HANOVER INSURANCE GROUP, INC.
Form 10-Q
November 01, 2013
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2013

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

For the transition period from _________ to _________

Commission File Number 1-13754

THE HANOVER INSURANCE GROUP, INC.

(Exact name of registrant as specified in its charter)

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

440 Lincoln Street, Worcester, Massachusetts 01653

(Address of principal executive offices) (Zip Code)

(508) 855-1000

(Registrant s telephone number, including area code)

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

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

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

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

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

The number of shares outstanding of the registrant s common stock was 43,858,956 as of October 28, 2013.

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PART I - FINANCIAL INFORMATION

ITEM 1 - FINANCIAL STATEMENTS

THE HANOVER INSURANCE GROUP, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)

(In millions, except per share data)	Three Months Ended September 30, 2013	Three Months Ended September 30, 2012	Nine Months Ended September 30, 2013	Nine Months Ended September 30, 2012
Revenues				
Premiums	**$ 1,124.7**	$ 1,071.0	**$ 3,309.8**	$ 3,156.6
Net investment income	**65.7**	69.2	**200.9**	206.5
Net realized investment gains (losses):				
Net realized gains from sales and other	**3.1**	7.2	**26.5**	10.4
Net other than temporary impairment losses on investments recognized in earnings	**(2.1)**	(2.2)	**(3.7)**	(5.7)
Total net realized investment gains	**1.0**	5.0	**22.8**	4.7
Fees and other income	**10.4**	12.5	**31.2**	38.9
Total revenues	**1,201.8**	1,157.7	**3,564.7**	3,406.7
Losses and expenses				
Losses and loss adjustment expenses	**695.9**	708.4	**2,071.4**	2,101.9
Amortization of deferred acquisition costs	**243.9**	235.8	**719.1**	697.0
Interest expense	**16.6**	14.6	**48.7**	46.7
Other operating expenses	**159.3**	145.7	**484.6**	426.0
Total losses and expenses	**1,115.7**	1,104.5	**3,323.8**	3,271.6
Income before income taxes	**86.1**	53.2	**240.9**	135.1
Income tax expense (benefit):				
Current	**2.4**	(16.9)	**5.9**	11.2
Deferred	**22.4**	29.2	**54.2**	22.5
Total income tax expense	**24.8**	12.3	**60.1**	33.7
Income from continuing operations	**61.3**	40.9	**180.8**	101.4
Net gain (loss) from other discontinued operations (net of tax benefit of $0.1 and $0.3 for the three months ended September 30, 2013 and September 30, 2012 and $0.1 and $0.7 for the nine months ended September 30, 2013 and September 30, 2012)		(0.5)	**0.1**	9.5
Net income	**$ 61.3**	$ 40.4	**$ 180.9**	$ 110.9
Earnings per common share:				
Basic:				
Income from continuing operations	**$ 1.40**	$ 0.92	**$ 4.10**	$ 2.26

Net gain (loss) from discontinued operations				(0.01)				0.21
Net income per share	**$**	**1.40**	$	0.91	**$**	**4.10**	$	2.47
Weighted average shares outstanding		**43.8**		44.6		**44.1**		44.8
Diluted:								
Income from continuing operations	**$**	**1.37**	$	0.90	**$**	**4.03**	$	2.23
Net gain (loss) from discontinued operations				(0.01)				0.21
Net income per share	**$**	**1.37**	$	0.89	**$**	**4.03**	$	2.44
Weighted average shares outstanding		**44.6**		45.2		**44.9**		45.4

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

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THE HANOVER INSURANCE GROUP, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (UNAUDITED)

	Three Months Ended September 30,		Nine Months Ended September 30,	
(In millions)	**2013**	**2012**	**2013**	**2012**
Net income	**$ 61.3**	$ 40.4	**$ 180.9**	$ 110.9
Other comprehensive income (loss), net of tax:				
Available-for-sale securities and derivative instruments:				
Net appreciation (depreciation) during the period	**(9.3)**	49.4	**(142.0)**	133.5
Portion of other-than-temporary impairment losses transferred from (to) other comprehensive income	**(0.2)**	2.4	**0.5**	7.1
Total available-for-sale securities and derivative instruments	**(9.5)**	51.8	**(141.5)**	140.6
Pension and postretirement benefits:				
Amortization recognized as net periodic benefit and postretirement cost	**1.9**	1.6	**7.9**	4.6
Cumulative foreign currency translation adjustment:				
Amount recognized as cumulative foreign currency translation during the period	**5.7**	7.5	**(4.4)**	8.4
Total other comprehensive income (loss), net of tax	**(1.9)**	60.9	**(138.0)**	153.6
Comprehensive income	**$ 59.4**	$ 101.3	**$ 42.9**	$ 264.5

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

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THE HANOVER INSURANCE GROUP, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS (UNAUDITED)

