PROASSURANCE CORP
Form 10-Q
November 04, 2008

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q

(Mark One)

þ **Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
For the quarterly period ended September 30, 2008 or _____

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

Commission file number 0-16533
ProAssurance Corporation
(Exact Name of Registrant as Specified in Its Charter)

Delaware	63-1261433
(State or Other Jurisdiction of Incorporation or Organization)	(IRS Employer Identification No.)
100 Brookwood Place, Birmingham, AL	35209
(Address of Principal Executive Offices)	(Zip Code)

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

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

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

Large accelerated filer þ	Accelerated filer o	Non-accelerated filer o	Smaller reporting company o
		(Do not check if a 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 o No þ

As of October 24, 2008 there were 33,505,234 shares of the registrant s common stock outstanding.

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FORWARD-LOOKING STATEMENTS

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

Forward-looking statements relating to our business include among other things: statements concerning liquidity and capital requirements, return on equity, financial ratios, net income, premiums, losses and loss reserves, premium rates and retention of current business, competition and market conditions, the expansion of product lines, the development or acquisition of business in new geographical areas, the availability of acceptable reinsurance, actions by regulators and rating agencies, court actions, legislative actions, payment or performance of obligations under indebtedness, payment of dividends, and other matters.

These forward-looking statements are subject to significant risks, assumptions and uncertainties, including, among other things, the following factors that could affect the actual outcome of future events:

general economic conditions, either nationally or in our market area, that are different than anticipated;

regulatory, legislative and judicial actions or decisions that affect our business plans or operations;

inflation, particularly in loss costs trends;

changes in the interest rate environment;

the effect that the 2008 Emergency Economic Stabilization Act may have on the U.S. economy and our business;

performance of financial markets affecting the fair value of our investments or making it difficult to determine the value of our investments;

changes in laws or government regulations affecting medical professional liability insurance or the financial community;

changes to our ratings assigned by rating agencies;

the effects of changes in the health care delivery system;

uncertainties inherent in the estimate of loss and loss adjustment expense reserves and reinsurance, and changes in the availability, cost, quality, or collectibility of insurance/reinsurance;

the results of litigation, including pre-or-post-trial motions, trials and/or appeals we undertake;

bad faith litigation which may arise from our handling of any particular claim, including failure to settle;

changes in competition among insurance providers and related pricing weaknesses in our markets;

loss of independent agents;

our ability to purchase reinsurance and collect payments from our reinsurers;

increases in guaranty fund assessments;

our ability to achieve continued growth through expansion into other states or through acquisitions or business combinations;

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

changes in accounting policies and practices that may be adopted by our regulatory agencies, the Financial Accounting Standards Board, or the Securities and Exchange Commission;

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changes in our organization, compensation and benefit plans;

our ability to retain and recruit senior management; and

our proposed transaction with PICA may not be approved by PICA s mutual policyholders or regulators.

Our results may differ materially from those we expect and discuss in any forward-looking statements. The principal risk factors that may cause these differences are described in Item 1A, Risk Factors in our annual report on Form 10K and other documents we file with the Securities and Exchange Commission, such as our current reports on Form 8-K, and our regular reports on Forms 10-Q and 10-K.

We caution readers not to place undue reliance on any such forward-looking statements, which speak only as of the date made, and advise readers that the factors listed above could affect our financial performance and could cause actual results for future periods to differ materially from any opinions or statements expressed with respect to future periods in any current statements. Except as required by law or regulations, we do not undertake and specifically decline any obligation to publicly release the result of any revisions that may be made to any forward-looking statements to reflect events or circumstances after the date of such statements or to reflect the occurrence of anticipated or unanticipated events.

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ProAssurance Corporation and Subsidiaries
Condensed Consolidated Balance Sheets

(In thousands, except share data)	**September 30 2008 (Unaudited)**	December 31 2007
Assets		
Investments		
Fixed maturities available for sale, at fair value	**$3,041,171**	$3,236,739
Equity securities, available for sale, at fair value	**8,538**	15,451
Equity securities, trading, at fair value	**15,160**	14,173
Short-term investments	**298,707**	229,817
Business owned life insurance	**62,990**	61,509
Investment in unconsolidated subsidiaries	**46,453**	26,767
Other	**51,008**	54,939
Total Investments	**3,524,027**	3,639,395
Cash and cash equivalents	**4,564**	30,274
Premiums receivable	**90,938**	98,693
Receivable from reinsurers on paid losses and loss adjustment expenses	**17,804**	39,567
Receivable from reinsurers on unpaid losses and loss adjustment expenses	**279,427**	327,111
Prepaid reinsurance premiums	**13,255**	14,835
Deferred policy acquisition costs	**20,954**	22,120
Deferred taxes	**135,447**	103,105
Real estate, net	**23,725**	24,004
Goodwill	**72,213**	72,213
Other assets	**158,008**	69,491
Total Assets	**$4,340,362**	$4,440,808
Liabilities and Stockholders Equity		
Liabilities		
Policy liabilities and accruals:		
Reserve for losses and loss adjustment expenses	**$2,481,404**	$2,559,707
Unearned premiums	**210,188**	218,028
Reinsurance premiums payable	**126,079**	128,582
Total Policy Liabilities	**2,817,671**	2,906,317
Other liabilities	**131,480**	115,263
Long-term debt	**58,296**	164,158
Total Liabilities	**3,007,447**	3,185,738
Stockholders Equity		
Common stock, par value $0.01 per share 100,000,000 shares authorized, 34,104,006 and 33,570,685 shares issued, respectively	**341**	336
Additional paid-in capital	**517,003**	505,923
	(55,817)	9,902

Accumulated other comprehensive income (loss), net of deferred tax expense (benefit) of ($30,054) and $5,334, respectively		
Retained earnings	**894,599**	793,166
	1,356,126	1,309,327
Treasury stock, at cost, 598,772 shares and 1,128,111 shares, respectively	**(23,211)**	(54,257)
Total Stockholders Equity	**1,332,915**	1,255,070
Total Liabilities and Stockholders Equity	**$4,340,362**	$4,440,808

See accompanying notes

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

(In thousands)	**Total**	**Accumulated Other Comprehensive Income (Loss)**	**Retained Earnings**	**Other Capital Accounts**
Balance at December 31, 2007	**$1,255,070**	**$ 9,902**	**$793,166**	**$452,002**
Net income	**101,433**		**101,433**	
Change in net unrealized gains (losses) on investments, after tax, net of reclassification adjustments	**(65,719)**	**(65,719)**		
Purchase of treasury stock	**(80,335)**			**(80,335)**
Common shares issued as compensation	**3,687**			**3,687**
Share-based compensation	**6,351**			**6,351**
Net effect of stock options exercised	**(50)**			**(50)**
Conversion of convertible debentures	**112,478**			**112,478**
Balance at September 30, 2008	**$1,332,915**	**$ (55,817)**	**$894,599**	**$494,133**

(In thousands)	Total	Accumulated Other Comprehensive Income (Loss)	Retained Earnings	Other Capital Accounts
Balance at December 31, 2006	$1,118,547	$ 111	$622,310	$496,126
Cumulative effect of accounting change	2,670		2,670	
Net income	116,823		116,823	
Change in net unrealized gains (losses) on investments, after tax, net of reclassification adjustments	(8,882)	(8,882)		
Purchase of treasury stock	(41,265)			(41,265)
Common shares issued as compensation	3,136			3,136
Share-based compensation	6,377			6,377
Net effect of stock options exercised	735			735
Balance at September 30, 2007	$1,198,141	$ (8,771)	$741,803	$465,109

See accompanying notes

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ProAssurance Corporation and Subsidiaries
Condensed Consolidated Statements of Income (Unaudited)

(In thousands, except per share data)	Three Months Ended September 30		Nine Months Ended September 30	
	2008	2007	**2008**	2007
Revenues:				
Gross premiums written	**$126,122**	$149,138	**$374,393**	$440,186
Net premiums written	**$116,409**	$139,483	**$343,609**	$401,809
Premiums earned	**$123,733**	$147,130	**$382,158**	$446,437
Premiums ceded	**(10,284)**	(11,622)	**(32,364)**	(41,089)
Net premiums earned	**113,449**	135,508	**349,794**	405,348
Net investment income	**39,845**	41,075	**122,218**	128,194
Equity in earnings (loss) of unconsolidated subsidiaries	**(1,967)**	(589)	**(3,916)**	1,241
Net realized investment gains (losses)	**(34,236)**	1,321	**(41,011)**	(1,564)
Other income	**997**	1,302	**3,694**	4,409
Total revenues	**118,088**	178,617	**430,779**	537,628
Expenses:				
Losses and loss adjustment expenses	**73,739**	99,142	**242,033**	338,793
Reinsurance recoveries	**(8,516)**	(11,034)	**(29,457)**	(52,844)
Net losses and loss adjustment expenses	**65,223**	88,108	**212,576**	285,949
Underwriting, acquisition and insurance expenses	**24,527**	27,439	**75,927**	79,913
Interest expense	**1,141**	3,006	**5,855**	8,950
Total expenses	**90,891**	118,553	**294,358**	374,812
Income before income taxes	**27,197**	60,064	**136,421**	162,816
Provision for income taxes:				
Current expense (benefit)	**(228)**	14,997	**21,907**	37,200
Deferred expense (benefit)	**5,178**	1,955	**13,081**	8,793
	4,950	16,952	**34,988**	45,993
Net income	**$ 22,247**	$ 43,112	**$101,433**	$116,823
Earnings per share:				
Basic	**$ 0.66**	$ 1.32	**$ 3.12**	$ 3.53

Diluted	**$ 0.66**	$ 1.23	**$ 2.98**	$ 3.31
Weighted average number of common shares outstanding:				
Basic	**33,496**	32,779	**32,519**	33,082
Diluted	**33,866**	35,604	**34,561**	35,949

See accompanying notes

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ProAssurance Corporation and Subsidiaries
Condensed Consolidated Statements of Comprehensive Income
(Unaudited)

(In thousands)	Three Months Ended September 30		Nine Months Ended September 30	
	2008	2007	**2008**	2007
Comprehensive income:				
Net income	**$ 22,247**	$43,112	**$101,433**	$116,823
Change in net unrealized gains (losses) on investments, after tax, net of reclassification adjustments	**(40,811)**	19,411	**(65,719)**	(8,882)
Comprehensive income (loss)	**$(18,564)**	$62,523	**$ 35,714**	$107,941

See accompanying notes

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

(In thousands)	Nine Months Ended September 30 2008	2007
Operating Activities		
Net Income	**$ 101,433**	$ 116,823
Depreciation and amortization	**12,201**	11,727
Net realized investment (gains) losses	**41,011**	1,564
Net sales (purchases) of trading portfolio securities	**(2,876)**	43,619
Share-based compensation	**6,351**	6,377
Deferred income taxes	**13,081**	8,793
Changes in assets and liabilities:		
Premiums receivable	**7,755**	2,591
Reserve for losses and loss adjustment expenses	**(78,303)**	(10,263)
Unearned premiums	**(7,840)**	(5,730)
Reinsurance related assets and liabilities	**68,524**	24,331
Other	**(19,326)**	7,379
Net cash provided by operating activities	**142,011**	207,211
Investing Activities		
Purchases of:		
Fixed maturities available for sale	**(632,679)**	(1,076,729)
Equity securities available for sale	**(2,650)**	(657)
Other investments	**(278)**	(552)
Cash invested in unconsolidated subsidiaries	**(23,601)**	(10,226)
Proceeds from sale or maturities of:		
Fixed maturities available for sale	**691,493**	970,292
Equity securities available for sale	**417**	811
Other investments	**3,587**	8,279
Net (increase) decrease in short-term investments, excluding unsettled redemptions	**(117,395)**	(96,566)
Other	**(11,613)**	9,329
Net cash provided (used) by investing activities	**(92,719)**	(196,019)
Financing Activities		
Repurchase of treasury stock	**(80,335)**	(41,265)
Excess tax benefit from options exercised	**165**	1,673
Book overdraft	**5,167**	12,257
Other	**1**	117
Net cash provided (used) by financing activities	**(75,002)**	(27,218)

Increase (decrease) in cash and cash equivalents	**(25,710)**	(16,026)
Cash and cash equivalents at beginning of period	**30,274**	21,236
Cash and cash equivalents at end of period	**$ 4,564**	$ 5,210
Significant Non-cash Transactions:		
Fixed maturity securities transferred, at fair value, to other investments	**$**	$ 34,732
Unsettled redemption of short-term money market investment	**$ 48,505**	$
Equity increase due to conversion of debt see Notes 7 and 8	**$ 112,478**	$

See accompanying notes

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ProAssurance Corporation and Subsidiaries
Notes to Condensed Consolidated Financial Statements (Unaudited)
September 30, 2008

1. Basis of Presentation

The accompanying unaudited Condensed Consolidated Financial Statements include the accounts of ProAssurance Corporation and its consolidated subsidiaries (ProAssurance). The financial statements have been prepared in accordance with accounting principles generally accepted in the United States (GAAP) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and notes required by GAAP for complete financial statements. In the opinion of management, all adjustments considered necessary for a fair presentation, consisting of normal recurring adjustments, have been included. Operating results for the nine months ended September 30, 2008 are not necessarily indicative of the results that may be expected for the year ending December 31, 2008. The accompanying Condensed Consolidated Financial Statements should be read in conjunction with the Consolidated Financial Statements and notes contained in ProAssurance s December 31, 2007 report on Form 10-K.

Certain reclassifications have been made in the prior period consolidated financial statements to conform to the current period presentation.

Accounting Changes

In September 2006, the FASB issued Statement of Financial Accounting Standards 157, *Fair Value Measurements* (SFAS 157). The standard establishes a revised definition of fair value: fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. SFAS 157 also establishes a framework for measuring fair value under GAAP, and expands disclosures about fair value measurements. SFAS 157 is applicable to other accounting pronouncements that require or permit fair value measurements but does not establish new guidance regarding the assets and liabilities required or allowed to be measured at fair value. The statement is effective for fiscal years beginning after November 15, 2007, with early adoption permitted. ProAssurance adopted SFAS 157 on January 1, 2008. ProAssurance did not recognize any cumulative effect related to the adoption of SFAS 157 and adoption did not have a significant effect on ProAssurance s results of operations or financial condition.

