HANOVER INSURANCE GROUP, INC.
Form 10-Q
November 07, 2008
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

FORM 10-Q

(Mark One)

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the quarterly period ended September 30, 2008

or

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the transition period from ______ to ______

Commission File Number: 1-13754

THE HANOVER INSURANCE GROUP, INC.

(Exact name of registrant as specified in its charter)

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

440 Lincoln Street, Worcester, Massachusetts 01653

(Address of principal executive offices) (Zip Code)

(508) 855-1000

(Registrant s telephone number, including area code)

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

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

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

Large accelerated filer x		Accelerated filer ¨
Non-accelerated filer ¨	(Do not check if a Smaller Reporting Company)	Smaller Reporting Company ¨

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

APPLICABLE ONLY TO ISSUERS INVOLVED IN BANKRUPTCY

PROCEEDINGS DURING THE PRECEDING FIVE YEARS:

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

APPLICABLE ONLY TO CORPORATE ISSUERS:

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date: 51,082,287 shares of common stock outstanding, as of November 1, 2008.

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PART I - FINANCIAL INFORMATION

ITEM 1 - FINANCIAL STATEMENTS

THE HANOVER INSURANCE GROUP, INC.

CONSOLIDATED STATEMENTS OF INCOME

(In millions, except per share data)	(Unaudited) Quarter Ended September 30, 2008	2007	(Unaudited) Nine Months Ended September 30, 2008	2007
REVENUES				
Premiums	**$ 621.1**	$ 595.2	**$ 1,858.1**	$ 1,770.3
Net investment income	**65.5**	62.8	**193.9**	183.7
Net realized investment losses	**(52.8)**	(0.8)	**(60.7)**	(0.3)
Fees and other income	**8.3**	14.6	**25.7**	41.7
Total revenues	**642.1**	671.8	**2,017.0**	1,995.4
BENEFITS, LOSSES AND EXPENSES				
Policy benefits, claims, losses and loss adjustment expenses	**474.2**	373.8	**1,239.7**	1,091.3
Policy acquisition expenses	**139.7**	132.5	**416.1**	389.5
Other operating expenses	**77.2**	88.0	**247.1**	260.5
Total benefits, losses and expenses	**691.1**	594.3	**1,902.9**	1,741.3
(Loss) income from continuing operations before federal income taxes	**(49.0)**	77.5	**114.1**	254.1
Federal income tax (benefit) expense:				
Current	**(1.1)**	25.3	**40.6**	81.5
Deferred	**(4.4)**	0.7	**11.8**	4.6
Total federal income tax (benefit) expense	**(5.5)**	26.0	**52.4**	86.1
(Loss) income from continuing operations	**(43.5)**	51.5	**61.7**	168.0
Discontinued operations (See Notes 3,4 and 13):				
(Loss) income from operations of discontinued FAFLIC business (net of income tax (expense) benefit of $(1.7) and $1.3 for the quarters ended September 30, 2008 and 2007 and $(1.3) and $3.3 for the nine months ended September 30, 2008 and 2007, including loss on assets held-for-sale of $6.1 and $72.2 for the quarter and nine months ended September 30, 2008)	**(21.7)**	1.5	**(92.9)**	8.3
Income from operations of AMGRO (net of income tax benefit of $1.3 for the nine months ended September 30, 2008, including gain on disposal of $11.1 in 2008)			**10.1**	
Gain on disposal of variable life insurance and annuity business (net of income tax benefit of $2.6 for the quarter ended September 30, 2008 and $3.0 and $0.2 for the nine months ended September 30, 2008 and 2007)	**2.7**	0.1	**8.1**	0.2
Other	**0.7**	0.8	**(0.5)**	0.8
Net (loss) income	**$ (61.8)**	$ 53.9	**$ (13.5)**	$ 177.3
PER SHARE DATA				
Basic				
(Loss) income from continuing operations	**$ (0.85)**	$ 0.99	**$ 1.20**	$ 3.26