(In millions, except share data)	September 30, 2013	December 31, 2012
Assets		
Investments:		
Fixed maturities, at fair value (amortized cost of $6,473.3 and $6,529.5)	**$ 6,675.5**	$ 6,952.2
Equity securities, at fair value (cost of $449.0 and $299.0)	**494.1**	315.8
Other investments	**185.3**	210.3
Total investments	**7,354.9**	7,478.3
Cash and cash equivalents	**602.2**	564.8
Accrued investment income	**70.0**	69.0
Premiums and accounts receivable, net	**1,410.7**	1,308.8
Reinsurance recoverable on paid and unpaid losses and unearned premiums	**2,390.3**	2,479.7
Deferred acquisition costs	**521.7**	489.5
Deferred income taxes	**263.2**	267.6
Goodwill	**184.8**	184.9
Other assets	**544.7**	511.8
Assets of discontinued operations	**120.8**	130.5
Total assets	**$ 13,463.3**	$ 13,484.9
Liabilities		
Loss and loss adjustment expense reserves	**$ 6,162.8**	$ 6,197.0
Unearned premiums	**2,645.5**	2,474.8
Expenses and taxes payable	**638.4**	775.8
Reinsurance premiums payable	**412.2**	466.2
Debt	**938.7**	849.4
Liabilities of discontinued operations	**121.5**	126.3
Total liabilities	**10,919.1**	10,889.5
Commitments and contingencies		
Shareholders Equity		
Preferred stock, par value $0.01 per share; 20.0 million shares authorized; none issued		
Common stock, par value $0.01 per share; 300.0 million shares authorized; 60.5 million shares issued	**0.6**	0.6
Additional paid-in capital	**1,829.6**	1,787.1
Accumulated other comprehensive income	**187.8**	325.8
Retained earnings	**1,295.2**	1,211.6
Treasury stock at cost (16.9 and 16.2 million shares)	**(769.0)**	(729.7)
Total shareholders equity	**2,544.2**	2,595.4
Total liabilities and shareholders equity	**$ 13,463.3**	$ 13,484.9

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

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THE HANOVER INSURANCE GROUP, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF SHAREHOLDERS EQUITY (UNAUDITED)

(In millions)	Nine Months Ended September 30, 2013	2012
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	**1,787.1**	1,784.8
Employee and director stock-based awards and other	**42.5**	0.2
Balance at end of period	**1,829.6**	1,785.0
Accumulated Other Comprehensive Income (Loss), net of tax		
Net Unrealized Appreciation (Depreciation) on Investments and Derivative Instruments:		
Balance at beginning of period	**426.0**	308.7
Net appreciation during the period:		
Net appreciation (depreciation) on available-for-sale securities and derivative instruments	**(141.5)**	140.6
Balance at end of period	**284.5**	449.3
Defined Benefit Pension and Postretirement Plans:		
Balance at beginning of period	**(96.6)**	(86.8)
Net amount recognized as net periodic benefit cost	**7.9**	4.6
Balance at end of period	**(88.7)**	(82.2)
Cumulative Foreign Currency Translation Adjustment:		
Balance at beginning of period	**(3.6)**	(11.5)
Amount recognized as cumulative foreign currency translation during the period	**(4.4)**	8.4
Balance at end of period	**(8.0)**	(3.1)
Total accumulated other comprehensive income	**187.8**	364.0
Retained Earnings		
Balance at beginning of period	**1,211.6**	1,211.3
Net income	**180.9**	110.9
Dividends to shareholders	**(43.8)**	(40.3)
Stock-based compensation	**(53.5)**	0.2
Balance at end of period	**1,295.2**	1,282.1
Treasury Stock		
Balance at beginning of period	**(729.7)**	(723.1)
Shares purchased at cost	**(78.2)**	(20.0)
Net shares reissued at cost under employee stock-based compensation plans	**38.9**	10.8

Balance at end of period	**(769.0)**	(732.3)
Total shareholders equity	**$ 2,544.2**	$ 2,699.4

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

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THE HANOVER INSURANCE GROUP, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

(In millions)	Nine Months Ended September 30, 2013	2012
Cash Flows From Operating Activities		
Net income	**$ 180.9**	$ 110.9
Adjustments to reconcile net income to net cash provided by operating activities:		
Loss on repurchase of debt	**11.3**	
Net realized investment gains	**(22.8)**	(3.8)
Net amortization and depreciation	**25.4**	26.0
Gain on sale of Citizens Management, Inc.		(10.8)
Stock-based compensation expense	**8.9**	9.8
Amortization of defined benefit plan costs	**12.1**	7.0
Deferred income taxes expense	**54.1**	21.9
Change in deferred acquisition costs	**(32.2)**	(42.6)
Change in premiums receivable, net of reinsurance premiums payable	**(155.9)**	(87.5)
Change in loss, loss adjustment expense and unearned premium reserves	**146.5**	408.0
Change in reinsurance recoverable	**83.9**	(170.0)
Change in expenses and taxes payable	**(102.8)**	(23.8)
Other, net	**(27.5)**	(40.5)
Net cash provided by operating activities	**181.9**	204.6
Cash Flows From Investing Activities		
Proceeds from disposals and maturities of fixed maturities	**1,130.1**	1,267.4
Proceeds from disposals of equity securities and other investments	**111.5**	21.7
Purchase of fixed maturities	**(1,090.9)**	(1,601.1)
Purchase of equity securities and other investments	**(228.3)**	(206.1)
Proceeds from disposal of Citizens Management, Inc., net of cash transferred		5.2
Capital expenditures	**(17.0)**	(11.2)
Net payments related to derivative agreements		(4.4)
Net cash used in investing activities	**(94.6)**	(528.5)
Cash Flows From Financing Activities		
Proceeds from exercise of employee stock options	**21.7**	1.9
Proceeds from debt borrowings, net	**169.5**	7.4
Decrease in cash collateral related to securities lending program	**(18.1)**	(6.6)
Dividends paid to shareholders	**(43.8)**	(40.3)
Repurchases of debt	**(96.8)**	(0.8)
Repurchases of common stock	**(78.2)**	(20.0)
Other financing activities	**(3.8)**	(0.2)
Net cash used in financing activities	**(49.5)**	(58.6)
Effect of exchange rate changes on cash	**(0.5)**	24.0
Net change in cash and cash equivalents	**37.3**	(358.5)
Net change in cash related to discontinued operations	**0.1**	0.1
Cash and cash equivalents, beginning of period	**564.8**	820.4

