

HANOVER INSURANCE GROUP, INC.

Form 10-Q

May 08, 2008

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2008

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: 1-13754

THE HANOVER INSURANCE GROUP, INC.

(Exact name of registrant as specified in its charter)

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Delaware
(State or other jurisdiction of
incorporation or organization)

04-3263626
(I.R.S. Employer
Identification No.)

440 Lincoln Street, Worcester, Massachusetts 01653
(Address of principal executive offices) (Zip Code)

(508) 855-1000
(Registrant's telephone number, including area code)

(Former name, former address and former fiscal year, if changed since last report)

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

Indicate by check mark whether the registrant 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 (check one):

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 Act). Yes ☐ No ☒

APPLICABLE ONLY TO ISSUERS INVOLVED IN BANKRUPTCY

PROCEEDINGS DURING THE PRECEDING FIVE YEARS:

Indicate by check mark whether the registrant has filed all documents and reports required to be filed by Section 12, 13 or 15(d) of the Securities Exchange Act of 1934 subsequent to the distribution of securities under a plan confirmed by a court. Yes ☐ No ☐

APPLICABLE ONLY TO CORPORATE ISSUERS:

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date: 51,396,389 shares of common stock outstanding, as of May 1, 2008.

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Table of Contents**PART I FINANCIAL INFORMATION****ITEM 1 FINANCIAL STATEMENTS****THE HANOVER INSURANCE GROUP, INC.****CONSOLIDATED STATEMENTS OF INCOME**

(In millions, except per share data)	(Unaudited) Three Months Ended March 31,	
	2008	2007
REVENUES		
Premiums	\$ 630.6	\$ 602.2
Net investment income	80.7	80.2
Net realized investment (losses) gains	(5.0)	2.3
Fees and other income	11.1	13.4
Total revenues	717.4	698.1
BENEFITS, LOSSES AND EXPENSES		
Policy benefits, claims, losses and loss adjustment expenses	406.4	385.5
Policy acquisition expenses	137.6	127.2
Other operating expenses	92.9	93.5
Total benefits, losses and expenses	636.9	606.2
Income before federal income taxes	80.5	91.9
Federal income tax expense:		
Current	10.8	22.0
Deferred	16.2	6.1
Total federal income tax expense	27.0	28.1
Income from continuing operations	53.5	63.8
Discontinued operations (See Note 3):		
Gain (loss) on disposal of variable life insurance and annuity business (net of income tax benefit of \$0.2 in 2007)	6.2	(0.2)
Other	(1.2)	
Net income	\$ 58.5	\$ 63.6
PER SHARE DATA		
Basic		
Income from continuing operations	\$ 1.03	\$ 1.25
Discontinued operations:		
Gain (loss) on disposal of variable life insurance and annuity business	0.12	(0.01)
Other	(0.02)	
Net income per share	\$ 1.13	\$ 1.24

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Weighted average shares outstanding	51.7	51.2
<u>Diluted</u>		
Income from continuing operations	\$ 1.02	\$ 1.23
Discontinued operations:		
Gain (loss) on disposal of variable life insurance and annuity business	0.12	(0.01)
Other	(0.02)	
Net income per share	\$ 1.12	\$ 1.22
Weighted average shares outstanding	52.3	51.9

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

Table of Contents**THE HANOVER INSURANCE GROUP, INC .****CONSOLIDATED BALANCE SHEETS**

	(Unaudited) March 31, 2008	December 31, 2007
(In millions, except per share data)		
ASSETS		
Investments:		
Fixed maturities, at fair value (amortized cost of \$5,654.8 and \$5,723.1)	\$ 5,646.6	\$ 5,722.0
Equity securities, at fair value (cost of \$45.2 and \$37.6)	49.1	44.9
Mortgage loans	38.3	41.2
Policy loans	111.9	116.0
Other long-term investments	30.1	30.7
Total investments	5,876.0	5,954.8
Cash and cash equivalents	233.3	262.8
Accrued investment income	73.5	70.9
Premiums, accounts and notes receivable, net	557.5	540.8
Reinsurance receivable on paid and unpaid losses, benefits and unearned premiums	1,353.2	1,378.9
Deferred policy acquisition costs	254.5	250.5
Deferred federal income taxes	316.5	330.5
Goodwill	131.9	126.0
Other assets	479.8	419.1
Separate account assets	424.4	481.3
Total assets	\$ 9,700.6	\$ 9,815.6
LIABILITIES		
Policy liabilities and accruals:		
Future policy benefits	\$ 1,157.3	\$ 1,164.9
Outstanding claims, losses and loss adjustment expenses	3,194.5	3,239.5
Unearned premiums	1,163.2	1,157.1
Contractholder deposit funds and other policy liabilities	163.3	179.2
Total policy liabilities and accruals	5,678.3	5,740.7
Expenses and taxes payable	677.0	696.4
Reinsurance premiums payable	48.5	47.2
Trust instruments supported by funding obligations	39.8	39.1
Long-term debt	511.9	511.9
Separate account liabilities	424.4	481.3
Total liabilities	7,379.9	7,516.6
Commitments and contingencies (Note 13)		
SHAREHOLDERS' EQUITY		
Preferred stock, \$0.01 par value, 20.0 million shares authorized, none issued		
Common stock, \$0.01 par value, 300.0 million shares authorized, 60.5 million shares issued	0.6	0.6
Additional paid-in capital	1,798.4	1,822.6
Accumulated other comprehensive loss	(23.7)	(20.4)

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Retained earnings	1,012.6	946.9
Treasury stock at cost (9.2 million and 8.7 million shares)	(467.2)	(450.7)
Total shareholders' equity	2,320.7	2,299.0
Total liabilities and shareholders' equity	\$ 9,700.6	\$ 9,815.6

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

Table of Contents**THE HANOVER INSURANCE GROUP, INC.****CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY**

(In millions)	(Unaudited) Three Months Ended March 31,	
	2008	2007
PREFERRED STOCK		
Balance at beginning and end of period	\$	\$
COMMON STOCK		
Balance at beginning and end of period	0.6	0.6
ADDITIONAL PAID-IN CAPITAL		
Balance at beginning of period	1,822.6	1,814.3
Tax benefit from stock options and other	0.2	0.8
Employee and director stock-based awards	(24.4)	(0.4)
Balance at end of period	1,798.4	1,814.7
ACCUMULATED OTHER COMPREHENSIVE LOSS		
NET UNREALIZED APPRECIATION (DEPRECIATION) ON INVESTMENTS AND DERIVATIVE INSTRUMENTS:		
Balance at beginning of period	5.5	(9.0)
Net (depreciation) appreciation during the period:		
Net (depreciation) appreciation on available-for-sale securities and derivative instruments	(3.6)	24.1
Benefit (provision) for deferred federal income taxes	1.2	(4.7)
	(2.4)	19.4
Balance at end of period	3.1	10.4
DEFINED BENEFIT PENSION AND POSTRETIREMENT PLANS:		
Balance at beginning of period	(25.9)	(30.9)
Amounts arising in the period	(0.1)	
Amortization during the period:		
Amount recognized as net periodic benefit cost	(1.2)	(0.9)
Benefit for deferred federal income taxes	0.4	0.3
	(0.9)	(0.6)
Balance at end of period	(26.8)	(31.5)
Total accumulated other comprehensive loss	(23.7)	(21.1)
RETAINED EARNINGS		
Balance at beginning of period, before cumulative effect of accounting change	946.9	712.0
Cumulative effect of accounting change		11.5
Balance at beginning of period, as adjusted	946.9	723.5

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Net income	58.5	63.6
Treasury stock issued for less than cost	(5.6)	(4.7)
Recognition of share-based compensation	12.8	0.4
Balance at end of period	1,012.6	782.8
TREASURY STOCK		
Balance at beginning of period	(450.7)	(487.8)
Shares purchased at cost	(32.9)	
Net shares reissued at cost under employee stock-based compensation plans	16.4	11.5
Balance at end of period	(467.2)	(476.3)
Total shareholders' equity	\$ 2,320.7	\$ 2,100.7

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

Table of Contents**THE HANOVER INSURANCE GROUP, INC.****CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**

(In millions)	(Unaudited)	
	Three Months Ended	
	March 31,	
	2008	2007
Net income	\$ 58.5	\$ 63.6
Other comprehensive (loss) income :		
Available-for-sale securities:		
Net (depreciation) appreciation during the period	(3.3)	24.3
Benefit (provision) for deferred federal income taxes	1.1	(4.8)
Total available-for-sale securities	(2.2)	19.5
Derivative instruments:		
Net depreciation during the period	(0.3)	(0.2)
Benefit for deferred federal income taxes	0.1	0.1
Total derivative instruments	(0.2)	(0.1)
	(2.4)	19.4
Pension and postretirement benefits:		
Amounts arising in the period	(0.1)	
Amortization recognized as net periodic benefit costs:		
Net actuarial loss	0.3	0.1
Prior service cost	(1.1)	(0.6)
Transition asset	(0.4)	(0.4)
Total amortization recognized as net periodic benefit costs	(1.2)	(0.9)
Benefit for deferred federal income taxes	0.4	0.3
Total pension and postretirement benefits	(0.9)	(0.6)
Other comprehensive (loss) income	(3.3)	18.8
Comprehensive income	\$ 55.2	\$ 82.4

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

Table of Contents**THE HANOVER INSURANCE GROUP, INC.****CONSOLIDATED STATEMENTS OF CASH FLOWS**

(In millions)	(Unaudited) Three Months Ended March 31,	
	2008	2007
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	\$ 58.5	\$ 63.6
Adjustments to reconcile net income to net cash used in operating activities:		
(Gain) loss on disposal of variable life insurance and annuity business	(6.2)	0.2
Loss from other discontinued operations	1.2	
Net realized investment losses (gains)	5.0	(2.3)
Net amortization and depreciation	4.1	4.9
Stock-based compensation expense	3.4	4.4
Deferred federal income taxes	16.2	6.1
Change in deferred acquisition costs	(3.0)	(6.0)
Change in premiums and notes receivable, net of reinsurance premiums payable	(60.4)	(14.7)
Change in accrued investment income	(2.6)	(2.6)
Change in policy liabilities and accruals, net	(67.6)	(3.9)
Change in reinsurance receivable	31.2	8.6
Change in expenses and taxes payable	(56.8)	(99.6)
Other, net	(4.3)	0.7
Net cash used in operating activities	(81.3)	(40.6)
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from disposals and maturities of available-for-sale fixed maturities	276.6	292.3
Proceeds from disposals of equity securities and other investments	4.8	5.9
Proceeds from mortgages sold, matured or collected	2.9	0.8
Proceeds from collections of installment finance and notes receivable	118.7	104.2
Net cash used to acquire Verlan Holdings, Inc (1)	(2.2)	
Purchase of available-for-sale fixed maturities	(214.8)	(309.5)
Purchase of equity securities and other investments	(8.1)	
Capital expenditures	(3.9)	(2.4)
Disbursements to fund installment finance and notes receivable	(106.9)	(122.3)
Net cash provided by (used in) investing activities	67.1	(31.0)
CASH FLOWS FROM FINANCING ACTIVITIES		
Exercise of options	2.5	5.7
Proceeds from excess tax benefits related to share-based payments	0.1	0.6
Change in short term debt	37.2	
Change in collateral related to securities lending program	(16.5)	(88.9)
Treasury stock purchased at cost	(32.9)	
Net cash used in financing activities	(9.6)	(82.6)
Net change in cash and cash equivalents	(23.8)	(154.2)
Net change in cash and cash equivalents held by AMGRO, Inc. (See Note - 12)	(5.7)	3.7
Cash and cash equivalents, beginning of period	262.4	364.4

Cash and cash equivalents, end of period	\$ 233.3	\$ 213.9
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- (1) The net cash used to acquire Verlan Holdings, Inc. excludes \$24.5 million of funds being held by Hanover Insurance, who is acting as the facilitator of the transaction payments to shareholders. As of May 1, 2008, approximately \$22 million of these funds has been paid to shareholders of Verlan. See Note 12 - Significant Transactions.

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

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THE HANOVER INSURANCE GROUP, INC.