In February 2007, the FASB issued SFAS 159, *The Fair Value Option for Financial Assets and Financial Liabilities Including an Amendment of FASB Statement No. 115* (SFAS 159). SFAS 159 permits many financial assets and liabilities to be reported at fair value that are not otherwise required under GAAP to be measured at fair value. Under SFAS 159 guidance, the election of fair value treatment is specific to individual assets and liabilities, with changes in fair value recognized in earnings as they occur. The election of fair value measurement is generally irrevocable. SFAS 159 is effective for fiscal years beginning after November 15, 2007, with early adoption permitted. ProAssurance adopted SFAS 159 on January 1, 2008 but did not elect fair value measurement for any financial assets or liabilities that were not otherwise required to be measured at fair value.

Recent Accounting Developments

In May 2008, the FASB issued FASB Staff Position (FSP) APB 14-1, *Accounting for Convertible Debt Instruments That May Be Settled in Cash upon Conversion (Including Partial Cash Settlement),* which will alter the accounting for ProAssurance s Convertible Debentures. FSP APB 14-1 requires issuers to account for convertible debt securities that allow for either mandatory or optional cash settlement (including partial cash settlement) by separating the liability and equity components in a manner that reflects the issuer s nonconvertible debt borrowing rate at the time of issuance and requires recognition of additional (non-cash) interest expense in subsequent periods based on the nonconvertible rate. Additionally, FSP APB 14-1 requires that when such debt instruments are repaid or converted any consideration transferred at settlement is to be allocated between the extinguishment of the liability component and the reacquisition of the equity component. FSP APB 14-1 is effective for ProAssurance on January 1, 2009, and must be applied retrospectively with a cumulative effect adjustment being made as of the earliest period presented. Early adoption is not permitted. ProAssurance is currently assessing

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ProAssurance Corporation and Subsidiaries
Notes to Condensed Consolidated Financial Statements (Unaudited)
September 30, 2008

1. Basis of Presentation (continued)

the impact that the adoption will have on its financial condition and results of operations, but expects no impact on ending Total Stockholders Equity after the conversion of the Convertible Debentures (July 2, 2008).

In December 2007 the FASB issued SFAS 160, *Noncontrolling Interests in Consolidated Financial Statements.* SFAS 160 amends Accounting Research Bulletin 51 to establish accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. The Statement is effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2008. Earlier adoption is prohibited. ProAssurance will adopt the Statement on its effective date. Adoption is not expected to have an effect on ProAssurance s results of operations or financial position.

In December 2007 the FASB issued SFAS 141 (Revised 2007), *Business Combinations.* SFAS 141R replaces FASB Statement No. 141, *Business Combinations,* but retains the fundamental requirement in SFAS 141 that the acquisition method (referred to as the purchase method in SFAS 141) of accounting be used for all business combinations. SFAS 141R provides new or additional guidance with respect to business combinations including: defining the acquirer in a transaction, the valuation of assets and liabilities when noncontrolling interests exist, the treatment of contingent consideration, the treatment of costs incurred to effect the acquisition, the treatment of reorganization costs, and the valuation of assets and liabilities when the purchase price is below the net fair value of assets acquired. SFAS 141R applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. Earlier adoption is prohibited. ProAssurance will adopt the Statement on its effective date.

2. Fair Value Measurement

Effective January 1, 2008 ProAssurance adopted SFAS 157 which establishes a framework for measuring fair value and requires specific disclosures regarding assets and liabilities that are measured at fair value.

As defined in SFAS 157, fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. SFAS 157 establishes a three level hierarchy for valuing assets and liabilities based on how transparent (observable) the inputs are that are used to determine fair value, with the inputs considered most observable categorized as Level 1 and those that are the least observable categorized as Level 3. Hierarchy levels are defined by SFAS 157 as follows:

Level 1: quoted (unadjusted) market prices in active markets for identical assets and liabilities. For ProAssurance, Level 1 inputs are generally quotes for debt or equity securities actively traded in exchange or over-the-counter markets.

Level 2: market data obtained from sources independent of the reporting entity (observable inputs). For ProAssurance, Level 2 inputs generally include quoted prices in markets that are not active, quoted prices for similar assets/liabilities, and other observable inputs such as interest rates and yield curves that are generally available at commonly quoted intervals.

Level 3: the reporting entity s own assumptions about market participant assumptions developed based on the best information available in the circumstances (unobservable inputs). For ProAssurance, Level 3 inputs are used in situations where little or no Level 1 or 2 inputs are available or are inappropriate given the particular circumstances. Level 3 inputs include results from pricing models and discounted cash flow methodologies as well as adjustments to externally quoted prices that are based on management judgment or estimation.

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ProAssurance Corporation and Subsidiaries
Notes to Condensed Consolidated Financial Statements (Unaudited)
September 30, 2008

2. Fair Value Measurement (continued)

The following tables present information about ProAssurance s assets measured at fair value on a recurring basis as of September 30, 2008, and indicate the fair value hierarchy of the valuation techniques utilized to determine such value. No liabilities are measured at fair value at September 30, 2008. For some assets, the inputs used to measure fair value may fall into different levels of the fair value hierarchy. When this is the case, the asset is categorized in the table based on the lowest level input that is significant to the fair value measurement in its entirety. ProAssurance s assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment, and considers factors specific to the assets being valued.

Assets measured at fair value on a recurring basis as of September 30, 2008 are as follows:

	September 30, 2008			
	Fair Value Measurements Using			Total
(In thousands)	Level 1	Level 2	Level 3	Fair Value
Assets:				
Fixed maturities, available for sale				
U.S. Government and Government-sponsored enterprises	**$**	**$ 227,761**	**$**	**$ 227,761**
Asset-backed securities		**864,712**	**1,578**	**866,290**
Corporate bonds		**547,038**	**39,393**	**586,431**
State and municipal bonds		**1,360,689**		**1,360,689**
Equity securities, available-for-sale	**8,188**		**350**	**8,538**
Equity securities, trading	**15,160**			**15,160**
Other investments(1)			**18,218**	**18,218**
Short-term investments(2)	**105,224**	**193,483**		**298,707**
Total assets	**$128,572**	**$3,193,683**	**$59,539**	**$3,381,794**

(1) Other investments also include investments of $32.8 million accounted for using the cost method that are not included in the table above.

(2) Short-term investments are reported at amortized cost, which approximates fair value.

Level 3 assets in the above table consist primarily of asset-backed securities (as shown in the table), private placement senior notes (included in Corporate bonds), and a beneficial interest in asset-backed securities held in a private investment fund (included in Other Investments).

The private placement senior notes are unconditionally guaranteed by large regional banks rated A or better. The asset-backed securities have a weighted average rating of AA or better, and are collateralized by a timber trust and a Fannie Mae mortgage backed security. The fair value of these assets are primarily derived using pricing models that may require multiple market input parameters as is considered appropriate for the asset being valued.

The asset-backed securities held in a private investment fund are primarily backed by manufactured housing, recreational vehicle receivables, and subprime securities, have an average rating of BB, and are valued using a broker dealer quote.

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ProAssurance Corporation and Subsidiaries
Notes to Condensed Consolidated Financial Statements (Unaudited)
September 30, 2008

2. Fair Value Measurement (continued)

The following table presents additional information about assets measured at fair value using Level 3 inputs for the three and nine months ended September 30, 2008:

	September 30, 2008 Fair Value Measurements					
(In thousands)	Asset-backed Securities	Corporate Bonds	State and Municipal Bonds	Equity Securities	Other Invested Assets	Total
Balance June 30, 2008	**$ 1,576**	**$ 60,487**	**$ 11,142**	**$ 740**	**$19,156**	**$ 93,101**
Total gains (losses), realized and unrealized:						
Included in earnings, as a part of net realized investment gains (losses)		**(349)**				**(349)**
Included in other comprehensive income	**15**	**(406)**		**(390)**	**(486)**	**(1,267)**
Purchases, sales or settlements	**(13)**	**(20,339)**			**(452)**	**(20,804)**
Transfers in (out) of Level 3, net			**(11,142)**			**(11,142)**
Balance September 30, 2008	**$ 1,578**	**$ 39,393**	**$**	**$ 350**	**$18,218**	**$ 59,539**
The amount of total gains (losses) for the three months ended September 30, 2008 included in earnings attributable to the change in unrealized gains (losses) relating to assets still held at September 30, 2008	**$**	**$ (349)**	**$**	**$**	**$**	**$ (349)**
Balance January 1, 2008	**$ 33,283**	**$ 86,969**	**$ 7,183**	**$**	**$20,981**	**$148,416**

Total gains (losses), realized and unrealized:						
Included in earnings, as a part of net realized investment gains (losses)		**(429)**				**(429)**
Included in other comprehensive income	**(1,698)**	**(941)**	**(886)**	**(390)**	**(1,750)**	**(5,665)**
Purchases, sales or settlements	**(415)**	**(6,211)**	**(158)**	**740**	**(1,013)**	**(7,057)**
Transfers in (out) of Level 3, net	**(29,592)**	**(39,995)**	**(6,139)**			**(75,726)**
Balance September 30, 2008	**$ 1,578**	**$ 39,393**	**$**	**$ 350**	**$18,218**	**$ 59,539**
The amount of total gains (losses) for the nine months ended September 30, 2008 included in earnings attributable to the change in unrealized gains (losses) relating to assets still held at September 30, 2008	**$**	**$ (429)**	**$**	**$**	**$**	**$ (429)**

Municipal bonds with an estimated fair value of $11.1 million at June 30, 2008 were transferred out of Level 3 into Level 2 as of September 30, 2008. Trades of these bonds by market participants were completed during the third quarter, which provided more transparent inputs for establishing the fair value of these municipal bonds as of September 30, 2008. Additional transfers from Level 3 into Level 2 for the year-to-date period ended September 30, 2008 primarily consist of $40 million of bank loans and $30 million of asset backed bonds that were previously valued using either a pricing model or a single broker dealer quote, that are now priced using multiple observable inputs including pricing services that use multiple broker quotes for assessing fair value.

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ProAssurance Corporation and Subsidiaries
Notes to Condensed Consolidated Financial Statements (Unaudited)
September 30, 2008

3. Investments

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

	September 30, 2008			
(In thousands)	**Amortized Cost**	**Gross Unrealized Gains**	**Gross Unrealized Losses**	**Estimated Fair Value**
Fixed maturities	**$3,118,984**	**$17,971**	**$(95,784)**	**$3,041,171**
Equity securities	**9,015**	**1,361**	**(1,838)**	**8,538**
	$3,127,999	**$19,332**	**$(97,622)**	**$3,049,709**

	December 31, 2007			
(In thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Fixed maturities	$3,217,194	$37,246	$(17,701)	$3,236,739
Equity securities	13,931	2,724	(1,204)	15,451
	$3,231,125	$39,970	$(18,905)	$3,252,190

Proceeds from sales of fixed maturities and equity securities during the nine months ended September 30, 2008 and 2007 are $376.7 million and $789.5 million, respectively, including proceeds from sales of adjustable rate, short-duration fixed maturities of approximately $134.4 million and $474.4 million, respectively. Purchases of adjustable rate, short-duration fixed maturities approximated $99.3 million and $468.5 million during the same respective periods.

Net realized investment gains (losses) are comprised of the following:

	Three Months Ended September 30		**Nine Months Ended September 30**	
(In thousands)	**2008**	2007	**2008**	2007
Gross realized gains	**$ 2,395**	$1,163	**$ 3,484**	$ 2,897
Gross realized (losses)	**(5,495)**	(242)	**(6,438)**	(502)
Other-than-temporary impairment (losses)	**(29,862)**	(428)	**(36,169)**	(4,602)
Trading portfolio net gains (losses)	**(1,274)**	828	**(1,888)**	643
Net realized investment gains (losses)	**$(34,236)**	$1,321	**$(41,011)**	$(1,564)

During the third quarter of 2008 we recognized other-than-temporary impairment losses of $29.9 million, which included $788,000 related to asset backed bonds, $19.6 million related to corporate bonds of which $18.9 million were Lehman Brothers bonds, and $9.5 million related to our equity holdings in Fannie Mae and Freddie Mac. During the

first and second quarters of 2008 we recognized other-than-temporary impairment losses of $6.3 million, which included $5.1 million related to asset backed bonds, $513,000 related to corporate bonds and $353,000 related to a passive investment in a private investment fund, and $300,000 related to our equity holdings.

In January 2007, ProAssurance transferred high yield asset backed bonds (previously considered as available-for-sale securities) having a fair value of approximately $34.7 million to a private investment fund that is primarily focused on managing such investments. ProAssurance maintains a direct beneficial interest (the separate interest) in the securities originally contributed to the fund. ProAssurance recognized an impairment of $4.2 million related to these securities in 2007. The securities held in the separate interest are included in Other Investments, at fair value totaling $13.1 million at September 30, 2008 (net of unrealized losses of $7.6 million). Cash flows of the separate interest, including net

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ProAssurance Corporation and Subsidiaries
Notes to Condensed Consolidated Financial Statements (Unaudited)
September 30, 2008

3. Investments (continued)

investment earnings and proceeds from sales or maturities, (totaling $12.9 million to date), are routinely transferred to a joint interest (the joint interest) of the fund.

The joint interest is accounted for using the equity method and is included in Investment in Unconsolidated Subsidiaries. In March 2008 ProAssurance contributed an additional $20 million to the joint interest to take advantage of current dislocations in the credit market. At September 30, 2008 the carrying value of the joint interest is $31.4 million and ProAssurance s ownership interest approximates 21.8%.