Cash and cash equivalents, end of period	**$**	**602.2**	$	462.0

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

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THE HANOVER INSURANCE GROUP, INC. AND SUBSIDIARIES

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

1. Basis of Presentation and Principles of Consolidation

The accompanying unaudited consolidated financial statements of The Hanover Insurance Group, Inc. and subsidiaries (THG or the Company) have been prepared in accordance with generally accepted accounting principles in the United States of America (U.S. GAAP) for interim financial information and with the requirements of Form 10-Q. Certain financial information that is provided in annual financial statements, but is not required in interim reports, has been omitted.

The interim consolidated financial statements of THG include the accounts of The Hanover Insurance Company (Hanover Insurance) and Citizens Insurance Company of America, THG s principal U.S. domiciled property and casualty companies; Chaucer Holdings plc (Chaucer), a specialist insurance underwriting group which operates through the Society and Corporation of Lloyd s (Lloyd s) and certain other insurance and non-insurance subsidiaries. These legal entities conduct their operations through several business segments discussed in Note 9 Segment Information . Additionally, the interim consolidated financial statements include the Company s discontinued operations, consisting primarily of the Company s former life insurance businesses, its accident and health business and prior to April 30, 2012, its third party administrator. All intercompany accounts and transactions have been eliminated. During the quarter, the Company increased additional paid-in capital and decreased retained earnings by $34 million to correct the classification of amounts relating to stock-based compensation in prior periods. This reclassification within shareholders equity had no impact on net income, assets, liabilities or total shareholders equity of the Company for the current or any prior period.

The preparation of financial statements in conformity with U.S. GAAP 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.

In the opinion of the Company s management, the accompanying interim consolidated financial statements reflect all adjustments, consisting of normal recurring items, necessary for a fair presentation of the financial position and results of operations. The results of operations for the three and nine months ended September 30, 2013 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 2012 Annual Report on Form 10-K filed with the Securities and Exchange Commission (SEC) on February 26, 2013.

2. New Accounting Pronouncements

Recently Implemented Standards

In February 2013, the Financial Accounting Standards Board (FASB) issued Accounting Standards Codification (ASC) Update No. 2013-02 (Topic 220) *Comprehensive Income Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income*. This guidance requires an entity to provide information about the amounts reclassified out of accumulated other comprehensive income (AOCI) either on the face of the Statement of Income or in the Notes to the Consolidated Financial Statements. Significant amounts reclassified out of AOCI should be provided by the respective line items of net income but only if the amount reclassified is required under U.S. GAAP to be reclassified in its entirety to net income in the same reporting period. For amounts not required to be reclassified in their entirety to net income, a cross-reference to other disclosures provided for in accordance with U.S. GAAP is required. This guidance was applicable for reporting periods beginning after December 15, 2012. The Company implemented the guidance effective January 1, 2013. The effect of implementing the guidance relates to financial statement presentation and disclosures. (See disclosures in Note 8 Other Comprehensive Income.)

In July 2012, the FASB issued ASC Update No. 2012-02 (Topic 350) *Testing Indefinite Lived Intangible Assets for Impairment.* This ASC update allows an entity to first assess qualitative factors to determine whether the existence of events and circumstances indicates that it is more likely than not that the indefinite lived intangible asset is impaired. This assessment should be used as a basis for determining whether it is necessary to perform the quantitative impairment test. An entity would not be required to calculate the fair value of the intangible asset and perform the quantitative test unless the entity determines, based upon its qualitative assessment, that it is more likely than not that its fair value is less than its carrying value. The update further improves previous guidance by expanding upon the examples of events and circumstances that an entity should consider in determining whether it is more likely than not that the fair value of an indefinite lived intangible asset is less than its carrying amount. The update also allows an entity the option to bypass the qualitative assessment for any indefinite-lived intangible asset in any period and proceed directly to performing the quantitative impairment test. An entity will be able to resume performing the qualitative assessment in any subsequent period. This ASC update was effective for annual and interim periods beginning after September 15, 2012, with early adoption permitted. The Company implemented this guidance effective October 1, 2012. The effect of implementing this guidance was not material to the Company s financial position or results of operations.