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

1. Basis of Presentation and Principles of Consolidation

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

The interim consolidated financial statements of THG include the accounts of The Hanover Insurance Company (Hanover Insurance), and Citizens Insurance Company of America (Citizens), THG's principal property and casualty companies; First Allmerica Financial Life Insurance Company (FAFLIC), THG's life insurance and annuity subsidiary; and certain other insurance and non-insurance subsidiaries. These legal entities conduct their operations through several business segments discussed in Note 9. All significant intercompany accounts and transactions have been eliminated.

The accompanying interim consolidated financial statements reflect, in the opinion of the Company's management, all adjustments necessary for a fair presentation of the financial position and results of operations. The results of operations for the three months ended March 31, 2008 are not necessarily indicative of the results to be expected for the full year. These financial statements should be read in conjunction with the Company's 2007 Annual Report on Form 10-K filed with the Securities and Exchange Commission.

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

2. New Accounting Pronouncements

Recently Issued Standards

In December 2007, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 141 (revised 2007), *Business Combinations* (Statement No. 141(R)). Statement No. 141(R) requires the acquiring entity in a business combination to recognize all assets acquired and liabilities assumed in a transaction at the acquisition-date fair value, with certain exceptions. Additionally, the statement requires changes to the accounting treatment of acquisition related items, including, among other items, transaction costs, contingent consideration, restructuring costs, indemnification assets and tax benefits. Statement No. 141(R) also provides for a substantial number of new disclosure requirements. This statement is effective for business combinations initiated on or after the first annual reporting period beginning after December 15, 2008. The Company expects that Statement No. 141(R) will have an impact on its accounting for future business combinations once the statement is adopted, but the effect is dependent upon acquisitions, if any, that are made in the future.

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

Recently Adopted Standards

In February 2007, the FASB issued Statement of Financial Accounting Standards No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities Including an amendment of FASB Statement No. 115* (Statement No. 159). Statement No. 159 permits a company to choose, at specified election dates, to measure at fair value certain eligible financial assets and liabilities that are not currently required to be measured at fair value. The specified election dates include, but are not limited to, the date when an entity first recognizes the item, when an entity enters into a firm commitment or when changes in the financial instrument causes it to no longer qualify for fair value accounting under a different accounting standard. An entity may elect the fair value

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option for eligible items that exist at the effective date. At that date, the difference between the carrying amounts and the fair values of eligible items for which the fair value option is elected should be recognized as a cumulative effect adjustment to the opening balance of retained earnings. The fair value option may be elected for each entire financial instrument, but need not be applied to all similar instruments. Once the fair value option has been elected, it is irrevocable. Unrealized gains and losses on items for which the fair value option has been elected will be reported in earnings. Statement No. 159 was effective as of the beginning of fiscal years that begin after November 15, 2007. The Company did not elect to implement the fair value option for eligible financial assets and liabilities as of January 1, 2008.

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157, *Fair Value Measurements* (Statement No. 157). This statement creates a common definition of fair value to be used throughout generally accepted accounting principles. Statement No. 157 will apply whenever another standard requires or permits assets or liabilities to be measured at fair value, with certain exceptions. The standard establishes a hierarchy for determining fair value which emphasizes the use of observable market data whenever available. The statement also requires expanded disclosures which include the extent to which assets and liabilities are measured at fair value, the methods and assumptions used to measure fair value and the effect of fair value measures on earnings. Statement No. 157 was effective for fiscal years beginning after November 15, 2007 and interim periods within those fiscal years. The difference between the carrying amounts and fair values of those financial instruments held at the date this statement is initially applied should be recognized as a cumulative effect adjustment to the opening balance of retained earnings for the fiscal year in which this statement is initially applied. Additionally, in February 2008, the FASB issued Staff Position FAS 157-2, *Effective Date of FASB Statement No. 157*, which delays the effective date of Statement No. 157 for all non-recurring fair value measurements of nonfinancial assets and nonfinancial liabilities until the fiscal year beginning after November 15, 2008. As a result, the Company has partially applied the provisions of Statement No. 157 upon adoption at January 1, 2008 and has deferred the adoption for certain nonfinancial assets and liabilities as allowed by this staff position. The effect of adopting Statement No. 157 was not material to the Company's financial position or results of operations. See further disclosure in Note 7 Fair Value .

In June 2006, the FASB issued Interpretation No. 48, *Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109* (FIN 48). The interpretation requires companies to recognize the tax benefits of uncertain tax positions only when the position is more likely than not to be sustained upon examination by tax authorities. The amount recognized would be the amount that represents the largest amount of tax benefit that is greater than 50% likely of being ultimately realized. A liability would be recognized for any benefit claimed, or expected to be claimed, in a tax return in excess of the benefit recorded in the financial statements, along with any interest and penalty on the excess. FIN 48 will require, among other items, a tabular reconciliation of the change during the reporting period, in the aggregate unrecognized tax benefits claimed or expected to be claimed in tax returns and disclosure relating to accrued interest and penalties for unrecognized tax benefits. Additional disclosure will also be required for those uncertain tax positions where it is reasonably possible that the estimate of the tax benefit will change significantly in the next twelve months. FIN 48 was effective for fiscal years beginning after December 15, 2006. The Company adopted FIN 48 as of January 1, 2007 which resulted in an increase to shareholders' equity of \$11.5 million (See also Note 4-Federal Income Taxes).

3. Sale of Variable Life Insurance and Annuity Business

On December 30, 2005, the Company sold all of the outstanding shares of capital stock of Allmerica Financial Life Insurance and Annuity Company (AFLIAC), a life insurance subsidiary representing approximately 95% of the Company's run-off variable life insurance and annuity business, to The Goldman Sachs Group, Inc. (Goldman Sachs). The transaction also included the reinsurance of 100% of the variable business of FAFLIC. In connection with these transactions, Allmerica Investment Trust agreed to transfer certain assets and liabilities of its funds to certain Goldman Sachs Variable Insurance Trust managed funds through a fund reorganization transaction. Finally, the Company agreed to sell to Goldman Sachs all of the outstanding shares of capital stock of Allmerica Financial Investment Management Services, Inc. (AFIMS), its investment advisory subsidiary, concurrently with the consummation of a fund reorganization transaction. The fund reorganization transaction was consummated on January 9, 2006. Total proceeds from this transaction were \$318.8 million, of which the Company has received \$307.1 million as of March 31, 2008. The remaining \$11.7 million will be received in December 2008.

The Company and Goldman Sachs have made various representations, warranties and covenants in connection with the transaction. The Company has agreed to indemnify Goldman Sachs for the breaches of the Company's representations, warranties and covenants. THG has also agreed to indemnify Goldman Sachs for certain litigation, regulatory matters and other liabilities relating to the pre-closing activities of the business that was sold.

The Company accounted for the disposal of AFLIAC as a discontinued operation in accordance with Statement of Financial Accounting Standards No. 144, *Accounting for the Impairment or Disposal of Long-lived Assets*. The Company recognized a net gain of \$6.2 million and a net loss of \$0.2 million during the first quarter of 2008 and 2007, respectively, which are presented in

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the Consolidated Statements of Income as Gain (Loss) on Disposal of Variable Life Insurance and Annuity Business, a component of discontinued operations.

Included in the \$6.2 million gain in 2008 was a release of \$5.8 million related to the Company's estimated potential liability for certain contractual indemnities to Goldman Sachs relating to the pre-sale activities of the business sold recorded under FASB Interpretation No. 45, *Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Others* (FIN 45). The Company regularly reviews and updates its FIN 45 liability for legal and regulatory matter indemnities. Although the Company believes its current estimate for its FIN 45 liability is appropriate, there can be no assurance that these estimates will not materially increase in the future. Adjustments to this reserve are recorded in the results of the Company in the period in which they are determined. The loss in 2007 primarily consists of operations conversion costs associated with this variable business.

4. Federal Income Taxes

Federal income tax expense for the three months ended March 31, 2008 and 2007 has been computed using estimated effective tax rates. These rates are revised, if necessary, at the end of each successive interim period to reflect the current estimates of the annual effective tax rates.

In the first quarter of 2008, the Company increased its valuation allowance related to its deferred tax asset by \$3.3 million, from \$166.1 million to \$169.4 million. The increase in this valuation allowance resulted primarily from our realized capital loss and unrealized depreciation of the Company's investment portfolio. Accordingly, the Company recorded a valuation allowance of \$1.8 million as an adjustment to Federal Income Tax Expense in its Consolidated Statements of Income, as well as a \$1.5 million valuation allowance as an adjustment to Contractholder Deposit Funds and Other Policy Liabilities for the deferred tax associated with unrealized losses of the Closed Block.

The Company or its subsidiaries files income tax returns in the U.S. federal jurisdiction and various state jurisdictions. With few exceptions, the Company and its subsidiaries are no longer subject to U.S. federal and state income tax examinations by tax authorities for years before 1995. The years 1995 through 2001 are currently being reviewed with the Internal Revenue Service (IRS) Appeals Division. The IRS audit of the years 2005 through 2006 commenced in December 2007.

Effective January 1, 2007, the Company adopted the provisions of FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109* (FIN 48). As a result of the implementation of FIN 48, the Company recognized an \$11.5 million decrease in the liability for unrecognized tax benefits, which was reflected as an increase in the January 1, 2007 balance of retained earnings.

5. Pension and Other Postretirement Benefit Plans

The Company's defined benefit pension plans, which provided retirement benefits based on a cash balance formula, were frozen as of January 1, 2005; therefore, no further cash balance allocations have been credited for plan years beginning on or after January 1, 2005. In addition, certain transition group employees were eligible for a grandfathered benefit based upon service and compensation; such benefits were also frozen at January 1, 2005 levels with an annual transition pension adjustment. The Company has additional unfunded pension plans and postretirement plans to provide benefits to certain full-time employees, former agents, retirees and their dependents.

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The components of net periodic benefit cost for pension and other postretirement benefit plans are as follows:

(In millions)	(Unaudited)			
	Three Months Ended March 31,			
	2008 Pension Benefits	2007 Pension Benefits	2008 Postretirement Benefits	2007 Postretirement Benefits
Service cost benefits earned during the period	\$	\$	\$ 0.2	\$ 0.2
Interest cost	8.2	7.3	0.9	1.2
Expected return on plan assets	(8.5)	(8.0)		
Recognized net actuarial loss	0.3		0.1	0.2
Amortization of transition asset	(0.4)	(0.4)		
Amortization of prior service cost			(1.1)	(0.6)
Net periodic (benefit) cost	\$ (0.4)	\$ (1.1)	\$ 0.1	\$ 1.0

6. Closed Block

Summarized financial information of the Closed Block is as follows for the periods indicated:

(In millions)	(Unaudited)	
	March 31, 2008	December 31, 2007
ASSETS		
Fixed maturities, at fair value (amortized cost of \$512.4 and \$512.0)	\$ 507.5	\$ 514.7
Mortgage loans	21.1	21.4
Policy loans	111.9	116.0
Cash and cash equivalents	3.4	3.8
Accrued investment income	10.2	11.0
Other assets	6.3	6.1
Total assets	\$ 660.4	\$ 673.0
LIABILITIES		
Policy liabilities and accruals	\$ 670.1	\$ 670.8
Policyholder dividends	5.3	22.1
Other liabilities	1.3	1.3
Total liabilities	\$ 676.7	\$ 694.2
Excess of Closed Block liabilities over assets designated to the Closed Block and maximum future earnings to be recognized from Closed Block assets and liabilities	\$ 16.3	\$ 21.2

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(In millions)	(Unaudited) Three Months Ended March 31,	
	2008	2007
REVENUES		
Premiums	\$ 12.8	\$ 17.6
Net investment income	9.8	9.6
Net realized investment (losses) gains	(1.3)	0.3
Total revenues	21.3	27.5
BENEFITS AND EXPENSES		
Policy benefits	18.2	26.4
Policy acquisition and other operating expenses	0.1	
Total benefits and expenses	18.3	26.4
Contribution from the Closed Block	\$ 3.0	\$ 1.1

Many expenses related to Closed Block operations are charged to operations outside the Closed Block; accordingly, the contribution from the Closed Block does not represent the actual profitability of the Closed Block operations. Operating costs and expenses outside of the Closed Block are, therefore, disproportionate to the business outside the Closed Block.