4. Income Taxes

The provision for income taxes is different from that which would be obtained by applying the statutory Federal income tax rate to income before taxes primarily because a portion of ProAssurance s investment income is tax-exempt.

5. Deferred Policy Acquisition Costs

Policy acquisition costs, most significantly commissions, premium taxes, and underwriting salaries, that are primarily and directly related to the production of new and renewal premiums are capitalized as policy acquisition costs and amortized to expense as the related premium revenues are earned.

Amortization of deferred acquisition costs are $11.2 million and $34.6 million for the three and nine months ended September 30, 2008. Amortization of deferred acquisition costs was $13.8 million and $40.6 million for the three and nine months ended September 30, 2007.

6. Reserves for Losses and Loss Adjustment Expenses

The reserve for losses is established based on estimates of individual claims and actuarially determined estimates of future losses based on ProAssurance s past loss experience, available industry data and projections as to future claims frequency, severity, inflationary trends and settlement patterns. Estimating reserves is a complex process. Claims may be resolved over an extended period of time, often five years or more, and may be subject to litigation. Estimating losses for liability claims requires ProAssurance to make and revise judgments and assessments regarding multiple uncertainties over an extended period of time. As a result, reserve estimates may vary significantly from the eventual outcome. The assumptions used in establishing ProAssurance s reserves are regularly reviewed and updated by management as new data becomes available. Changes to estimates of previously established reserves are included in earnings in the period in which the estimate is changed.

ProAssurance recognized favorable net loss development of $30.0 million related to previously established reserves for the three months ended September 30, 2008 and recognized $81.3 million of favorable net loss development for the nine months ended September 30, 2008. The favorable net loss development reflects reductions in the Company s estimates of claim severity, principally for the 2004 through 2007 accident years but also includes $3.7 million recognized in the second quarter of 2008 related to prior year reinsurance contracts that were commuted during the period.

For the three and nine months ended September 30, 2007, ProAssurance recognized favorable net loss development of $25.0 million and $60.6 million, respectively, to reflect reductions in estimated claim severity principally for accident years 2003 through 2005, offset by an increase to the reserves for losses in excess of policy limits.

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7. Long-term Debt

Outstanding long-term debt, as of September 30, 2008 and December 31, 2007, consists of the following:

		(In thousands)	
		September 30 2008	December 31 2007
Convertible Debentures due June 2023 but converted into common stock in July 2008, see below. Unsecured, principal of $107.6 million bearing a fixed interest rate of 3.9%, net of unamortized discount of $1.6 million at December 31, 2007.		**$**	$105,973
Trust Preferred Subordinated Debentures (the 2034 Subordinated Debentures), unsecured, bearing interest at a floating rate, adjusted quarterly.			
	9/30/2008		
Due	Rate		
April 2034	6.65%	**13,403**	13,403
May 2034	6.65%	**32,992**	32,992
Surplus Notes due May 2034 (the Surplus Notes), unsecured, principal of $12 million, net of unamortized discounts of $0.1 million and $0.2 million at September 30, 2008 and December 31, 2007, bearing a fixed interest rate of 7.7%, until May 2009, when the rate converts to a floating rate of LIBOR plus 3.85%, adjusted quarterly.		**11,901**	11,790
		$58,296	$164,158

Convertible Debentures

ProAssurance completed the conversion of all of its outstanding Convertible Debentures (aggregate principal of $107.6 million) in July 2008. Approximately 2,572,000 shares of ProAssurance common stock were issued in the transaction (conversion rate was 23.9037 per $1,000 debenture). Of the common shares issued, approximately 2.12 million were reissued Treasury Shares and 450,000 were newly issued shares. No gain or loss was recorded related to the conversion.

Fair Value

At September 30, 2008, the fair value of the 2034 Subordinated Debentures approximated 83% of their $46.4 million face value and the fair value of the Surplus Notes approximated 83% of their $12.0 million face value, based on the present value of underlying cash flows discounted at rates available at September 30, 2008 for similar debt.

Additional Information

For additional information regarding the terms of ProAssurance s outstanding long-term debt see Note 10 of the Notes to the Consolidated Financial Statements in ProAssurance s December 31, 2007 Annual Report on Form 10K.

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ProAssurance Corporation and Subsidiaries
Notes to Condensed Consolidated Financial Statements (Unaudited)
September 30, 2008

8. Stockholders Equity

At September 30, 2008 ProAssurance had 100 million shares of authorized common stock and 50 million shares of authorized preferred stock. The Board of Directors of ProAssurance Corporation (the Board) has the authority to determine the provisions for the issuance of preferred shares, including the number of shares to be issued, the designations, powers, preferences and rights, and the qualifications, limitations or restrictions of such shares. To date, the Board has not approved the issuance of preferred stock.

ProAssurance repurchased approximately 764,000 common shares, having a total cost of $41.3 million, during the nine months ended September 30, 2007 (including approximately 397,000 shares at a total cost of $21.3 million during the three months ended September 30, 2007). ProAssurance repurchased approximately 1.6 million common shares, having a total cost of $80.3 million, during the nine months ended September 30, 2008 (including approximately 360,000 shares at a cost of $17.3 million during the three months ended September 30, 2008). This fully utilized the $150 million repurchase authorization approved by the Board of Directors of ProAssurance in April 2007. On August 5, 2008 the Board of Directors authorized an additional $100 million over the $150 million authorized in April 2007 for the repurchase of common shares or retirement of outstanding debt. As of September 30, 2008 all $100.0 million of this repurchase authorization remains available for use. Treasury shares are reported at cost, and are reflected on the balance sheet as an unallocated reduction of total equity.

As discussed in Note 7, on July 2, 2008 approximately 2.12 million treasury shares and 450,000 newly issued common shares were used to complete the conversion of ProAssurance s Convertible Debentures. The conversion of the debt increased Stockholders Equity by $112.5 million, consisting of the carrying amount of the Convertible Debentures (principal of $107.6 million, less the unamortized portion of related loan discounts and costs of $1.8 million) and a $6.7 million tax benefit from the reversal of interest-related deferred tax liabilities.

ProAssurance adopted the provisions of FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes,* on January 1, 2007. In accordance with the guidance provided in the statement, the cumulative effect of adoption, a $2.7 million reduction in tax liabilities, was recorded as an increase to beginning retained earnings.

ProAssurance provides performance-based stock compensation to employees under the ProAssurance 2004 Equity Incentive Plan and the ProAssurance Corporation Incentive Compensation Stock Plan. Share-based compensation expense is approximately $1.8 million and $6.4 million with a related tax benefit of approximately $621,000 and $2.2 million for the three and nine months ended September 30, 2008. Share-based compensation expense is approximately $2.6 million and $6.4 million with a related tax benefit of approximately $898,000 and $2.2 million for the three and nine months ended September 30, 2007.

ProAssurance granted approximately 133,000 options during the nine months ended September 30, 2008. The estimated fair value of the options averaged $16.49 per option. Fair values were estimated as of the date of grant, using the Black-Scholes option pricing model and the following assumptions:

	2008
Weighted average assumptions:	
Risk-free interest rate	**3.1%**
Expected volatility	**0.23**
Dividend yield	**0%**
Expected average term (in years)	**6**

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ProAssurance Corporation and Subsidiaries
Notes to Condensed Consolidated Financial Statements (Unaudited)
September 30, 2008

8. Stockholders Equity (continued)

ProAssurance also granted Performance Share awards to employees in March 2008 under the ProAssurance 2004 Equity Incentive Plan. The Performance Share awards vest at the end of a three year service period if specified Performance Measures are attained. The number of Performance Shares ultimately awarded varies from 75% to 125% of the target award depending upon the degree to which Performance Measures are attained. The fair value of each Performance Share was estimated as the market value of ProAssurance s common shares on the respective date of grant. The following table provides information regarding ProAssurance s Performance Shares awards:

	2008
100% vesting date	**12/31/2010**
Shares awarded (target)	**73,000**
Grant date fair value	**$ 54.28**

9. Commitments and Contingencies

As a result of the acquisition of NCRIC Corporation in 2005, ProAssurance assumed the risk of loss for a judgment entered against NCRIC, Inc. (NCRIC) on February 20, 2004 by a District of Columbia Superior Court in favor of Columbia Hospital for Women Medical Center, Inc. (CHW) in the amount of $18.2 million (the judgment), which was appealed. In October 2008 the judgment was affirmed by the District of Columbia Court of Appeals. NCRIC has filed a petition for rehearing with the Court of Appeals. As of September 30, 2008, ProAssurance carries a $22.3 million liability related to the judgment, including an estimate for post-trial interest and legal costs. Approximately $19.5 million of the liability was established as a component of the fair value of assets acquired and liabilities assumed in the allocation of the NCRIC purchase price.

ProAssurance is involved in various other legal actions arising primarily from claims against ProAssurance related to insurance policies and claims handling, including but not limited to claims asserted by policyholders. Such legal actions have been considered by ProAssurance in establishing its loss and loss adjustment expense reserves. The outcome of such legal actions is not presently determinable for a number of reasons. For example, in the event that ProAssurance or its insureds receive adverse verdicts, post-trial motions may be denied, in whole or in part; any appeals that may be undertaken may be unsuccessful; ProAssurance may be unsuccessful in legal efforts to limit the scope of coverage available to its insureds, and ProAssurance may become a party to bad faith litigation over the amount of the judgment above an insured s policy limits. ProAssurance s management is of the opinion, based on consultation with legal counsel, that the resolution of these actions will not have a material adverse effect on ProAssurance s financial position. However, the ultimate cost of resolving these legal actions may differ from the reserves established; the resulting difference could have a material effect on ProAssurance s results of operations for the period in which any such action is resolved.

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ProAssurance Corporation and Subsidiaries
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September 30, 2008

10. Earnings Per Share

The following table provides detailed information regarding the calculation of basic and diluted earnings per share for each period presented:

	Three Months Ended September 30		Nine Months Ended September 30	
(In thousands, except per share data)	**2008**	2007	**2008**	2007
Basic earnings per share calculation:				
Numerator:				
Net income	**$22,247**	$43,112	**$101,433**	$116,823
Denominator:				
Weighted average number of common shares outstanding	**33,496**	32,779	**32,519**	33,082
Basic earnings per share	**$ 0.66**	$ 1.32	**$ 3.12**	$ 3.53
Diluted earnings per share calculation:				
Numerator:				
Net income	**$22,247**	$43,112	**$101,433**	$116,823
Effect of assumed conversion of contingently convertible debt instruments		742	**1,484**	2,226
Net income diluted computation	**$22,247**	$43,854	**$102,917**	$119,049
Denominator:				
Weighted average number of common shares outstanding	**33,496**	32,779	**32,519**	33,082
Assumed exercise of dilutive stock options and issuance of performance shares	**342**	253	**318**	295
Assumed conversion of contingently convertible debt instruments	**28**	2,572	**1,724**	2,572
Diluted weighted average equivalent shares	**33,866**	35,604	**34,561**	35,949
Diluted earnings per share	**$ 0.66**	$ 1.23	**$ 2.98**	$ 3.31

In accordance with SFAS 128, *Earnings per Share,* the diluted weighted average number of shares outstanding includes an incremental adjustment for the assumed exercise of dilutive stock options. The adjustment is computed quarterly; the annual incremental adjustment is the average of the quarterly adjustments. Stock options are considered

dilutive stock options if the assumed exercise of the options, using the treasury stock method as specified by SFAS 128, produces an increased number of shares. Approximately 354,000 and 207,000 of ProAssurance s outstanding options, on average, were not considered to be dilutive during the nine-months periods ended September 30, 2008 and 2007, respectively.

11. Subsequent Events

As discussed in Note 9, in October 2008 ProAssurance received notice that an $18.2 million judgment entered against its NCRIC insurance subsidiary in favor of Columbia Hospital for Women Medical Center, Inc. was affirmed on appeal by the District of Columbia Court of Appeals. NCRIC has filed a petition for rehearing with the Court of Appeals. At September 30, 2008 ProAssurance carries a liability of $22.3 million related to the judgment, including an estimate for post-trial interest and legal costs.

In mid-October ProAssurance announced the purchase of Georgia Lawyers Insurance Company (Georgia Lawyers) for approximately $4.3 million in cash. The transaction is subject to approval by the Georgia Department of Insurance but is expected to close by the first quarter of 2009. Georgia Lawyers provides professional liability insurance for lawyers in the state of Georgia and reported premiums written of $5.5 million in 2007.

ProAssurance announced in late October 2008 that the PICA Group (PICA) will become part of ProAssurance through an all cash sponsored demutualization. The transaction is expected to utilize cash of approximately $135 million, including credits of $15 million to be refunded to eligible policyholders over three years, beginning in 2010. PICA primarily provides professional liability coverages to doctors of podiatric medicine throughout most of the United States and had gross written premium of $99 million in 2007. The transaction is subject to the approval of PICA policyholders and insurance regulators in Illinois. The transaction is expected to close in the first quarter of 2009.

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

The following discussion should be read in conjunction with the unaudited Condensed Consolidated Financial Statements and Notes to those statements which accompany this report as well as ProAssurance s Annual Report on Form 10K for the year ended December 31, 2007, which includes a glossary of insurance terms and phrases. Throughout the discussion, references to ProAssurance, we, us and our refers to ProAssurance Corporation and its consolidated subsidiaries. The discussion contains certain forward-looking information that involves risks and uncertainties. As discussed under Forward-Looking Statements, our actual financial condition and operating results could differ significantly from these forward-looking statements.

Critical Accounting Estimates

Our Condensed Consolidated Financial Statements are prepared in accordance with accounting principles generally accepted in the United States of America (GAAP). Preparation of these financial statements requires us to make estimates and assumptions that affect the amounts we report on those statements. We evaluate these estimates and assumptions on an ongoing basis based on current and historical developments, market conditions, industry trends and other information that we believe to be reasonable under the circumstances. There can be no assurance that actual results will conform to our estimates and assumptions; reported results of operations may be materially affected by changes in these estimates and assumptions.

