PROASSURANCE CORP
Form 10-Q
May 09, 2016
Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q
(Mark One)
ý Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the quarterly period ended March 31, 2016 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 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 ý No ¨
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter), during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ý No ¨
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer ý	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 ý
As of April 29, 2016, there were 53,194,593 shares of the registrant's common stock outstanding.

Table of Contents

Glossary of Terms and Acronyms

When the following terms and acronyms appear in the text of this report, they have the meanings indicated below.

Term	Meaning
AOCI	Accumulated other comprehensive income (loss)
Board	Board of Directors of ProAssurance Corporation
BOLI	Business owned life insurance
Council of Lloyd's	The governing body for Lloyd's of London
DPAC	Deferred policy acquisition costs
Eastern Re	Eastern Re, LTD, S.P.C.
EBUB	Earned, but unbilled premium
FAL	Funds at Lloyd's
FASB	Financial Accounting Standards Board
FHLB	Federal Home Loan Bank
GAAP	Generally accepted accounting principles in the United States of America
HCPL	Healthcare professional liability
IRS	Internal Revenue Service
LLC	Limited liability company
Lloyd's	Lloyd's of London market
LP	Limited partnership
Medical Technology Liability	Medical technology and life sciences products liability
NAV	Net asset value
NYSE	New York Stock Exchange
NRSRO	Nationally recognized statistical rating organization
OCI	Other comprehensive income (loss)
OTTI	Other-than-temporary impairment
PCAOB	Public Company Accounting Oversight Board
Revolving Credit Agreement	ProAssurance's $250 million revolving credit agreement
ROE	Return on equity
SEC	Securities and Exchange Commission
SPC	Segregated portfolio cell
Specialty P&C	Specialty Property and Casualty
Syndicate 1729	Lloyd's of London Syndicate 1729
Syndicate Credit Agreement	Unconditional revolving credit agreement with the Premium Trust Fund of Syndicate 1729
TIPS	Treasury Inflation Protected Securities
U.K.	United Kingdom of Great Britain and Northern Ireland
ULAE	Unallocated loss adjustment expense
VIE	Variable interest entity

Table of Contents

Forward-Looking Statements

Any statements in this Form 10-Q 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," "likely," "may," "optimistic," "possible," "potential," "preliminary," "project," "should," "will" and other 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 10-Q that are identified as giving our outlook on future business.

Forward-looking statements relating to our business include among other things: statements concerning future liquidity and capital requirements, investment valuation and performance, return on equity, financial ratios, net income, premiums, losses and loss reserve, premium rates and retention of current business, competition and market conditions, the expansion of product lines, the development or acquisition of business, 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:

changes in general economic conditions, including the impact of inflation or deflation and unemployment;

our ability to maintain our dividend payments;

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

the enactment or repeal of tort reforms;

formation or dissolution of state-sponsored insurance entities providing coverages now offered by ProAssurance which could remove or add sizable numbers of insureds from or to the private insurance market;

changes in the interest rate environment;

changes in U.S. laws or government regulations regarding financial markets or market activity that may affect the U.S. economy and our business;

changes in the ability of the U.S. government to meet its obligations that may affect 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 requirements or accounting policies and practices that may be adopted by our regulatory agencies, the FASB, the SEC, the PCAOB, or the NYSE that may affect our business;

changes in laws or government regulations affecting the financial services industry, the property and casualty insurance industry or particular insurance lines underwritten by our subsidiaries;

the effect on our insureds, particularly the insurance needs of our insureds, and our loss costs, of changes in the healthcare delivery system, including changes attributable to the Patient Protection and Affordable Care Act;

consolidation of our insureds into or under larger entities which may be insured by competitors, or may not have a risk profile that meets our underwriting criteria or which may not use external providers for insuring or otherwise managing substantial portions of their liability risk;

uncertainties inherent in the estimate of our loss and loss adjustment expense reserve and reinsurance recoverable;

changes in the availability, cost, quality, or collectability of insurance/reinsurance;

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

effects on our claims costs from mass tort litigation that are different from that anticipated by us;

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

loss or consolidation of independent agents, agencies, brokers, or brokerage firms;

changes in our organization, compensation and benefit plans;

changes in the business or competitive environment may limit the effectiveness of our business strategy and impact our revenues;
our ability to retain and recruit senior management;

3

Table of Contents

- the availability, integrity and security of our technology infrastructure or that of our third-party providers of technology infrastructure, including any susceptibility to cyber-attacks which might result in a loss of information or operating capability;
- the impact of a catastrophic event, as it relates to both our operations and our insured risks;
- the impact of acts of terrorism and acts of war;
- the effects of terrorism-related insurance legislation and laws;
- assessments from guaranty funds;
- our ability to achieve continued growth through expansion into new markets or through acquisitions or business combinations;
- changes to the ratings assigned by rating agencies to our insurance subsidiaries, individually or as a group;
- provisions in our charter documents, Delaware law and state insurance laws may impede attempts to replace or remove management or may impede a takeover;
- state insurance restrictions may prohibit assets held by our insurance subsidiaries, including cash and investment securities, from being used for general corporate purposes;
- taxing authorities can take exception to our tax positions and cause us to incur significant amounts of legal and accounting costs and, if our defense is not successful, additional tax costs, including interest and penalties; and
- expected benefits from completed and proposed acquisitions may not be achieved or may be delayed longer than expected due to business disruption; loss of customers, employees or key agents; increased operating costs or inability to achieve cost savings; and assumption of greater than expected liabilities, among other reasons.

Additional risks that could arise from our membership in the Lloyd's of London market and our participation in Syndicate 1729 include, but are not limited to, the following:

- members of Lloyd's are subject to levies by the Council of Lloyd's based on a percentage of the member's underwriting capacity, currently a maximum of 3%, but can be increased by Lloyd's;
- Syndicate operating results can be affected by decisions made by the Council of Lloyd's over which the management of Syndicate 1729 has little ability to control, such as a decision to not approve the business plan of Syndicate 1729, or a decision to increase the capital required to continue operations, and by our obligation to pay levies to Lloyd's;
- Lloyd's insurance and reinsurance relationships and distribution channels could be disrupted or Lloyd's trading licenses could be revoked making it more difficult for Syndicate 1729 to distribute and market its products;
- rating agencies could downgrade their ratings of Lloyd's as a whole; and
- Syndicate 1729 operations are dependent on a small, specialized management team and the loss of their services could adversely affect the Syndicate’s business. The inability to identify, hire and retain other highly qualified personnel in the future, could adversely affect the quality and profitability of Syndicate 1729’s business.

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 Form 10-K and other documents we file with the SEC, such as our current reports on Form 8-K, and our regular reports on Form 10-Q.

We caution readers not to place undue reliance on any such forward-looking statements, which are based upon conditions existing only as of the date made, and advise readers that these factors 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.

TABLE OF CONTENTS

PART I. FINANCIAL INFORMATION

ITEM 1.	FINANCIAL STATEMENTS	
	CONDENSED CONSOLIDATED BALANCE SHEETS (UNAUDITED) - MARCH 31, 2016 AND DECEMBER 31, 2015	6
	CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN CAPITAL (UNAUDITED) - THREE MONTHS ENDED MARCH 31, 2016 AND 2015	7
	CONDENSED CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME (UNAUDITED) - THREE MONTHS ENDED MARCH 31, 2016 AND 2015	8
	CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED) - THREE MONTHS ENDED MARCH 31, 2016 AND 2015	9
	NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)	11
ITEM 2.	MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS	37
ITEM 3.	QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK	80
ITEM 4.	CONTROLS AND PROCEDURES	82

PART II. OTHER INFORMATION

ITEM 1.	LEGAL PROCEEDINGS	82
ITEM 1A.	RISK FACTORS	82
ITEM 2.	UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS	82
ITEM 6.	EXHIBITS	83
SIGNATURE		84

Table of Contents

ProAssurance Corporation and Subsidiaries
Condensed Consolidated Balance Sheets (Unaudited)
(In thousands, except share data)

	March 31, 2016	December 31, 2015
Assets		
Investments		
Fixed maturities, available for sale, at fair value; amortized cost, $2,681,385 and $2,722,063, respectively	$2,755,209	$2,760,287
Equity securities, trading, at fair value; cost, $324,731 and $319,320, respectively	328,472	322,353
Short-term investments	148,355	119,236
Business owned life insurance	57,672	57,213
Investment in unconsolidated subsidiaries	327,867	311,908
Other investments, $30,494 and $30,611 at fair value, respectively, otherwise at cost or amortized cost	80,700	79,133
Total Investments	3,698,275	3,650,130
Cash and cash equivalents	197,312	241,100
Premiums receivable	219,883	217,034
Receivable from reinsurers on paid losses and loss adjustment expenses	17,881	9,249
Receivable from reinsurers on unpaid losses and loss adjustment expenses	245,403	249,350
Prepaid reinsurance premiums	40,443	34,050
Deferred policy acquisition costs	44,958	44,388
Deferred tax asset, net	877	15,097
Real estate, net	38,450	38,470
Intangible assets	90,394	92,462
Goodwill	210,725	210,725
Other assets	89,898	103,966
Total Assets	$4,894,499	$4,906,021
Liabilities and Shareholders' Equity		
Liabilities		
Policy liabilities and accruals		
Reserve for losses and loss adjustment expenses	$2,005,770	$2,005,326
Unearned premiums	387,085	362,066
Reinsurance premiums payable	29,513	30,114
Total Policy Liabilities	2,422,368	2,397,506
Other liabilities	139,673	202,303
Debt less debt issuance costs	347,944	347,858
Total Liabilities	2,909,985	2,947,667
Shareholders' Equity		
Common shares, par value $0.01 per share, 100,000,000 shares authorized, 62,631,713 and 62,503,255 shares issued, respectively	626	625
Additional paid-in capital	366,727	365,399
Accumulated other comprehensive income (loss), net of deferred tax expense (benefit) of $25,232 and $12,972, respectively	47,115	23,855
Retained earnings	1,990,907	1,988,035
Treasury shares, at cost, 9,430,366 shares and 9,402,697 shares, respectively	(420,861)	(419,560)
Total Shareholders' Equity	1,984,514	1,958,354
Total Liabilities and Shareholders' Equity	$4,894,499	$4,906,021

See accompanying notes.