Recently Issued Standards

In July 2013, the FASB issued ASC Update No. 2013-11 (Topic 740) *Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists* (*a consensus of the FASB Emerging Issues Task Force*). This ASC update clarifies the applicable guidance for the presentation of an unrecognized tax benefit when a net operating loss carryforward, a similar tax loss, or a tax credit carryforward exists. An unrecognized tax benefit, or a portion of an unrecognized tax benefit, should be presented in the financial statements as a reduction to a deferred tax asset for a net operating loss carryforward, a similar tax loss, or a tax credit carryforward as long as it is available, at the reporting date under the tax law of the applicable jurisdiction, to settle any additional income taxes that would result from the disallowance of a tax position (with certain exceptions). The assessment of whether a deferred tax asset is available is based on the unrecognized tax benefit and deferred tax asset that exist at the reporting date and should be made presuming disallowance of the tax position at the reporting date. This ASC update is effective for annual and interim periods beginning after December 15, 2013, with early adoption permitted, and is to be applied prospectively to all unrecognized tax benefits that exist at the effective date. Retrospective application is permitted. The Company does not expect the adoption of ASC Update 2013-11 to have a material impact on its financial position or results of operations.

In March 2013, the FASB issued ASC Update No. 2013-05 (Topic 830) *Foreign Currency Matters-Parent s Accounting for the Cumulative Translation Adjustment upon Derecognition of Certain Subsidiaries or Groups of Assets within a Foreign Entity or of an Investment in a Foreign Entity* (*a consensus of the FASB Emerging Issues Task Force*). This ASC update clarifies the applicable guidance for the release of the cumulative translation adjustment into net income when a parent either sells all or a portion of its investment in a foreign entity. This guidance is also required to be applied when an entity no longer holds a controlling financial interest in a subsidiary or group of assets that is a nonprofit activity or a business within a foreign entity (with certain exceptions). Additionally, this update clarifies that the sale of an investment in a foreign entity includes events that result in an acquirer obtaining control of an acquiree in which it held an equity interest immediately before the acquisition date in a business combination achieved in stages. This ASC update is effective for annual and interim periods beginning after December 15, 2013, with early adoption permitted, and is to be applied prospectively to derecognition events occurring after the effective date. The Company does not expect the adoption of ASC Update 2013-05 to have a material impact on its financial position or results of operations.

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3. Income Taxes

Income tax expense for the nine months ended September 30, 2013 and 2012 has been computed using estimated annual effective tax rates. These rates are revised, if necessary, at the end of each successive interim period to reflect current estimates of the annual effective tax rates.

For the nine months ended September 30, 2013, the tax provision is comprised of a $41.8 million U.S. federal income tax expense and $18.3 million foreign income tax expense. For the nine months ended September 30, 2012, the tax provision was comprised of a $3.4 million U.S. federal income tax expense and $30.3 million in foreign income tax expense.

Although most of the Company s non U.S. income is subject to U.S. federal income tax, certain of its non U.S. income is not subject to U.S. federal income tax until repatriated. Foreign taxes on this non U.S. income are accrued at the local foreign tax rate, as opposed to the higher U.S. statutory rate, since these earnings currently are expected to be indefinitely reinvested overseas. This assumption could change, as a result of a sale of the subsidiaries, the receipt of dividends from the subsidiaries, a change in management s intentions, or as a result of various other events. The Company has not made a provision for U.S. taxes on $14.7 million of non-U.S. income for the nine months ended September 30, 2013. All of the Company s non-U.S. income was subject to U.S. taxes during the same period in 2012.

The Company or its subsidiaries files income tax returns in the U.S. federal jurisdiction and various state jurisdictions, as well as foreign jurisdictions. With few exceptions, the Company and its subsidiaries are no longer subject to U.S. federal income tax examinations by tax authorities for years before 2007. The IRS audits of the years 2009 and 2010 commenced in June 2012. The Company and its subsidiaries are still subject to U.S. state income tax examinations by tax authorities for years after 2006 and foreign examinations for years after 2010.

4. Debt

Debt consists of the following:

(in millions)	**September 30, 2013**	**December 31, 2012**
Senior debentures maturing June 15, 2021	**$ 300.0**	$ 300.0
Senior debentures maturing March 1, 2020	**200.0**	200.0
Senior debentures maturing October 15, 2025	**81.2**	120.9
Subordinated debentures maturing March 30, 2053	**175.0**	
Subordinated debentures maturing February 3, 2027	**59.7**	59.7
FHLBB borrowings (secured)	**125.0**	171.3
Total principal debt	**$ 940.9**	$ 851.9
Unamortized debt discount	**(2.2)**	(2.5)
Total	**$ 938.7**	$ 849.4

During the second quarter of 2013, the Company repurchased senior debentures maturing October 15, 2025, with a carrying value of $39.2 million at a cost of $50.5 million, resulting in a loss of $11.3 million.

On March 20, 2013, the Company issued $175.0 million aggregate principal amount of 6.35% subordinated unsecured debentures due March 30, 2053. These debentures pay interest quarterly. The Company may redeem these debentures in whole at any time, or in part from time to time, on or after March 30, 2018, at a redemption price equal to their principal amount plus accrued and unpaid interest. If the debentures are not redeemed in whole, at least $25.0 million aggregate principal amount of the debentures must remain outstanding.

In 2009, Hanover Insurance received a $125.0 million Federal Home Loan Bank of Boston (FHLBB) advance through its membership in the FHLBB. This collateralized advance bears interest at a fixed rate of 5.50% per annum over a twenty-year term. In July 2010, Hanover Insurance committed to an additional $46.3 million of FHLBB advances. These advances were drawn in several increments from July 2010 to January 2012 and carried fixed interest rates with a weighted average of 3.88%. In January 2013, Hanover Insurance repaid the $46.3 million of FHLBB advances plus prepayment fees of $7.8 million for a total payment of $54.1 million. These advances would have matured on July 30, 2020.