7. Fair Value

Effective January 1, 2008, the Company adopted the provisions of Statement No. 157 as it relates to its financial assets and liabilities, which defines fair value as the price that would be received to sell an asset or paid to transfer a liability, i.e., exit price, in an orderly transaction between market participants. Statement No. 157 also establishes a hierarchy for determining fair value which emphasizes the use of observable market data whenever available. The three broad levels defined by the hierarchy are as follows, with the highest priority level given to Level 1 as these are the most reliable, and the lowest priority given to Level 3:

- Level 1 Quoted prices in active markets for identical assets.
 - Level 2 Quoted prices for similar assets in active markets, quoted prices for identical or similar assets in markets that are not active, or other inputs that are observable or can be corroborated by observable market data, including model-derived valuations.
 - Level 3 Unobservable inputs that are supported by little or no market activity.
- When more than one level of input is used to determine fair value, the financial instrument is classified as Level 1, 2 or 3 according to the lowest priority level that has a significant impact on the fair value measurement.

The Company performs a review of the fair value hierarchy classification on a quarterly basis. Changes in the observability of valuation inputs may result in the reclassification of certain financial assets or liabilities within the fair value hierarchy. Reclassifications related to Level 3 of the fair value hierarchy are reported as transfers in or out of Level 3 as of the beginning of the quarter in which the reclassification occurs.

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The Company holds fixed maturity securities, equity securities, derivative instruments and separate account assets for which fair value is determined on a recurring basis. The following table presents for each hierarchy level, the Company's assets and liabilities that are measured at fair value at March 31, 2008.

(in millions)	Total	Fair Value		
		Level 1	Level 2	Level 3
U.S. Treasury securities and U.S. Government and agency securities	\$ 370.9	\$ 99.2	\$ 271.7	\$
States and political subdivisions	824.7		824.7	
Foreign governments	5.1	2.0	3.1	
Corporate fixed maturities	2,858.3	23.7	2,817.2	17.4
Mortgage-backed securities	1,587.6		1,566.8	20.8
Total fixed maturities	5,646.6	124.9	5,483.5	38.2
Equity securities (1)	38.1	36.8		1.3
Separate account assets	424.4	424.4		
Derivative assets (2)	7.8			7.8
Total assets at fair value	\$ 6,116.9	\$ 586.1	\$ 5,483.5	\$ 47.3
Derivative liabilities (3)	\$ (3.3)	\$	\$	\$ (3.3)

(1) Excludes certain investments in equities of unconsolidated affiliates totaling \$11.0 million that are carried at cost.

(2) Included on the Consolidated Balance Sheets in other assets.

(3) Included on the Consolidated Balance Sheets in expenses and taxes payable.

The table below presents a reconciliation for all assets and liabilities measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the three months ended March 31, 2008.

(in millions)	Level 3 Assets			Level 3 Liabilities	
	Fixed Maturities	Equity Securities	Derivatives	Total Assets	Derivatives
Balance January 1, 2008	\$ 30.5	\$ 1.3	\$ 5.8	\$ 37.6	\$ (1.1)
Total gains (losses):					
Included in earnings			2.3	2.3	(2.2)
Included in other comprehensive income	(0.1)		(0.3)	(0.4)	
Net purchases (redemptions/sales)	7.8			7.8	
Balance March 31, 2008	\$ 38.2	\$ 1.3	\$ 7.8	\$ 47.3	\$ (3.3)

The Company had no transfers in or out of Level 3 during the three months ended March 31, 2008. The amount included in earnings attributable to the change in unrealized gains relating to derivative assets still held as of March 31, 2008 was \$2.3 million, which is reflected in the Consolidated Statements of Income in fees and other income. The amount included in earnings attributable to the change in unrealized losses related to derivative liabilities still held as of March 31, 2008 was \$2.2 million, which is reflected in the Consolidated Statements of Income in other operating expenses.

The valuation methodologies used to measure financial instruments at fair value, and the level in the fair value hierarchy in which these instruments are generally classified are as follows:

Fixed Maturities: Level 1 securities generally include U.S. Treasury issues and other securities that are highly liquid and for which quoted market prices are available. Level 2 securities are valued using pricing for similar securities and pricing models that incorporate observable

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inputs including, but not limited to yield curves, broker/dealer quotes and issuer spreads. Level 3 securities include issues for which little observable data can be obtained, primarily due to the illiquid nature of the securities, and the majority of the inputs used to determine fair value are based on the Company's own assumptions.

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

Derivative instruments: These Level 3 valuations are derived from the counterparties' internally developed models which do not necessarily represent observable market data.

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Separate account assets: The Company's separate accounts are invested in variable insurance trust funds which have a daily net asset value obtainable from an active market.

8. Other Comprehensive Income

The following table provides a reconciliation of gross unrealized investment gains (losses) to the net balance shown in the Consolidated Statements of Comprehensive Income:

(In millions)	(Unaudited) Three Months Ended March 31,	
	2008	2007
Unrealized (depreciation) appreciation on available-for-sale securities:		
Unrealized holding (losses) gains arising during period, net of income tax benefit of \$2.9 in 2008 and expense of \$5.6 in 2007	\$ (5.4)	\$ 21.0
Less: reclassification adjustment for (losses) gains included in net income, net of income tax benefit of \$1.8 in 2008 and expense of \$0.8 in 2007	(3.2)	1.5
Total available-for-sale securities	(2.2)	19.5
Unrealized depreciation on derivative instruments:		
Unrealized holding losses arising during period, net of income tax benefit of \$0.1	(0.2)	
Less: reclassification adjustment for gains included in net income, net of income tax expense of \$0.1		0.1
Total derivative instruments	(0.2)	(0.1)
Other comprehensive (loss) income	\$ (2.4)	\$ 19.4

9. Segment Information

The Company's primary business operations include insurance products and services in three property and casualty operating segments. These segments are Personal Lines, Commercial Lines, and Other Property and Casualty. The fourth operating segment, Life Companies, is in run-off. In accordance with Statement of Financial Accounting Standards No. 131, *Disclosures About Segments of an Enterprise and Related Information* (Statement No. 131), the separate financial information of each segment is presented consistent with the way results are regularly evaluated by the chief operating decision maker in deciding how to allocate resources and in assessing performance. A summary of the Company's reportable segments is included below.

The Property and Casualty group manages its operations principally through three segments: Personal Lines, Commercial Lines and Other Property and Casualty. Personal Lines includes personal automobile, homeowners and other personal coverages, while Commercial Lines includes commercial multiple peril, commercial automobile, workers' compensation, and other commercial coverages, such as bonds and inland marine. In addition, the Other Property and Casualty segment consists of: Opus Investment Management, Inc. (Opus), which markets investment management services to institutions, pension funds and other organizations; earnings on holding company assets; AMGRO, Inc. (AMGRO), the Company's premium financing business; as well as voluntary pools in which the Company has not actively participated since 1995.

The Life Companies segment consists primarily of a block of traditional life insurance products (principally the Closed Block), the group retirement annuity contract business and the guaranteed investment contract business. Assets and liabilities related to the reinsured variable life insurance and annuity business, as well as the discontinued group life and health business, including group life and health voluntary pools, are also reflected in this segment. (See Note 3 Sale of Variable Life Insurance and Annuity Business)

The Company reports interest expense related to its corporate debt separately from the earnings of its operating segments. Corporate debt consists of the Company's junior subordinated debentures and its senior debentures.

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Management evaluates the results of the aforementioned segments on a pre-tax basis. Segment income excludes certain items which are included in net income, such as federal income taxes and net realized investment gains and losses, including certain gains or losses on derivative instruments, because fluctuations in these gains and losses are determined by interest rates, financial markets and the timing of sales. Also, segment income excludes net gains and losses on disposals of businesses, discontinued operations, restructuring costs, extraordinary items, the cumulative effect of accounting changes and certain other items. While

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these items may be significant components in understanding and assessing the Company's financial performance, management believes that the presentation of segment income enhances understanding of the Company's results of operations by highlighting net income attributable to the core operations of the business. However, segment income should not be construed as a substitute for net income determined in accordance with generally accepted accounting principles.

Summarized below is financial information with respect to business segments:

(In millions)	(Unaudited) Three Months Ended March 31,	
	2008	2007
Segment revenues:		
Property and Casualty:		
Personal Lines	\$ 403.2	\$ 393.6
Commercial Lines	283.6	255.5
Other Property and Casualty Commercial Lines	10.7	11.0
Total Property and Casualty	697.5	660.1
Life Companies	29.1	37.5
Intersegment revenues	(2.1)	(2.0)
Total segment revenues	724.5	695.6
Adjustments to segment revenues:		
Net realized investment (losses) gains	(5.0)	2.3
Other (loss) income	(2.1)	0.2
Total revenues	\$ 717.4	\$ 698.1
Segment income before federal income taxes:		
Property and Casualty:		
Personal Lines:		
GAAP underwriting (loss) income	\$ (4.6)	\$ 14.9
Net investment income	29.7	29.5
Other	2.5	3.0
Personal Lines segment income	27.6	47.4
Commercial Lines:		
GAAP underwriting income	36.4	20.9
Net investment income	30.9	27.3
Other	1.0	0.8
Commercial Lines segment income	68.3	49.0
Other Property and Casualty:		
GAAP underwriting (loss) income	(1.0)	0.3
Net investment income	3.7	3.9
Other	(0.6)	0.3
Other Property and Casualty segment income	2.1	4.5
Total Property and Casualty	98.0	100.9
Life Companies	(2.5)	(0.9)
Interest on corporate debt	(10.0)	(10.0)

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Segment income before federal income taxes	85.5	90.0
Adjustments to segment income:		
Net realized investment (losses) gains, net of amortization	(5.1)	1.9
Gain on derivative instruments	0.1	
Income from continuing operations before federal income taxes	\$ 80.5	\$ 91.9

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(In millions)	Identifiable Assets (Unaudited)	
	March 31, 2008	December 31, 2007
Property and Casualty (1)	\$ 7,490.3	\$ 7,313.2
Life Companies (2)	2,209.9	2,502.0
Intersegment eliminations	0.4	0.4
Total	\$ 9,700.6	\$ 9,815.6

(1) The Company reviews assets based on the total Property and Casualty Group and does not allocate between the Personal Lines, Commercial Lines and Other Property and Casualty segments. Includes \$146.6 million and \$110.7 million at March 31, 2008 and December 31, 2007, respectively related to AMGRO.

(2) Includes assets related to the Company's discontinued group life and health operations.

Discontinued Operations Group Life and Health

During 1999, the Company exited its group life and health insurance business, consisting of its Employee Benefit Services (EBS) business, its Affinity Group Underwriters business and its accident and health assumed reinsurance pool business. Prior to 1999, these businesses comprised substantially all of the former Corporate Risk Management Services segment. Accordingly, the operating results of the discontinued segment have been reported in accordance with Accounting Principles Board Opinion No. 30, *Reporting the Results of Operations Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions* (APB Opinion No. 30). In 1999, the Company recorded a \$30.5 million loss, net of taxes, on the disposal of this segment, consisting of after-tax losses from the run-off of the group life and health business of approximately \$46.9 million, partially offset by net proceeds from the sale of the EBS business of approximately \$16.4 million. Subsequent to the measurement date of June 30, 1999, approximately \$29.4 million of the aforementioned \$46.9 million loss has been generated from the operations of the discontinued business and net proceeds of \$12.5 million were received from the sale of the EBS business.

As permitted by APB Opinion No. 30, the Consolidated Balance Sheets have not been segregated between continuing and discontinued operations. At March 31, 2008 and December 31, 2007, the discontinued segment had assets of approximately \$304.2 million and \$311.1 million, respectively, consisting primarily of invested assets and reinsurance recoverables, and liabilities of approximately \$374.8 million and \$381.6 million, respectively, consisting primarily of policy liabilities.

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10. Stock-based Compensation

Compensation cost recorded pursuant to Statement No. 123(R) and the related tax benefits were as follows:

(In millions)	(Unaudited) Quarter Ended March 31,	
	2008	2007
Stock-based compensation expense	\$ 3.4	\$ 4.4
Tax benefit	1.2	1.5
Stock Options		

Information on the Company's stock option plan activity is summarized below.