6

Table of Contents

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

	Common Stock	Additional Paid-in Capital	Accumulated Other Comprehensive Income (Loss)	Retained Earnings	Treasury Stock	Total
Balance at December 31, 2015	$ 625	$365,399	$ 23,855	$1,988,035	$(419,560)	$1,958,354
Common shares reacquired	—	—	—	—	(1,301)	(1,301)
Common shares issued for compensation and effect of shares reissued to stock purchase plan	—	1,509	—	—	—	1,509
Share-based compensation	—	2,715	—	—	—	2,715
Net effect of restricted and performance shares issued and stock options exercised	1	(2,896)	—	—	—	(2,895)
Dividends to shareholders	—	—	—	(16,445)	—	(16,445)
Other comprehensive income (loss)	—	—	23,260	—	—	23,260
Net income	—	—	—	19,317	—	19,317
Balance at March 31, 2016	$ 626	$366,727	$ 47,115	$1,990,907	$(420,861)	$1,984,514

	Common Stock	Additional Paid-in Capital	Accumulated Other Comprehensive Income (Loss)	Retained Earnings	Treasury Stock	Total
Balance at December 31, 2014	$ 623	$359,577	$ 58,204	$1,991,704	$(252,164)	$2,157,944
Common shares reacquired	—	—	—	—	(57,157)	(57,157)
Common shares issued for compensation and effect of shares reissued to stock purchase plan	—	1,270	—	—	—	1,270
Share-based compensation	—	2,703	—	—	—	2,703
Net effect of restricted and performance shares issued and stock options exercised	2	(4,415)	—	—	—	(4,413)
Dividends to shareholders	—	—	—	(17,190)	—	(17,190)
Other comprehensive income (loss)	—	—	7,673	—	—	7,673
Net income	—	—	—	37,814	—	37,814
Balance at March 31, 2015	$ 625	$359,135	$ 65,877	$2,012,328	$(309,321)	$2,128,644

See accompanying notes.

Table of Contents

ProAssurance Corporation and Subsidiaries
Condensed Consolidated Statements of Income and Comprehensive Income (Unaudited)
(In thousands, except per share data)

	Three Months Ended March 31	
	2016	2015
Revenues		
Net premiums earned	$ 177,579	$ 171,899
Net investment income	25,440	27,304
Equity in earnings (loss) of unconsolidated subsidiaries	(3,634)	1,622
Net realized investment gains (losses):		
Other-than-temporary impairment (OTTI) losses	(10,734)	(3,271)
Portion of OTTI losses recognized in other comprehensive income before taxes	1,068	1,441
Net impairment losses recognized in earnings	(9,666)	(1,830)
Other net realized investment gains (losses)	1,314	6,669
Total net realized investment gains (losses)	(8,352)	4,839
Other income	2,354	2,169
Total revenues	193,387	207,833
Expenses		
Losses and loss adjustment expenses	128,186	118,169
Reinsurance recoveries	(17,231)	(13,029)
Net losses and loss adjustment expenses	110,955	105,140
Underwriting, policy acquisition and operating expenses	56,889	51,356
Segregated portfolio cells dividend expense (income)	1,176	2,184
Interest expense	3,686	3,631
Total expenses	172,706	162,311
Income before income taxes	20,681	45,522
Provision for income taxes		
Current expense (benefit)	(651)	352
Deferred expense (benefit)	2,015	7,356
Total income tax expense (benefit)	1,364	7,708
Net income	19,317	37,814
Other comprehensive income (loss), after tax, net of reclassification adjustments	23,260	7,673

Comprehensive income	$	42,577	$	45,487
Earnings per share:				
Basic	$	0.36	$	0.67
Diluted	$	0.36	$	0.67
Weighted average number of common shares outstanding:				
Basic	53,157		56,592	
Diluted	53,346		56,813	
Cash dividends declared per common share	$	0.31	$	0.31

See accompanying notes.

Table of Contents

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

	Three Months Ended March 31	
	2016	2015
Operating Activities		
Net income	$19,317	$37,814
Adjustments to reconcile income to net cash provided by operating activities:		
Depreciation and amortization, net of accretion	8,853	9,568
(Increase) decrease in cash surrender value of BOLI	(460)	(456)
Net realized investment (gains) losses	8,352	(4,839)
Share-based compensation	2,715	2,703
Deferred income taxes	2,015	7,356
Policy acquisition costs, net amortization (net deferral)	(570)	(2,164)
Equity in earnings of unconsolidated subsidiaries, excluding income distributions received	3,411	(899)
Other	971	(983)
Other changes in assets and liabilities, excluding effect of business combinations:		
Premiums receivable	(2,849)	(6,744)
Reinsurance related assets and liabilities*	(11,679)	(1,346)
Other assets	15,782	(3,919)
Reserve for losses and loss adjustment expenses	444	(14,036)
Unearned premiums	25,019	27,623
Other liabilities	(14,339)	(12,835)
Net cash provided (used) by operating activities*	56,982	36,843
Investing Activities		
Purchases of:		
Fixed maturities, available for sale	(199,590)	(215,122)
Equity securities, trading	(23,746)	(97,626)
Other investments	(9,623)	(9,288)
Funding of qualified affordable housing tax credit limited partnerships	(702)	(590)
Investment in unconsolidated subsidiaries	(20,581)	(15,416)
Proceeds from sales or maturities of:		
Fixed maturities, available for sale	225,897	323,386
Equity securities, trading	20,496	82,984
Other investments	4,830	3,052
Distributions from unconsolidated subsidiaries	1,643	4,159
Net sales or maturities (purchases) of short-term investments	(29,130)	16,479
Unsettled security transactions, net change	(229)	9,246
Other	(1,100)	(2,857)
Net cash provided (used) by investing activities	(31,835)	98,407

Continued on following page.

Table of Contents

	Three Months Ended March 31	
	2016	2015
Financing Activities		
Borrowing under revolving credit agreement	—	100,000
Repurchase of common stock	(1,301)	(57,157)
Dividends to shareholders	(69,438)	(167,211)
External capital contribution received for segregated portfolio cells	4,336	—
Other	(2,532)	(4,346)
Net cash provided (used) by financing activities	(68,935)	(128,714)
Increase (decrease) in cash and cash equivalents	(43,788)	6,536
Cash and cash equivalents at beginning of period	241,100	197,040
Cash and cash equivalents at end of period	$197,312	$203,576
Significant non-cash transactions		
Dividends declared and not yet paid	$16,445	$17,190

*Reflects receipt of proceeds from a commutation with Syndicate 1729 of $16.0 million. Due to the reporting delay, ProAssurance's pro rata share ($9.2 million) of the offsetting disbursement made by Syndicate 1729 will be recorded in the second quarter of 2016.

See accompanying notes.

1. Basis of Presentation

The accompanying unaudited Condensed Consolidated Financial Statements include the accounts of ProAssurance Corporation and its consolidated subsidiaries (ProAssurance, PRA or the Company). The financial statements have been prepared in accordance with 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. ProAssurance's results for the three-month period ended March 31, 2016 are not necessarily indicative of the results that may be expected for the year ending December 31, 2016. The accompanying Condensed Consolidated Financial Statements should be read in conjunction with the Consolidated Financial Statements and Notes contained in ProAssurance's December 31, 2015 report on Form 10-K. In connection with its preparation of the Condensed Consolidated Financial Statements, ProAssurance evaluated events that occurred subsequent to March 31, 2016 for recognition or disclosure in its financial statements and notes to financial statements.

ProAssurance operates in four reportable segments as follows: Specialty P&C, Workers' Compensation, Lloyd's Syndicate, and Corporate. For more information on the nature of products and services provided and for financial information by segment, refer to Note 12 of the Notes to Condensed Consolidated Financial Statements.

Reclassifications

On January 1, 2016 in accordance with adopted guidance, ProAssurance began presenting debt issuance costs as a direct deduction from the carrying amount of debt on the Condensed Consolidated Balance Sheet, and the December 31, 2015 Condensed Consolidated Balance Sheet has been conformed to the current presentation. Previously, debt issuance costs ($2.1 million at December 31, 2015) were reported in Other assets.

Other Liabilities

Other liabilities consisted of the following:

(In millions)	March 31, 2016	December 31, 2015
SPC dividends payable	$ 23.1	$ 16.7
Unpaid dividends	16.4	69.4
All other	100.2	116.2
Total other liabilities	$ 139.7	$ 202.3

SPC dividends payable are the cumulative undistributed earnings contractually payable to the external preferred shareholders of SPCs operated by ProAssurance's Cayman Islands subsidiary, Eastern Re.

Unpaid dividends represent common stock dividends declared by ProAssurance's Board of Directors that had not yet been paid. Unpaid dividends at December 31, 2015 reflect a special dividend declared in late 2015 that was paid in January 2016.