Discontinued operations:				
(Loss) income from operations of discontinued FAFLIC business (net of income tax (expense) benefit of $(0.03) and $0.02 for the quarters ended September 30, 2008 and 2007 and $(0.03) and $0.06 for the nine months ended September 30, 2008 and 2007, including loss on assets held-for-sale of $0.12 and $1.39 for the quarter and nine months ended September 30, 2008)	**(0.42)**	0.03	**(1.81)**	0.16
Income from operations of AMGRO (net of income tax benefit of $0.03 for the quarter and nine months ended September 30, 2008, including gain on disposal of $0.21 in 2008)			**0.20**	
Gain on disposal of variable life insurance and annuity business (net of income tax benefit of $0.05 and $0.06 for the quarter and nine months ended September 30, 2008)	**0.05**		**0.16**	
Other	**0.01**	0.02	**(0.01)**	0.02
Net (loss) income per share	**$ (1.21)**	$ 1.04	**$ (0.26)**	$ 3.44
Weighted average shares outstanding	**51.0**	51.8	**51.3**	51.6
<u>Diluted</u>				
(Loss) income from continuing operations	**$ (0.85)**	$ 0.98	**$ 1.19**	$ 3.21
Discontinued operations:				
(Loss) income from operations of discontinued FAFLIC business (net of income tax (expense) benefit of $(0.03) and $0.02 for the quarters ended September 30, 2008 and 2007 and $(0.03) and $0.06 for the nine months ended September 30, 2008 and 2007, including loss on assets held-for-sale of $0.12 and $1.39 for the quarter and nine months ended September 30, 2008)	**(0.42)**	0.03	**(1.80)**	0.16
Income from operations of AMGRO (net of income tax benefit of $0.03 for the nine months ended September 30, 2008, including gain on disposal of $0.21 in 2008)			**0.20**	
Gain on disposal of variable life insurance and annuity business (net of income tax benefit of $0.05 and $0.06 for the quarter and nine months ended September 30, 2008)	**0.05**		**0.16**	
Other	**0.01**	0.02	**(0.01)**	0.02
Net (loss) income per share	**$ (1.21)**	$ 1.03	**$ (0.26)**	$ 3.39
Weighted average shares outstanding	**51.0**	52.5	**51.8**	52.3

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

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THE HANOVER INSURANCE GROUP, INC.

CONSOLIDATED BALANCE SHEETS

(In millions, except per share data)	(Unaudited) September 30, 2008	December 31, 2007
ASSETS		
Investments:		
Fixed maturities, at fair value (amortized cost of $4,529.3 and $4,585.7)	**$ 4,353.5**	$ 4,584.8
Equity securities, at fair value (cost of $60.3 and $37.6)	**54.0**	44.6
Mortgage loans	**31.5**	41.2
Other long-term investments	**14.2**	30.7
Total investments	**4,453.2**	4,701.3
Cash and cash equivalents	**314.3**	210.6
Accrued investment income	**55.7**	53.3
Premiums, accounts and notes receivable, net	**571.1**	626.7
Reinsurance receivable on paid and unpaid losses, benefits and unearned premiums	**1,030.4**	1,067.3
Deferred policy acquisition costs	**264.4**	246.8
Deferred federal income taxes	**258.6**	300.8
Goodwill	**131.9**	126.0
Other assets	**302.8**	309.6
Assets held-for-sale	**1,872.4**	2,173.2
Total assets	**$ 9,254.8**	$ 9,815.6
LIABILITIES		
Policy liabilities and accruals:		
Outstanding claims, losses and loss adjustment expenses	**3,118.0**	3,165.9
Unearned premiums	**1,208.6**	1,155.9
Contractholder deposit funds and other policy liabilities	**1.8**	1.9
Total policy liabilities and accruals	**4,328.4**	4,323.7
Expenses and taxes payable	**553.4**	633.6
Reinsurance premiums payable	**48.3**	44.9
Long-term debt	**511.9**	511.9
Liabilities held-for-sale	**1,772.7**	2,002.5
Total liabilities	**7,214.7**	7,516.6
Commitments and contingencies (Note 14)		
SHAREHOLDERS EQUITY		
Preferred stock, $0.01 par value, 20.0 million shares authorized, none issued		
Common stock, $0.01 par value, 300.0 million shares authorized, 60.5 million shares issued	**0.6**	0.6
Additional paid-in capital	**1,801.5**	1,822.6
Accumulated other comprehensive loss	**(217.9)**	(20.4)
Retained earnings	**938.7**	946.9
Treasury stock at cost (9.6 million and 8.7 million shares)	**(482.8)**	(450.7)
Total shareholders equity	**2,040.1**	2,299.0

Total liabilities and shareholders equity	**$ 9,254.8**	$ 9,815.6

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

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THE HANOVER INSURANCE GROUP, INC.