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As collateral to FHLBB, Hanover Insurance pledged government agency securities with a fair value of $145.2 million and $200.8 million, for the aggregate borrowings of $125.0 million and $171.3 million as of September 30, 2013 and December 31, 2012, respectively. The amount of required collateral decreased in conjunction with the repayment of the $46.3 million of FHLBB advances. The fair value of the collateral pledged must be maintained at certain specified levels of the borrowed amount, which can vary depending on the type of assets pledged. If the fair value of this collateral declines below these specified levels, Hanover Insurance would be required to pledge additional collateral or repay outstanding borrowings. Hanover Insurance is permitted to voluntarily repay the outstanding borrowings at any time, subject to a repayment fee. As a requirement of membership in the FHLBB, Hanover Insurance maintains a certain level of investment in FHLBB stock. Total holdings of FHLBB stock were $9.3 million and $9.7 million at September 30, 2013 and December 31, 2012, respectively.

At September 30, 2013, the Company was in compliance with the covenants associated with all of its debt indentures and credit arrangements.

5. Investments

A. Fixed maturities and equity securities

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

			September 30, 2013		
(in millions)	**Amortized Cost or Cost**	**Gross Unrealized Gains**	**Gross Unrealized Losses**	**Fair Value**	**OTTI Unrealized Losses**
Fixed maturities:					
U.S. Treasury and government agencies	**$ 376.3**	**$ 4.6**	**$ 10.4**	**$ 370.5**	**$**
Foreign government	**286.6**	**2.6**	**0.8**	**288.4**	
Municipal	**1,062.0**	**47.4**	**12.5**	**1,096.9**	
Corporate	**3,532.7**	**183.6**	**34.4**	**3,681.9**	**8.6**
Residential mortgage-backed	**694.0**	**22.7**	**9.6**	**707.1**	**1.7**
Commercial mortgage-backed	**349.1**	**11.2**	**4.4**	**355.9**	
Asset-backed	**172.6**	**2.5**	**0.3**	**174.8**	
Total fixed maturities	**$ 6,473.3**	**$ 274.6**	**$ 72.4**	**$ 6,675.5**	**$ 10.3**
Equity securities	**$ 449.0**	**$ 50.5**	**$ 5.4**	**$ 494.1**	**$**

			December 31, 2012		
(in millions)	**Amortized Cost or Cost**	**Gross Unrealized Gains**	**Gross Unrealized Losses**	**Fair Value**	**OTTI Unrealized Losses**
Fixed maturities:					
U.S. Treasury and government agencies	$ 317.2	$ 8.8	$ 0.4	$ 325.6	$
Foreign government	348.5	4.6	0.2	352.9	
Municipal	1,010.2	87.2	1.1	1,096.3	
Corporate	3,512.8	275.4	14.8	3,773.4	9.3
Residential mortgage-backed	769.0	39.4	3.2	805.2	1.7
Commercial mortgage-backed	373.3	23.2	0.3	396.2	
Asset-backed	198.5	4.1		202.6	
Total fixed maturities	$ 6,529.5	$ 442.7	$ 20.0	$ 6,952.2	$ 11.0
Equity securities	$ 299.0	$ 21.6	$ 4.8	$ 315.8	$

Other-than-temporary impairments (OTTI) unrealized losses in the tables above represent OTTI recognized in accumulated other comprehensive income. This amount excludes net unrealized gains on impaired securities relating to changes in the value of such securities subsequent to the impairment measurement date of $16.4 million and $20.5 million as of September 30, 2013 and December 31, 2012, respectively.

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The amortized cost and fair value by maturity periods for fixed maturities are shown below. Actual maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties, or the Company may have the right to put or sell the obligations back to the issuers.

(in millions)	September 30, 2013	
	Amortized Cost	Fair Value
Due in one year or less	$ 444.7	$ 450.6
Due after one year through five years	2,216.9	2,321.5
Due after five years through ten years	1,904.4	1,959.0
Due after ten years	691.6	706.6
	5,257.6	5,437.7
Mortgage-backed and asset-backed securities	1,215.7	1,237.8
Total fixed maturities	$ 6,473.3	$ 6,675.5

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B. Securities in an unrealized loss position

The following tables provide information about the Company s fixed maturities and equity securities that were in an unrealized loss position at September 30, 2013 and December 31, 2012.

	September 30, 2013					
	12 months or less		Greater than 12 months		Total	
(in millions)	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value
Fixed maturities:						
Investment grade:						
U.S. Treasury and government agencies	**$ 10.3**	**$ 178.4**	**$ 0.1**	**$ 4.6**	**$ 10.4**	**$ 183.0**
Foreign governments	**0.7**	**73.1**	**0.1**	**15.5**	**0.8**	**88.6**
Municipal	**11.5**	**277.1**	**1.0**	**17.8**	**12.5**	**294.9**
Corporate	**20.1**	**666.2**	**6.8**	**37.5**	**26.9**	**703.7**
Residential mortgage-backed	**7.5**	**218.5**	**1.6**	**10.9**	**9.1**	**229.4**
Commercial mortgage-backed	**4.4**	**113.8**		**0.9**	**4.4**	**114.7**
Asset-backed	**0.3**	**41.3**		**0.2**	**0.3**	**41.5**
Total investment grade	**54.8**	**1,568.4**	**9.6**	**87.4**	**64.4**	**1,655.8**
Below investment grade:						
Corporate	**4.4**	**91.9**	**3.1**	**27.8**	**7.5**	**119.7**
Residential mortgage-backed	**0.1**	**3.0**	**0.4**	**1.6**	**0.5**	**4.6**
Total below investment grade	**4.5**	**94.9**	**3.5**	**29.4**	**8.0**	**124.3**
Total fixed maturities	**59.3**	**1,663.3**	**13.1**	**116.8**	**72.4**	**1,780.1**
Equity securities	**3.6**	**128.7**	**1.8**	**3.9**	**5.4**	**132.6**
Total	**$ 62.9**	**$ 1,792.0**	**$ 14.9**	**$ 120.7**	**$ 77.8**	**$ 1,912.7**