Table of Contents
ProAssurance Corporation and Subsidiaries
Notes to Condensed Consolidated Financial Statements (Unaudited)
March 31, 2016

Accounting Changes Adopted
Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved After the Requisite Service Period
Effective for fiscal years beginning after December 15, 2015, the FASB issued guidance for share-based payments in which the terms of the award provide that a performance target can be achieved after completion of the requisite service period. The new guidance provides that compensation cost for such awards is to be recognized in the period in which it becomes probable that the performance target will be achieved and is to represent the compensation cost attributable to the period(s) for which the requisite service has already been rendered. ProAssurance adopted the guidance as of January 1, 2016. Adoption of the guidance had no effect on ProAssurance’s results of operations or financial position as ProAssurance has no awards with performance targets extending beyond the requisite service period.
Simplifying the Presentation of Debt Issuance Costs
Effective for fiscal years beginning after December 15, 2015, the FASB issued guidance related to the presentation of debt issuance costs. The new guidance requires that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts. Related guidance issued by the SEC permits issuance costs associated with line-of-credit arrangements to be presented as an asset and subsequently amortized proportionally over the term of the arrangement. ProAssurance adopted the guidance as of January 1, 2016. Adoption of the guidance had no material effect on ProAssurance’s results of operations or financial position as it affected disclosure only.
Amendments to the Consolidation Analysis
Effective for fiscal years beginning after December 15, 2015, the FASB issued additional guidance regarding the consolidation of legal entities such as limited partnerships, limited liability corporations, and securitization structures (collateralized debt obligations, collateralized loan obligations, and mortgage-backed security transactions). The new standard modifies the evaluation of whether or not entities are VIEs and the consolidation analysis to be performed by entities involved with VIEs, particularly VIE's for which there are fee arrangements and related party relationships. ProAssurance retrospectively adopted the guidance as of January 1, 2016. Adoption of the guidance had no material effect on ProAssurance’s results of operations or financial position as it affected disclosure only.
Customer’s Accounting for Fees Paid in a Cloud Computing Arrangement
Effective for fiscal years beginning after December 15, 2015, the FASB issued additional guidance regarding accounting for cloud computing arrangements. Under the new guidance, the software license elements of cloud computing arrangements are to be accounted for in a manner that is consistent with the acquisition of other software licenses. Cloud computing arrangements that do not include a software license are to be accounted for as a service contract, following existing guidance for service contracts. ProAssurance adopted the guidance on a prospective basis as of January 1, 2016. Adoption of the guidance had no material effect on ProAssurance’s results of operations or financial position.
Disclosures about Short-Duration Contracts
Effective for fiscal years beginning after December 15, 2015 and interim periods within fiscal years beginning after December 15, 2016, the FASB issued guidance that requires insurance entities that issue short-duration contracts to provide detailed disclosures relative to the reserve for losses and loss adjustment expenses in annual reporting periods and a roll-forward of the reserve for losses and loss adjustment expenses in interim reporting periods. The guidance also requires disclosures regarding significant changes in the methodologies and assumptions used to calculate the reserve for losses and loss adjustment expenses, including reasons for and the effects of such changes. ProAssurance adopted the guidance as of January 1, 2016. Adoption of the guidance affects disclosures for the fiscal year 2016 and interims periods thereafter and is not expected to have a material effect on ProAssurance's results of operations or financial position.

12

Table of Contents

Simplifying the Accounting for Measurement-Period Adjustments
Effective for fiscal years beginning after December 15, 2015 and interim periods within those fiscal years, the FASB issued guidance that requires an acquirer to recognize adjustments to estimated amounts that are identified during the measurement period in the reporting period in which the adjustment amounts are determined. An acquirer must also record, in the same period's financial statements, the effect on earnings of changes in depreciation, amortization, or other income effects, if any, as a result of the change to the estimated amounts, calculated as if the accounting had been completed at the acquisition date. The amendments also require an entity to present separately on the face of the income statement or disclose in the notes the portion of the amount recorded in current-period earnings by line item that would have been recorded in previous reporting periods if the adjustment to the estimated amounts had been recognized as of the acquisition date. ProAssurance adopted the guidance as of January 1, 2016. Adoption of the guidance had no material effect on ProAssurance's results of operations or financial position.
Accounting Changes Not Yet Adopted
Revenue from Contracts with Customers
Effective for fiscal years beginning after December 15, 2017, the FASB issued guidance related to revenue from contracts with customers. The core principle of the new guidance is that revenue is recognized to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. ProAssurance plans to adopt the guidance beginning January 1, 2018. As the majority of ProAssurance's revenues come from insurance contracts which fall under the scope of other FASB standards, adoption of the guidance is expected to have no material effect on ProAssurance's results of operations or financial position.
Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern
Effective for fiscal years ending after December 15, 2016 and interim periods beginning after December 15, 2016, the FASB issued guidance that establishes principles and definitions related to management's evaluation of whether there is substantial doubt about the organization's ability to continue as a going concern. For each interim and annual reporting period, the new guidance requires management to evaluate the organization's ability to meet its obligations as they are due within one year of the date the financial statements are issued and requires disclosure when there is substantial doubt regarding the organization's ability to continue as a going concern. ProAssurance plans to adopt the guidance on its effective date. Adoption is expected to have no effect on ProAssurance's results of operations or financial position.
Recognition and Measurement of Financial Assets and Financial Liabilities
Effective for fiscal years beginning after December 15, 2017 and interim periods within those fiscal years, the FASB issued guidance that requires equity investments (except those accounted for under the equity method of accounting, or those that result in consolidation of the investee) to be measured at fair value with changes in fair value recognized in net income. The new guidance also specifies that an entity use the exit price notion when measuring the fair value of financial instruments for disclosure purposes and present financial assets and liabilities by measurement category and form of financial asset. Other provisions of the new guidance include: revised disclosure requirements related to the presentation in comprehensive income of changes in the fair value of liabilities; elimination, for public companies, of disclosure requirements relative to the method(s) and significant assumptions underlying fair values disclosed for financial instruments measured at amortized cost; and simplified impairment assessments for equity investments without readily determinable fair values. ProAssurance plans to adopt the guidance beginning January 1, 2018. Adoption of the guidance is not expected to have a material effect on ProAssurance's results of operations or financial position.
Leases
Effective for fiscal years beginning after December 15, 2018 and interim periods within those fiscal years, the FASB issued guidance that requires a lessee to recognize for all leases (with the exception of short-term leases) a lease

liability, which is a lessee's obligation to make lease payments arising from a lease, measured on a discounted basis, and a right-of-use asset, which is an asset that represents the lessee's right to use, or control the use of, a specified asset for the lease term. ProAssurance plans to adopt the guidance beginning January 1, 2019. Adoption of the guidance is not expected to have a material effect on ProAssurance's results of operations or financial position as ProAssurance does not have any material leases.

Simplifying the Transition to the Equity Method of Accounting

Effective for fiscal years beginning after December 15, 2016 and interim periods within those fiscal years, the FASB issued guidance that eliminates the requirement for retroactive restatement when an investment qualifies for use of the equity method as a result of an increase in the level of ownership interest or degree of influence. The new guidance provides that the cost of acquiring an additional interest in an investee is to be added to the current basis of an investor's previously held interest and the equity method of accounting adopted as of the date the investment becomes qualified for equity method accounting with no retroactive adjustment of the investment. If an available-for-sale equity security qualifies for the equity method of accounting the unrealized holding gain or loss in accumulated other comprehensive income is to be recognized through earnings at the date the investment becomes qualified for use of the equity method. ProAssurance plans to adopt the guidance beginning January 1, 2017. Adoption of the guidance is not expected to have a material effect on ProAssurance's results of operations or financial position.

Improvements to Employee Share-Based Payment Accounting

Effective for fiscal years beginning after December 15, 2016 and interim periods within those fiscal years, the FASB issued guidance that simplifies several aspects of the accounting for share-based payment transactions, including the income tax consequences, classification of cash flows, and the classification of awards as either equity or liabilities. Under the new guidance, the difference between the deduction for tax purposes and the compensation cost recognized for financial reporting purposes is to be recognized as income tax expense in the current period and included with other income tax cash flows as an operating activity. Also the threshold for equity classification has been revised to permit withholdings up to the maximum statutory tax rates in the applicable jurisdictions. ProAssurance plans to adopt the guidance beginning January 1, 2017. Adoption of the guidance is not expected to have a material effect on ProAssurance's results of operations or financial position.

Table of Contents
ProAssurance Corporation and Subsidiaries
Notes to Condensed Consolidated Financial Statements (Unaudited)
March 31, 2016

2. Fair Value Measurement

Fair value is defined 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. A three level hierarchy has been established 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 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 or liabilities, and results from pricing models that use 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 based on the best information available in the circumstances (non-observable 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 for which some or all of the inputs are not observable, discounted cash flow methodologies, single non-binding broker quotes and adjustments to externally quoted prices that are based on management judgment or estimation.

Fair values of assets measured at fair value on a recurring basis as of March 31, 2016 and December 31, 2015 are shown in the following tables. Where applicable, the tables also indicate the fair value hierarchy of the valuation techniques utilized to determine those fair values. 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 based on the level of the most significant input to the fair value measurement. Assessments of the significance of a particular input to the fair value measurement require judgment and consideration of factors specific to the assets being valued.

Table of Contents
ProAssurance Corporation and Subsidiaries
Notes to Condensed Consolidated Financial Statements (Unaudited)
March 31, 2016

	March 31, 2016 Fair Value Measurements Using			Total
(In thousands)	Level 1	Level 2	Level 3	Fair Value
Assets:				
Fixed maturities, available for sale				
U.S. Treasury obligations	$—	$148,307	$—	$148,307
U.S. Government-sponsored enterprise obligations	—	26,478	—	26,478
State and municipal bonds	—	902,329	—	902,329
Corporate debt, multiple observable inputs	2,409	1,258,042	—	1,260,451
Corporate debt, limited observable inputs	—	—	13,649	13,649
Residential mortgage-backed securities	—	263,834	—	263,834
Agency commercial mortgage-backed securities	—	13,716	—	13,716
Other commercial mortgage-backed securities	—	26,238	—	26,238
Other asset-backed securities	—	96,119	4,088	100,207
Equity securities				
Financial	71,380	—	—	71,380
Utilities/Energy	42,003	—	—	42,003
Consumer oriented	57,890	—	—	57,890
Industrial	50,531	—	—	50,531
Bond funds	75,862	—	—	75,862
All other	16,100	14,706	—	30,806
Short-term investments	144,335	2,462	1,558	148,355
Other investments	2,874	27,620	—	30,494
Total assets categorized within the fair value hierarchy	$463,384	$2,779,851	$19,295	3,262,530
LP/LLC interests carried at NAV which approximates fair value. These interests, reported as a part of Investment in unconsolidated subsidiaries, are not categorized within the fair value hierarchy.				177,830
Total assets at fair value				$3,440,360

Table of Contents

ProAssurance Corporation and Subsidiaries
Notes to Condensed Consolidated Financial Statements (Unaudited)
March 31, 2016