(In whole shares and dollars)	(Unaudited) Three Months Ended March 31, 2008		(Unaudited) Three Months Ended March 31, 2007	
	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price
Outstanding, beginning of period	3,268,912	\$ 41.15	3,855,892	\$ 40.14
Granted	92,909	44.79	375,117	48.46
Exercised	69,350	35.98	164,368	34.87
Forfeited, cancelled or expired	123,650	52.70	18,575	39.61
Outstanding, end of period	3,168,821	\$ 40.91	4,048,066	\$ 41.13

Restricted Stock and Restricted Stock Units

The following table summarizes activity information about employee nonvested stock and performance based restricted share units:

(In whole shares and dollars)	(Unaudited) Three Months Ended March 31, 2008		(Unaudited) Three Months Ended March 31, 2007	
	Shares	Weighted Average Grant Date Fair Value	Shares	Weighted Average Grant Date Fair Value
Restricted stock and restricted stock units:				
Outstanding, beginning of period	179,416	\$ 46.79	53,835	\$ 38.82
Granted	284,202	45.09	144,522	48.35
Vested and exercised	6,000	35.87		
Forfeited	2,561	45.16	3,053	43.13
Outstanding, end of period	455,057	\$ 45.87	195,304	\$ 45.80
Performance-based restricted stock units:				
Outstanding, beginning of period (1)	402,929	\$ 44.16	515,710	\$ 42.22
Granted (1) (2)	127,624	42.40	75,286	48.46
Vested and exercised	342,757	44.27	112,616	36.88

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Forfeited	882	50.60	8,952	44.93
Outstanding, end of period (1)	186,914	\$ 45.64	469,428	\$ 43.68

- (1) Performance based restricted stock units are based upon the achievement of the performance metric at 100%. These units have the potential to range from 0% to 150% of the shares disclosed, which varies based on grant year and individual participation level.
- (2) In 2008, 69,644 performance based stock units were included as granted due to completion levels related to both the 2005 and 2006 grants, in excess of 100%. The weighted average grant date fair value for these awards was \$40.06. In 2007, 30,716 performance based stock units were included as granted due to completion levels related to 2004 grant, in excess of 100%. The weighted average grant date fair value for these awards was \$36.88.

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11. Earnings Per Share

The following table provides share information used in the calculation of the Company's basic and diluted earnings per share:

(In millions, except per share data)	(Unaudited) Three Months Ended March 31,	
	2008	2007
Basic shares used in the calculation of earnings per share	51.7	51.2
Dilutive effect of securities:		
Employee stock options	0.3	0.5
Non-vested stock grants	0.3	0.2
Diluted shares used in the calculation of earnings per share	52.3	51.9
Per share effect of dilutive securities on income from continuing operations and net income	\$ (0.01)	\$ (0.02)

Diluted earnings per share for the three months ended March 31, 2008 and 2007 excludes 2.0 million and 1.5 million, respectively, of common shares issuable under the Company's stock compensation plans, because their effect would be antidilutive.

12. Significant Transactions

On March 14, 2008, the Company acquired all of the outstanding shares of Verlan Holdings, Inc. for \$29.0 million. Verlan Holdings, Inc. is a specialty company providing property insurance to small and medium-sized manufacturing and distribution companies, and which historically has generated annual written premium of approximately \$18 million.

On March 10, 2008, the Company reached an agreement to sell its premium financing subsidiary, AMGRO to Premium Financing Specialists, Inc. The transaction is subject to regulatory review and approval, as well as the satisfaction of certain closing conditions, and is expected to close in the second quarter of 2008.

In accordance with Statement of Financial Accounting Standard No. 144, *Accounting for Impairment or Disposal of Long-Lived Assets*, the Balance Sheet for AMGRO has been reclassified as assets held for sale. The following table details the significant assets and liabilities reflected in AMGRO's Balance Sheet under the captions Other Assets and Expenses and taxes payable, respectively.

(In millions)	(Unaudited)	
	March 31, 2008	December 31, 2007
Assets:		
Cash and equivalents	\$ 18.3	\$ 12.6
Premiums, accounts and notes receivable	121.2	88.7
Other assets	7.1	9.4
Total assets	\$ 146.6	\$ 110.7
Liabilities:		
Expenses and taxes payable	\$ 12.2	\$ 19.8
Short-term debt (1)	128.3	85.0
Total liabilities	\$ 140.5	\$ 104.8

- (1) In 2007, this balance reflects intercompany borrowings from Hanover Insurance. In 2008, \$91.1 million of the borrowings were from Hanover Insurance and \$37.2 million were borrowing from an unaffiliated party. All intercompany amounts are eliminated in the Consolidated Balance Sheets.

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13. Commitments and Contingencies

LITIGATION

Durand Litigation

On March 12, 2007, a putative class action suit captioned Jennifer A. Durand v. The Hanover Insurance Group, Inc., The Allmerica Financial Cash Balance Pension Plan was filed in the United States District Court for the Western District of Kentucky. The named plaintiff, a former employee who received a lump sum distribution from the Company's Cash Balance Plan at or about the time of her termination, claims that she and others similarly situated did not receive the appropriate lump sum distribution because in computing the lump sum, the plan understated the accrued benefit in the calculation. The Company filed a motion to dismiss on the basis that the plaintiff failed to exhaust administrative remedies, which motion was granted without prejudice in a decision dated November 7, 2007. On December 3, 2007, plaintiff filed a Notice of Appeal of this dismissal to the United States Court of Appeals for the Sixth Circuit. In the Company's judgment, the outcome is not expected to be material to the Company's financial position, although it could have a material effect on the results of operations for a particular quarter or annual period.

Emerald Litigation

On July 24, 2002, an action captioned American National Bank and Trust Company of Chicago, as Trustee f/b/o Emerald Investments Limited Partnership, and Emerald Investments Limited Partnership v. Allmerica Financial Life Insurance and Annuity Company (Emerald) was commenced in the United States District Court for the Northern District of Illinois, Eastern Division. Although AFLIAC was sold to Goldman Sachs on December 30, 2005, the Company has agreed to indemnify AFLIAC and Goldman Sachs with respect to this litigation.

In 1999, plaintiffs purchased two variable annuity contracts with initial premiums aggregating \$5 million. Plaintiffs, who AFLIAC subsequently identified as engaging in frequent transfers of significant sums between sub-accounts that in the Company's opinion constituted market timing, were subject to restrictions upon such trading that AFLIAC imposed in December 2001. Plaintiffs allege that such restrictions constituted a breach of the terms of the annuity contracts. In December 2003, the court granted partial summary judgment to the plaintiffs, holding that at least certain restrictions imposed on their trading activities violated the terms of the annuity contracts.

On May 19, 2004, plaintiffs filed a Brief Statement of Damages in which, without quantifying their damage claim, they outlined a claim for (i) amounts totaling \$150,000 for surrender charges imposed on the partial surrender by plaintiffs of the annuity contracts, (ii) loss of trading profits they expected over the remaining term of each annuity contract, and (iii) lost trading profits resulting from AFLIAC's alleged refusal to process five specific transfers in 2002 because of trading restrictions imposed on market timers. With respect to the lost profits, plaintiffs claim that pursuant to their trading strategy of transferring money from money market accounts to international equity accounts and back again to money market accounts, they have been able to consistently obtain relatively risk free returns of between 35% and 40% annually. Plaintiffs claim that they would have been able to continue to maintain such returns on the account values of their annuity contracts over the remaining terms of the annuity contracts (which are based in part on the lives of the named annuitants). The aggregate account value of plaintiffs' annuities was approximately \$12.8 million in December 2001. On February 1, 2006, the Court issued a ruling which precluded plaintiffs from claiming any damages accruing beyond July 31, 2004.

A jury trial on plaintiffs' damage claim was held in December 2006, which resulted in an aggregate award to plaintiffs of \$1.3 million for lost profits and reimbursement of surrender charges. Plaintiffs' motion for a new trial was subsequently denied. On March 5, 2007, plaintiffs filed a Notice of Appeal to the United States Court of Appeals, Seventh Circuit which, in a decision rendered on February 20, 2008, reversed the lower court with respect to damages and ordered the district court to enter a judgment that plaintiffs are entitled to no damages other than the return of the \$150,000 surrender charge. On March 5, 2008, plaintiffs filed a Petition for Rehearing with the Seventh Circuit, which was denied on March 13, 2008, which decision is final and conclusive.

Hurricane Katrina Litigation

The Company has been named as a defendant in various litigations, including putative class actions, relating to disputes arising from damages which occurred as a result of Hurricane Katrina in 2005. As of March 31, 2008, there were approximately 270 such cases, at least two of which were styled as putative class actions. These cases have been filed in both Louisiana state courts and federal district courts. These cases involve, among other claims, disputes as to the amount of reimbursable claims in particular cases, as well as the scope of insurance coverage under homeowners and commercial property policies due to flooding, civil authority actions, loss of landscaping, business interruption and other matters. Certain of these cases claim a breach of duty of good faith or violations of Louisiana insurance claims handling laws or regulations and involve claims for punitive or exemplary damages. Certain of the cases claim that under Louisiana's so-called Valued Policy Law, the insurers

must pay the total insured

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value of a home which is totally destroyed if any portion of such damage was caused by a covered peril, even if the principal cause of the loss was an excluded peril. Other cases challenge the scope or enforceability of the water damage exclusion in the policies. On April 8, 2008, the Louisiana Supreme Court issued a decision in the case of Sher v. Lafayette Insurance Company, et al, No. 2007-C-2441, holding that flood exclusions used in the Company's policies are unambiguous and enforceable.

Plaintiffs in several consolidated cases (including Sampia v. Massachusetts Bay Insurance Company, E.D. La. Civil Action No. 06-0559) appealed an Order of the Federal District Court dated August 6, 2006 rejecting plaintiffs' contention that the Louisiana Valued Policy Law has the effect of requiring coverage for a total loss proximately caused by a non-covered peril so long as there was any covered loss. This consolidated appeal was heard by the United States Court of Appeals, Fifth Circuit, in a case captioned Chauvin, et al., v. State Farm Fire & Casualty Co., No. 06-30946. On August 6, 2007, the Fifth Circuit Court issued an opinion upholding the District Court decision dismissing plaintiffs' claims. Plaintiffs thereafter filed a petition for a writ of certiorari with the United States Supreme Court, which was denied on January 14, 2008. Currently pending before the Louisiana Supreme Court is the case of Landry v. Louisiana Citizens Property Insurance Corporation, No. 2007-C-1907, in which plaintiffs have asserted a construction of the Valued Policy Law similar to that rejected by the Fifth Circuit in Chauvin. Landry was argued on February 26, 2008; the Court subsequently requested additional briefing from the parties to be filed no later than April 18, 2008.

On August 23, 2007, the State of Louisiana (individually and on behalf of the State of Louisiana, Division of Administration, Office of Community Development) filed a putative class action in the Civil District Court for the Parish of Orleans, State of Louisiana, entitled State of Louisiana, individually and on behalf of State of Louisiana, Division of Administration, Office of Community Development ex rel The Honorable Charles C. Foti, Jr., The Attorney General For the State of Louisiana, individually and as a class action on behalf of all recipients of funds as well as all eligible and/or future recipients of funds through The Road Home Program v. AAA Insurance, et al., No. 07-8970. The complaint named as defendants over 200 foreign and domestic insurance carriers, including THG. Plaintiff seeks to represent a class of current and former Louisiana citizens who have applied for and received or will receive funds through Louisiana's Road Home program. On August 29, 2007, Plaintiff filed an Amended Petition in this case, asserting myriad claims, including claims under Louisiana's Valued Policy Law, as well as claims for breach of: contract, the implied covenant of good faith and fair dealing, fiduciary duty and Louisiana's bad faith statutes. Plaintiff seeks relief in the form of, among other things, declarations that (a) the efficient proximate cause of losses suffered by putative class members was windstorm, a covered peril under their policies; (b) the second efficient proximate cause of their losses was storm surge, which Plaintiff contends is not excluded under class members' policies; (c) the damage caused by water entering affected parishes of Louisiana does not fall within the definition of "flood"; (d) the damages caused by water entering Orleans Parish and the surrounding area was a result of man-made occurrence and are properly covered under class members' policies; (e) many class members suffered total losses to their residences; and (f) many class members are entitled to recover the full value for their residences stated on their policies pursuant to the Louisiana Valued Policy Law. In accordance with these requested declarations, Plaintiff seeks to recover amounts that it alleges should have been paid to policyholders under their insurance agreements, as well as penalties, attorneys' fees, and costs. The case has been removed to the Federal District Court for the Eastern District of Louisiana.