	December 31, 2012					
	12 months or less		Greater than 12 months		Total	
(in millions)	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value
Fixed maturities:						
Investment grade:						
U.S. Treasury and government agencies	$ 0.2	$ 89.5	$ 0.2	$ 8.5	$ 0.4	$ 98.0
Foreign governments	0.2	81.2		0.4	0.2	81.6
Municipal	0.5	61.9	0.6	24.0	1.1	85.9
Corporate	1.8	224.8	6.6	59.0	8.4	283.8
Residential mortgage-backed	0.5	47.3	2.0	9.4	2.5	56.7
Commercial mortgage-backed	0.2	29.9	0.1	4.9	0.3	34.8
Asset-backed		11.4		0.3		11.7
Total investment grade	3.4	546.0	9.5	106.5	12.9	652.5
Below investment grade:						

Municipal				2.0		2.0
Corporate	1.1	26.6	5.3	50.6	6.4	77.2
Residential mortgage-backed	0.1	1.6	0.6	2.5	0.7	4.1
Total below investment grade	1.2	28.2	5.9	55.1	7.1	83.3
Total fixed maturities	4.6	574.2	15.4	161.6	20.0	735.8
Equity securities	4.8	74.4			4.8	74.4
Total	$ 9.4	$ 648.6	$ 15.4	$ 161.6	$ 24.8	$ 810.2

The Company views gross unrealized losses on fixed maturities and equity securities as being temporary since it is its assessment that these securities will recover in the near term, allowing the Company to realize the anticipated long-term economic value. The Company employs a systematic methodology to evaluate declines in fair value below amortized cost for fixed maturity securities or cost for equity securities. In determining OTTI of fixed maturity and equity securities, the Company evaluates several factors and circumstances, including the issuer s overall financial condition; the issuer s credit and financial strength ratings; the issuer s financial performance, including earnings trends, dividend payments and asset quality; any specific events which may influence the operations of the issuer; the general outlook for market conditions in the industry or geographic region in which the issuer operates; and the length of time and the degree to which the fair value of an issuer s securities remains below the Company s cost. With respect to fixed maturity investments, the Company considers any factors that might raise doubt about the issuer s ability to make contractual payments as they come due and whether the Company expects to recover the entire amortized cost basis of the security. With respect to equity securities, the Company considers its ability and intent to hold the investment for a period of time to allow for a recovery in value.

C. Proceeds from sales

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

	Three Months Ended September 30,					
	2013			2012		
(in millions)	Proceeds from Sales	Gross Gains	Gross Losses	Proceeds from Sales	Gross Gains	Gross Losses
Fixed maturities	**$ 83.3**	**$ 1.0**	**$ 0.9**	$ 78.8	$ 2.3	$ 0.3
Equity securities	**$ 10.8**	**$ 1.5**	**$**	$ 13.6	$ 2.4	$

	Nine Months Ended September 30,					
	2013			2012		
(in millions)	Proceeds from Sales	Gross Gains	Gross Losses	Proceeds from Sales	Gross Gains	Gross Losses
Fixed maturities	**$ 369.0**	**$ 5.6**	**$ 1.9**	$ 486.8	$ 8.9	$ 1.9
Equity securities	**$ 89.7**	**$ 18.5**	**$ 0.3**	$ 17.1	$ 2.9	$ 0.2

D. Other-than-temporary impairments

For the three months ended September 30, 2013, total OTTI of fixed maturities and equity securities were $2.5 million. Of this amount, $2.1 million was recognized in earnings and the remaining $0.4 million was recorded as unrealized losses in accumulated other comprehensive income. For the first nine months of 2013, total OTTI of fixed maturities and equity securities were $4.5 million. Of this amount, $3.7 million was recognized in earnings and the remaining $0.8 million was recorded as unrealized losses in accumulated other comprehensive income.

For the three months ended September 30, 2012, total OTTI of fixed maturities and equity securities were $1.4 million. Of this amount, $2.2 million was recognized in earnings, including $0.8 million that was transferred from accumulated other comprehensive income. For the first nine months of 2012, total OTTI of fixed maturities and equity securities were $5.2 million. Of this amount, $5.7 million was recognized in earnings, including $0.5 million that was transferred from accumulated other comprehensive income.

The methodology and significant inputs used to measure the amount of credit losses on fixed maturities in 2013 and 2012 were as follows:

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

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

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

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The following table provides rollforwards of the cumulative amounts related to the Company s credit loss portion of the OTTI losses on fixed maturity securities for which the non-credit portion of the loss is included in other comprehensive income.