Management considers the following accounting estimates to be critical because they involve significant judgment by management and the effect of those judgments could result in a material effect on our financial statements.

Reserve for Losses and Loss Adjustment Expenses (reserve for losses or reserve)

The largest component of our liabilities is our reserve for losses and the largest component of expense for our operations is incurred losses. Net losses in any period reflect our estimate of net losses incurred related to the premiums earned in that period as well as any changes to our estimates of the reserve established for net losses of prior periods.

The estimation of medical professional liability losses is inherently difficult. Ultimate loss costs, even for claims with similar characteristics, vary significantly depending upon many factors, including but not limited to, the nature of the injury and the personal situation of the claimant or the claimant s family, the outcome of jury trials, the legislative and judicial climate where the insured event occurred, general economic conditions and the trend of health care costs. Medical professional liability claims are typically resolved over an extended period of time, often five years or more. The combination of changing conditions and the extended time required for claim resolution results in a loss cost estimation process that requires actuarial skill and the application of judgment, and such estimates require periodic revision.

In establishing our reserve for losses, management considers a variety of factors including claims frequency, historical paid and incurred loss development trends, the effect of inflation on medical care, general economic trends and the legal environment. We perform an in-depth review of our reserve for losses on a semi-annual basis. Additionally, during each reporting period we update and review the data underlying the estimation of our reserve for losses and make adjustments that we believe best reflect emerging data. Any adjustments are reflected in the then-current operations. Due to the size of our reserve for losses, even a small percentage adjustment to these estimates could have a material effect on our results of operations for the period in which the adjustment is made.

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Reinsurance

We use insurance and reinsurance (collectively, reinsurance) to provide capacity to write larger limits of liability, to provide protection against losses in excess of policy limits, and to stabilize underwriting results in years in which higher losses occur. The purchase of reinsurance does not relieve us from the ultimate risk on our policies, but it does provide reimbursement for certain losses we pay.

We evaluate each of our ceded reinsurance contracts at inception to determine if there is sufficient risk transfer to allow the contract to be accounted for as reinsurance under current accounting guidance. At September 30, 2008 all ceded contracts are accounted for as risk transferring contracts.

Our receivable from reinsurers on unpaid losses and loss adjustment expenses represents our estimate of the amount of our reserve for losses that will be recoverable under our insurance and reinsurance programs. We base our estimate of funds recoverable upon our expectation of ultimate losses and the portion of those losses that we estimate to be allocable to reinsurers based upon the terms of our reinsurance agreements.

We estimate premiums ceded under reinsurance agreements wherein the premium due to the reinsurer, subject to certain maximums and minimums, is based in part on losses reimbursed or to be reimbursed under the agreement. Our estimates of the amounts due from and to reinsurers are regularly reviewed and updated by management as new data becomes available. Our assessment of the collectibility of the recorded amounts receivable from reinsurers considers the payment history of the reinsurer, publicly available financial and rating agency data, our interpretation of the underlying contracts and policies, and responses by reinsurers. Appropriate reserves are established for any balances we believe may not be collected.

Given the uncertainty of the ultimate amounts of our losses, our estimates of losses and related amounts recoverable may vary significantly from the eventual outcome. Any adjustments are reflected in then-current operations. Due to the size of our reinsurance balances, an adjustment to these estimates could have a material effect on our results of operations for the period in which the adjustment is made.

Investment Valuations

We adopted a new accounting pronouncement, Statement of Financial Accounting Standards 157, *Fair Value Measurements,* effective January 1, 2008. The new pronouncement revises the definition of fair value and establishes a framework for measuring fair value. The pronouncement defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The framework establishes a three level hierarchy for valuing assets and liabilities based on how transparent (observable) the inputs are that are used to determine fair value. For example, a quoted market price for an actively traded security on an established trading exchange is considered the most transparent (observable) input used to establish a fair value for that security and is classified as a Level 1 in the fair value hierarchy. An investment valued using multiple broker dealer quotes is considered to be valued using observable input that is not as transparent as a quoted market price on an exchange and is classified as a Level 2. An investment valued using either a single broker dealer quote or based on a cash flow valuation model is considered to be valued based on limited observable input and a significant amount of judgment and is classified as Level 3. For further information on the adoption of the pronouncement and the fair value of our investments, see Note 2 to the Condensed Consolidated Financial Statements.

Virtually all of our financial assets are comprised of investments recorded at fair value. Of the Company s investments recorded at fair value totaling $3.4 billion, approximately 98% of our investments are based on observable market prices, observable market parameters (i.e. broker quotes, benchmark yield curves, issuer spreads, bids, etc.) or are derived from such prices or parameters. The availability of observable market prices and pricing parameters (referred to as observable inputs) can vary from investment to investment. We utilize observable inputs, where available, to value our investments. In many cases, we obtain multiple observable inputs for an investment to derive the fair value without requiring significant judgments.

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We use a pricing service, Interactive Data Corporation (IDC), to value our investments that have observable market prices and observable market parameters. All securities priced by IDC using an exchange traded price are a Level 1 designation. For securities not actively traded on an exchange, IDC typically uses multiple observable inputs including last reported trade, broker quotes, benchmark yield curves, issuer spreads, two sided markets, benchmark securities, bids, offers, and assumed prepayment speeds. These securities are designated as Level 2. We review the pricing as received from IDC for reasonableness each quarter. To date, no IDC prices have been adjusted.

For investments that are not actively traded, limited or no observable inputs may be available and fair value is determined using valuation techniques appropriate for that investment whether valued internally or externally. The valuation techniques involve some degree of judgment. Approximately $60 million (2% of investments recorded at fair value) are valued using less observable market inputs and valuation techniques and consist of asset-backed securities that are priced by external managers using single broker dealer quotes, private placements, and other investments valued internally by management.

Most of our investments recorded at fair value are considered available-for-sale with a small portion classified as trading. For investments considered as available-for-sale, changes in the fair value are recognized as unrealized gains and losses and are included, net of related tax effects, in stockholders equity as a component of other comprehensive income (loss). Gains or losses on these investments are recognized in earnings in the period the investment is sold or an other-than-temporary impairment is deemed to have occurred. Changes in the fair value of investments considered as trading are recorded in realized investment gains and losses in the current period.

We also have other investments, primarily comprised of equity interests in private investment funds (non-public investment partnerships and limited liability companies), $46.5 million of which are accounted for using the equity method and $32.8 million of which are carried at cost. We evaluate these investments for other-than-temporary impairment by considering any declines in fair value below the recorded value. Determining whether there has been a decline in fair value involves assumptions and estimates as there are typically no observable inputs to determine the fair value of these investments.

We evaluate all our investments on at least a quarterly basis for declines in fair value that represent other-than-temporary impairments. Some of the factors we consider in the evaluation of our investments are:

the extent to which the fair value of an investment is less than its recorded basis,

the length of time for which the fair value of the investment has been less than its recorded basis,

the financial condition and near-term prospects of the issuer underlying the investment, taking into consideration the economic prospects of the issuer s industry and geographical region, to the extent that information is publicly available,

third party research and credit rating reports,

the extent to which the decline in fair value is attributable to credit risk specifically associated with an investment or its issuer,

the extent to which we believe market assessments of credit risk for a specific investment or category of investments are either well founded or are speculative,

our internal assessments and those of our external portfolio managers regarding specific circumstances surrounding an investment, which can cause us to believe the investment is more or less likely to recover its value than other investments with a similar structure,

for asset backed securities: the origination date of the underlying loans, the remaining average life, the probability that credit performance of the underlying loans will deteriorate in the future, and our assessment of the quality of the collateral underlying the loan, and

our ability and intent to hold the investment for a period of time sufficient to allow for any anticipated recovery in fair value.

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Determining whether a decline in the fair value of investments is an other-than-temporary impairment may also involve a variety of assumptions and estimates, particularly for investments that are not actively traded in established markets or during periods of market dislocation. For example, assessing the value of certain investments requires us to perform an analysis of expected future cash flows or prepayments. For investments in tranches of structured transactions, we are required to assess the credit worthiness of the underlying investments of the structured transaction.

When we judge a decline in fair value to be other-than-temporary, we reduce the basis of the investment to fair value and recognize a loss in the current period income statement for the amount of the reduction. In subsequent periods, we base any measurement of gain or loss or decline in value upon the adjusted cost basis of the investment.

Deferred Policy Acquisition Costs

Policy acquisition costs, primarily commissions, premium taxes and underwriting salaries, which are primarily and directly related to the acquisition of new and renewal premiums are capitalized as deferred policy acquisition costs and charged to expense as the related premium revenue is recognized. We evaluate the recoverability of our deferred policy acquisition costs and any amounts estimated to be unrecoverable are charged to expense in the current period.

Recent Accounting Pronouncements and Guidance

In May 2008, the FASB issued FASB Staff Position (FSP) APB 14-1, *Accounting for Convertible Debt Instruments That May Be Settled in Cash upon Conversion (Including Partial Cash Settlement),* which will alter the accounting for our Convertible Debentures. FSP APB 14-1 requires issuers to account for convertible debt securities that allow for either mandatory or optional cash settlement (including partial cash settlement) by separating the liability and equity components in a manner that reflects the issuer s nonconvertible debt borrowing rate at the time of issuance and requires recognition of additional (non-cash) interest expense in subsequent periods based on the nonconvertible rate. Additionally, FSP APB 14-1 requires that when such debt instruments are repaid or converted any consideration transferred at settlement is to be allocated between the extinguishment of the liability component and the reacquisition of the equity component. FSP APB 14-1 will become effective for ProAssurance on January 1, 2009 and must be applied retrospectively with a cumulative effect adjustment being made as of the earliest period presented. Early adoption is not permitted. We are currently assessing the impact that the adoption will have on our financial condition and results of operations but expect no impact on Total Stockholders Equity after the conversion of the Convertible Debentures (July 2008).

In December 2007 the FASB issued SFAS 160, *Noncontrolling Interests in Consolidated Financial Statements.* SFAS 160 amends Accounting Research Bulletin (ARB) 51 to establish accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. The Statement is effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2008. Earlier adoption is prohibited. We will adopt the Statement on its effective date. The adoption is not expected to have an effect on our results of operations or financial position.

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In December 2007 the FASB issued SFAS 141 (Revised December 2007), *Business Combinations.* SFAS 141R replaces FASB Statement No. 141, *Business Combinations,* but retains the fundamental requirement in SFAS 141 that the acquisition method (referred to as the purchase method in SFAS 141) of accounting be used for all business combinations. SFAS 141R provides new or additional guidance with respect to business combinations including: defining the acquirer in a transaction, the valuation of assets and liabilities when noncontrolling interests exist, the treatment of contingent consideration, the treatment of costs incurred to effect the acquisition, the treatment of reorganization costs, and the valuation of assets and liabilities when the purchase price is below the net fair value of assets acquired. SFAS 141R applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. Earlier adoption is prohibited. We will adopt the Statement on its effective date.

Accounting Changes

In September 2006, the FASB issued SFAS 157, *Fair Value Measurements.* The standard revises the definition of fair value, establishes a framework for measuring fair value under GAAP, and expands disclosures about fair value measurements. SFAS 157 is applicable to other accounting pronouncements that require or permit fair value measurements but does not establish new guidance regarding the assets and liabilities required or allowed to be measured at fair value. The statement is effective for fiscal years beginning after November 15, 2007, with early adoption permitted. We adopted SFAS 157 on January 1, 2008. We did not recognize any cumulative effect related to the adoption of SFAS 157 and the adoption did not have a significant effect on our results of operations or financial condition.

In February 2007, the FASB issued SFAS 159, *The Fair Value Option for Financial Assets and Financial Liabilities Including an Amendment of FASB Statement No. 115.* SFAS 159 permits many financial assets and liabilities to be reported at fair value that are not otherwise required under GAAP to be measured at fair value. Under SFAS 159 guidance, the election of fair value treatment is specific to individual assets and liabilities, with changes in fair value recognized in earnings as they occur. The election of fair value measurement is generally irrevocable. SFAS 159 is effective for fiscal years beginning after November 15, 2007, with early adoption permitted. We adopted SFAS 159 on January 1, 2008 but did not elect fair value measurement for any financial assets or liabilities that were not otherwise required to be measured at fair value.

Change in Chairman of the Board

On September 22, 2008, A. Derrill Crowe, M.D. resigned as non-executive Chairman of the Board and from his position as a director, for personal reasons. On October 16, 2008, our Board of Directors elected our CEO, W. Stancil Starnes, to serve as the Chairman of the Board.

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Liquidity and Capital Resources and Financial Condition

Overview

ProAssurance Corporation is a holding company and is a legal entity separate and distinct from its subsidiaries. Because it has no other business operations, dividends from its operating subsidiaries represent a significant source of funds for its obligations, including debt service. The ability of our insurance subsidiaries to pay dividends is subject to limitation by state insurance regulations. See our discussions under Regulation of Dividends and Other Payments from Our Operating Subsidiaries in Part I, and in Note 15 of our Notes to the Consolidated Financial Statements in our December 31, 2007 Form 10K for additional information regarding the ordinary dividends that can be paid by our insurance subsidiaries in 2008. In August 2008 we received dividends of $125 million from and also contributed $25 million of capital to our insurance subsidiaries. At September 30, 2008 we held cash and investments of approximately $187 million outside of our insurance subsidiaries that are available for use without regulatory approval. Cash of approximately $139 million will be used in the ProAssurance-sponsored demutualization of PICA and the purchase of Georgia Lawyers, both of which are expected to close by the first quarter of 2009 as discussed in Note 11 to the Condensed Consolidated Financial Statements.

Cash Flows

The principal components of our operating cash flows are the excess of net investment income and premiums collected over net losses paid and operating costs, including income taxes. Timing delays exist between the collection of premiums and the ultimate payment of losses. Premiums are generally collected within the twelve-month period after the policy is written while our claim payments are generally paid over a more extended period of time. Likewise, timing delays exist between the payment of claims and the collection of reinsurance recoveries. Our operating activities provided positive cash flows of approximately $142.0 million and $207.2 million for the nine months ended September 30, 2008 and 2007, respectively.