	December 31, 2015 Fair Value Measurements Using			Total
(In thousands)	Level 1	Level 2	Level 3	Fair Value
Assets:				
Fixed maturities, available for sale				
U.S. Treasury obligations	$—	$123,892	$—	$123,892
U.S. Government-sponsored enterprise obligations	—	26,334	—	26,334
State and municipal bonds	—	940,635	—	940,635
Corporate debt, multiple observable inputs	2,362	1,274,824	—	1,277,186
Corporate debt, limited observable inputs	—	—	14,500	14,500
Residential mortgage-backed securities	—	238,387	—	238,387
Agency commercial mortgage-backed securities	—	10,999	—	10,999
Other commercial mortgage-backed securities	—	30,134	—	30,134
Other asset-backed securities	—	97,463	757	98,220
Equity securities				
Financial	67,764	—	—	67,764
Utilities/Energy	41,050	—	—	41,050
Consumer oriented	56,470	—	—	56,470
Industrial	48,305	—	—	48,305
Bond funds	76,316	—	—	76,316
All other	18,239	14,209	—	32,448
Short-term investments	86,271	32,965	—	119,236
Other investments	3,478	27,133	—	30,611
Total assets categorized within the fair value hierarchy	$400,255	$2,816,975	$15,257	3,232,487
LP/LLC interests carried at NAV which approximates fair value. These interests, reported as a part of Investment in unconsolidated subsidiaries, are not categorized within the fair value hierarchy.				162,624
Total assets at fair value				$3,395,111

The fair values for securities included in the Level 2 category, with the few exceptions described below, were developed by one of several third party, nationally recognized pricing services, including services that price only certain types of securities. Each service uses complex methodologies to determine values for securities and subject the values they develop to quality control reviews. Management selected a primary source for each type of security in the portfolio and reviewed the values provided for reasonableness by comparing data to alternate pricing services and to available market and trade data. Values that appeared inconsistent were further reviewed for appropriateness. Any value that did not appear reasonable was discussed with the service that provided the value and would have been adjusted, if necessary. No such adjustments were necessary in 2016 or 2015.

Level 2 Valuations

Below is a summary description of the valuation methodologies primarily used by the pricing services for securities in the Level 2 category, by security type:

U.S. Treasury obligations were valued based on quoted prices for identical assets, or, in markets that are not active, quotes for similar assets, taking into consideration adjustments for variations in contractual cash flows and yields to maturity.

U.S. Government-sponsored enterprise obligations were valued using pricing models that consider current and historical market data, normal trading conventions, credit ratings, and the particular structure and characteristics of the

security being valued, such as yield to maturity, redemption options, and contractual cash flows. Adjustments to model inputs or model results were included in the valuation process when necessary to reflect recent regulatory, government or corporate actions or significant economic, industry or geographic events affecting the security's fair value.

State and municipal bonds were valued using a series of matrices that considered credit ratings, the structure of the security, the sector in which the security falls, yields, and contractual cash flows. Valuations were further adjusted, when necessary, to reflect the expected effect on fair value of recent significant economic or geographic events or ratings changes.

Corporate debt with multiple observable inputs consisted primarily of corporate bonds, but also included a small number of bank loans. The methodology used to value Level 2 corporate bonds was the same as the methodology previously described for U.S. Government-sponsored enterprise obligations. Bank loans were valued based on an average of broker quotes for the loans in question, if available. If quotes were not available, the loans were valued based on quoted prices for comparable loans or, if the loan was newly issued, by comparison to similar seasoned issues. Broker quotes were compared to actual trade prices on a regular basis to permit assessment of the reliability of the quotes; unreliable quotes were not considered in quoted averages.

Residential and commercial mortgage backed securities. Agency pass-through securities were valued using a pricing matrix which considers the issuer type, coupon rate and longest cash flows outstanding. The matrix used was based on the most recently available market information. Agency and non-agency collateralized mortgage obligations were both valued using models that consider the structure of the security, current and historical information regarding prepayment speeds, ratings and ratings updates, and current and historical interest rate and interest rate spread data.

Other asset-backed securities were valued using models that consider the structure of the security, monthly payment information, current and historical information regarding prepayment speeds, ratings and ratings updates, and current and historical interest rate and interest rate spread data. Spreads and prepayment speeds consider collateral type.

Equity securities were securities not traded on an exchange on the valuation date. The securities were valued using the most recently available quotes for the securities.

Short-term investments are securities maturing within one year, carried at cost which approximated the fair value of the security due to the short term to maturity.

Other investments consisted primarily of convertible bonds valued using a pricing model that incorporated selected dealer quotes as well as current market data regarding equity prices and risk free rates. If dealer quotes were unavailable for the security being valued, quotes for securities with similar terms and credit status were used in the pricing model. Dealer quotes selected for use were those considered most accurate based on parameters such as underwriter status and historical reliability.

Level 3 Valuations

Below is a summary description of the valuation processes and methodologies used as well as quantitative information regarding securities in the Level 3 category.

Level 3 Valuation Processes

- Level 3 securities are priced by the Chief Investment Officer.
- Level 3 valuations are computed quarterly. Prices are evaluated quarterly against prior period prices and the expected change in price.
- ProAssurance Level 3 securities are primarily NRSRO rated debt instruments for which comparable market inputs are commonly available for evaluating the securities in question. Valuation of these debt instruments is not overly sensitive to changes in the unobservable inputs used.

Table of Contents
ProAssurance Corporation and Subsidiaries
Notes to Condensed Consolidated Financial Statements (Unaudited)
March 31, 2016

Level 3 Valuation Methodologies
Corporate debt with limited observable inputs consisted of corporate bonds valued using dealer quotes for similar securities or discounted cash flow models using yields currently available for similar securities. Similar securities are defined as securities of comparable credit quality that have like terms and payment features. Assessments of credit quality were based on NRSRO ratings, if available, or were subjectively determined by management if not available. At March 31, 2016, 83% of the securities were rated; the average rating was A-. At December 31, 2015, 83% of the securities were rated; the average rating was A-.
Other asset-backed securities consisted of securitizations of receivables valued using dealer quotes for similar securities or discounted cash flow models using yields currently available for similar securities.
Short-term investments consisted of corporate bonds valued using dealer quotes for similar securities or discounted cash flow models using yields currently available for similar securities. Similar securities are defined as securities of comparable credit quality that have like terms and payment features.
Quantitative Information Regarding Level 3 Valuations

(In millions)	Fair Value at March 31, 2016	December 31, 2015	Valuation Technique	Unobservable Input	Range (Weighted Average)
Assets:					
Corporate debt with limited observable inputs	$13.6	$14.5	Market Comparable Securities	Comparability Adjustment	0% - 5% (2.5%)
			Discounted Cash Flows	Comparability Adjustment	0% - 5% (2.5%)
Other asset-backed securities	$4.1	$0.8	Market Comparable Securities	Comparability Adjustment	0% - 5% (2.5%)
			Discounted Cash Flows	Comparability Adjustment	0% - 5% (2.5%)
Short-term investments	$1.6	$—	Market Comparable Securities	Comparability Adjustment	0% - 5% (2.5%)
			Discounted Cash Flows	Comparability Adjustment	0% - 5% (2.5%)

The significant unobservable inputs used in the fair value measurement of the above listed securities were the valuations of comparable securities with similar issuers, credit quality and maturity. Changes in the availability of comparable securities could result in changes in the fair value measurements.

Table of Contents
ProAssurance Corporation and Subsidiaries
Notes to Condensed Consolidated Financial Statements (Unaudited)
March 31, 2016

Fair Value Measurements - Level 3 Assets
The following tables (the Level 3 Tables) present summary information regarding changes in the fair value of assets measured at fair value using Level 3 inputs.

	March 31, 2016				
	Level 3 Fair Value Measurements – Assets				
(In thousands)	State and Municipal Bonds	Corporate Debt	Asset-backed Securities	All other investments	Total
Balance December 31, 2015	$ —	$ 14,500	$ 757	$ —	$ 15,257
Total gains (losses) realized and unrealized:					
Included in earnings, as a part of:					
Net investment income	—	(14)	—	(1)	(15)
Net realized investment gains (losses)	—	(75)	—	—	(75)
Included in other comprehensive income	—	(75)	(2)	(1)	(78)
Purchases	—	—	3,500	1,560	5,060
Sales	—	(681)	(167)	—	(848)
Transfers in	—	—	—	—	—
Transfers out	—	(6)	—	—	(6)
Balance March 31, 2016	$ —	$ 13,649	$ 4,088	$ 1,558	$ 19,295
Change in unrealized gains (losses) included in earnings for the above period for Level 3 assets held at period-end	$ —	$ —	$ —	$ —	$ —

	March 31, 2015				
	Level 3 Fair Value Measurements – Assets				
(In thousands)	State and Municipal Bonds	Corporate Debt	Asset-backed Securities	All other investments	Total
Balance December 31, 2014	$ 5,025	$ 13,081	$ 4,769	$ —	$ 22,875
Total gains (losses) realized and unrealized:					
Included in earnings, as a part of:					
Net investment income	—	17	—	—	17
Net realized investment gains (losses)	—	2	—	—	2
Included in other comprehensive income	—	(283)	19	—	(264)
Purchases	—	1,516	—	—	1,516
Sales	—	(301)	—	—	(301)
Transfers in	—	—	—	—	—
Transfers out	—	(4,055)	—	—	(4,055)
Balance March 31, 2015	$ 5,025	$ 9,977	$ 4,788	$ —	$ 19,790
Change in unrealized gains (losses) included in earnings for the above period for Level 3 assets held at period-end	$ —	$ —	$ —	$ —	$ —

Transfers

There were no transfers between the Level 1 and Level 2 categories during the three months ended March 31, 2016 or 2015.

Transfers shown in the preceding Level 3 tables were as of the end of the period in which the transfer occurred. All transfers were to or from Level 2.

All transfers during the three months ended March 31, 2016 and 2015 related to securities held for which the level of market activity for identical or nearly identical securities varies from period to period. The securities were valued using multiple observable inputs when those inputs were available; otherwise the securities were valued using limited observable inputs.