A final, non-appealable order that under the Louisiana Valued Policy Law the Company's flood exclusion is inapplicable where any portion of a loss is attributable to a covered peril, could have a material adverse effect on the Company's financial position, and would likely have such effect on the Company's results of operations. The Company has established its loss and LAE reserves on the assumption that the application of the Valued Policy Law will not result in the Company having to pay damages for perils not otherwise covered and that the Company will not have any liability under the Road Home or similar litigation.

Other Matters

The Company has been named a defendant in various other legal proceedings arising in the normal course of business, including two other suits which, like the Emerald case described above, challenge the Company's imposition of certain restrictions on trading funds invested in separate accounts. The potential outcome of any such proceedings in which the Company has been named a defendant, and the Company's ultimate liability, if any, from such legal proceedings, is difficult to predict at this time. In the Company's opinion, based on the advice of legal counsel, the ultimate resolutions of such proceedings will not have a material effect on the Company's financial position, although they could have a material effect on the results of operations for a particular quarter or annual period.

REGULATORY AND INDUSTRY DEVELOPMENTS

Unfavorable economic conditions may contribute to an increase in the number of insurance companies that are under regulatory supervision. This may result in an increase in mandatory assessments by state guaranty funds, or voluntary payments by solvent insurance companies to cover losses to policyholders of insolvent or rehabilitated companies. Mandatory assessments, which are

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subject to statutory limits, can be partially recovered through a reduction in future premium taxes in some states. The Company is not able to reasonably estimate the potential impact of any such future assessments or voluntary payments.

On July 16, 2007, Massachusetts Commissioner of Insurance issued two decisions pertaining to personal automobile insurance. The first decision calls for the end of the "fix-and-establish" system of setting automobile rates and replaces it with a system of "managed competition". The second decision orders the implementation of an Assigned Risk Plan beginning with new business as of April 1, 2008.

The Commissioner of Insurance has issued a regulation providing the framework for the transition from a market in which the rates are set by the Commissioner to one in which companies propose their own rates. The Company's rate filing was approved by the Massachusetts Division of Insurance on January 18, 2008 and implemented effective April 1, 2008. It is anticipated that on average, the Company's overall Massachusetts personal automobile rate levels will decline approximately 8% in 2008.

The Assigned Risk Plan will distribute the Massachusetts residual automobile market based on individual policyholder assignments rather than assigning carriers Exclusive Representative Producers. The Company believes the Assigned Risk Plan will provide for a more equitable distribution of residual market risks across all carriers in the market, and therefore, such plan, is not likely to adversely affect THG's results of operations or financial position.

Over the past year, other state-sponsored insurers, reinsurers or involuntary pools have increased significantly, particularly those in states which have Atlantic or Gulf Coast exposures. As a result, the potential assessment exposure of insurers doing business in such states and the attendant collection risks has increased, particularly, in the states of Massachusetts, Louisiana and Florida. Such actions and related regulatory restrictions may limit the Company's ability to reduce its potential exposure to hurricane related losses. It is possible that other states may take action similar to those taken in the state of Florida. At this time the Company is unable to predict the likelihood or impact of any such potential assessments or other actions.

In addition, the Company is involved, from time to time, in investigations and proceedings by governmental and self-regulatory agencies. The potential outcome of any such action or regulatory proceedings in which the Company has been named a defendant, and the Company's ultimate liability, if any, from such action or regulatory proceedings, is difficult to predict at this time. In the Company's opinion, based on the advice of legal counsel, the ultimate resolutions of such proceedings will not have a material effect on the Company's financial position, although they could have a material effect on the results of operations for a particular quarter or annual period.

RESIDUAL MARKETS

The Company is required to participate in residual markets in various states, which generally pertains to high risk insureds. The results of the residual markets are not subject to the predictability associated with the Company's own managed business, and are significant to the workers compensation line of business, the homeowners line of business and both the personal and commercial automobile lines of business.

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PART I

ITEM 2

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

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Introduction

The following Management's Discussion and Analysis of Financial Condition and Results of Operations is intended to assist readers in understanding the interim consolidated results of operations and financial condition of The Hanover Insurance Group, Inc. and subsidiaries (THG) and should be read in conjunction with the interim Consolidated Financial Statements and related footnotes included elsewhere in this Quarterly Report on Form 10-Q and the Management's Discussion and Analysis of Financial Condition and Results of Operations contained in our 2007 Annual Report on Form 10-K filed with the Securities and Exchange Commission.

Our results of operations include the accounts of The Hanover Insurance Company (Hanover Insurance) and Citizens Insurance Company of America (Citizens), our principal property and casualty companies; First Allmerica Financial Life Insurance Company (FAFLIC), our life insurance and annuity company; and certain other insurance and non-insurance subsidiaries.

Executive Overview

Our property and casualty business constitutes our primary ongoing operations and includes our Personal Lines segment, our Commercial Lines segment and our Other Property and Casualty segment.

Personal Lines

In our Personal Lines business, we are focused on making investments that are intended to help us maintain profitability, build a distinctive position in the market and provide us with profitable growth opportunities. Current market conditions, however, continue to be challenging as pricing pressures and economic conditions are becoming more difficult, especially in Michigan, impacting our ability to grow and retain business in the state. We are working closely with our partner agents in Michigan to remain a significant writer with strong margins. We believe that market conditions will remain challenging and competitive in Personal Lines throughout 2008 and beyond. As a result of the implementation of managed competition in Massachusetts, 2008 is a transition year for the industry and while we expect to grow in this state over the long-term, we do not expect Massachusetts to contribute to premium growth during 2008 due to the current rate environment. We have also initiated catastrophe management actions in coastal states, including Florida and Louisiana that, while reducing premium in our homeowners line, has improved our risk profile. Despite these challenges and transitions, we expect our growth levels to be relatively flat in Personal Lines in 2008.

As of April 1, 2008, our **Connections[®] Auto** product is available in seventeen states, including Massachusetts. We believe that this product will help us to profitably grow our market share over time. **Connections Auto** is designed to be competitive for a wide spectrum of drivers through its multivariate rating application, which calculates rates based upon the magnitude and correlation of multiple risk factors. At the same time, a core strategy is to broaden our portfolio offerings and write total accounts, which are accounts that include multiple personal line coverages for the same customer. Our homeowners product, **Connections[®] Home**, which is available in sixteen states, is intended to improve our competitiveness and attract more total account business. Additionally, we continue to make investments in and focus on growing our umbrella product and other personal lines coverages. Having implemented a broader portfolio of products, we continue to work closely with high potential agents to increase the percentage of business they place with us and to ensure this business is consistent with our preferred mix of business. Additionally, we remain focused on diversifying our state mix beyond our four core states of Michigan, Massachusetts, New York and New Jersey. We expect these efforts to contribute to profitable growth and improved retention in our Personal Lines segment over time.

Commercial Lines

In the Commercial Lines business, the market continues to be increasingly competitive, a trend that we expect to continue and intensify for the foreseeable future. More significant price competition requires us to continue to be highly disciplined in our underwriting process to ensure that we grow the business only at acceptable margins. We continue to target, through mid-sized agents, small and first-tier middle markets, which encompass clients whose premiums are generally below \$200,000. We also continue to develop our specialty businesses, particularly bond and inland marine, which on average are expected to offer higher margins over time and enable us to deliver a more complete product portfolio to our agents and policyholders. During the first quarter of 2008, we experienced new business growth in our specialty lines, which now accounts for approximately one third of our Commercial Lines business. Additional growth in these lines continues to be a significant part of our strategy in the future. We continue to focus on expanding our product offerings in specialty businesses as evidenced by our acquisition on March 14, 2008, of Verlan Holdings, Inc. (Verlan), a specialty company providing property insurance to small and medium-sized manufacturing and distribution companies. Last year we acquired Professionals Direct, Inc. (PDI), which provides professional liability coverage for small legal practices. We believe these acquisitions provide us with better breadth and diversification of products and improve our competitive position with our agents.

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The 2007 enhancements of our small commercial business platform provide for additional growth opportunities in our more traditional lines of business. We have expanded the breadth of our underwriting for small account, low hazard workers' compensation and business owners' policies, and have introduced *Avenues® Auto*, a price segmented product for small, commercial automobile policies. We have also provided additional coverage features in our business owners' policies. Our technology investments are intended to provide our agents with the ability to view a customer's full account and provide eligibility guidance, as well as other important ease of business improvements. Our focus continues to be on improving and expanding our partnerships with agents. We believe our specialty capabilities and small commercial opportunities, coupled with distinctiveness in the middle market, enables us to deliver significant value to our agents and policyholders in our target markets.

2008 Results

During the first quarter of 2008, our property and casualty group's segment income decreased \$2.9 million, or 2.9%, compared to the prior year. This decrease was attributable to a \$5.0 million increase in catastrophe related activity, as well as approximately \$6 million of higher underwriting and loss adjustment expenses. These decreases were partially offset by a \$3.6 million increase in favorable development of prior year loss and loss adjustment expense (LAE) reserves and \$3.6 million of higher net investment income. Net premiums written for our property and casualty group increased \$16.5 million, or 2.7%, as compared to the first quarter of 2007.

Description of Operating Segments

Our primary business operations include insurance products and services in three property and casualty operating segments. These segments are Personal Lines, Commercial Lines and Other Property and Casualty. Our fourth operating segment, Life Companies, is in run-off. We present the separate financial information of each segment consistent with the manner in which our chief operating decision maker evaluates results in deciding how to allocate resources and in assessing performance.

The Property and Casualty group manages its operations principally through three segments: Personal Lines, Commercial Lines and Other Property and Casualty. Personal Lines includes personal automobile, homeowners and other personal coverages, while Commercial Lines includes commercial multiple peril, commercial automobile, workers' compensation and other commercial coverages, such as bonds and inland marine business. In addition, the Other Property and Casualty segment consists of: Opus Investment Management, Inc. (Opus), which markets investment management services to institutions, pension funds and other organizations; earnings on holding company assets, as well as voluntary pools business in which we have not actively participated since 1999; and Amgro, Inc. (AMGRO), our premium financing business. We have entered into an agreement to sell AMGRO and its subsidiaries; such transaction is expected to close in the second quarter of 2008.

Our Life Companies segment, which is in runoff, consists primarily of a block of traditional life insurance products (principally the Closed Block), a block of group retirement annuity contracts and two remaining guaranteed investment contracts (GICs). Assets and liabilities related to our reinsured variable life insurance and annuity business, as well as our discontinued group life and health business, including group life and health voluntary pools, are reflected in this segment.

We report interest expense related to our corporate debt separately from the earnings of our operating segments. Corporate debt consists of our junior subordinated debentures and our senior debentures.

Results of Operations

Our consolidated net income includes the results of our four operating segments (segment income), which we evaluate on a pre-tax basis, and our interest expense on corporate debt. In addition, segment income excludes certain items which we believe are not indicative of our core operations. The income of our segments excludes items such as federal income taxes and net realized investment gains and losses, including net gains or losses on certain derivative instruments, because fluctuations in these gains and losses are determined by interest rates, financial markets and the timing of sales. Also, segment income excludes net gains and losses on disposals of businesses, discontinued operations, restructuring costs, extraordinary items, the cumulative effect of accounting changes and certain other items. Although the items excluded from segment income may be significant components in understanding and assessing our financial performance, we believe segment income enhances an investor's understanding of our results of operations by highlighting net income attributable to the core operations of the business. However, segment income should not be construed as a substitute for net income determined in accordance with generally accepted accounting principles (GAAP).

Catastrophe losses are a significant component in understanding and assessing the financial performance of our property and casualty insurance business. However, catastrophic events, such as Hurricane Katrina in 2005, make it difficult to assess the underlying trends in this business. Management believes that providing certain financial metrics and trends excluding the effects of catastrophes, helps investors to understand the variability in periodic earnings and to evaluate the underlying performance of our operations.

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Our consolidated net income for the first quarter of 2008 was \$58.5 million, compared to \$63.6 million for the same period in 2007. The \$5.1 million decrease in earnings primarily reflects a net realized investment loss of \$5.1 million in 2008 compared to a \$1.9 million gain in 2007, decreased pre-tax segment results of \$2.9 million related to our property and casualty business, and the absence of a \$2.4 million benefit received in 2007 related to federal income tax settlements of prior years. These decreases were partially offset by a gain on the disposal of the variable life insurance and annuity business.