The decline in operating cash flows in 2008 as compared to 2007 primarily reflects lower premium receipts due to the decline in premiums written during 2008, and also reflects higher income tax payments (attributable to an increase in taxable income in the fourth quarter of 2007 as compared to the fourth quarter of 2006) and the effect of trading security sales in 2007 of approximately $44 million versus trading security purchases in 2008 of approximately $3 million. These declines in operating cash flows are offset by lower loss payments, net of reinsurance received (including $24 million received related to the commutation of a number of prior year reinsurance contracts).

Two metrics commonly used to analyze the operating cash flows of insurance companies are the net paid-to-incurred ratio and the net paid loss ratio.

	Three Months Ended September 30		Nine Months Ended September 30	
	2008	2007	**2008**	2007
Net paid-to-incurred ratio	**136.1%**	98.2%	**114.4%**	94.5%
Net paid loss ratio	**78.2%**	63.8%	**69.5%**	66.7%

The net paid-to-incurred ratio is calculated as net paid losses divided by net incurred losses. The net paid loss ratio is calculated as net paid losses divided by net premiums earned. In calculating both of these ratios, net paid losses is defined as losses and loss adjustment expenses paid during the period, net of the anticipated reinsurance recoveries related to those losses.

For a long-tailed business such as ProAssurance, fluctuations in the ratios over short periods of time are not unexpected and are not necessarily indicative of either positive or negative changes in loss experience. The timing of our indemnity payments is affected by many factors, including the nature and number of the claims in process during any one period and the speed at which cases work through the trial and appellate process. The ratios are affected not only by variations in net paid losses, but also by variations in premium volume and the recognition of reserve development.

Net paid losses decreased in 2008 as compared to 2007 by $27 million. However, the net paid loss ratios and net paid-to-incurred ratios have increased as compared to 2007 due to the effects of lower values for the denominators in

each ratio (net earned premiums for the paid loss ratio; net incurred losses

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for the paid-to-incurred ratio) even though we also experienced a decline in net paid losses. Net earned premiums and net incurred losses both reflect reductions in insured risks in 2008 as compared to 2007; net incurred losses also reflect a greater amount of prior year favorable net loss development in 2008 than 2007.

Losses paid in 2008 have not, as a whole, exceeded amounts reserved for those losses as of December 31, 2007, nor has the payment of losses accelerated in an unexpected manner. In the contractual obligations table included in Part II of our December 31, 2007 Form 10K we projected, largely based on historical payment patterns, that we would pay gross losses of $541 million during 2008 related to the reserves that were established at December 31, 2007. Through September 30, 2008, our gross loss payments total approximately $320 million, which, when annualized, is consistent with and lower than the amount estimated for purposes of the table.

Recent Events

During the third quarter of 2008 and continuing into the fourth quarter the financial markets have experienced unusual turmoil and there have been a number of market events which have affected our investment results for the quarter. Our investment portfolio was directly affected by the U.S. Treasury conservatorship of Federal National Mortgage Association (Fannie Mae) and Federal Home Loan Mortgage Corporation (Freddie Mac), the Federal Reserve s lending facility to American International Group, Inc. (AIG), the declaration of bankruptcy by Lehman Brothers Holdings, Inc. (Lehman Brothers), and the ratings downgrades and subsequent FDIC facilitated sale of Washington Mutual Bank (Washington Mutual). We filed an 8K regarding our exposures to these entities on September 17, 2008. The following table presents an updated listing of our direct exposures to these financial institutions and the impact on our investment results during the quarter.

	For the Three Months Ended September 30, 2008			Ending Value as of September 30, 2008		
(In thousands)	Proceeds from Sale or Redemption	Net Realized Investment Losses	Other Than Temporary Impairments	Amortized Cost	Market Value	Unrealized Gain (Loss)
Fannie Mae Preferred Stock*	$	$	$ (8,501)	$ 421	$ 421	$
Fannie Mae Senior Debt	$	$	$	$42,433	$43,400	$ 967
Fannie Mae Discount Note	$	$	$	$ 2,797	$ 2,797	$
Freddie Mac Common Stock	$ (31)	$	$ (299)	$	$	$
Freddie Mac Preferred Stock	$	$	$ (967)	$ 64	$ 64	$
Freddie Mac Senior Debt	$ (9,200)	$	$	$52,545	$53,214	$ 669
Freddie Mac Discount Note	$ (200)	$	$	$	$	$
Lehman Brothers Senior Debt	$ (1,058)	$(1,995)	$(18,862)	$ 2,719	$ 2,719	$
AIG Senior Debt	$	$	$ (395)	$ 566	$ 566	$
AIG Common Stock	$ (107)	$ (78)	$	$	$	$
Washington Mutual Debt	$ (785)	$(1,644)	$	$	$	$
Reserve Primary Fund (see below)	$(48,505)	$(1,010)	$	$	$	$

* Sold at gain of $56,000 in October 2008

In addition to the direct exposures indicated in the table above, we have indirect exposure to Fannie Mae and Freddie Mac through $428 million in mortgage-backed securities guaranteed by these agencies. We have assessed the individual securities for other-than-temporary impairment and determined that no write-downs are warranted in the third quarter based on our review of expected future cash flows and our intent and ability to hold these securities until recovery.

Transatlantic Re (Transatlantic) has been one of our reinsurers for a number of years and we estimate that the amount owed to us by Transatlantic as of September 30, 2008 approximates $23 million. Transatlantic is an independent publicly traded company (NYSE) and, while AIG owns 59% of Transatlantic, the Transatlantic Board of Directors is not controlled by AIG. To date in 2008, Transatlantic has continued to reimburse us for paid claims in a manner consistent with its past practices. As of

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September 30, we have not recognized any reduction to Transatlantic reinsurance receivables for credit reasons.

In connection with the recent credit market events, the net asset value of our $49.5 million investment in the Reserve Primary Fund (the Reserve Fund), a money market fund, fell below $1 per share during the third quarter. We requested redemption of our holdings, realizing a loss of $1.0 million during the third quarter. The amount due us of $48.5 million is recorded as a receivable as of September 30, 2008 and is included in Other Assets. To date, $25.1 million of this balance has been received; the remainder may not be received for some time due to liquidity issues faced by the Reserve Fund. At this time we do not expect to experience any additional loss in value and do not believe a valuation allowance against the receivable is required.

Financial institutions, as a whole, have been particularly affected by the recent credit crisis. As of September 30, 2008 we hold fixed income securities of financial institutions that have a fair value of approximately $284 million (adjusted cost basis of the securities is approximately $312 million). The average rating of these securities is between AA- and A+ and the duration is approximately 2.5 years. The value of these securities or ultimate settlement of obligations is subject to the financial performance of these entities. Our largest fixed income exposures are to Bank of America/Merrill Lynch, totaling $25.4 million ($27.3 million cost). We have indirect exposure to JP Morgan related to our business owned life insurance policies, of which $16.5 million is held in a separate account with a stable value agreement guaranteed by JP Morgan. In light of the recent credit crisis and market dislocations, these institutions have experienced market disruptions.

Mortgage backed securities are generally categorized according to the expected credit quality of underlying mortgage loans. Generally, subprime loans are issued to borrowers with lower credit ratings while Alt-A borrowers have better credit ratings but the mortgage loan is of a type regarded as having a higher risk profile. As of September 30, 2008, we hold securities with a fair value of approximately $13.4 million (adjusted cost basis of approximately $15.7 million) that are supported by collateral we classify as subprime, of which approximately 59% are AAA rated, 33% are AA, 4% are A, 3% are BBB, and 1% are BB. Additionally we have approximately $1.4 million (adjusted cost basis of approximately $5.5 million) of securities with exposure to below investment grade fixed income securities with subprime exposure that are held in a high-yield investment fund; the average rating of the securities is B. We also hold securities with a fair value of approximately $12.3 million (adjusted cost basis of approximately $12.9 million) that are supported by privately issued residential mortgage backed securities we classify as Alt-A, of which approximately 41% are AAA rated, 25% are AA, 27% are A, and 7% are A-. Ratings given are as of September 30, 2008. During 2008 we evaluated our securities with subprime and Alt-A exposures and recognized other-than-temporary impairments of $788,000 for the three months and $4.9 million for the nine months ended September 30, 2008.

Fair values of fixed maturity and equity securities declined during the third quarter due to widening interest spreads, declines in credit quality and increased uncertainty regarding the future of the U.S. economy. At September 30, 2008 pre-tax net unrealized losses on our available-for sale securities are $78.3 million as compared to pre-tax unrealized losses of $16.0 million at June 30, 2008. To date in the fourth quarter, financial markets have continued to exhibit volatility and market values are overall lower at the end of October than at September 30, 2008. As of October 28, 2008 the net unrealized losses on our available-for-sale portfolio approximate $124 million, which is consistent with declines seen in market indices applicable to the securities we hold. It is difficult to predict when market prices will stabilize; however, we are unaware of facts or circumstances that would warrant additional other-than-temporary impairment write-downs at September 30, 2008. A complete listing of our investment holdings as of September 30, 2008, may be obtained from the Investor Home Page Supplemental Investor Information section of our website.

On October 3, 2008 the 2008 Emergency Economic Stabilization Act (EESA) was signed into law. This legislation is intended to reestablish liquidity in US financial markets and to promote financial market stability . EESA authorizes the Secretary of the U.S. Treasury to establish the Troubled Asset Relief Program (TARP) for the repurchase of up to $700 billion of mortgage backed securities and other troubled financial instruments from financial institutions. Among other EESA provisions are tax code revisions, budget measures, guidance related to the administration of TARP, and measures intended to mitigate mortgage foreclosures. The authority under EESA to purchase and insure assets expires December 31, 2009 but may, with certification of need to Congress, be extended to December 31, 2010.

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Investments

The following table provides the percentage breakdown of Total Investments by investment category at September 30, 2008:

Investment Category	Percentage of Total Investments
Fixed maturities available for sale, at fair value	86.3%
Short-term investments	8.5%
Business owned life insurance	1.8%
Other	1.5%
Investment in unconsolidated subsidiaries	1.3%
Equity securities, trading, at fair value	0.4%
Equity securities, available for sale, at fair value	0.2%
Total Investments	100%

We manage our investments to ensure that we will have sufficient liquidity to meet our obligations, taking into consideration the timing of cash flows from our investments, including interest payments, dividends and principal payments, as well as the expected cash flows to be generated by our operations. Typically, between $50 million and $75 million of our investments mature or are paid down in a given quarter and are available, if needed, to meet our cash flow requirements. At our insurance subsidiaries level, the primary outflow of cash is related to net paid losses and operating costs, including income taxes. The payment of individual claims cannot be predicted with certainty; therefore, we rely upon the history of paid claims in estimating the timing of future claims payments. To the extent that we have an unanticipated shortfall in cash we may either liquidate securities or borrow funds under previously established borrowing arrangements. However, given the relatively short duration of our investments, we do not foresee any such shortfall.

We held cash and short-term securities of $303.3 million at September 30, 2008 as compared to $260.1 million at December 31, 2007. The increased balance as of September 30, 2008 is net of the redemption of our $49.5 million interest in the Reserve Primary Fund, as discussed under Recent Events , and reflects our intent to hold additional funds in our short-term portfolio in response to the instability of credit markets.

Our investment in unconsolidated subsidiaries increased to $46.5 million at September 30, 2008 as compared to $26.8 million at December 31, 2007. During the first quarter of 2008 we increased our investment in one of our unconsolidated subsidiaries by $20 million in order to take advantage of dislocations in the credit market.

Approximately 98% of our fixed maturities are either United States government agency obligations or investment grade securities as determined by national rating agencies. Our available-for-sale fixed maturities have a dollar weighted average rating of AA at September 30, 2008. The weighted average effective duration of our fixed maturity securities at September 30, 2008 is 4.4 years; the weighted average effective duration of our fixed maturity securities and our short-term securities combined is 4.1 years.

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Fixed maturity securities have declined in value in 2008, particularly in the third quarter and continuing into the fourth quarter, reflecting widespread concern regarding the credit quality of financial institutions, the future of U.S. credit markets in general, and fears that the U.S. will experience a severe economic recession. Although treasury yields at September 30, 2008 declined as compared to December 31, 2007, spreads have widened which has reduced the fair value of our securities. Changes in market interest rate levels generally affect our net income to the extent that reinvestment yields are different than the yields on maturing securities. Changes in market interest rates also affect the fair value of our fixed maturity securities. On a pre-tax basis, net unrealized gains (losses) on our available-for-sale fixed maturity securities are comprised as follows:

(In millions)	**September 30 2008**	December 31 2007
Gross unrealized gains	**$ 18.0**	$ 37.2
Gross unrealized (losses)	**(95.8)**	(17.7)
Net unrealized gains (losses)	**$ (77.8)**	$ 19.5

We have the intent, and, due to the duration of our overall portfolio and positive cash flows, believe we have the ability to hold bonds in an unrealized loss position to recovery of book value or maturity and do not consider the declines in value to be other-than-temporary. For a discussion of the potential effects that future changes in interest rates may have on our investment portfolio see Item 3, Quantitative and Qualitative Disclosures about Market Risk.

Our investments in securities classified as Alt-A mortgage backed securities, subprime mortgage backed securities and various other asset backed securities have become less liquid than they have been historically due to recent market turmoil and resulting liquidity disruptions. While the markets for these securities have temporarily become more intermittent and less active, trades are occurring. We determine the fair value of these securities by obtaining information from IDC which includes trade data. We confirmed the reasonableness of the fair value of these securities as of September 30, 2008 by reviewing market yields of the securities. Current yields are substantially elevated and reflect those seen on similar securities of similar credit quality and collateral. In addition to these securities which have become illiquid as a result of current market disruptions, we historically have purchased certain other investments that do not have a readily available market, which includes private placements, limited partnerships, inverse coupon mortgage backed securities, municipal auction rate securities and Federal Home Loan Bank (FHLB) capital stock. The net unrealized gains (losses) as of September 30, 2008 associated with securities currently considered to be illiquid are detailed in the following table.