CONSOLIDATED STATEMENTS OF SHAREHOLDERS EQUITY

(In millions)	(Unaudited) Nine Months Ended September 30, 2008	2007
PREFERRED STOCK		
Balance at beginning and end of period	**$**	$
COMMON STOCK		
Balance at beginning and end of period	**0.6**	0.6
ADDITIONAL PAID-IN CAPITAL		
Balance at beginning of period	**1,822.6**	1,814.3
Tax benefit from stock options and other	**0.6**	2.3
Employee and director stock-based awards	**(21.7)**	1.8
Balance at end of period	**1,801.5**	1,818.4
ACCUMULATED OTHER COMPREHENSIVE LOSS		
NET UNREALIZED (DEPRECIATION) APPRECIATION ON INVESTMENTS AND DERIVATIVE INSTRUMENTS:		
Balance at beginning of period	**5.5**	(9.0)
Depreciation during the period:		
Net depreciation on available-for-sale securities and derivative instruments	**(197.4)**	(12.1)
Benefit (provision) for deferred federal income taxes	**2.2**	(0.9)
	(195.2)	(13.0)
Balance at end of period	**(189.7)**	(22.0)
DEFINED BENEFIT PENSION AND POSTRETIREMENT PLANS:		
Balance at beginning of period	**(25.9)**	(30.9)
Amounts arising in the period	**(0.8)**	(26.0)
Amortization during the period:		
Amount recognized as net periodic benefit cost	**(2.7)**	4.8
Benefit for deferred federal income taxes	**1.2**	7.4
	(2.3)	(13.8)
Balance at end of period	**(28.2)**	(44.7)
Total accumulated other comprehensive loss	**(217.9)**	(66.7)
RETAINED EARNINGS		
Balance at beginning of period, before cumulative effect of accounting change, net of tax	**946.9**	712.0
Cumulative effect of accounting change, net of tax		11.5
Balance at beginning of period, as adjusted	**946.9**	723.5
Net (loss) income	**(13.5)**	177.3
Treasury stock issued for less than cost	**(9.4)**	(12.5)
Recognition of share-based compensation	**14.7**	4.5

Balance at end of period	**938.7**	892.8
Treasury Stock		
Balance at beginning of period	**(450.7)**	(487.8)
Shares purchased at cost	**(58.5)**	
Net shares reissued at cost under employee stock-based compensation plans Issuance of common stock	**26.4**	35.3
Balance at end of period	**(482.8)**	(452.5)
Total shareholders equity	**$ 2,040.1**	$ 2,192.6

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

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THE HANOVER INSURANCE GROUP, INC.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(In millions)	(Unaudited) Quarter Ended September 30, 2008	2007	(Unaudited) Nine Months Ended September 30, 2008	2007
Net (loss) income	**$ (61.8)**	$ 53.9	**$ (13.5)**	$ 177.3
Other comprehensive (loss) income:				
Available-for-sale securities:				
Net (depreciation) appreciation during the period	**(117.4)**	42.7	**(197.5)**	(11.9)
Benefit (provision) for deferred federal income taxes	**0.1**	(1.0)	**2.2**	(1.0)
Total available-for-sale securities	**(117.3)**	41.7	**(195.3)**	(12.9)
Derivative instruments:				
Net appreciation (depreciation) during the period	**0.5**	0.1	**0.1**	(0.2)
(Provision) benefit for deferred federal income taxes	**(0.1)**			0.1
Total derivative instruments	**0.4**	0.1	**0.1**	(0.1)
	(116.9)	41.8	**(195.2)**	(13.0)
Pension and postretirement benefits:				
Amounts arising in the period:				
Net actuarial loss		(16.0)	**(0.8)**	(26.0)
Amortization recognized as net periodic benefit costs:				
Net actuarial gain	**0.7**	6.5	**2.2**	7.8
Prior service cost	**(1.2)**	(0.6)	**(3.7)**	(1.8)
Transition asset	**(0.4)**	(0.4)	**(1.2)**	(1.2)
Total amortization recognized as net periodic benefit costs	**(0.9)**	(10.5)	**(2.7)**	(21.2)
Benefit for deferred federal income taxes	**0.3**	3.6	**1.2**	7.4
Total pension and postretirement benefits	**(0.6)**	(6.9)	**(2.3)**	(13.8)
Other comprehensive (loss) income	**(117.5)**	34.9	**(197.5)**	(26.8)
Comprehensive (loss) income	**$ (179.3)**	$ 88.8	**$ (211.0)**	$ 150.5