The following table reflects segment income as determined in accordance with Statement of Financial Accounting Standards No. 131, *Disclosures about Segments of an Enterprise and Related Information*, and a reconciliation of total segment income to consolidated net income.

(In millions)	Three Months Ended March 31,	
	2008	2007
Segment income before federal income taxes:		
Property and Casualty		
Personal Lines	\$ 27.6	\$ 47.4
Commercial Lines	68.3	49.0
Other Property and Casualty	2.1	4.5
Total Property and Casualty	98.0	100.9
Life Companies	(2.5)	(0.9)
Interest expense on corporate debt	(10.0)	(10.0)
Total segment income before federal income taxes	85.5	90.0
Federal income tax expense on segment income	(28.2)	(29.8)
Federal income tax settlement		2.4
Net realized investment (losses) gains, net of amortization	(5.1)	1.9
Gains on derivative instruments	0.1	
Federal income tax benefit (expense) on non-segment items	1.2	(0.7)
Income from continuing operations, net of taxes	53.5	63.8
Discontinued operations:		
Gain (loss) on disposal of variable life insurance and annuity business, net of taxes	6.2	(0.2)
Other	(1.2)	
Net income	\$ 58.5	\$ 63.6

Segment Income

Three Months Ended March 31, 2008 Compared to Three Months Ended March 31, 2007

The Property and Casualty group's segment income decreased \$2.9 million, or 2.9%, to \$98.0 million, in the first quarter of 2008, compared to \$100.9 million in the first quarter of 2007. Excluding higher catastrophe related activity of \$5.0 million in the quarter, earnings would have increased by \$2.1 million. This increase is primarily due to lower losses and higher net investment income, partially offset by higher underwriting and loss adjustment expenses. Losses were lower in the current year due to \$3.6 million of increased favorable development on prior years' loss and LAE reserves and approximately \$2 million of improvement in current accident year results. Net investment income increased \$3.6 million, primarily due to earnings on invested assets transferred from our Life Companies segment to our Property and Casualty group related to a change in common employer from FAFLIC to Hanover Insurance, and from favorable operational cash flows. Underwriting and loss adjustment expenses increased approximately \$6 million, primarily due to expenses related to recently acquired subsidiaries, salaries and employee benefit costs, expenses related to the introduction of our **Connections Auto** product in Massachusetts, technology costs related to a new claims system, and higher expenses related to independent adjusters.

Life Companies' segment loss was \$2.5 million for the first quarter of 2007 compared to a loss of \$0.9 million during the same period in 2007. This increase was primarily due to lower net investment income primarily from the intercompany asset transfer.

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Our federal income tax expense on segment income was \$28.2 million for the first quarter of 2008 compared to \$29.8 million for the same period in 2007, primarily due to lower underwriting income in our property and casualty business.

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Other Items

Net realized losses on investments were \$5.1 million in the first quarter of 2008 compared to a gain of \$1.9 million in the same period of 2007. Net realized losses in 2008 are due to \$7.5 million of impairments, primarily from fixed maturities and other invested assets, partially offset by \$2.3 million of gains recognized principally from the sale of approximately \$280 million of fixed maturities.

In 2005, we sold our variable life insurance and annuity business to The Goldman Sachs Group, Inc. ("Goldman Sachs"). In the first quarter of 2008, we recorded a gain of \$6.2 million primarily due to the release of liabilities related to certain contractual indemnities to Goldman Sachs relating to the pre-sale activities of the business sold, which were recorded under FASB Interpretation No. 45, *Guarantors Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Others* ("FIN 45"). (See also Note 3 Sale of Variable Life Insurance and Annuity Business) In the first quarter of 2007, we recorded a loss of \$0.2 million related to operations conversion expenses. Additionally, in 2008, we recognized \$1.2 million of losses associated with the sale of a subsidiary, related to pre-sale activities.

Net income includes the following items by segment:

(In millions)	Three Months Ended March 31, 2008				
	Property and Casualty		Other Property and Casualty (2)	Life Companies	Total
	Personal Lines	Commercial Lines			
Net realized investment (losses) gains (1)	\$ (2.0)	\$ (1.4)	\$ 3.1	\$ (4.8)	\$ (5.1)
Gains on derivative instruments				0.1	0.1
Gain on disposal of variable life insurance and annuity business, net of taxes				6.2	6.2
Other				(1.2)	(1.2)

(In millions)	Three Months Ended March 31, 2007				
	Property and Casualty		Other Property and Casualty (2)	Life Companies	Total
	Personal Lines	Commercial Lines			
Net realized investment (losses) gains (1)	\$ (0.4)	\$ (0.3)	\$ 1.0	\$ 1.6	\$ 1.9
Federal income tax settlement				2.4	2.4
Loss on disposal of variable life insurance and annuity business, net of taxes				(0.2)	(0.2)

- (1) We manage investment assets for our property and casualty business based on the requirements of the entire property and casualty group. We allocate the investment income, expenses and realized gains (losses) to our Personal Lines, Commercial Lines and Other Property and Casualty segments based on actuarial information related to the underlying businesses.
- (2) Includes corporate eliminations.

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The following is our discussion and analysis of the results of operations by business segment. The segment results are presented before taxes and other items, such as realized gains and losses, which we believe are not indicative of core operations.

Property and Casualty

The following table summarizes the results of operations for the Property and Casualty group:

(In millions)	Three Months Ended March 31,	
	2008	2007
Segment revenues		
Net premiums written	\$ 628.5	\$ 612.0
Net premiums earned	\$ 617.7	\$ 584.4
Net investment income	64.3	60.7
Other income	15.5	15.0
Total segment revenues	697.5	660.1
Losses and operating expenses		
Losses and loss adjustment expenses	379.7	353.1
Policy acquisition expenses	137.4	127.0
Other operating expenses	82.4	79.1
Total losses and operating expenses	599.5	559.2
Segment income	\$ 98.0	\$ 100.9

Three Months Ended March 31, 2008 Compared to Three Months Ended March 31, 2007

The Property and Casualty group's segment income decreased \$2.9 million, or 2.9%, to \$98.0 million, in the first quarter of 2008, compared to \$100.9 million in the first quarter of 2007. Catastrophe related activity increased by \$5.0 million in the quarter, to \$19.3 million, from \$14.3 million in the same period of 2007. Excluding the impact of catastrophe related activity, earnings would have increased by \$2.1 million. This increase is primarily due to favorable development of prior years' loss and LAE reserves, higher net investment income and more favorable current accident year results, partially offset by higher expenses. Favorable development on prior years' reserves increased \$3.6 million, to \$55.6 million in the first quarter of 2008, from \$52.0 million in the same period of 2007. Net investment income increased \$3.6 million, primarily due to earnings on invested assets transferred from our Life Companies segment to the Property and Casualty group related to a change in common employer from FAFLIC to Hanover Insurance, and from favorable operational cash flows. Current accident year results improved approximately \$2 million, with improvements in Commercial Lines being partially offset by declines in Personal Lines. Underwriting and loss adjustment expenses increased approximately \$6 million primarily due to expenses related to recently acquired subsidiaries, salaries and employee benefit costs, expenses related to the introduction of our **Connections Auto** product in Massachusetts, technology costs related to a new claims system, and higher expenses related to independent adjusters for increased weather related claims.

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Production and Underwriting Results

The following table summarizes GAAP net premiums written and GAAP loss, LAE, expense and combined ratios for the Personal Lines and Commercial Lines segments. These items are not meaningful for our Other Property and Casualty segment.

(In millions, except ratios)	Three Months Ended March 31,					
	GAAP Net Premiums Written	2008 GAAP Loss Ratios (1)(2)	Catastrophe loss ratios (3)	GAAP Net Premiums Written	2007 GAAP Loss Ratios (1)(2)	Catastrophe loss ratios (3)
Personal Lines:						
Personal automobile	\$ 259.3	59.8	0.2	\$ 273.5	56.6	0.1
Homeowners	83.3	65.7	9.1	84.5	51.5	5.3
Other personal	9.1	32.6	7.1	8.3	39.8	4.1
Total Personal Lines	351.7	60.8	3.0	366.3	54.7	1.7
Commercial Lines:						
Workers compensation	38.2	38.9		34.5	33.6	
Commercial automobile	53.5	41.9		51.6	43.8	
Commercial multiple peril	94.3	36.9	7.6	91.8	47.2	5.6
Other commercial	90.8	29.6	2.1	67.8	30.4	1.0
Total Commercial Lines	276.8	35.9	3.3	245.7	40.3	2.5
Total	\$ 628.5	51.0	3.1	\$ 612.0	49.1	2.0

	2008			2007		
	GAAP LAE Ratio	GAAP Expense Ratio	GAAP Combined Ratio (4)	GAAP LAE Ratio	GAAP Expense Ratio	GAAP Combined Ratio (4)
Personal Lines	11.1	29.3	101.2	11.6	29.6	95.9
Commercial Lines	9.5	39.9	85.3	10.8	39.7	90.8
Total	10.5	33.5	95.0	11.3	33.4	93.8

- (1) GAAP loss ratio is a common industry measurement of the results of property and casualty insurance underwriting. This ratio reflects incurred claims compared to premiums earned. Our GAAP loss ratios include catastrophe losses.
- (2) Includes policyholders' dividends.
- (3) Catastrophe loss ratio reflects incurred catastrophe claims compared to premiums earned.
- (4) GAAP combined ratio is a common industry measurement of the results of property and casualty insurance underwriting. This ratio is the sum of incurred claims, claim expenses and underwriting expenses incurred to premiums earned. Our GAAP combined ratios also include the impact of catastrophes. Federal income taxes, net investment income and other non-underwriting expenses are not reflected in the GAAP combined ratio.

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The following table summarizes GAAP underwriting results for the Personal Lines, Commercial Lines and Other Property and Casualty segments and reconciles it to GAAP segment income.

	Three Months Ended March 31, 2008				Three Months Ended March 31, 2007			
	Personal Lines	Commercial Lines	Other Property and Casualty	Total	Personal Lines	Commercial Lines	Other Property and Casualty	Total
GAAP underwriting (loss) profit, excluding prior year reserve development and catastrophes	\$ (5.6)	\$ 0.1	\$	\$ (5.5)	\$ 0.6	\$ (2.5)	\$ 0.3	\$ (1.6)
Prior year reserve development favorable (unfavorable)	12.0	44.6	(1.0)	55.6	21.5	30.5		52.0
Pretax catastrophe effect	(11.0)	(8.3)		(19.3)	(7.2)	(7.1)		(14.3)
GAAP underwriting (loss) profit	(4.6)	36.4	(1.0)	30.8	14.9	20.9	0.3	36.1
Net investment income	29.7	30.9	3.7	64.3	29.5	27.3	3.9	60.7
Fees and other income	4.2	4.3	7.0	15.5	3.8	4.1	7.1	15.0
Other operating expenses	(1.7)	(3.3)	(7.6)	(12.6)	(0.8)	(3.3)	(6.8)	(10.9)
Segment income	\$ 27.6	\$ 68.3	\$ 2.1	\$ 98.0	\$ 47.4	\$ 49.0	\$ 4.5	\$ 100.9

Personal Lines

Personal Lines net premiums written decreased \$14.6 million, or 4.0%, to \$351.7 million for the first quarter of 2008. The most significant factor contributing to this decrease was a decline in net premiums written in Michigan, which we attribute to the declining economy in the state. We also experienced a decrease in Massachusetts, which resulted from the state mandated rate decrease of 12% effective April 1, 2007 and a decrease in premium from the Massachusetts Commonwealth Automobile Reinsurers (CAR) facility. Our exposure management actions, primarily in Florida and Louisiana, also contributed to the decrease in net premiums written. Additionally, premium decreases in our targeted growth states resulted from our **Connections Auto** profitability management actions implemented over the past several quarters, partially offset by growth in personal automobile renewal premium and an increase in new homeowners premium in these targeted growth states. These decreases in net written premium were partially offset by a favorable impact from changes in our reinsurance structure as discussed on page 14 of our 2007 Annual Report on Form 10-K, which increased net written premium by \$5.7 million in the first quarter of 2008.

Policies in force in the personal automobile line of business increased 0.2% at the end of the first quarter of 2008 compared to the first quarter of 2007. The increase was primarily the result of net growth in policies in force outside of Michigan, partially offset by a decrease in Michigan.