Fair Values Not Categorized

Investments in unconsolidated subsidiaries at both March 31, 2016 and December 31, 2015 included interests in investment fund LPs/LLCs that measure fund assets at fair value on a recurring basis and that provide a NAV for the interest. The carrying value of these interests is based on the NAV provided, and was considered to approximate the fair value of the interests. In accordance with GAAP, the fair value of these investments was not classified within the fair value hierarchy. Additional information regarding these investments is as follows:

	Unfunded Commitments	Fair Value	
(In thousands)	March 31, 2016	March 31, 2016	December 31, 2015
Investments in LPs/LLCs:			
Private debt funds (1)	$10,799	$52,860	$ 50,268
Long equity fund (2)	None	5,945	6,407
Long/short equity funds (3)	None	28,521	28,030
Non-public equity funds (4)	$46,443	68,734	65,722
Multi-strategy fund of funds (5)	None	7,975	8,252
Structured credit fund (6)	None	3,748	3,945
Long/short commodities fund (7)	None	10,047	—
		$177,830	$ 162,624

(1) Comprised of interests in two unrelated LP funds that are structured to provide interest distributions primarily through diversified portfolios of private debt instruments. One LP allows redemption by special consent; the other does not permit redemption. Income and capital are to be periodically distributed at the discretion of the LPs over an anticipated time frame that spans from 3 to 8 years.

(2) The fund is a LP that holds long equities of public international companies. Redemptions are allowed at the end of any calendar month with a prior notice requirement of 15 days and are paid within 10 days of the end of the calendar month of the redemption request.

(3) Comprised of interests in multiple unrelated LP funds. The funds hold primarily long and short North American equities, and target absolute returns using strategies designed to take advantage of market opportunities. The funds generally permit quarterly or semi-annual capital redemptions subject to notice requirements of 30 to 90 days. For some funds, redemptions above specified thresholds (lowest threshold is 90%) may be only partially payable until after a fund audit is completed and are then payable within 30 days.

(4) Comprised of interests in three unrelated LP funds, each structured to provide capital appreciation through diversified investments in private equity, which can include investments in buyout, venture capital, mezzanine debt, distressed debt and other private equity-oriented LPs. One LP allows redemption by special consent; the others do not permit redemption. Income and capital are to be periodically distributed at the discretion of the LP over time frames that are anticipated to span up to 9 years.

(5) This fund is a LLC structured to build and manage low volatility, multi-manager portfolios that have little or no correlation to the broader fixed income and equity security markets. Redemptions are not permitted but offers to repurchase units of the LLC may be extended periodically.

(6) This fund is a LP seeking to obtain superior risk-adjusted absolute returns by acquiring and actively managing a diversified portfolio of debt securities, including bonds, loans and other asset-backed instruments. Redemptions are allowed at any quarter-end with a prior notice requirement of 90 days.

(7) This fund is a LLC invested across a broad range of commodities and focuses primarily on market neutral, relative value strategies, seeking to generate absolute returns with low correlation to broad commodity, equity and fixed income markets. Following an initial one year lock-up period, redemptions are allowed with a prior notice

requirement of 30 days and are payable within 30 days.

ProAssurance may not sell, transfer or assign its interest in any of the above LPs/LLCs without special consent from the LP/LLC.

Financial Instruments - Methodologies Other Than Fair Value

The following table provides the estimated fair value of our financial instruments that, in accordance with GAAP for the type of investment, are measured using a methodology other than fair value. All fair values provided fall within the Level 3 fair value category.

(In thousands)	March 31, 2016		December 31, 2015	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Financial assets:				
BOLI	$57,672	$57,672	$57,213	$57,213
Other investments	50,206	53,803	48,522	51,646
Other assets	23,722	23,707	24,215	24,193
Financial liabilities:				
Senior notes due 2023	$250,000	$270,355	$250,000	$261,308
Revolving credit agreement	100,000	100,000	100,000	100,000
Other liabilities	15,029	15,027	14,897	14,893

The fair value of the BOLI was equal to the cash surrender value associated with the policies on the valuation date.

Other investments listed in the table above include interests in certain investment fund LPs/LLCs accounted for using the cost method, investments in FHLB common stock carried at cost, and an annuity investment carried at amortized cost. The estimated fair value of the LP/LLC interests was based on the equity value of the interest provided by the LP/LLC managers for the most recent quarter, which approximates the fair value of the interest. The estimated fair value of the FHLB common stock was based on the amount ProAssurance would receive if its membership were canceled, as the membership cannot be sold. The fair value of the annuity represents the present value of the expected future cash flows discounted using a rate available in active markets for similarly structured instruments.

Other assets and Other liabilities primarily consisted of related investment assets and liabilities associated with funded deferred compensation agreements. Fair values of the funded deferred compensation assets and liabilities were based on the NAVs provided by the underlying funds. Other assets also included a secured note receivable and an unsecured receivable under a revolving credit agreement. Fair value of these receivables was based on the present value of expected cash flows from the receivables, discounted at market rates on the valuation date for receivables with similar credit standings and similar payment structures. Other liabilities also included contractual liabilities related to prior business combinations. The fair values of the business combination liabilities were based on the present value of the expected future cash outflows, discounted at ProAssurance's assumed incremental borrowing rate on the valuation date for unsecured liabilities with similar repayment structures.

The fair value of the debt was estimated based on the present value of expected future cash outflows, discounted at rates available on the valuation date for similar debt issued by entities with a similar credit standing to ProAssurance.

Table of Contents
ProAssurance Corporation and Subsidiaries
Notes to Condensed Consolidated Financial Statements (Unaudited)
March 31, 2016

3. Investments
Available-for-sale securities at March 31, 2016 and December 31, 2015 included the following:

	March 31, 2016			
(In thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Fixed maturities				
U.S. Treasury obligations	$145,191	$ 3,128	$ 12	$148,307
U.S. Government-sponsored enterprise obligations	25,457	1,023	2	26,478
State and municipal bonds	862,973	40,010	654	902,329
Corporate debt	1,252,021	35,495	13,416	1,274,100
Residential mortgage-backed securities	256,340	7,609	115	263,834
Agency commercial mortgage-backed securities	13,472	261	17	13,716
Other commercial mortgage-backed securities	26,009	297	68	26,238
Other asset-backed securities	99,922	385	100	100,207
	$2,681,385	$ 88,208	$ 14,384	$2,755,209

	December 31, 2015			
(In thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Fixed maturities				
U.S. Treasury obligations	$122,855	$ 1,696	$ 659	$123,892
U.S. Government-sponsored enterprise obligations	25,456	927	49	26,334
State and municipal bonds	904,719	36,739	823	940,635
Corporate debt	1,296,128	24,720	29,162	1,291,686
Residential mortgage-backed securities	233,659	6,039	1,311	238,387
Agency commercial mortgage-backed securities	10,851	174	26	10,999
Other commercial mortgage-backed securities	29,983	354	203	30,134
Other asset-backed securities	98,412	54	246	98,220
	$2,722,063	$ 70,703	$ 32,479	$2,760,287

The recorded cost basis and estimated fair value of available-for-sale fixed maturities at March 31, 2016, by contractual maturity, are shown below. Actual maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

(In thousands)	Amortized Cost	Due in one year or less	Due after one year through five years	Due after five years through ten years	Due after ten years	Total Fair Value
Fixed maturities, available for sale						
U.S. Treasury obligations	$145,191	$ 8,239	$122,464	$14,255	$3,349	$148,307
U.S. Government-sponsored enterprise obligations	25,457	2,472	16,157	6,093	1,756	26,478
State and municipal bonds	862,973	41,235	324,603	409,263	127,228	902,329
Corporate debt	1,252,021	86,049	724,590	433,918	29,543	1,274,100
Residential mortgage-backed securities	256,340					263,834
Agency commercial mortgage-backed securities	13,472					13,716
Other commercial mortgage-backed securities	26,009					26,238
Other asset-backed securities	99,922					100,207
	$2,681,385					$2,755,209

Excluding obligations of the U.S. Government or U.S. Government-sponsored enterprises, no investment in any entity or its affiliates exceeded 10% of Shareholders' equity at March 31, 2016.

Cash and securities with a carrying value of $46.8 million at March 31, 2016 were on deposit with various state insurance departments to meet regulatory requirements. ProAssurance also held securities with a carrying value of $126.5 million at March 31, 2016 that are pledged as collateral security for advances under the Revolving Credit Agreement (see Note 8 of the Notes to Condensed Consolidated Financial Statements for additional detail on the Revolving Credit Agreement).

As a member of Lloyd's and a capital provider to Syndicate 1729, ProAssurance is required to maintain capital at Lloyd's, referred to as FAL. ProAssurance investments at March 31, 2016 included fixed maturities with a fair value of $94.0 million and short term investments with a fair value of approximately $2.6 million on deposit with Lloyd's in order to satisfy these FAL requirements.

BOLI

ProAssurance holds BOLI policies that are carried at the current cash surrender value of the policies (original cost $33 million). All insured individuals were management employees at the time the policies were acquired. The primary purpose of the program is to offset future employee benefit expenses through earnings on the cash value of the policies. ProAssurance is the owner and principal beneficiary of these policies.

Other Investments

Other investments at March 31, 2016 and December 31, 2015 were comprised as follows:

(In thousands)	March 31, 2016	December 31, 2015
Investments in LPs/LLCs, at cost	$ 46,719	$ 44,958
Convertible securities, at fair value	30,494	30,611
Other, principally FHLB capital stock, at cost	3,487	3,564
	$ 80,700	$ 79,133

Investments in convertible securities are carried at fair value as permitted by the accounting guidance for hybrid financial instruments, with changes in fair value recognized in income as a component of Net realized investment gains or losses during the period of change.

FHLB capital stock is not marketable, but may be liquidated by terminating membership in the FHLB. The liquidation process can take up to five years.