	Values at September 30, 2008	
(In thousands)	**Fair Value**	**Net Unrealized Gains (Losses)**
Fixed maturities, available for sale		
Mortgage backed securities classified as:		
Inverse coupon	$ 22,115	$ 1,532
Alt-A	10,240	(902)
Subprime	13,390	(2,288)
Prime, privately issued	42,603	(3,242)
Prime, agency issued	524	23
Other asset backed securities:		
Timber land	1,054	54
Hotel	941	(61)

Manufactured housing	225	(69)
Other	2,494	(482)
Corporate bonds:		
Privately placed	39,222	(1,136)
Equipment trusts	172	
Municipal auction rated bonds	10,025	
Equity, available for sale:		
Privately placed	350	(390)
Other investments:		
FHLB capital stock	5,088	
Limited partnerships	13,129	(7,576)
	$ 161,572	$ (14,537)

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We believe the fair values of these securities reflect declines due to the market disruptions and are below the true economic value. The unrealized losses should reverse over the remaining lives of the securities should no further deterioration of collateral relative to our position in the securities capital structures be experienced.

Equity investments represent less than 1% of our total investments and less than 3% of our stockholders equity at both September 30, 2008 and December 31, 2007. At September 30, 2008, the carrying value of our equity investments (including equities in our available-for-sale and trading portfolios) totaled $23.7 million as compared to $29.6 million at December 31, 2007. The decline in our equity investments is primarily attributable to the impairment of Fannie Mae preferred securities.

Reinsurance

We use reinsurance to provide capacity to write larger limits of liability, to provide protection against losses in excess of policy limits, and to stabilize underwriting results in years in which higher losses occur. The purchase of reinsurance does not relieve us from the ultimate risk on our policies, but it does provide reimbursement from the reinsurer for certain losses paid by us.

Our risk retention level is dependent upon numerous factors including our risk appetite and the capital we have to support it, the price and availability of reinsurance, volume of business, level of experience and our analysis of the potential underwriting results within each state. We purchase reinsurance from a number of companies to mitigate concentrations of credit risk. Our reinsurance broker assists us in the analysis of the credit quality of our reinsurers. We base our reinsurance buying decisions on an evaluation of the then-current financial strength, rating and stability of prospective reinsurers. However, the financial strength of our reinsurers, and their corresponding ability to pay us, may change in the future due to forces or events we cannot control or anticipate.

Periodically, reinsurers may dispute our claim for reimbursement from them; however, we have not experienced significant collection difficulties due to the financial condition of any reinsurer. We have established appropriate reserves for any balances that we believe may not be ultimately collected. Should future events lead us to believe that any reinsurer will not meet its obligations to us, adjustments to the amounts recoverable would be reflected in the results of current operations. Such an adjustment has the potential to be significant to the results of operations in the period in which it is recorded; however, we would not expect such an adjustment to have a material effect on our capital position or our liquidity.

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Debt

Our long-term debt as of September 30, 2008 is comprised of the following.

(In thousands, except %)	Rate	September 30 2008	First Redemption Date
2034 Subordinated Debentures	6.7%, LIBOR adjusted	**$ 46,395**	May 2009
2034 Surplus Notes	7.7%, fixed until May 2009	**11,901**	May 2009*
		$ 58,296	

* *Subject to approval by the Wisconsin Commissioner of Insurance*

A detailed description of our debt is provided in Note 7 to the Condensed Consolidated Financial Statements.

As discussed in Note 7, we completed the conversion of all of our outstanding Convertible Debentures (aggregate principal of $107.6 million) in July 2008. Approximately 2,572,000 shares of our common stock were issued in the transaction (conversion rate was 23.9037 per $1,000 debenture). Of the common shares issued, approximately 2.12 million were reissued Treasury Shares and 450,000 were newly issued shares. The transaction resulted in a net increase to Stockholders Equity of approximately $112.5 million in the third quarter of 2008. No gain or loss was recorded related to the conversion. Because the dilutive effect of the debentures has historically been included in our calculation of diluted earnings per share, the conversion of the debentures did not affect this measurement. Book value increased approximately $0.28 per share from the conversion.

Treasury Stock

During the nine months ended September 30, 2008, we repurchased approximately 1.6 million of our common shares having a total cost of $80.3 million (including approximately 360,000 shares purchased at a cost of $17.3 million during the three months ended September 30, 2008). This fully utilized the $150 million repurchase authorization approved by our Board of Directors in April 2007. On August 5, 2008 our Board of Directors authorized an additional $100 million for the repurchase of common shares or retirement of outstanding debt. As of September 30, 2008 all $100.0 million of this repurchase authorization remains available for use.

Litigation

We are involved in various legal actions arising primarily from claims against us related to insurance policies and claims handling, including, but not limited to, claims asserted by our policyholders. Legal actions are generally divided into two categories: (1) Legal actions dealing with claims and claim-related activities which we consider in our evaluation of our reserve for losses, and (2) legal actions falling outside of these areas which we evaluate and reserve for separately as a part of our Other Liabilities.

Claim-related actions are considered as a part of our reserving process under the guidance provided by SFAS 60 *Accounting and Reporting by Insurance Enterprises.* We evaluate the likely outcomes from these actions giving consideration to the facts and laws applicable to each case, appellate issues, coverage issues, potential recoveries from our insurance and reinsurance programs, and settlement discussions as well as our historical claims resolution practices. This data is then given consideration in the overall evaluation of our reserve for losses.

For non-claim-related actions we evaluate each case separately and establish what we believe is an appropriate reserve under the guidance provided by SFAS 5 *Accounting for Contingencies.* As a result of the acquisition of NCRIC Corporation in 2005, we assumed the risk of loss for a judgment entered against NCRIC, Inc. (NCRIC) on February 20, 2004 by a District of Columbia Superior Court in favor of Columbia Hospital for Women Medical

Center, Inc. (CHW) in the amount of $18.2 million (the judgment), which was appealed. In October 2008 the judgment was affirmed by the District of Columbia Court of Appeals. NCRIC has filed a petition for rehearing with the Court of Appeals. As of September 30, 2008, we carry a $22.3 million liability related to the judgment, including an estimate for post-trial interest and legal costs. Approximately $19.5 million of the liability was established as a component of the fair value of assets acquired and liabilities assumed in the allocation of the NCRIC purchase price.

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There are risks, as outlined in our Risk Factors in Part 1 of our 10K, that any of these actions could cost us more than our estimates. In particular, we or our insureds may receive adverse verdicts; post-trial motions may be denied, in whole or in part; any appeals that may be undertaken may be unsuccessful; we may be unsuccessful in our legal efforts to limit the scope of coverage available to insureds; and we may become a party to bad faith litigation over the settlement of a claim. To the extent that the cost of resolving these actions exceeds our estimates, the legal actions could have a material effect on ProAssurance s results of operations in the period in which any such action is resolved.

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Overview of Results-Three and Nine Months Ended September 30, 2008 and 2007

Net income totaled $22.2 million and $101.4 million for the three-month and nine-month periods ended September 30, 2008 as compared to $43.1 million and $116.8 million, respectively, for the same periods in 2007. The decrease in net income for both the three and the nine month periods is principally attributable to a substantial increase in the recognition of other-than-temporary impairments in the third quarter of 2008. The effect of impairments was partially offset by an increase of favorable prior year loss development in both the third quarter and the year-to-date periods of 2008. Net income per diluted share was $0.66 and $2.98 for the three-month and nine-month periods ended September 30, 2008, respectively, as compared to $1.23 and $3.31 for the same periods in 2007. The decrease in diluted earnings per share was primarily attributable to the decline in net income.

Results from the three and nine months ended September 30, 2008 compare to the same respective periods in 2007 as follows:

Revenues

Net premiums earned declined in 2008 by approximately $22.1 million (16%) for the three-month period and $55.6 million (14%) for the nine-month period. The declines reflect the effects of a highly competitive market place and rate reductions.

Our net investment result, which includes both net investment income and earnings from unconsolidated subsidiaries, declined in 2008 by $2.6 million (6%) for the three-month period and $11.1 million (9%) for the nine-month period. The decline primarily reflects lower interest rates on short-term funds during 2008 and unfavorable conditions in the credit markets.

We recognized net realized investment losses during both the three-month and nine-month periods of 2008, primarily due to the recognition of other-than-temporary impairments which increased $29.4 million and $31.6 million for the quarter and year-to-date periods, respectively, as compared to 2007. The 2008 impairments are primarily related to our investments in the preferred stock of Fannie Mae and Freddie Mac, and debt securities issued by Lehman Brothers, AIG, and Washington Mutual.

Expenses

Net losses decreased in 2008 as compared to 2007 by $22.9 million for the three months and by $73.4 million for the nine months ended September 30, 2008 due to a decline in insured risks and increased recognition of favorable prior year loss development in 2008 of $5.0 million for the third quarter and $20.7 million for the nine-month period. Underwriting, acquisition and insurance expenses declined by approximately $2.9 million and $4.0 million for the comparative three- and nine-month periods, respectively. Interest expense declined by $1.9 million and $3.1 million for the three months and nine months, respectively, because of lower debt.

Ratios

Our net loss ratio decreased in 2008 by 7.5 points for the three-month period and 9.7 points for the nine-month period as a result of the recognition of favorable net loss development as discussed above. Our expense ratio increased by 1.4 points for the three months and 2.0 points for the nine months ended September 30, 2008 primarily due to the decline in premium. Our operating ratio decreased by 10.9 points for the three months and 11.0 points for the nine months. Return on equity (annualized) decreased to 6.9% for the three-month period and to 10.5% for the nine-month period.

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Results of Operations-Three and Nine Months Ended September 30, 2008 Compared to Three and Nine Months Ended September 30, 2007

Selected consolidated financial data for each period is summarized in the table below.

	Three Months Ended September 30			Nine Months Ended September 30		
($ in thousands, except share data)	**2008**	2007	*Change*	**2008**	2007	*Change*
Revenues:						
Gross premiums written	**$126,122**	$149,138	*$(23,016)*	**$374,393**	$440,186	*$ (65,793)*
Net premiums written	**$116,409**	$139,483	*$(23,074)*	**$343,609**	$401,809	*$ (58,200)*
Premiums earned	**$123,733**	$147,130	*$(23,397)*	**$382,158**	$446,437	*$ (64,279)*
Premiums ceded	**(10,284)**	(11,622)	*1,338*	**(32,364)**	(41,089)	*8,725*
Net premiums earned	**113,449**	135,508	*(22,059)*	**349,794**	405,348	*(55,554)*
Net investment income	**39,845**	41,075	*(1,230)*	**122,218**	128,194	*(5,976)*
Equity in earnings of unconsolidated subsidiaries	**(1,967)**	(589)	*(1,378)*	**(3,916)**	1,241	*(5,157)*
Net realized investment gains (losses)	**(34,236)**	1,321	*(35,557)*	**(41,011)**	(1,564)	*(39,447)*
Other income	**997**	1,302	*(305)*	**3,694**	4,409	*(715)*
Total revenues	**118,088**	178,617	*(60,529)*	**430,779**	537,628	*(106,849)*
Expenses:						
Losses and loss adjustment expenses	**73,739**	99,142	*(25,403)*	**242,033**	338,793	*(96,760)*
Reinsurance recoveries	**(8,516)**	(11,034)	*2,518*	**(29,457)**	(52,844)	*23,387*
Net losses and loss adjustment expenses	**65,223**	88,108	*(22,885)*	**212,576**	285,949	*(73,373)*
Underwriting, acquisition and insurance expenses	**24,527**	27,439	*(2,912)*	**75,927**	79,913	*(3,986)*
Interest expense	**1,141**	3,006	*(1,865)*	**5,855**	8,950	*(3,095)*
Total expenses	**90,891**	118,553	*(27,662)*	**294,358**	374,812	*(80,454)*
Income before income taxes	**27,197**	60,064	*(32,867)*	**136,421**	162,816	*(26,395)*
Income taxes	**4,950**	16,952	*(12,002)*	**34,988**	45,993	*(11,005)*
Net income	**$ 22,247**	$ 43,112	*$(20,865)*	**$101,433**	$116,823	*$ (15,390)*

Earnings per share:								
Basic	**$ 0.66**	$ 1.32	*$ (0.66)*	**$ 3.12**	$ 3.53	*$ (0.41)*		
Diluted	**$ 0.66**	$ 1.23	*$ (0.57)*	**$ 2.98**	$ 3.31	*$ (0.33)*		
Net loss ratio	**57.5%**	65.0%	*(7.5)*	**60.8%**	70.5%	*(9.7)*		
Underwriting expense ratio	**21.6%**	20.2%	*1.4*	**21.7%**	19.7%	*2.0*		
Combined ratio	**79.1%**	85.2%	*(6.1)*	**82.5%**	90.2%	*(7.7)*		
Operating ratio	**44.0%**	54.9%	*(10.9)*	**47.6%**	58.6%	*(11.0)*		
Return on equity*	**6.9%**	14.7%	*(7.8)*	**10.5%**	13.4%	*(2.9)*		

* *Annualized*

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Premiums

	Three Months Ended September 30				Nine Months Ended September 30			
($ in thousands)	**2008**	2007	*Change*		**2008**	2007	*Change*	
Gross premiums written	**$126,122**	$149,138	*$(23,016)*	*(15.4%)*	**$374,393**	$440,186	*$(65,793)*	*(14.9%)*
Premiums earned	**$123,733**	$147,130	*$(23,397)*	*(15.9%)*	**$382,158**	$446,437	*$(64,279)*	*(14.4%)*
Premiums ceded	**(10,284)**	(11,622)	*1,338*	*(11.5%)*	**(32,364)**	(41,089)	*8,725*	*(21.2%)*
Net premiums earned	**$113,449**	$135,508	*$(22,059)*	*(16.3%)*	**$349,794**	$405,348	*$(55,554)*	*(13.7%)*

Gross Premiums Written

Gross premiums written declined during both the three- and nine-month periods ended September 30, 2008 as compared to the same periods in 2007, reflecting the effects of lower premium rates and a very competitive market. During 2007 we began to recognize improving loss trends in our rate making analysis, and have lowered the rates we charge our insureds where indicated. As policies take effect at these lower rates our premiums written have declined. For our physician business, which is discussed in more detail below, on our renewed business, our charged rates reflect average decreases of 7% for both the three and nine months ended September 30, 2008. Charged rates include the effects of filed rates, surcharges and discounts. Our competitors have also lowered rates, and we face strong price-based competition in virtually all of our markets. Our retention rate has remained above 85% but the acquisition of new business continues to be challenging. Despite competitive pressures, we remain committed to a rate structure that will allow us to fulfill our obligations to our insureds, including excellent claims and customer services as well as adequate loss reserves, while still generating fair returns for our stockholders.