	Three Months Ended September 30,		Nine Months Ended September 30,	
(in millions)	**2013**	**2012**	**2013**	**2012**
Credit losses at beginning of period	**$ 7.3**	$ 13.8	**$ 8.6**	$ 14.5
Credit losses for which an OTTI was not previously recognized	**0.1**	0.1	**0.4**	0.5
Additional credit losses on securities for which an OTTI was previously recognized			**0.2**	0.6
Reductions for securities sold, matured or called	**(0.1)**	(2.5)	**(1.9)**	(4.2)
Reductions for securities reclassified as intended to sell		(0.2)		(0.2)
Credit losses at the end of period	**$ 7.3**	$ 11.2	**$ 7.3**	$ 11.2

E. Funds at Lloyd s

In accordance with Lloyd s operating guidelines, the Company deposits funds at Lloyd s to support underwriting operations. These funds are available only to fund claim obligations. These assets consisted of approximately $341 million of fixed maturities and $28 million of cash and cash equivalents as of September 30, 2013. The Company also deposits funds with various state and governmental authorities in the U.S. For a discussion of the Company s deposits with state and governmental authorities, see also Note 3 Investments of the Notes to Consolidated Financial Statements in our Annual Report on Form 10-K for the year ended December 31, 2012.

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6. Fair Value

Fair value is defined 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. The Company emphasizes the use of observable market data whenever available in determining fair value. Fair values presented for certain financial instruments are estimates which, in many cases, may differ significantly from the amounts that could be realized upon immediate liquidation. A hierarchy of the three broad levels of fair value are as follows, with the highest priority given to Level 1 as these are the most observable, and the lowest priority given to Level 3:

Level 1 Unadjusted quoted prices in active markets for identical assets or liabilities.

Level 2 Quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar assets or liabilities 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 2 or 3 according to the lowest level input that has a significant impact on the fair value measurement.

The following methods and assumptions were used to estimate the fair value of each class of financial instruments and have not changed since last year.

Cash and Cash Equivalents

The carrying amount approximates fair value. Cash equivalents primarily consist of money market instruments, which are generally valued using unadjusted quoted prices in active markets that are accessible for identical assets and are classified as Level 1.

Fixed Maturities

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

The Company utilizes a third party pricing service for the valuation of the majority of its fixed maturity securities and receives one quote per security. When quoted market prices in an active market are available, they are provided by the pricing service as the fair value and such values are classified as Level 1. Since fixed maturities other than U.S. Treasury securities generally do not trade on a daily basis, the pricing service prepares estimates of fair value for those securities using pricing applications based on a market approach. Inputs into the fair value pricing common to all asset classes include: benchmark U.S. Treasury security yield curves; reported trades of identical or similar fixed maturity securities; broker/dealer quotes of identical or similar fixed maturity securities and structural characteristics such as maturity date, coupon, mandatory principal payment dates, frequency of interest and principal payments, and optional redemption features. Inputs into the fair value applications that are unique by asset class include, but are not limited to:

U.S. government agencies determination of direct versus indirect government support and whether any contingencies exist with respect to the timely payment of principal and interest.

Foreign government estimates of appropriate market spread versus underlying related sovereign treasury curve(s) dependent on liquidity and direct or contingent support.

Municipals overall credit quality, including assessments of the level and variability of: sources of payment such as income, sales or property taxes, levies or user fees; credit support such as insurance; state or local economic and political base; natural resource availability; and susceptibility to natural or man-made catastrophic events such as hurricanes, earthquakes or acts of terrorism.

Corporate fixed maturities overall credit quality, including assessments of the level and variability of: economic sensitivity; liquidity; corporate financial policies; management quality; regulatory environment; competitive position; ownership; restrictive covenants; and security or collateral.

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Residential mortgage-backed securities estimates of prepayment speeds based upon: historical prepayment rate trends; underlying collateral interest rates; geographic concentration; vintage year; borrower credit quality characteristics; interest rate and yield curve forecasts; government or monetary authority support programs; tax policies; delinquency/default trends; and, in the case of non-agency collateralized mortgage obligations, severity of loss upon default and length of time to recover proceeds following default.

Commercial mortgage-backed securities overall credit quality, including assessments of the value and supply/demand characteristics of: collateral type such as office, retail, residential, lodging, or other; geographic concentration by region, state, metropolitan statistical area and locale; vintage year; historical collateral performance including defeasance, delinquency, default and special servicer trends; and capital structure support features.

Asset-backed securities overall credit quality, including assessments of the underlying collateral type such as credit card receivables, auto loan receivables and equipment lease receivables; geographic diversification; vintage year; historical collateral performance including delinquency, default and casualty trends; economic conditions influencing use rates and resale values; and contract structural support features.

Generally, all prices provided by the pricing service, except actively traded securities with quoted market prices, are reported as Level 2.

The Company holds privately placed fixed maturity securities and certain other fixed maturity securities that do not have an active market and for which the pricing service cannot provide fair values. The Company determines fair values for these securities using either matrix pricing utilizing the market approach or broker quotes. The Company will use observable market data as inputs into the fair value applications, as discussed in the determination of Level 2 fair values, to the extent it is available, but is also required to use a certain amount of unobservable judgment due to the illiquid nature of the securities involved. Unobservable judgment reflected in the Company s matrix model accounts for estimates of additional spread required by market participants for factors such as issue size, structural complexity, high bond coupon, long maturity term or other unique features. These matrix-priced securities are reported as Level 2 or Level 3, depending on the significance of the impact of unobservable judgment on the security s value. Additionally, the Company may obtain non-binding broker quotes which are reported as Level 3.