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

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THE HANOVER INSURANCE GROUP, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(In millions)	(Unaudited) Nine Months Ended September 30, 2008	2007
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	**$ (13.5)**	$ 177.3
Adjustments to reconcile net income to net cash provided by operating activities:		
Gain on disposal of variable life insurance and annuity business	**(8.1)**	(0.2)
Estimated loss on sale of FAFLIC	**72.2**	
Gain on sale of AMGRO, Inc.	**(11.1)**	
Loss (gain) on sale from other discontinued operations	**0.5**	(0.8)
Net realized investment losses (gains)	**83.7**	(1.9)
Net amortization and depreciation	**14.1**	13.9
Stock-based compensation expense	**8.9**	11.2
Interest credited to contractholder deposit funds and trust instruments supported by funding obligations	**1.5**	1.8
Deferred federal income taxes	**33.3**	35.6
Change in deferred acquisition costs	**(16.2)**	(20.8)
Change in premiums and notes receivable, net of reinsurance premiums payable	**44.4**	(38.5)
Change in accrued investment income	**(1.1)**	(3.9)
Change in policy liabilities and accruals, net	**(60.0)**	(31.8)
Change in reinsurance receivable	**111.4**	(3.2)
Change in expenses and taxes payable	**(102.9)**	(106.1)
Other, net	**17.4**	7.8
Net cash provided by operating activities	**174.5**	40.4
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from disposals and maturities of available-for-sale fixed maturities	**646.4**	971.0
Proceeds from disposals of equity securities and other investments	**7.9**	12.8
Proceeds from mortgages matured or collected	**14.6**	15.3
Proceeds from collections of installment finance and notes receivable	**192.2**	329.9
Net proceeds from sale of AMGRO, Inc.	**1.0**	
Purchase of available-for-sale fixed maturities	**(594.6)**	(1,040.4)
Purchase of equity securities and other investments	**(24.8)**	(15.3)
Capital expenditures	**(7.4)**	(6.6)
Net cash used to acquire Verlan Holdings, Inc.	**(26.4)**	
Net cash used to acquire Professionals Direct, Inc.		(16.9)
Net payments on swap agreements	**(0.3)**	
Disbursements to fund installment finance and notes receivable	**(178.6)**	(350.2)
Net cash provided by (used in) investing activities	**30.0**	(100.4)
CASH FLOWS FROM FINANCING ACTIVITIES		
Withdrawals from trust instruments supported by funding obligations	**(21.0)**	
Exercise of options	**7.9**	21.5
Proceeds from excess tax benefits related to share-based payments	**0.1**	5.2
Change in collateral related to securities lending program	**8.5**	(109.7)
Treasury stock purchased at cost	**(58.5)**	
Net cash used in financing activities	**(63.0)**	(83.0)

Net change in cash and cash equivalents	**141.5**	(143.0)
Net change in cash held by discontinued FAFLIC business	**(37.8)**	33.5
Cash and cash equivalents, beginning of period	**210.6**	316.2
Cash and cash equivalents, end of period	**$ 314.3**	$ 206.7

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

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THE HANOVER INSURANCE GROUP, INC.

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

1. Basis of Presentation and Principles of Consolidation

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

The interim consolidated financial statements of THG include the accounts of The Hanover Insurance Company (Hanover Insurance) and Citizens Insurance Company of America (Citizens), THG s principal property and casualty companies; and certain other insurance and non-insurance subsidiaries. These legal entities conduct their operations through several business segments discussed in Note 10. As of September 30, 2008 and for all prior periods, due to the anticipated sale of First Allmerica Financial Life Insurance Company (FAFLIC), THG s life insurance and annuity subsidiary, a portion of FAFLIC s accounts have been classified as held-for-sale in the Consolidated Balance Sheets and as discontinued operations in the Consolidated Statements of Income (See Note 3 Discontinued Operations of FAFLIC Business). All significant intercompany accounts and transactions have been eliminated.

The accompanying interim consolidated financial statements reflect, in the opinion of the Company s management, all adjustments necessary for a fair presentation of the financial position and results of operations. The results of operations for the nine months ended September 30, 2008 are not necessarily indicative of the results to be expected for the full year. These financial statements should be read in conjunction with the Company s 2007 Annual Report on Form 10-K filed with the Securities and Exchange Commission.

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

2. New Accounting Pronouncements

Recently Issued Standards

In May 2008, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 163, *Accounting for Financial Guarantee Insurance Contracts an interpretation of FASB Statement No. 60* (Statement No. 163). Statement No. 163 provides for changes to both the recognition and measurement of premium revenues and claim liabilities for financial guarantee insurance contracts that are within the scope of Statement of Financial Accounting Standards No. 60, *Accounting and Reporting by Insurance Enterprises* and that do not qualify as a derivative instrument in accordance with Statement of Financial Accounting Standards No. 133, *Accounting for Derivative Instruments and Hedging Activities*. This statement also expands the disclosure requirements related to financial guarantee insurance contracts to include such items as the Company s method of tracking insured financial obligations with credit deterioration, financial information about the insured financial obligations, and management s policies for placing and monitoring the insured financial obligations. Statement No. 163 is effective for fiscal years beginning after December 15, 2008, except for certain disclosures related to the insured financial obligations, which are effective for the third quarter of 2008. The Company expects that the effect of adopting Statement No. 163 will not be material to its results of operations or financial position.