Table of Contents

ProAssurance Corporation and Subsidiaries
Notes to Condensed Consolidated Financial Statements (Unaudited)
March 31, 2016

Unconsolidated Subsidiaries

ProAssurance holds investments in unconsolidated subsidiaries, accounted for under the equity method. The investments include the following:

(In thousands)	March 31, 2016 Percentage Ownership	Carrying Value March 31, 2016	December 31, 2015
Investment in LPs/LLCs:			
Qualified affordable housing tax credit partnerships	See below	$117,170	$ 121,550
Other tax credit partnerships	See below	10,214	8,362
All other LPs/LLCs	See below	200,483	181,996
		$327,867	$ 311,908

Qualified affordable housing tax credit partnership interests held by ProAssurance generate investment returns by providing tax benefits to fund investors in the form of tax credits and project operating losses. The carrying value of these investments reflects ProAssurance's total commitments (both funded and unfunded) to the partnerships. ProAssurance's ownership percentage relative to two of the tax credit partnership interests is almost 100%; these interests had a carrying value of $50.0 million at March 31, 2016. ProAssurance's ownership percentage relative to the remaining tax credit partnership interests is less than 20%; these interests had a carrying value of $67.2 million at March 31, 2016. ProAssurance does not have the ability to exert control over the partnerships; all are accounted for using the equity method.

Other tax credit partnerships are comprised entirely of historic tax credits. The historic tax credits generate investment returns by providing benefits to fund investors in the form of tax credits, tax deductible project operating losses and positive cash flows. ProAssurance's ownership percentage relative to the tax credit partnerships is almost 100%. ProAssurance does not have the ability to exert control over the partnerships; the interests are accounted for using the equity method.

As discussed in additional detail in Note 2 of the Notes to Condensed Consolidated Financial Statements, ProAssurance holds interests in certain LPs/LLCs that are investment funds which measure fund assets at fair value on a recurring basis and the fund managers provide a NAV for the interest. The carrying value of these interests is based on the NAV provided, and is considered to approximate the fair value of the interests; such interests totaled $177.8 million at March 31, 2016 and $162.6 million at December 31, 2015. ProAssurance also holds interests in other LPs/LLCs which are not considered to be investment funds; such interests totaled $22.7 million at March 31, 2016 and $19.4 million at December 31, 2015. ProAssurance's ownership percentage relative to two of the LPs/LLCs is greater than 25%, which is expected to be reduced as the funds mature and other investors participate in the fund; these investments had a carrying value of $8.2 million at March 31, 2016 and $8.3 million at December 31, 2015. ProAssurance's ownership percentage relative to the remaining LPs/LLCs is less than 25%; these interests had a carrying value of $192.3 million at March 31, 2016 and $173.7 million at December 31, 2015. ProAssurance does not have the ability to exert control over any of these funds.

Table of Contents
ProAssurance Corporation and Subsidiaries
Notes to Condensed Consolidated Financial Statements (Unaudited)
March 31, 2016

Investments Held in a Loss Position
The following tables provide summarized information with respect to investments held in an unrealized loss position at March 31, 2016 and December 31, 2015, including the length of time the investment had been held in a continuous unrealized loss position.

	March 31, 2016					
	Total		Less than 12 months		12 months or longer	
(In thousands)	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
Fixed maturities, available for sale						
U.S. Treasury obligations	$12,688	$ 12	$9,408	$ 4	$3,280	$ 8
U.S. Government-sponsored enterprise obligations	424	2	—	—	424	2
State and municipal bonds	15,993	654	7,964	34	8,029	620
Corporate debt	273,750	13,416	171,968	5,729	101,782	7,687
Residential mortgage-backed securities	34,773	115	6,262	29	28,511	86
Agency commercial mortgage-backed securities	415	17	—	—	415	17
Other commercial mortgage-backed securities	10,659	68	7,328	48	3,331	20
Other asset-backed securities	39,089	100	35,864	96	3,225	4
	$387,791	$ 14,384	$238,794	$ 5,940	$148,997	$ 8,444
Other investments						
Investments in LPs/LLCs carried at cost	$23,691	$ —	$23,691	$ —	$—	$ —

	December 31, 2015					
	Total		Less than 12 months		12 months or longer	
(In thousands)	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
Fixed maturities, available for sale						
U.S. Treasury obligations	$66,685	$ 658	$61,869	$ 591	$4,816	$ 67
U.S. Government-sponsored enterprise obligations	6,819	49	6,819	49	—	—
State and municipal bonds	46,193	823	36,822	703	9,371	120
Corporate debt	622,991	29,162	555,097	15,691	67,894	13,471
Residential mortgage-backed securities	87,567	1,311	78,961	1,095	8,606	216
Agency commercial mortgage-backed securities	409	26	—	—	409	26
Other commercial mortgage-backed securities	15,960	203	12,635	170	3,325	33
Other asset-backed securities	79,637	247	74,150	237	5,487	10
	$926,261	$ 32,479	$826,353	$ 18,536	$99,908	$ 13,943

As of March 31, 2016, excluding U.S. Government backed securities, there were 365 debt securities (13.9% of all available-for-sale fixed maturity securities held) in an unrealized loss position representing 284 issuers. The greatest and second greatest unrealized loss positions among those securities were approximately $0.7 million and $0.6 million, respectively. The securities were evaluated for impairment as of March 31, 2016.

As of December 31, 2015, excluding U.S. Government backed securities, there were 773 debt securities (28.8% of all available-for-sale fixed maturity securities held) in an unrealized loss position representing 506 issuers. The greatest and second greatest unrealized loss position among those securities approximated $1.4 million and $1.3 million, respectively. The securities were evaluated for impairment as of December 31, 2015.

Each quarter, ProAssurance performs a detailed analysis for the purpose of assessing whether any of the securities it holds in an unrealized loss position have suffered an OTTI in value. A detailed discussion of the factors considered in the assessment is included in Note 1 of the Notes to Consolidated Financial Statements included in ProAssurance's December 31, 2015 Form 10-K.

Fixed maturity securities held in an unrealized loss position at March 31, 2016, excluding asset-backed securities, have paid all scheduled contractual payments and are expected to continue doing so. Expected future cash flows of asset-backed securities held in an unrealized loss position were estimated as part of the March 31, 2016 impairment evaluation using the most recently available six-month historical performance data for the collateral (loans) underlying the security or, if historical data was not available, sector based assumptions, and equaled or exceeded the current amortized cost basis of the security.

Net Investment Income

Net investment income by investment category was as follows:

	Three Months Ended March 31	
(In thousands)	2016	2015
Fixed maturities	$22,575	$24,959
Equities	3,643	3,013
Short-term and Other investments	405	504
BOLI	460	456
Investment fees and expenses	(1,643)	(1,628)
Net investment income	$25,440	$27,304

Equity in Earnings (Loss) from Unconsolidated Subsidiaries

Equity in earnings (loss) from unconsolidated subsidiaries included losses from qualified affordable housing project tax credit investments of $5.2 million for the three-month period ended March 31, 2016, and $2.5 million for the three-month period ended March 31, 2015. The losses recorded reflect ProAssurance's allocable portion of partnership operating losses. ProAssurance recognized tax credits related to these qualified affordable housing investments that totaled $4.6 million for both the three-month periods ended March 31, 2016 and 2015. Tax credits recognized reduced income tax expense in the respective periods.

Table of Contents
ProAssurance Corporation and Subsidiaries
Notes to Condensed Consolidated Financial Statements (Unaudited)
March 31, 2016

Net Realized Investment Gains (Losses)

Realized investment gains and losses are recognized on the specific identification basis. The following table provides detailed information regarding net realized investment gains (losses):

	Three Months Ended March 31	
(In thousands)	2016	2015
Total OTTI losses:		
Corporate debt	$(7,604)	$(3,271)
Other investments	(3,130)	—
Portion recognized in OCI:		
Corporate debt	1,068	1,441
Net impairments recognized in earnings	$(9,666)	$(1,830)
Gross realized gains, available-for-sale securities	3,185	4,013
Gross realized (losses), available-for-sale securities	(4,647)	(1,255)
Net realized gains (losses), trading securities	2,055	2,667
Net realized gains (losses), Other investments	52	116
Change in unrealized holding gains (losses), trading securities	733	858
Change in unrealized holding gains (losses), convertible securities, carried at fair value	(66)	270
Other	2	—
Net realized investment gains (losses)	$(8,352)	$4,839

During the first quarter of 2016, ProAssurance recognized OTTI through earnings of $6.5 million related to corporate bonds, including credit-related OTTI of $5.5 million related to debt instruments from ten issuers in the energy sector. The fair value of these bonds declined in the first quarter of 2016 as did the credit quality of the issuers and ProAssurance recognized credit-related OTTI to reduce the amortized cost basis of the bonds to the present value of future cash flows expected to be received from the bonds. ProAssurance also recognized non-credit impairments of $0.9 million in OCI relative to the bonds of these energy sector issuers, as the fair value of the bonds was less than the present value of the expected future cash flows from the securities.

ProAssurance recognized a $3.1 million OTTI in earnings for the 2016 three-month period related to an investment fund that is accounted for using the cost method (classified as Other investments). The fund is focused on the energy sector and securities held by the fund have declined in value. An OTTI was recognized to reduce ProAssurance's carrying value of the investment to the NAV reported by the fund.

During the first quarter of 2015, ProAssurance recognized credit-related impairments of $1.8 million related to investments in high-yield securities from three issuers in the energy industry. ProAssurance also recognized non-credit impairments of $1.4 million related to these securities as the fair value of the securities was less than the future cash flows expected to be received from the securities.

The following table presents a roll forward of cumulative credit losses recorded in earnings related to impaired debt securities for which a portion of the OTTI was recorded in OCI.

	Three Months Ended March 31	
(In thousands)	2016	2015
Balance beginning of period	$5,751	$232
Additional credit losses recognized during the period, related to securities for which:		
No OTTI has been previously recognized	2,398	1,830
OTTI has been previously recognized	2,154	—

Reductions due to:		
Securities sold during the period (realized)	(3,744)	—
Balance March 31	$6,559	$2,062

29

Other information regarding sales and purchases of available-for-sale securities is as follows:

	Three Months Ended March 31	
(In millions)	2016	2015
Proceeds from sales (exclusive of maturities and paydowns)	$109.9	$205.9
Purchases	$199.6	$215.1

4. Income Taxes

ProAssurance estimates its annual effective tax rate at the end of each quarterly reporting period and uses this estimated rate to record the provision for income taxes in the interim financial statements. 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, and because ProAssurance utilizes tax credit benefits transferred from tax credit partnership investments. Also, in 2016 no U.K. tax expense was recognized relative to ProAssurance's pro rata portion of the operating profits of Syndicate 1729 as prior year operating losses were available to offset the profits. In 2015, no U.K. tax benefit was recognized relative to ProAssurance's pro rata portion of Syndicate 1729's operating losses as there was no income against which the losses could be offset.