Physician premiums represent 83% and 84% of gross premiums written during the three months ended September 30, 2008 and 2007, respectively (84% and 85% for the same respective nine-month periods) but amounts written in 2008 have declined as compared to 2007, as shown below.

	Three Months Ended September 30				Nine Months Ended September 30			
($ in thousands)	**2008**	2007	*Change*		**2008**	2007	*Change*	
Physician Premiums*	**$105,228**	$124,591	*$(19,363)*	*(15.5%)*	**$313,962**	$373,847	*$(59,885)*	*(16.0%)*

* *Exclusive of tail premiums as discussed below*

Our overall retention rate (without adjustment to eliminate retirees or any risks not sought to be renewed by us) is approximately 87% for both three- and nine-month periods ended September 30, 2008, respectively, as compared to 86% for both the three- and the nine-month periods ended September 30, 2007.

Premiums written for non-physician coverages represent 12% and 11% of our total gross premiums written for the three months and 11% of our total gross premiums written for both of the nine months ended September 30, 2008 and 2007, respectively.

	Three Months Ended September 30				Nine Months Ended September 30			
($ in thousands)	**2008**	2007	*Change*		**2008**	2007	*Change*	

Non-physician Premiums*								
Hospital and facility	**$ 6,484**	$ 7,585	*$(1,101)*	*(14.5%)*	**$22,031**	$24,541	*$(2,510)*	*(10.2%)*
Other non-physician	**7,871**	8,850	*(979)*	*(11.1%)*	**20,453**	22,023	*(1,570)*	*(7.1%)*
	$14,355	$16,435	*$(2,080)*	*(12.7%)*	**$42,484**	$46,564	*$(4,080)*	*(8.8%)*

* *Exclusive of tail premiums as discussed below*

Hospital and facility coverages are the most significant component of non-physician premiums and represent 5% of our total gross premiums written for both of the three-month periods ended September 30, 2008 and 2007, and represent 6% of our total gross premiums written for both of the nine-month periods in 2008 and 2007. Other non-physician coverages consist primarily of professional liability coverages provided to lawyers and to other health care professionals such as dentists and nurses. We are seeing the same competitive pressures in these areas as we are seeing in our physician business.

We are required to offer extended reporting endorsement or tail policies to insureds that are discontinuing their claims-made coverage with us, but we do not market such coverages separately. The

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amount of tail premium written and earned can vary widely from period to period. Tail premiums totaled approximately $6.5 million and $17.9 million (5% of gross written premiums for both periods) for the three and nine months ended September 30, 2008, respectively, representing decreases of $1.6 million and $1.8 million as compared to the same respective periods in 2007.

Premiums Earned

	Three Months Ended September 30				Nine Months Ended September 30			
($ in thousands)	**2008**	2007	*Change*		**2008**	2007	*Change*	
Premiums earned	**$123,733**	$147,130	*$(23,397)*	*(15.9%)*	**$382,158**	$446,437	*$(64,279)*	*(14.4%)*

Because premiums are generally earned pro rata over the entire policy period, fluctuations in premiums earned tend to lag those of premiums written. Our policies generally carry a term of one year. Tail premiums are 100% earned in the period written because the policies insure only incidents that occurred in prior periods and are not cancellable.

Exclusive of the effect of tail premiums, the decline in premiums earned for the three and nine months ended September 30, 2008 as compared to the same period in 2007 reflects declines in gross premiums written during 2007 and 2008, as well as a decline of $72,000 for the three months and $10.1 million for the nine months that is due to premium earned in 2007 related to unearned premiums acquired in the merger with PIC Wisconsin.

During the twelve months preceding September 30, 2008, our written premiums have declined as compared to written premiums for the twelve months preceding September 30, 2007. Consequently, 2008 earned premiums are expected to continue to be lower than 2007 earned premiums.

Premiums Ceded

	Three Months Ended September 30				Nine Months Ended September 30			
($ in thousands)	**2008**	2007	*Change*		**2008**	2007	*Change*	
Premiums ceded	**$10,284**	$11,622	*$(1,338)*	*(11.5%)*	**$32,364**	$41,089	*$(8,725)*	*(21.2%)*

Premiums ceded represent the portion of earned premiums that we pay our reinsurers for their assumption of a portion of our losses. The premium that we cede to our reinsurers is determined, in part, by the loss experience (subject to minimums and maximums) of the business ceded to them. It takes a number of years before all losses are known, and in the intervening period, premiums due to the reinsurers are estimated.

Our reinsurance expense ratio (premiums ceded as a percentage of premiums earned) is 8.3% and 8.5% for the three-month and nine-month periods ended September 30, 2008 as compared to 9.2% and 9.0% (exclusive of certain non-recurring items as detailed in the next paragraph) for the three-month and nine-month periods of 2007. The decrease in the ratio in 2008 is primarily because ceded business decreased as compared to 2007, both in amount and in proportion to retained business. Also, in 2007 a portion of PIC Wisconsin premiums were earned under pre-acquisition reinsurance arrangements; those arrangements ceded a greater portion of all premium to reinsurers than do the post-acquisition reinsurance arrangements.

Premiums ceded for the third quarter of 2007 were reduced by $1.9 million due to the commutation of certain reinsurance agreements. Premiums ceded were increased in the second quarter of 2007 by approximately $2.6 million to reflect the impact of increases in our projection of ceded losses for prior year agreements. Because there are no similar items in 2008, we excluded these amounts in calculating the 2007 reinsurance expense ratios given in the above paragraph. When these items are included, the 2007 reinsurance expense ratios are 7.9% for the three months and 9.2% for the nine months ended September 30, 2007.

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Net Investment Income, Net Realized Investment Gains (Losses); Equity in Earnings (Loss) of Unconsolidated Subsidiaries

Net Investment Income

	Three Months Ended September 30				Nine Months Ended September 30			
($ in thousands)	**2008**	2007	*Change*		**2008**	2007	*Change*	
Net investment income	**$39,845**	$41,075	*$(1,230)*	*(3.0%)*	**$122,218**	$128,194	*$(5,976)*	*(4.7%)*

Net investment income is primarily derived from the income earned by our fixed maturity securities and also includes income from short-term, trading portfolio and cash equivalent investments, dividend income from equity securities, earnings from other investments and increases in the cash surrender value of business owned executive life insurance contracts. Investment fees and expenses are deducted from investment income.

Net investment income by investment category is as follows:

	Three Months Ended September 30		Nine Months Ended September 30	
(In thousands)	**2008**	2007	**2008**	2007
Fixed maturities	**$37,513**	$36,970	**$115,378**	$111,149
Equities	**689**	87	**1,037**	226
Short-term investments	**1,599**	4,070	**5,544**	11,779
Other invested assets	**874**	966	**2,260**	7,106
Business owned life insurance	**301**	99	**1,481**	1,254
Investment expenses	**(1,131)**	(1,117)	**(3,482)**	(3,320)
Net investment income	**$39,845**	$41,075	**$122,218**	$128,194

The decrease in net investment income for both the three- and the nine-month periods results primarily from lower earnings on short-term investments due to a decline in market interest rates (on average of 275 basis points) on such investments, and other invested assets for the nine-month period, offset to an extent by higher earnings related to fixed maturity securities and equities. Due to the instability of credit markets in 2008, we have held additional funds in our short-term portfolio, a practice that may continue into 2009.

The increase in income from our investment in fixed maturities for the three months ended September 30, 2008 as compared to the same period in 2007 primarily reflects improved yields. On a year-to-date basis, the increase in income from our investment in fixed maturities is attributable to both improved yields and higher average invested funds. During 2008 the average outstanding balance of our fixed maturities has increased on a year-to-date basis, but remained relatively flat during the third quarter. Market interest rates during 2007 and 2008 allowed us to consistently invest new and matured funds at rates that exceed the average held in our portfolio, which improved our yields in 2008 as compared to 2007. Average yields for our available-for-sale fixed maturity securities during the three and nine months ended September 30, 2008 and 2007 are as follows:

	Three Months Ended September 30		Nine Months Ended September 30	
	2008	2007	**2008**	2007
Average income yield	**4.8%**	4.6%	**4.8%**	4.6%
Average tax equivalent income yield	**5.5%**	5.4%	**5.6%**	5.3%

Income from other invested assets is principally derived from private investment funds accounted for on a cost basis. Because we recognize the income related to these funds as it is distributed to us, our income from these holdings can vary significantly from period to period. In particular, the company has an investment in a distressed debt fund that has reduced its quarterly distributions given the turmoil in the debt markets.

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Equity in Earnings (Loss) of Unconsolidated Subsidiaries

	Three Months Ended September 30			Nine Months Ended September 30		
(In thousands)	**2008**	2007	*Change*	**2008**	2007	*Change*
Equity in earnings (loss) of unconsolidated subsidiaries	**$(1,967)**	$(589)	*$(1,378)*	**$(3,916)**	$1,241	*$(5,157)*

Equity in earnings (loss) of unconsolidated subsidiaries is derived from our ownership interests in three private investment funds accounted for on the equity method. The performance of the three funds reflects the decline and volatility of equity and credit markets in 2008, and we experienced negative returns from our interest in a fund of high-yield asset backed securities and our interest in a long/short equity fund during both the quarter and year-to-date periods. The third fund is an early phase private equity fund of funds that is still incurring the costs associated with its startup phase.

Net Realized Investment Gains (Losses)

The components of net realized investment gains (losses) are shown in the following table.

	Three Months Ended September 30		Nine Months Ended September 30	
(In thousands)	**2008**	2007	**2008**	2007
Net gains (losses) from sales	**$ (3,100)**	$ 921	**$ (2,954)**	$ 2,395
Other-than-temporary impairment (losses)	**(29,862)**	(428)	**(36,169)**	(4,602)
Trading portfolio gains (losses)	**(1,274)**	828	**(1,888)**	643
Net realized investment gains (losses)	**$(34,236)**	$1,321	**$(41,011)**	$(1,564)

During the third quarter of 2008 we recognized other-than-temporary impairment losses of $29.9 million, which included $788,000 related to asset backed bonds, $19.6 million related to corporate bonds of which $18.9 million were Lehman Brothers bonds, and $9.5 million related to our equity holdings in Fannie Mae and Freddie Mac. During the first and second quarters of 2008 we recognized other-than-temporary impairment losses of $6.3 million, which included $5.1 million related to asset backed bonds, $513,000 related to corporate bonds and $353,000 related to a passive investment in a private investment fund, and $300,000 related to our equity holdings.

In the third quarter of 2007 we recognized other-than-temporary impairment losses related to certain fixed maturity securities and a passive investment that we hold in a non-public investment pool. We also recognized other-than-temporary impairment losses in the first quarter of 2007 related to certain high yield asset backed bonds, particularly those with subprime loan exposures.

Losses and Loss Adjustment Expenses

The determination of calendar year losses involves the actuarial evaluation of incurred losses for the current accident year and the actuarial re-evaluation of incurred losses for prior accident years, including an evaluation of the reserve amounts required for losses in excess of policy limits.

Accident year refers to the accounting period in which the insured event becomes a liability of the insurer. For occurrence policies the insured event becomes a liability when the event takes place; for claims-made policies, which represent the majority of the Company s business, the insured event generally becomes a liability when the event is first reported to the insurer. We believe that measuring losses on an accident year basis is the most indicative measure of the underlying profitability of the premiums earned in that period since it associates policy premiums earned with the estimate of the losses incurred related to those policy premiums.

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The following table summarizes calendar year net losses and net loss ratios for the three and nine months ended September 30, 2008 and 2007 by separating losses between the current accident year and all prior accident years.

	Net Losses					
	Three Months Ended September 30			Nine Months Ended September 30		
(In millions)	**2008**	2007	*Change*	**2008**	2007	*Change*
Current accident year	**$ 95.2**	$113.1	$(17.9)	**$293.9**	$346.5	$(52.6)
Prior accident years	**(30.0)**	(25.0)	(5.0)	**(81.3)**	(60.6)	(20.7)
Calendar year	**$ 65.2**	$ 88.1	$(22.9)	**$212.6**	$285.9	$(73.3)

	Net Loss Ratios*					
	Three Months Ended September 30			Nine Months Ended September 30		
	2008	2007	*Change*	**2008**	2007	*Change*
Current accident year	**83.9%**	83.5%	0.4	**84.0%**	85.5%	(1.5)
Prior accident years	**(26.4%)**	(18.5%)	(7.9)	**(23.2%)**	(15.0%)	(8.2)
Calendar year	**57.5%**	65.0%	(7.5)	**60.8%**	70.5%	(9.7)

* *Net losses as specified divided by net premiums earned.*

Our current accident year loss ratio increased slightly for the three months and decreased for the nine months ended September 30, 2008, as compared to the same periods in 2007. During the second quarter of 2007 the Company increased its current accident year loss reserves relating to excess of policy limit losses, which increased the 2007 current accident year loss ratio by 1.2 percentage points for the year-to-date periods. Excluding this item, the current accident year loss ratios vary only as a result of the mix of insured risks, and are comparable for both the quarter and year-to-date periods.