Equity Securities

Level 1 consists of publicly traded securities, including exchange traded funds, valued at quoted market prices. Level 2 includes securities that are valued using pricing for similar securities and pricing models that incorporate observable inputs. Level 2 also includes fair values obtained from net asset values provided by mutual fund investment managers, upon which subscriptions and redemptions can be executed. Level 3 consists of common or preferred stock of private companies for which observable inputs are not available. Non-binding broker quotes are also included in Level 3.

The Company utilizes a third party pricing service for the valuation of the majority of its equity securities and receives one quote for each equity security. When quoted market prices in an active market are available, they are provided by the pricing service as the fair value and such values are classified as Level 1. Generally, all prices provided by the pricing service, except quoted market prices, are reported as Level 2. The Company holds certain equity securities that have been issued by privately-held entities that do not have an active market and for which the pricing service cannot provide fair values. Generally, the Company estimates fair value for these securities based on the issuer s book value and market multiples. These securities are reported as Level 3 as market multiples represent significant unobservable inputs.

Other Investments

Other investments consist primarily of overseas trust funds, for which fair values are provided by the investment manager based on quoted prices for similar instruments in active markets and are reported as Level 2. Also included in other investments are cost basis limited partnerships and mortgage loans. Cost basis limited partnerships fair values are based on the net asset value provided by the general partner and recent financial information and are reported as Level 3. Mortgage loans fair values are estimated by discounting the future contractual cash flows using the current rates at which similar loans would be made to borrowers with similar credit ratings and are reported as Level 2.

Debt

The fair value of debt is estimated based on quoted market prices. If a quoted market price is not available, fair values are estimated using discounted cash flows that are based on current interest rates and yield curves for debt issuances with maturities and credit risks consistent with the debt being valued. Debt is reported as Level 2.

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

(in millions)	September 30, 2013		December 31, 2012	
	Carrying Value	**Fair Value**	**Carrying Value**	**Fair Value**
Financial Assets				
Cash and cash equivalents	**$ 602.2**	**$ 602.2**	$ 564.8	$ 564.8
Fixed maturities	**6,675.5**	**6,675.5**	6,952.2	6,952.2
Equity securities	**494.1**	**494.1**	315.8	315.8
Other investments	**165.5**	**165.9**	188.9	189.4
Total financial assets	**$ 7,937.3**	**$ 7,937.7**	$ 8,021.7	$ 8,022.2
Financial Liabilities				
Debt	**$ 938.7**	**$ 1,005.3**	$ 849.4	$ 995.2

The Company has processes designed to ensure that the values received from its third party pricing service are accurately recorded, that the data inputs and valuation techniques utilized are appropriate and consistently applied and that the assumptions are reasonable and consistent with the objective of determining fair value. The Company performs a review of the fair value hierarchy classifications and of prices received from its pricing service on a quarterly basis. The Company reviews the pricing services policies describing its methodology, processes, practices and inputs, including various financial models used to value securities. Also, the Company reviews the portfolio pricing, including securities with changes in prices that exceed a defined threshold are verified to independent sources, if available. If upon review, the Company is not satisfied with the validity of a given price, a pricing challenge would be submitted to the pricing service along with supporting documentation for its review. The Company does not adjust quotes or prices obtained from the pricing service unless the pricing service agrees with the Company s challenge. During 2013 and 2012, the Company did not adjust any prices received from brokers or its pricing service.

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Changes in the observability of valuation inputs may result in a reclassification of certain financial assets or liabilities within the fair value hierarchy. Reclassifications between levels of the fair value hierarchy are reported as of the beginning of the period in which the reclassification occurs. As previously discussed, the Company utilizes a third party pricing service for the valuation of the majority of its fixed maturities and equity securities. The pricing service has indicated that it will only produce an estimate of fair value if there is objectively verifiable information to produce a valuation. If the pricing service discontinues pricing an investment, the Company will use observable market data to the extent it is available, but may also be required to make assumptions for market based inputs that are unavailable due to market conditions.

The following tables provide, for each hierarchy level, the Company s assets that were measured at fair value on a recurring basis.

	September 30, 2013			
(in millions)	**Total**	**Level 1**	**Level 2**	**Level 3**
Fixed maturities:				
U.S. Treasury and government agencies	**$ 370.5**	**$ 167.1**	**$ 203.4**	**$**
Foreign government	**288.4**	**39.2**	**249.2**	
Municipal	**1,096.9**		**1,070.0**	**26.9**
Corporate	**3,681.9**		**3,662.3**	**19.6**
Residential mortgage-backed, U.S. agency backed	**541.5**		**541.5**	
Residential mortgage-backed, non-agency	**165.6**		**165.1**	**0.5**
Commercial mortgage-backed	**355.9**		**332.7**	**23.2**
Asset-backed	**174.8**		**174.8**	
Total fixed maturities	**6,675.5**	**206.3**	**6,399.0**	**70.2**
Equity securities	**484.8**	**453.3**		**31.5**
Other investments	**153.8**		**150.2**	**3.6**
Total investment assets at fair value	**$ 7,314.1**	**$ 659.6**	**$**	