Policies in force in the homeowners line of business decreased 2.5% at the end of the first quarter of 2008, compared to the first quarter of 2007, primarily as a result of declines in Michigan. Policies in force also decreased due to exposure management actions taken in coastal states, particularly in Florida, where we have begun non-renewing all homeowners policies, and in Louisiana, where policies in force declined 17% compared to the first quarter of 2007. Partially offsetting these reductions is an increase in policies in force in newer, growth-targeted states.

Our underwriting profit, excluding prior year reserve development and catastrophes, declined \$6.2 million, from a profit of \$0.6 million in the first quarter of 2007 to a loss of \$5.6 million in 2008. This decline was due to a reduction in current accident year profit of approximately \$4 million, primarily due to higher non-catastrophe weather related claims, principally in the homeowners line, resulting from a more severe winter in the Midwest and Northeast, partially offset by the benefit of changes in our 2008 reinsurance programs. Additionally, underwriting and loss adjustment expenses were approximately \$3 million higher, primarily due to expenses related to the introduction of our **Connections Auto** product in Massachusetts, higher independent adjuster costs for increased weather related claims, and salaries and employee benefits.

Favorable development on prior years loss and LAE reserves decreased \$9.5 million, from \$21.5 million in the first quarter of 2007 to \$12.0 million in 2008. This decrease was driven by adverse personal automobile personal injury and property development in the 2007 accident year, partially offset by favorable development in the 2003 through 2006 accident years.

The pre-tax effect of catastrophes increased \$3.8 million, from \$7.2 million in the first quarter of 2007 to \$11.0 million in 2008.

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Our ability to maintain and increase Personal Lines net written premium and to maintain and improve underwriting results is expected to be affected by increasing price competition, our ability to achieve acceptable margins, our ability to generate new business and to retain our existing business, regulatory actions, the difficult economic conditions in Michigan, and our plans to

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continue to reduce coastal exposures. In conjunction with the introduction of managed competition effective April 1, 2008, our overall personal automobile rate levels in Massachusetts are expected to decrease approximately 8%. Such rates may be subject to further revision throughout the year, depending on the competitive and regulatory environment.

In addition, as discussed under Contingencies and Regulatory Matters Other Regulatory Matters , certain coastal states may take actions which significantly affect the property and casualty insurance market, including ordering rate reductions for homeowners insurance products and subjecting insurance companies that do business in that state to potentially significant assessments in the event of catastrophic losses that are insured or reinsured by state-sponsored insurance or reinsurance entities. Such state actions or our responses thereto could have a significant impact on our underwriting margins and growth prospects, as well as our ability to manage exposures to hurricane losses.

Commercial Lines

Commercial Lines net premiums written increased \$31.1 million, or 12.7%, to \$276.8 million for the first quarter of 2008. This increase included the benefit of changes in our 2008 reinsurance programs, premiums written related to recently acquired subsidiaries, and modest growth in our Commercial Lines of business. Effective January 1, 2008, we renewed our property and casualty reinsurance program with changes to the reinsurance structure as discussed on page 14 of our 2007 Annual Report on Form 10-K. These changes resulted in an increase in net written premium of \$19.6 million in the first quarter of 2008, of which \$9.4 million is a non-recurring amount related to the termination of our 2007 umbrella excess of loss reinsurance treaty. Net written premium from our recent acquisitions, Verlan and PDI, was \$7.9 million, of which \$1.5 million was non-recurring due to the termination of existing reinsurance coverage. The remaining premium increase was due to growth in our underlying Commercial Lines business, most notably in our bond business.

Our underwriting profit, excluding prior year reserve development and catastrophes, increased \$2.6 million in 2008, from a loss of \$2.5 million in 2007 to a profit of \$0.1 million in 2008. This increase was primarily due to higher current accident year profit of approximately \$5 million, primarily due to the benefit of changes in our reinsurance programs, the results of our recently acquired subsidiaries and growth in our inland marine and bond lines of business. These were partially offset by higher underwriting and loss adjustment expenses of approximately \$2 million, primarily attributable to our recently acquired subsidiaries. The overall impact of our recent acquisitions on our underwriting profit and underwriting profit excluding prior year loss development, was a loss of \$0.8 million and a profit of \$0.1 million, respectively.

Favorable development on prior years loss and LAE reserves increased \$14.1 million, from \$30.5 million for the first quarter of 2007 to \$44.6 million in 2008. This increase primarily relates to the commercial multiple peril line of business.

The pre-tax effect of catastrophes increased \$1.2 million, to \$8.3 million in the first quarter of 2008 from \$7.1 million in the first quarter of 2007.

We are experiencing increasing competition in our Commercial Lines segment and modest premium decreases on renewal policies, most notably in our middle market and commercial automobile business and relatively flat pricing in our small commercial business. The industry is also generally experiencing overall rate decreases. Our ability to increase Commercial Lines net premiums written while maintaining or improving underwriting results is expected to be affected by increased price competition and the difficult economic conditions in Michigan.

Other Property and Casualty

Segment income of the Other Property and Casualty segment decreased \$2.4 million, to \$2.1 million for the quarter ended March 31, 2008, from \$4.5 million in the same period of 2007. The decrease is primarily due to adverse development in our run-off voluntary pools business and increased expenses related to our premium financing business.

Investment Results

Net investment income increased \$3.6 million, or 5.9%, to \$64.3 million for the quarter ended March 31, 2008, primarily due to earnings on invested assets transferred from our Life Companies segment to the Property and Casualty group. Effective January 1, 2008, Hanover Insurance became the common employer of all employees of the holding company and its subsidiaries and sponsorship of all employee benefit and pension plans was transferred from FAFLIC to Hanover Insurance. Accordingly, we transferred liabilities associated with these benefit plans and other employee related items, and an equal amount of assets to Hanover Insurance. Excluding earnings on these intersegment transfers, net investment income would have increased \$0.7 million, or 1.1%, in 2008, which is primarily due to higher average invested assets resulting from increased operational cash flows in the latter half of 2007. Net investment income also includes \$0.5 million related to our recently acquired subsidiaries.

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Reserve for Losses and Loss Adjustment Expenses

Overview of Loss Reserve Estimation Process

We maintain reserves for our property and casualty products to provide for our ultimate liability for losses and loss adjustment expenses with respect to reported and unreported claims incurred as of the end of each accounting period. These reserves are estimates, taking into account actuarial projections at a given point in time, of what we expect the ultimate settlement and administration of claims will cost based on facts and circumstances then known, estimates of future trends in claim severity and frequency, judicial theories of liability and policy coverage, and other factors.

We determine the amount of loss and loss adjustment expense reserves (the loss reserves) based on an estimation process that is very complex and uses information obtained from both company specific and industry data, as well as general economic information. The estimation process is judgmental, and requires us to continuously monitor and evaluate the life cycle of claims on type-of-business and nature-of-claim bases. Using data obtained from this monitoring and assumptions about emerging trends, our actuaries develop information about the size of ultimate claims based on historical experience and other available market information. The most significant assumptions used in the actuarial estimation process, which vary by line of business, include determining the expected consistency in the frequency and severity of claims incurred but not yet reported to prior years claims, the trend in loss costs, changes in the timing of the reporting of losses from the loss date to the notification date and expected costs to settle unpaid claims. This process assumes that past experience, adjusted for the estimated effects of current developments and anticipated trends, is an appropriate basis for predicting future events. On a quarterly basis, our actuaries provide to management a point estimate for each significant line of our direct business to summarize their analysis.

In establishing the appropriate loss reserve balances for any period, management carefully considers these actuarial point estimates, which are the principal bases for establishing our reserve balances, along with a qualitative evaluation of business trends, environmental changes, and numerous other factors. In general, such additional factors may include, but are not limited to, improvement or deterioration of the actuarial indications in the period, the maturity of the accident year, trends observed over the recent past such as changes in the mix of business or the impact of regulatory or litigation developments, the anticipated impact of new product introductions or expansion into new geographic areas, the level of volatility within a particular line of business, and the magnitude of the difference between the actuarial indication and the recorded reserves. Regarding our indirect business from voluntary and involuntary pools, we are provided loss estimates by managers of each pool. We adopt reserve estimates for the pools that consider this information and other facts.

Management's Review of Judgments and Key Assumptions

There is greater inherent uncertainty in estimating insurance reserves for certain types of property and casualty insurance lines, particularly workers compensation and other liability lines, where a longer period of time may elapse before a definitive determination of ultimate liability and losses may be made. In addition, the technological, judicial, regulatory and political climates involving these types of claims change regularly. There is also greater uncertainty in establishing reserves with respect to new business, particularly new business which is generated with respect to newly introduced product lines, by newly appointed agents or in geographies in which we have less experience in conducting business. In such cases, there is less historical experience or knowledge and less data upon which the actuaries can rely. Historically, we have limited the issuance of long-tailed other liability policies, including directors and officers (D&O) liability, errors and omissions (E&O) liability and medical malpractice liability. The industry has experienced adverse loss trends in these lines of business.

We regularly update our reserve estimates as new information becomes available and further events occur which may impact the resolution of unsettled claims. Reserve adjustments are reflected in the results of operations as adjustments to losses and LAE. Often, these adjustments are recognized in periods subsequent to the period in which the underlying policy was written and the loss event occurred. These types of subsequent adjustments are described separately as prior year reserve development. Such development can be either favorable or unfavorable to our financial results and may vary by line of business.

Inflation generally increases the cost of losses covered by insurance contracts. The effect of inflation varies by product. Our property and casualty insurance premiums are established before the amount of losses and LAE and the extent to which inflation may affect such expenses are known. Consequently, we attempt, in establishing rates and reserves, to anticipate the potential impact of inflation and increasing medical costs in the projection of ultimate costs. We have experienced increasing medical costs, including those associated with personal automobile personal injury protection claims, particularly in Michigan, as well as in our workers compensation line in most states. This increase is reflected in our reserve estimates, but continued increases could contribute to increased losses and LAE in the future.

We regularly review our reserving techniques, our overall reserving position and our reinsurance. Based on (i) our review of historical data, legislative enactments, judicial decisions, legal developments in impositions of damages and policy coverage,

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political attitudes and trends in general economic conditions, (ii) our review of per claim information, (iii) our historical loss experience and that of the industry, (iv) the relatively short-term nature of most policies written by us, and (v) our internal estimates of required reserves, we believe that adequate provision has been made for loss reserves. However, establishment of appropriate reserves is an inherently uncertain process and there can be no certainty that current established reserves will prove adequate in light of subsequent actual experience. A significant change to the estimated reserves could have a material impact on our results of operations and financial position. An increase or decrease in reserve estimates would result in a corresponding decrease or increase in financial results. For example, each one percentage point change in the aggregate loss and LAE ratio resulting from a change in reserve estimation is currently projected to have an approximate \$24 million impact on property and casualty segment income, based on 2007 full year premiums.

As discussed below, estimated loss and LAE reserves for claims occurring in prior years developed favorably by \$55.6 million and \$52.0 million for the quarters ended March 31, 2008 and 2007, respectively, which represents 2.5% and 2.3% of net loss reserves held, respectively.

The major causes of material uncertainty relating to ultimate losses and loss adjustment expenses (risk factors) generally vary for each line of business, as well as for each separately analyzed component of the line of business. In some cases, such risk factors are explicit assumptions of the estimation method and in others, they are implicit. For example, a method may explicitly assume that a certain percentage of claims will close each year, but will implicitly assume that the legal interpretation of existing contract language will remain unchanged. Actual results will likely vary from expectations for each of these assumptions, resulting in an ultimate claim liability that is different from that being estimated currently.

Some risk factors will affect more than one line of business. Examples include changes in claim department practices, changes in settlement patterns, regulatory and legislative actions, court actions, timeliness of claim reporting, state mix of claimants, and degree of claimant fraud. The extent of the impact of a risk factor will also vary by components within a line of business. Individual risk factors are also subject to interactions with other risk factors within line of business components. Thus, risk factors can have offsetting or compounding effects on required reserves.