Based upon claims data, we have reduced our expectation of claims severity within our retained layers of coverage. As a result, during the three and nine months ended September 30, 2008 we recognized favorable net loss development of $30.0 million and $81.3 million, respectively, generally related to our previously established (prior accident year) reserves. In particular, we have observed claims severity below our initial expectations, within the first $1 million of coverage, for the 2004 through 2007 accident years. Given both the long tailed nature of our business and the past volatility of claims, we are generally cautious in recognizing the impact of the underlying trends that lead to the recognition of favorable net loss development. As we conclude that sufficient data with respect to these trends exists to credibly impact our actuarial analysis we take appropriate actions. In the case of the claims severity trends for 2004-2007, we believe it is appropriate to recognize the impact of these trends in our actuarial evaluation of prior period loss estimates while also remaining cautious about the past volatility of claims severity. Favorable net loss development for the year-to-date period also includes $3.7 million recognized in the second quarter of 2008 related to prior year reinsurance contracts that were commuted during the period.

During the three and nine months ended September 30, 2007 we recognized favorable net loss development of $25.0 million and $60.6 million, respectively, related to our previously established (prior accident year) reserves, primarily to reflect reductions in our estimates of claim severity, within our retained layer of risk, for the 2003 through 2005 accident years.

Assumptions used in establishing our reserve are regularly reviewed and updated by management as new data becomes available. Any adjustments necessary are reflected in then current operations. Due to the size of our reserve, even a small percentage adjustment to the assumptions can have a material effect on our results of operations for the period in which the change is made.

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Underwriting, Acquisition and Insurance Expenses

	Three Months Ended September 30				Nine Months Ended September 30			
($ in thousands)	**2008**	2007	*Change*		**2008**	2007	*Change*	
Underwriting, acquisition and insurance expenses	**$24,527**	$27,439	*$(2,912)*	*(10.6%)*	**$75,927**	$79,913	*$(3,986)*	*(5.0%)*

	Three Months Ended September 30			Nine Months Ended September 30		
	2008	2007	*Change*	**2008**	2007	*Change*
Underwriting expense ratio	**21.6%**	20.2%	*1.4*	**21.7%**	19.7%	*2.0*

The increase in the underwriting expense ratio (expense ratio) for both the three- and nine-month periods is primarily the result of the decline in net premiums earned. The fixed costs associated with our insurance operations were only modestly higher, while underwriting and acquisition expenses were down in proportion to the decline in net earned premium.

Underwriting, acquisition and insurance expenses include share-based compensation expense of approximately $1.8 million for the three months and $6.4 million for the nine months ended September 30, 2008, as compared to $2.6 million and $6.4 million for the same periods in 2007, respectively. As compared to 2007, expense for 2008 reflects additional expense related to performance and option awards given to employees in 2008 but also reflects a decrease of $1.8 million related to option awards given to our new CEO and fully expensed in the third quarter of 2007. Awards to retirement eligible employees are fully expensed when granted (generally in the first quarter) and were approximately $680,000 and $1.2 million of share-based compensation expense for the nine-month periods ended September 30, 2008 and 2007.

In certain states we are permitted to recoup previous guaranty fund assessments through surcharges collected from our insureds. In both 2008 and 2007, the amounts recouped from our insureds primarily relate to assessments previously paid to the Florida Insurance Guaranty Association, Inc. Net guaranty fund assessments (recoupments) totaled ($356,000) and ($995,000) for the three and nine months ended September 30, 2008, compared to $1.0 million and $890,000 for the three and nine months ended September 30, 2007, respectively. The amounts recouped through surcharges collected from our insureds approximated $265,000 and $913,000 for the three and nine moths ended September 30, 2008, and $223,000 and $393,000 for the three and nine months ended September 30, 2007, respectively.

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Interest Expense

The conversion of our Convertible Debentures in July 2008 (see Note 7) and the redemption of our 2032 Subordinated Debentures in December 2007 decreased interest expense during the three and nine months ended September 30, 2008 as compared to the same periods in 2007. Also, the average interest rate of our 2034 Subordinated Debentures (which is based on three-month LIBOR) was approximately 300 and 200 basis points lower for the three- and nine-month periods of 2008, respectively, which further reduced interest expense. The three-month LIBOR rate has fluctuated in September and October of 2008, ranging from a low of 2.85% to a high of 4.8%. Our next reset date is mid-November 2008.

Interest expense by debt obligation is provided in the following table:

	Three Months Ended September 30			Nine Months Ended September 30		
(In thousands)	**2008**	2007	*Change*	**2008**	2007	*Change*
Convertible Debentures	**$**	$1,141	$(1,141)	**$2,283**	$3,424	$(1,141)
2032 Subordinated Debentures		402	(402)		1,189	(1,189)
2034 Subordinated Debentures	**856**	1,179	(323)	**2,710**	3,476	(766)
Surplus Notes	**284**	284		**853**	853	
Other	**1**		1	**9**	8	1
	$1,141	$3,006	$(1,865)	**$5,855**	$8,950	$(3,095)

Taxes

Our effective tax rate for each period is significantly lower than the 35% statutory rate because a considerable portion of our net investment income is tax-exempt. The effect of tax-exempt income on our effective tax rate is shown in the table below:

	Three Months Ended September 30		Nine Months Ended September 30	
	2008	2007	**2008**	2007
Statutory rate	**35.0%**	35.0%	**35.0%**	35.0%
Tax-exempt income	**(15.6%)**	(6.7%)	**(9.6%)**	(7.1%)
Other	**(1.2%)**	(0.1%)	**0.2%**	0.3%
Effective tax rate	**18.2%**	28.2%	**25.6%**	28.2%

The effect of tax-exempt income increased in the third quarter of 2008 as compared to third quarter of 2007 because income before taxes is $32.9 million less in 2008 than in 2007 while tax-exempt income remained level. Consequently, tax-exempt income represents a higher portion of pre-tax income for 2008 (45%) as compared to 2007 (19%).

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ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We believe that we are principally exposed to three types of market risk related to our investment operations. These risks are interest rate risk, credit risk and equity price risk.

Interest Rate Risk

Our fixed maturities portfolio is exposed to interest rate risk. Fluctuations in interest rates have a direct impact on the market valuation of these securities. As interest rates rise, market values of fixed income portfolios fall and vice versa. Certain of the securities are held in an unrealized loss position; we have the current ability and intent to hold such securities until recovery of book value or maturity.

The following table summarizes estimated changes in the fair value of our available-for-sale and trading fixed maturity securities for specific hypothetical changes in interest rates as of September 30, 2008.

(In millions, except duration)	**September 30, 2008**			December 31, 2007	
Interest Rates	**Portfolio Value**	**Change in Value**	**Effective Duration**	Portfolio Value	Effective Duration
200 basis point rise	**$2,768**	**$(273)**	**4.38**	$2,953	4.62
100 basis point rise	**$2,900**	**$(141)**	**4.48**	$3,095	4.52
Current rate *	**$3,041**	**$**	**4.42**	$3,237	4.13
100 basis point decline	**$3,180**	**$ 139**	**4.17**	$3,366	3.67
200 basis point decline	**$3,309**	**$ 268**	**4.20**	$3,486	3.48

* *Current rates are as of September 30, 2008 and December 31, 2007.*

At September 30, 2008, the fair value of our investment in preferred stocks was $2.9 million, including net unrealized losses of $1.6 million. Preferred stocks traditionally have been primarily subject to interest rate risk because they bear a fixed rate of return, but may also be subject to credit and equity price risk. The investments in the above table do not include preferred stocks.

Computations of prospective effects of hypothetical interest rate changes are based on numerous assumptions, including the maintenance of the existing level and composition of fixed income security assets, and should not be relied on as indicative of future results.

Certain shortcomings are inherent in the method of analysis presented in the computation of the fair value of fixed rate instruments. Actual values may differ from those projections presented should market conditions vary from assumptions used in the calculation of the fair value of individual securities, including non-parallel shifts in the term structure of interest rates and changing individual issuer credit spreads.

ProAssurance s cash and short-term investment portfolio at September 30, 2008 was on a cost basis which approximated its fair value. This portfolio lacks significant interest rate sensitivity due to its short duration.

Credit Risk

We have exposure to credit risk primarily as a holder of fixed income securities. We control this exposure by emphasizing investment grade credit quality in the fixed income securities we purchase.

As of September 30, 2008, 97.6% of our fixed maturity securities are rated investment grade as determined by Nationally Recognized Statistical Rating Organizations (NRSROs), (e.g. Moody s, Standard & Poor s and Fitch). We believe that this concentration in investment grade securities reduces our exposure to credit risk on our fixed income investments to an acceptable level. However, investment grade securities, in spite of their rating, can rapidly deteriorate and result in significant losses. Ratings published by the NRSROs are one of the tools used to evaluate the

credit worthiness of our securities. The ratings reflect the subjective opinion of the rating agencies as to the credit worthiness of the securities, and therefore, we may be subject to additional credit exposure should the rating prove to be unreliable.

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We hold $1.36 billion of municipal bonds, approximately $859 million (63%) of which are insured. Although these bonds may have improved credit ratings based on or as a result of guarantees of the debt obligations by a monoline insurer, we require the bonds that we purchase to meet our credit criteria on a stand-alone basis. As of September 30, 2008, our municipal bonds have a weighted average rating of AA, even when the benefits of insurance protection are excluded. Even though a number of the monoline insurers have had their ratings downgraded, our municipal bonds continue to be investment grade quality.

Equity Price Risk

At September 30, 2008 the fair value of our investment in common stocks was $20.8 million. These securities are subject to equity price risk, which is defined as the potential for loss in fair value due to a decline in equity prices. The weighted average Beta of this group of securities is 0.97. Beta measures the price sensitivity of an equity security or group of equity securities to a change in the broader equity market, in this case the S&P 500 Index. If the value of the S&P 500 Index increased by 10%, the fair value of these securities would be expected to increase by 9.7% to $22.8 million. Conversely, a 10% decrease in the S&P 500 Index would imply a decrease of 9.7% in the fair value of these securities to $18.8 million. The selected hypothetical changes of plus or minus 10% do not reflect what could be considered the best or worst case scenarios and are used for illustrative purposes only.

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ITEM 4. CONTROLS AND PROCEDURES

The Chief Executive Officer and Chief Financial Officer of the Company participated in management s evaluation of our disclosure controls and procedures (as defined in SEC Rule 13a-15(e)) as of September 30, 2008. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures are effective.

There have been no significant changes in our internal controls over financial reporting that have materially affected, or are reasonably likely to materially affect, those controls during the quarter.

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PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

See Note 9 to the Condensed Consolidated Financial Statements.

ITEM 1A. RISK FACTORS

With the exception of the two additional risk factors listed below, there are no changes to the Risk Factors in Part 1, Item 1A of the 2007 Form 10K.

The eventual effect that The 2008 Emergency Economic Stimulus Act will have on the U.S. economy is unclear.

On October 3, 2008 the 2008 Emergency Economic Stabilization Act (EESA) was signed into law. This legislation is intended to reestablish liquidity in U.S. financial markets and to promote financial market stability . Among other provisions, EESA authorizes the Secretary of the U.S. Treasury to establish the Troubled Asset Relief Program (TARP) for the repurchase of up to $700 billion of mortgage backed securities and other troubled financial instruments from financial institutions. The authority under EESA to purchase and insure assets expires December 31, 2009 but may, with certification of need to Congress, be extended to December 31, 2010. The effect that EESA will have on the U.S. economy and ProAssurance, in particular, cannot yet be determined.

In a period of market illiquidity and instability, the fair values of our investments are more difficult to assess and our assessments may prove to be greater or less than amounts received in actual transactions.

We value investments that are traded in active markets using quoted market prices. For all other investments, we estimate fair values based on broker dealer quotes and various other valuation methodologies, which may require us to choose among various input assumptions and which requires us to utilize judgment. When markets exhibit much volatility, there is more risk that we may utilize a quoted market price, broker dealer quote, valuation technique or input assumption that results in a fair value estimate that is either over or understated as compared to actual amounts received upon disposition or maturity of the security.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

Item (b) is inapplicable.

(a) On July 7, 2008, the Registrant s 3.90% Convertible Senior Debentures due 2023 in aggregate principal amount of $107,600,000 were converted into 2,572,029 shares of Registrant s common stock in accordance with the terms of the Debentures. The issuance of the shares was reported in Registrant s Current Report on Form 8-K filed on July 9, 2008.

(c) Information required by Item 703 of Regulation S-K

ISSUER PURCHASES OF EQUITY SECURITIES

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Approximate Dollar Value of Shares that May Yet Be Purchased Under the Plans or Programs
July 1 - 31, 2008	359,617	$48.23	359,617	$ 100,000,088
August 1 - 31, 2008		$		$ 100,000,088
September 1 - 30, 2008		$		$ 100,000,088
Total	359,617	$48.23	359,617	

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ITEM 6. EXHIBITS

31.1 Certification of Principal Executive Officer of ProAssurance as required under SEC rule 13a-14(a).

31.2 Certification of Principal Financial Officer of ProAssurance as required under SEC rule 13a-14(a).

32.1 Certification of Principal Executive Officer of ProAssurance as required under SEC Rule 13a-14(b) and Section 1350 of Chapter 63 of Title 18 of the United States Code, as amended (18 U.S.C. 1350).

32.2 Certification of Principal Financial Officer of ProAssurance as required under SEC Rule 13a-14(b) and Section 1350 of Chapter 63 of Title 18 of the United States Code, as amended (18 U.S.C. 1350).

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SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

PROASSURANCE CORPORATION

November 4, 2008

/s/ Edward L. Rand, Jr.
Edward L. Rand, Jr.
Chief Financial Officer
(Duly authorized officer and principal financial officer)