ProAssurance had receivables for Federal and U.K. income taxes of $2.5 million at March 31, 2016 and $16.4 million at December 31, 2015, both carried as a part of Other assets. The liability for unrecognized tax benefits was $8.3 million at March 31, 2016 and $8.2 million at December 31, 2015.

5. Deferred Policy Acquisition Costs

Policy acquisition costs that are primarily and directly related to the successful production of new and renewal insurance contracts, most significantly agent commissions, premium taxes, and underwriting salaries and benefits, are capitalized as policy acquisition costs and amortized to expense, net of ceding commissions earned, as the related premium revenues are earned.

Amortization of DPAC was $21.5 million and $19.0 million for the three months ended March 31, 2016 and 2015, respectively.

6. Reserve 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 the reserve, particularly the reserve appropriate for liability exposures, 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 requires ProAssurance to make and revise judgments and assessments regarding multiple uncertainties over an extended period of time. As a result, the reserve estimate may vary significantly from the eventual outcome. The assumptions used in establishing ProAssurance’s reserve 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.

During the three months ended March 31, 2016, ProAssurance recognized favorable net loss development of $28.7 million, related to prior accident years. The favorable net loss development primarily reflected reductions in the Company's estimates of claims severity related to the 2009 through 2013 accident years.

For the three months ended March 31, 2015, ProAssurance recognized favorable net loss development of $33.5 million, to reflect reductions in estimated claims severity related to the 2008 through 2012 accident years.

Table of Contents

7. Commitments and Contingencies

ProAssurance is involved in various legal actions related to insurance policies and claims handling including, but not limited to, claims asserted by policyholders. These types of legal actions arise in the Company's ordinary course of business and, in accordance with GAAP for insurance entities, are considered as a part of the Company's loss reserving process, which is described in detail under the heading "Losses and Loss Adjustment Expenses" in the Accounting Policies section in Note 1 of the Notes to Consolidated Financial Statements in ProAssurance's 2015 Form 10-K.

ProAssurance has funding commitments primarily related to non-public investment entities totaling approximately $95.6 million, expected to be paid as follows: $60.1 million in 2016, $34.5 million in 2017 and 2018 combined, $0.3 million in 2019 and 2020 combined and $0.7 million thereafter. Of these funding commitments, $1.5 million are related to qualified affordable housing project tax credit investments and are expected to be paid as follows: $0.2 million in 2016, $0.3 million in 2017 and 2018 combined, $0.3 million in 2019 and 2020 combined and $0.7 million thereafter.

As a member of Lloyd's and a capital provider to Syndicate 1729, ProAssurance is required to provide capital, referred to as FAL. At March 31, 2016, ProAssurance was satisfying the FAL requirement with investment securities on deposit with Lloyd's with a carrying value of $96.6 million (see Note 3 of the Notes to Condensed Consolidated Financial Statements).

ProAssurance has issued an unconditional revolving credit agreement to the Premium Trust Fund of Syndicate 1729 for the purpose of providing working capital. Permitted borrowings were expanded from £10 million at March 31, 2016 to £20 million under an amended Syndicate Credit Agreement executed in April 2016. Under the amended Syndicate Credit Agreement advances bear interest at 3.8% annually, and may be repaid at any time but are repayable upon demand after December 31, 2019. As of March 31, 2016, £9.2 million (approximately $13.2 million) had been advanced under the Syndicate Credit Agreement.

8. Debt

ProAssurance’s outstanding debt consisted of the following:

(In thousands)	March 31, 2016	December 31, 2015
Senior notes due 2023, unsecured, interest at 5.3% annually	$ 250,000	$ 250,000
Revolving Credit Agreement, outstanding borrowings are fully secured, see Note 3, and carried at an interest rate of 1.12%. Outstanding borrowings are not permitted to exceed $250 million aggregately; Agreement expires in 2020. The interest rate on the borrowing is set at the time the borrowing is initiated or renewed. The current borrowing can be repaid or renewed in July 2016. If renewed, the interest rate will reset.	100,000	100,000
Total principal	$ 350,000	$ 350,000
Less debt issuance costs	2,056	2,142
Debt less debt issuance costs	$ 347,944	$ 347,858

Covenant Compliance

There are no financial covenants associated with the Senior Notes due 2023.

The Revolving Credit Agreement contains customary representations, covenants and events constituting default, and remedies for default. The Revolving Credit Agreement also defines financial covenants regarding permitted leverage ratios. ProAssurance is currently in compliance with all covenants of the Agreement.

Additional Information

For additional information regarding ProAssurance's debt, see Note 10 of the Notes to Consolidated Financial Statements included in ProAssurance's December 31, 2015 Form 10-K.

9. Shareholders' Equity

At March 31, 2016 and December 31, 2015, ProAssurance had 100 million shares of authorized common stock and 50 million shares of authorized preferred stock. The Board has the authority to determine 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 declared cash dividends of $0.31 per share during the first quarters of both 2016 and 2015, totaling $16.4 million and $17.2 million, respectively.

At March 31, 2016, Board authorizations for the repurchase of common shares or the retirement of outstanding debt of $110.4 million remained available for use. ProAssurance repurchased approximately 27,700 shares at a cost of $1.3 million and 1.3 million shares at a cost of $57.2 million during the three-month periods ended March 31, 2016 and 2015, respectively.

Share-based compensation expense was $2.7 million for both the three months ended March 31, 2016 and 2015. Related tax benefits were $1.0 million and $0.9 million for the three months ended March 31, 2016 and 2015, respectively.

ProAssurance awarded approximately 109,200 restricted share units and 60,000 base performance share units to employees in February 2016. The fair value of each unit awarded was estimated at $45.58, equal to the market value of a ProAssurance common share on the date of grant less the estimated present value of dividends during the vesting period. All awards are charged to expense as an increase to equity over the service period (generally the vesting period) associated with the award. Restricted share units and performance share units vest in their entirety at the end of a three-year period following the grant date based on a continuous service requirement and, for performance share units, achievement of a performance objective. Partial vesting is permitted for retirees. A ProAssurance common share is issued for each unit once vesting requirements are met, except that units sufficient to satisfy required tax withholdings are paid in cash. The number of common shares issued for performance share units varies from 50% to 200% of base awards depending upon the degree to which stated performance objectives are achieved. ProAssurance issued approximately 22,000 and 72,000 common shares to employees in February 2016 related to restricted share units and performance share units, respectively, granted in 2013. Performance share units for the 2013 award were issued at levels ranging from 83% to 125%.

ProAssurance issued approximately 24,000 common shares to employees in February 2016 as bonus compensation, as approved by the Compensation Committee of the Board. The shares issued were valued at fair value (the market price of a ProAssurance common share on the date of award).

Other Comprehensive Income (Loss) and Accumulated Other Comprehensive Income (Loss)

For the three months ended March 31, 2016 and March 31, 2015, OCI was primarily comprised of unrealized gains and losses, including non-credit impairment losses, arising during the period related to available-for-sale securities, less reclassification adjustments as shown in the table that follows, net of tax. For the three months ended March 31, 2016 and March 31, 2015, OCI also included gains of $0.3 million and losses of $1.0 million, respectively, net of tax, related to unrecognized changes in defined benefit plan liabilities from the reestimation of two defined benefit plans assumed in the Eastern acquisition. Both plans are frozen as to the earning of additional benefits, but the unrecognized plan benefit liability is reestimated annually.

At March 31, 2016 and December 31, 2015, AOCI was primarily comprised of unrealized gains and losses from available-for-sale securities, including non-credit impairments recognized in OCI of $0.9 million and $2.0 million, respectively, net of tax. At March 31, 2016 and December 31, 2015, AOCI also included losses of $0.7 million and $1.0 million, respectively, related to unrecognized changes in defined benefit plan liabilities, net of tax. All tax effects were computed using a 35% rate, with the exception of unrealized gains and losses on available for sale securities held at our U.K. entities which were immaterial in amount. OCI and AOCI also included immaterial amounts of foreign

currency translation adjustments.

Table of Contents

Amounts reclassified from AOCI to net income and the amounts of deferred tax expense (benefit) included in OCI were as follows:

	Three Months Ended March 31	
(In thousands)	2016	2015
Reclassifications from AOCI to net income, available-for-sale securities:		
Realized investment gains (losses)	$(5,241)	$916
Non-credit impairment losses reclassified to earnings, due to sale of securities or reclassification as a credit loss	(2,758)	—
Total amounts reclassified, before tax effect	(7,999)	916
Tax effect (at 35%)	2,800	(321)
Net reclassification adjustments	$(5,199)	$595
Deferred tax expense (benefit) included in OCI	$12,260	$4,131

10. Variable Interest Entities

ProAssurance holds passive interests in a number of entities that are considered to be VIEs under GAAP guidance. As of January 1, 2016 ProAssurance has retrospectively adopted new guidance regarding the evaluation of whether or not entities are VIEs and the consolidation analysis required for VIEs (see Note 1 of the Notes to Condensed Consolidated Financial Statements). Adoption of the new guidance increased the number of ProAssurance investment interests considered to be interests in VIEs but did not require that any of the VIE interests be consolidated. ProAssurance's VIE interests principally consist of interests in LPs/LLCs formed for the purpose of achieving diversified equity and debt returns. ProAssurance's VIE interests carried as a part of Other investments totaled $27.6 million at March 31, 2016 and $26.0 million at December 31, 2015. ProAssurance's VIE interests carried as a part of Investment in unconsolidated subsidiaries totaled $278.9 million at March 31, 2016 and $275.0 million at December 31, 2015. ProAssurance has not consolidated these VIEs because it has either very limited or no power to control the activities that most significantly affect the economic performance of these entities and is not the primary beneficiary of any of the entities. ProAssurance's involvement with each entity is limited to its direct ownership interest in the entity. ProAssurance has no arrangements with any of the entities to provide other financial support to or on behalf of the entity. At March 31, 2016, ProAssurance's maximum loss exposure relative to these investments was limited to the carrying value of ProAssurance's investment in the VIE.