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

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

Recently Adopted Standards

In February 2007, the FASB issued Statement of Financial Accounting Standards No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities Including an amendment of FASB Statement No. 115* (Statement No. 159). Statement No. 159 permits a company to choose, at specified election dates, to measure at fair value certain eligible financial assets and liabilities that are not currently required to be measured at fair value. The specified election dates include, but are not limited to, the date when an entity first recognizes the item, when an entity enters into a firm commitment or when changes in the financial instrument causes it to no longer qualify for fair value accounting under a different accounting standard. An entity may elect the fair value option for eligible items that exist at the effective date. At that date, the difference between the carrying amounts and the fair values of eligible items for which the fair value option is elected should be recognized as a cumulative effect adjustment to the opening balance of retained earnings. The fair value option may be elected for each entire financial instrument, but need not be applied to all similar instruments. Once the fair value option has been elected, it is irrevocable. Unrealized gains and losses on items for which the fair value option has been elected will be reported in earnings. Statement No. 159 was effective as of the beginning of fiscal years that begin after November 15, 2007. The Company did not elect to implement the fair value option for eligible financial assets and liabilities as of January 1, 2008.

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157, *Fair Value Measurements* (Statement No. 157). This statement creates a common definition of fair value to be used throughout generally accepted accounting principles. Statement No. 157 will apply whenever another standard requires or permits assets or liabilities to be measured at fair value, with certain exceptions. The standard establishes a hierarchy for determining fair value which emphasizes the use of observable market data whenever available. The statement also requires expanded disclosures which include the extent to which assets and liabilities are measured at fair value, the methods and assumptions used to measure fair value and the effect of fair value measures on earnings. In October 2008, the FASB issued FASB Staff Position (FSP) FAS No. 157-3, *Determining the Fair Value of a Financial Asset When the Market for That Asset Is Not Active* (FSP FAS No. 157-3). This FSP clarifies how Statement No. 157 should be applied when valuing securities in markets that are not active. This Statement provides guidance on how companies may use judgment, in addition to market information, in certain circumstances to value assets which have inactive markets. This FSP is effective upon issuance, including prior periods that financial statements have not yet been issued. Statement No. 157 was effective for fiscal years beginning after November 15, 2007 and interim periods within those fiscal years. The difference between the carrying amounts and fair values of those financial instruments held at the date this statement is initially applied should be recognized as a cumulative effect adjustment to the opening balance of retained earnings for the fiscal year in which this statement is initially applied. Additionally, in February 2008, the FASB issued Staff Position FAS 157-2, *Effective Date of FASB Statement No. 157*, which delays the effective date of Statement No. 157 for all non-recurring fair value measurements of nonfinancial assets and nonfinancial liabilities until the fiscal year beginning after November 15, 2008. As a result, the Company has partially applied the provisions of Statement No. 157 upon adoption at January 1, 2008 and has deferred the adoption for certain nonfinancial assets and liabilities as allowed by this staff position. The effect of adopting Statement No. 157 and related FSP FAS No. 157-3 was not material to the Company s financial position or results of operations. See further disclosure in Note 8 Fair Value .

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In June 2006, the FASB issued Interpretation No. 48, *Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109* (FIN 48). The interpretation requires companies to recognize the tax benefits of uncertain tax positions only when the position is more likely than not to be sustained upon examination by tax authorities. The amount recognized would be the amount that represents the largest amount of tax benefit that is greater than 50% likely of being ultimately realized. A liability would be recognized for any benefit claimed, or expected to be claimed, in a tax return in excess of the benefit recorded in the financial statements, along with any interest and penalty on the excess. FIN 48 will require, among other items, a tabular reconciliation of the change during the reporting period, in the aggregate unrecognized tax benefits claimed or expected to be claimed in tax returns and disclosure relating to accrued interest and penalties for unrecognized tax benefits. Additional disclosure will also be required for those uncertain tax positions where it is reasonably possible that the estimate of the tax benefit will change significantly in the next twelve months. FIN 48 was effective for fiscal years beginning after December 15, 2006. The Company adopted FIN 48 as of January 1, 2007 which resulted in an increase to shareholders equity of $11.5 million. See further disclosure in Note 5 Federal Income Taxes .

3. Discontinued Operations of FAFLIC Business