elimination is not completed within the initial 180-day period, the Guarantee fee shall increase by 200 basis points. The Guarantee fee shall further increase by 100 basis points for each subsequent 90-day period thereafter, up to a maximum Guarantee fee of 425 basis points, until the Guarantee Elimination has been completed.

The Senior Notes were issued under an indenture which contains restrictive covenants that, among other things, limit the ability of White Mountains, Fund American and their respective subsidiaries, which includes us, as a subsidiary of White Mountains, to create liens and enter into sale and leaseback transactions and substantially limits the ability of Fund American and its respective subsidiaries to consolidate, merge or transfer their properties and assets. The indenture does not contain any financial ratios or specified levels of net worth or liquidity to which White Mountains or Fund American must adhere. At June 30, 2007, Fund American was in compliance with all of the covenants under the Senior Notes.

In connection with the initial public offering, White Mountains and Fund American terminated their existing \$400 million credit facility, under which they were both permitted borrowers. In November 2006, Fund American established a \$75 million revolving credit facility that matures in November 2011. As of June 30, 2007, the Bank Facility was undrawn. The Bank Facility contains various affirmative, negative and financial covenants which we consider to be customary for such borrowings and include maintaining certain minimum net worth and maximum debt to capitalization standards. Failure to meet one or more of these covenants could result in an event of default, which ultimately could eliminate availability under these facilities and result in acceleration of principal repayment on any amounts outstanding. At June 30, 2007, we were in compliance with all of the covenants under the Bank Facility, and anticipate we will continue to remain in compliance with these covenants for the foreseeable future.

#### **Off-Balance Sheet Arrangement**

Beginning in February 2006, OBIC, agreed to provide guarantees of the obligations of Galileo, to Galileo's counterparty in certain weather-related product transactions. Galileo is a subsidiary of White Mountains. The guarantees require OBIC to pay the full amount of Galileo's obligations to the counterparty in the event of Galileo's failure to pay these obligations. In the event of a payment, OBIC would be eligible to exercise all of the rights of the counterparty against Galileo. As of June 30, 2007 there was one outstanding guarantee with a principal value of \$5.0 million. In the event that the total guaranteed principal amount exceeds the lesser of 5% of OBIC's admitted assets of \$3.8 billion at December 31, 2006 or 25% of OBIC's statutory surplus of \$1.7 billion at December 31, 2006, OBIC would require the approval of the Pennsylvania Department of Insurance in order to make any further guarantees. OBIC has agreed, at White Mountains' option, to continue to make these guarantees available until October 2008 and will receive from Galileo an annual fee of 25 basis points of the value at risk for providing the guarantees. Pursuant to a separation agreement entered into by OneBeacon and White Mountains in connection with the initial public offering, White Mountains has agreed that it will take appropriate steps to ensure that OBIC will not be called on to make payment on these guarantees.

#### **Cash Flows**

Detailed information concerning our cash flows for the six months ended June 30, 2007 and 2006 follows:

##### *For the six months ended June 30, 2007*

##### *Financing and Other Capital Activities*

During the first six months of 2007, we declared \$42.0 million and paid \$26.9 million in cash dividends to holders of our common shares. The remaining \$15.1 million of dividends was paid in July 2007.

During the first six months of 2007, we declared and paid cash dividends of \$14.1 million and \$1.0 million to holders of the Berkshire Preferred Stock and the Zenith Preferred Stock, respectively.

During the second quarter of 2007, we redeemed the Zenith Preferred Stock for \$20.0 million, its redemption value.

##### *Acquisitions and Dispositions*

*We did not execute any significant acquisitions or dispositions during the first six months of 2007.*

##### *Other Liquidity and Capital Resource Activities*