We are also defendants in various litigation, including putative class actions, which claim punitive damages or claim a broader scope of policy coverage than our interpretation, particularly in connection with losses incurred from Hurricane Katrina. The reserves established with respect to Hurricane Katrina assume that we will prevail with respect to these matters (See also Contingencies and Regulatory Matters). Although we believe our current Hurricane Katrina reserves are adequate, there can be no assurance that our ultimate costs associated with this event will not substantially exceed these estimates.

Loss Reserves by Line of Business

We perform actuarial reviews on certain detailed line of business coverages. These individual estimates are summarized into nine broader lines of business including personal automobile, homeowners, workers compensation, commercial automobile, commercial multiple peril, and other personal and other commercial lines. Asbestos and environmental reserves and pools business are separately analyzed.

The process of estimating reserves involves considerable judgment by management and is inherently uncertain. Actuarial point estimates by lines of business are the primary bases for determining ultimate expected losses and LAE and the level of net reserves required; however, other factors are considered as well. In general, such additional factors may include, but are not limited to, improvement or deterioration of the actuarial indications in the period, the maturity of the accident year, trends observed over the recent past such as changes in the mix of business or the impact of regulatory or litigation developments, the amount of data or experience we have with respect to a particular product or geographic area, the level of volatility within a particular line of business, and the magnitude of the difference between the actuarial indication and the recorded reserves.

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The table below shows our recorded reserves, net of reinsurance, and the related actuarial reserve point estimates by line of business at March 31, 2008 and December 31, 2007.

(In millions)	March 31, 2008		December 31, 2007	
	Recorded Net Reserves	Actuarial Point Estimate	Recorded Net Reserves	Actuarial Point Estimate
Personal Automobile	\$ 682.2	\$ 649.8	\$ 696.7	\$ 672.8
Homeowners	116.3	114.6	99.4	97.4
Other Personal Lines	18.3	14.9	24.9	22.1
Workers Compensation	367.3	354.3	371.1	353.9
Commercial Automobile	164.6	152.9	169.9	159.8
Commercial Multiple Peril	449.5	410.4	463.3	424.2
Other Commercial Lines	184.8	171.7	179.9	165.4
Asbestos and Environmental	19.9	19.5	19.4	20.0
Pools and Other	197.5	197.5	200.7	200.7
Total	\$ 2,200.4	\$ 2,085.6	\$ 2,225.3	\$ 2,116.3

The principal factors considered by management in addition to the actuarial point estimates in determining the reserves at March 31, 2008 and December 31, 2007 vary by line of business. In our Commercial Lines segment, management considered the growth and product mix changes and recent adverse property related frequency trends in certain coverages. In addition, management also considered the significant growth in our inland marine and bond businesses for which we have limited actuarial data to estimate losses and the product mix change in our bond business towards a greater proportion of contract surety bonds where losses tend to emerge over a longer period of time and are cyclical related to general economic conditions. Moreover, in our Commercial Lines segment, management considered the potential for adverse development in the workers compensation line where losses tend to emerge over long periods of time and rising medical costs, while moderating, have continued to be a concern. In our Personal Lines segment, management considered the adverse personal automobile personal injury development and related potential for adverse trends due to costs shifting from health insurers to property and casualty insurers resulting from economic concerns and health insurance coverage trends, developments in personal automobile property costs in the 2007 accident year and an increase in physical damage frequency, all of which have added additional uncertainty to future development in our personal automobile line. Additionally, management considered the significant growth in our new business with our *Connections Auto* product and related growth in a number of states where there is additional uncertainty in the ultimate profitability and development of reserves due to the unseasoned nature of our new business and new agency relationships in these markets, as well as emerging loss trends which are higher than expected. Our lack of credible actuarial data to estimate losses in these new geographical areas and agency relationships and with this new product causes uncertainty in estimating ultimate reserves and requires considerable judgment by management. Also in Personal Lines, management considered the significant improvement in frequency trends the industry experienced during 2001 through 2006 in these lines of business which were unanticipated and remain to some extent unexplained. Management also considered the likelihood of future adverse development related to significant catastrophe losses experienced in 2005. Regarding our indirect business from voluntary and involuntary pools, we are provided loss estimates by managers of each pool. We adopt reserve estimates for the pools that consider this information and other factors. At March 31, 2008 and December 31, 2007, total recorded net reserves were 5.5% and 5.2% greater than actuarially indicated reserves, respectively.

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The table below provides a reconciliation of the gross beginning and ending reserve for unpaid losses and LAE as follows:

(In millions)	Three Months Ended March 31,	
	2008	2007
Reserve for losses and LAE, beginning of period	\$ 3,165.8	\$ 3,163.9
Incurred losses and LAE, net of reinsurance recoverable:		
Provision for insured events of current year	435.9	405.0
Decrease in provision for insured events of prior years; favorable development	(55.6)	(52.0)
Total incurred losses and LAE	380.3	353.0
Payments, net of reinsurance recoverable:		
Losses and LAE attributable to insured events of current year	131.7	115.1
Losses and LAE attributable to insured events of prior years	266.3	233.6
Hurricane Katrina	9.7	15.7
Total payments	407.7	364.4
Change in reinsurance recoverable on unpaid losses	(18.6)	4.6
Purchase of Verlan Fire Insurance Company	4.2	
Reserve for losses and LAE, end of period	\$ 3,124.0	\$ 3,157.1

The table below summarizes the gross reserve for losses and LAE by line of business.

(In millions)	March 31, 2008	December 31, 2007
Personal Automobile	\$ 1,263.3	\$ 1,277.4
Homeowners and Other	172.2	162.5
Total Personal	1,435.5	1,439.9
Workers Compensation	583.1	593.8
Commercial Automobile	242.7	250.8
Commercial Multiple Peril	522.4	541.8
Other Commercial	340.3	339.5
Total Commercial	1,688.5	1,725.9
Total reserve for losses and LAE	\$ 3,124.0	\$ 3,165.8

The total reserve for losses and LAE as disclosed in the above table decreased by \$41.8 million for the quarter ended March 31, 2008.

Prior Year Development by Line of Business

When trends emerge that we believe affect the future settlement of claims, we adjust our reserves accordingly. Reserve adjustments are reflected in the Consolidated Statements of Income as adjustments to losses and LAE. Often, we recognize these adjustments in periods subsequent to the period in which the underlying loss event occurred. These types of subsequent adjustments are disclosed and discussed separately as prior year reserve development. Such development can be either favorable or unfavorable to our financial results.

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The following table summarizes the change in provision for insured events of prior years by line of business.

(In millions)	Three Months Ended March 31,	
	2008	2007
(Decrease) increase in loss provision for insured events of prior years:		
Personal Automobile	\$ (16.2)	\$ (25.6)
Homeowners and Other	3.6	2.7
Total Personal	(12.6)	(22.9)
Workers Compensation	(9.6)	(10.0)
Commercial Automobile	(5.9)	(4.5)
Commercial Multiple Peril	(16.7)	(6.4)
Other Commercial	(9.5)	(7.0)
Total Commercial	(41.7)	(27.9)
Voluntary Pools	1.0	
Decrease in loss provision for insured events of prior years	(53.3)	(50.8)
Decrease in LAE provision for insured events of prior years	(2.3)	(1.2)
Decrease in total loss and LAE provision for insured events of prior years	\$ (55.6)	\$ (52.0)

Estimated loss reserves for claims occurring in prior years developed favorably by \$53.3 million and \$50.8 million during the first quarters of 2008 and 2007, respectively. The favorable loss reserve development during the first quarter of 2008 is primarily the result of lower than expected frequency of bodily injury in the personal automobile line, primarily in the 2003 through 2006 accident years, and lower than expected severity of liability claims in the commercial multiple peril line for the 2002 through 2007 accident years. In addition, lower than expected severity in the workers compensation line, primarily in the 2003 through 2007 accident years, contributed to the favorable development.

The favorable loss reserve development during the first quarter of 2007 was primarily the result of lower than expected bodily injury claim frequency in the personal automobile line, primarily in the three most recent accident years, and lower than expected severity in the workers compensation line, also primarily in the three most recent accident years. In addition, lower than expected frequency of liability claims in the commercial multiple peril line for the 2005 and prior accident years contributed to the favorable development.

During the first quarters of 2008 and 2007, estimated LAE reserves for claims occurring in prior years developed favorably by \$2.3 million and \$1.2 million, respectively. The favorable development in first quarter of 2008 and 2007 is primarily attributable to improvements in ultimate loss activity on prior accident years, primarily in the commercial multiple peril line, partially offset by an adverse litigation settlement in the first quarter of 2007, primarily impacting the personal automobile line.

Although we have experienced significant favorable development in both losses and LAE in recent years, there can be no assurance that this level of favorable development will occur in the future. We believe that we will experience less favorable prior year development in future years than we experienced recently. The factors that resulted in the favorable development of prior year reserves are considered in our ongoing process for establishing current accident year reserves. In light of our recent years of favorable development, the factors driving this development were considered to varying degrees in setting the more recent years accident year reserve. As a result, we expect the current and most recent accident year reserves not to develop as favorably as they have in the past. In light of the significance, in recent periods, of favorable development to our Property and Casualty segment income, declines in favorable development could be material to our results of operations.

Asbestos and Environmental Reserves

Although we attempt to limit our exposures to asbestos, environmental damage and toxic tort liability through specific policy exclusions, we have been and may continue to be subject to claims related to these exposures. Ending loss and LAE reserves for all direct business written by our property and casualty companies related to asbestos, environmental damage and toxic tort liability, included in the reserve for losses and LAE, were \$19.9 million and \$19.4 million at March 31, 2008 and December 31, 2007, respectively, net of reinsurance of \$8.4 million and

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\$11.1 million at March 31, 2008 and December 31, 2007, respectively. In recent years average asbestos and environmental payments have declined modestly. As a result of our historical direct underwriting mix of Commercial Lines policies toward smaller and middle market risks, past asbestos, environmental damage and toxic tort liability loss experience has remained minimal in relation to our total loss and LAE incurred experience.

In addition, and not included in the numbers above, we have established loss and LAE reserves for assumed reinsurance pool business with asbestos, environmental damage and toxic tort liability of \$57.1 million and \$56.9 million at March 31, 2008 and

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December 31, 2007, respectively. These reserves relate to pools in which we have terminated our participation; however, we continue to be subject to claims related to years in which we were a participant. A significant part of our pool reserves relates to our participation in the Excess and Casualty Reinsurance Association (ECRA) voluntary pool from 1950 to 1982. In 1982, the pool was dissolved and since that time, the business has been in runoff. Our percentage of the total pool liabilities varied from 1% to 6% during these years. Our participation in this pool has resulted in average paid losses of approximately \$2 million annually over the past ten years. Because of the inherent uncertainty regarding the types of claims in these pools, we cannot provide assurance that our reserves will be sufficient.

We estimate our ultimate liability for asbestos, environmental and toxic tort liability claims, whether resulting from direct business, assumed reinsurance or pool business, based upon currently known facts, reasonable assumptions where the facts are not known, current law and methodologies currently available. Although these outstanding claims are not significant, their existence gives rise to uncertainty and are discussed because of the possibility that they may become significant. We believe that, notwithstanding the evolution of case law expanding liability in asbestos and environmental claims, recorded reserves related to these claims are adequate. Nevertheless, the asbestos, environmental and toxic tort liability reserves could be revised, and any such revisions could have a material adverse effect on our results of operations for a particular quarterly or annual period or on our financial position.

Life Companies

On December 30, 2005, we sold all of the outstanding shares of capital stock of Allmerica Financial Life Insurance and Annuity Company (AFLIAC), a life insurance subsidiary representing approximately 95% of our run-off variable life insurance and annuity business, to Goldman Sachs. The transaction also included the reinsurance of 100% of the variable business of FAFLIC. Additionally, we continue to evaluate strategic alternatives related to our remaining life insurance subsidiary.

Our Life Companies segment is discussed in two major components: Continuing Operations and Discontinued Operations.

Continuing Operations

The following table summarizes the results of operations for the Continuing Operations segment for the periods indicated.

(In millions)	Three Months Ended March 31,	
	2008	2007
Segment revenues		
Premiums	\$ 12.9	\$ 17.8
Fees and other income		0.4
Net investment income	16.2	19.3
Total segment revenue	29.1	37.5
Policy benefits, claims and operating expenses		
Policy benefits, claims and losses	26.6	32.0
Policy acquisition and other operating expenses	5.0	6.4
Total policy benefits, claims and operating expenses	31.6	38.4