11. Earnings Per Share

Diluted weighted average shares is calculated as basic weighted average shares plus the effect, calculated using the treasury stock method, of assuming that dilutive stock options have been exercised and that performance, restricted and purchase share units have vested. All outstanding stock options, performance, restricted and purchase share units had a dilutive effect for the three months ended March 31, 2016 and 2015.

12. Segment Information

ProAssurance operates in four segments that are organized around the nature of the products and services provided: Specialty P&C, Workers' Compensation, Lloyd's Syndicate, and Corporate. A description of each segment follows.

Specialty P&C is primarily focused on professional liability insurance and medical technology liability insurance. Professional liability insurance is primarily offered to healthcare providers and institutions and to attorneys and their firms. Medical technology liability insurance is offered for medical technology and life sciences companies that manufacture or distribute products including entities conducting human clinical trials. The Specialty P&C segment cedes certain premium to the Lloyd's Syndicate segment under a quota share agreement with Syndicate 1729. As discussed below, Syndicate 1729 operating results are reported on a quarter delay. For consistency purposes, results from this ceding arrangement, other than cash receipts or disbursements, have been reported within the Specialty P&C segment on the same one quarter delay.

Workers' Compensation provides workers' compensation products primarily to employers with 1,000 or fewer employees. The segment also offers alternative market solutions whereby policies written are 100% ceded either to captive insurers unaffiliated with ProAssurance or to SPCs operated by a wholly owned subsidiary of ProAssurance. The SPCs are fully or partially owned by the employer (or employer group, association or affiliate) insured by the policies ceded. Financial results (underwriting profit or loss, plus investment results) of the SPCs accrue to the owners of that cell.

Lloyd's Syndicate includes operating results from ProAssurance's 58% participation in Lloyd's of London Syndicate 1729. Syndicate 1729 underwrites risks over a wide range of property and casualty insurance and reinsurance lines in both the U.S and international markets. The results of this segment are reported on a quarter delay, except that investment results associated with investment assets solely allocated to Syndicate 1729 operations and certain U.S. paid administrative expenses are reported concurrently as that information is available on an earlier time frame.

Corporate includes ProAssurance's U.S. investment operations, interest expense and U.S. income taxes, all of which are managed at the corporate level, non-premium revenues generated outside of our insurance entities, and corporate expenses.

The accounting policies of the segments are the same as those described in Note 1 of the Notes to Consolidated Financial Statements in ProAssurance’s December 31, 2015 report on Form 10-K and Note 1 of the Notes to Condensed Consolidated Financial Statements. ProAssurance evaluates performance of its Specialty P&C and Workers' Compensation segments based on before tax underwriting profit or loss, which excludes investment performance. Performance of the Lloyd's Syndicate segment is evaluated based on underwriting profit or loss, plus investment results of investment assets solely allocated to Syndicate 1729 operations, net of U.K. income tax expense. Performance of the Corporate segment is evaluated based on the contribution made to consolidated after tax results. ProAssurance accounts for inter-segment transactions as if the transactions were to third parties at current market prices. Assets are not allocated to segments because investments and other assets are not managed at the segment level.

Table of Contents
ProAssurance Corporation and Subsidiaries
Notes to Condensed Consolidated Financial Statements (Unaudited)
March 31, 2016

Financial data by segment were as follows:

	Three Months Ended March 31, 2016					
(In thousands)	Specialty P&C	Workers' Compensation	Lloyd's Syndicate	Corporate	Inter-segment Eliminations	Consolidated
Net premiums earned	$110,755	$ 54,383	$12,441	$—	$ —	$177,579
Net investment income	—	—	315	25,125	—	25,440
Equity in earnings (loss) of unconsolidated subsidiaries	—	—	—	(3,634)	—	(3,634)
Net realized gains (losses)	—	—	(5)	(8,347)	—	(8,352)
Other income	1,276	471	252	458	(103)	2,354
Net losses and loss adjustment expenses*	(71,174)	(35,027)	(6,189)	—	1,435	(110,955)
Underwriting, policy acquisition and operating expenses*	(25,054)	(17,829)	(5,167)	(7,507)	(1,332)	(56,889)
Segregated portfolio cells dividend (expense) income	—	(1,176)	—	—	—	(1,176)
Interest expense	—	—	—	(3,686)	—	(3,686)
Income tax benefit (expense)	—	—	(84)	(1,280)	—	(1,364)
Segment operating results	$15,803	$ 822	$1,563	$1,129	$ —	$19,317
Significant non-cash items:						
Depreciation and amortization	$2,011	$ 1,404	$66	$5,372	$ —	$8,853

	Three Months Ended March 31, 2015					
(In thousands)	Specialty P&C	Workers' Compensation	Lloyd's Syndicate	Corporate	Inter-segment Eliminations	Consolidated
Net premiums earned	$114,864	$ 51,277	$5,758	$—	$ —	$171,899
Net investment income	—	—	204	27,100	—	27,304
Equity in earnings (loss) of unconsolidated subsidiaries	—	—	—	1,622	—	1,622
Net realized gains (losses)	—	—	11	4,828	—	4,839
Other income	1,496	137	490	157	(111)	2,169
Net losses and loss adjustment expenses	(69,030)	(32,102)	(4,008)	—	—	(105,140)
Underwriting, policy acquisition and operating expenses*	(27,159)	(15,358)	(3,580)	(5,370)	111	(51,356)
Segregated portfolio cells dividend expense (income)	—	(2,184)	—	—	—	(2,184)
Interest expense	—	—	—	(3,631)	—	(3,631)
Income tax benefit (expense)	—	—	—	(7,708)	—	(7,708)
Segment operating results	$20,171	$ 1,770	$(1,125)	$16,998	$ —	$37,814
Significant non-cash items:						
Depreciation and amortization	$2,163	$ 1,440	$130	$5,835	$ —	$9,568

* Beginning in fourth quarter 2015, the portion of the management fee that is allocated to ULAE is eliminated in consolidation.

The following table provides detailed information regarding ProAssurance's gross premiums earned by product as well as a reconciliation to net premiums earned. All gross premiums earned are from external customers except as noted. ProAssurance's insured risks are primarily within the United States.

	Three Months Ended March 31	
(In thousands)	2016	2015
Specialty P&C Segment		
Gross premiums earned:		
Healthcare professional liability	$113,749	$115,831
Legal professional liability	6,614	7,200
Medical technology liability	8,550	8,972
Other	268	382
Less: Ceded premiums earned*	(18,426)	(17,521)
Segment net premiums earned	110,755	114,864
Workers' Compensation Segment		
Gross premiums earned:		
Traditional business	42,650	42,003
Alternative market business	18,294	15,730
Less: Ceded premiums earned	(6,561)	(6,456)
Segment net premiums earned	54,383	51,277
Lloyd's Syndicate Segment		
Gross premiums earned:		
Property and casualty*	13,373	6,537
Less: Ceded premiums earned	(932)	(779)
Segment net premiums earned	12,441	5,758
Consolidated net premiums earned	$177,579	$171,899

*Includes premium ceded from the Specialty P&C segment to the Lloyd's Syndicate segment of $3.6 million and $3.4 million for the three months ended March 31, 2016 and 2015, respectively.

Table of Contents

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

The following discussion should be read in conjunction with the Condensed Consolidated Financial Statements and Notes to those statements which accompany this report. A glossary of insurance terms and phrases is available on the investor section of our website. Throughout the discussion, references to "ProAssurance," "PRA," "Company," "we," "us" and "our" refer to ProAssurance Corporation and its consolidated subsidiaries. The discussion contains certain forward-looking information that involves risks and uncertainties. As discussed under the heading "Forward-Looking Statements," our actual financial condition and operating results could differ significantly from these forward-looking statements.

ProAssurance Overview

We report our results in four distinct segments based on the operational focus of the segment. Our Specialty P&C segment includes our professional liability business and our medical technology and life sciences liability business. Our Workers' Compensation segment includes workers' compensation insurance for employers, groups and associations. Our Lloyd's Syndicate segment reflects operating results from our 58% participation in Syndicate 1729. Syndicate 1729 underwrites risks over a wide range of property and casualty insurance and reinsurance lines in both the U.S. and international markets. Our Corporate segment includes our U.S. investment operations which are managed at the corporate level, non-premium revenues generated outside of our insurance entities, corporate expenses, interest and U.S. income taxes. Additional information regarding our segments is included in Note 12 of the Notes to Condensed Consolidated Financial Statements and in Part I of our 2015 Form 10-K.

Critical Accounting Estimates

Our Condensed Consolidated Financial Statements are prepared in conformity with 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

The largest component of our liabilities is our reserve for losses and loss adjustment expenses ("reserve for losses" or "reserve"), and the largest component of expense for our operations is incurred losses and loss adjustment expenses (also referred to as "losses and loss adjustment expenses," "incurred losses," "losses incurred," and "losses"). Incurred losses reported in any period reflect our estimate of losses incurred related to the premiums earned in that period as well as any changes to our previous estimate of the reserve required for prior periods.

As of March 31, 2016 our reserve is almost entirely comprised of long-tail exposures. The estimation of long-tailed losses is inherently difficult and is subject to significant judgment on the part of management. Due to the nature of our claims, our loss costs, even for claims with similar characteristics, can vary significantly depending upon many factors, including but not limited to the specific characteristics of the claim and the manner in which the claim is resolved. Long-tailed insurance is characterized by the extended period of time typically required to assess the viability of a claim, potential damages, if any, and to then reach a resolution of the claim. The claims resolution process may extend to more than five years. The combination of continually 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 significant judgment, and such estimates require periodic modification.

Our reserve is established by management after taking into consideration a variety of factors including premium rates, claims frequency, historical paid and incurred loss development trends, the expected effect of inflation, general economic trends, the legal and political environment, and the conclusions reached by our internal and consulting actuaries. We update and review the data underlying the estimation of our reserve for losses each reporting period and make adjustments to loss estimation assumptions that we believe best reflect emerging data. Both our internal and consulting actuaries perform an in-depth review of our reserve for losses on at least a semi-annual basis using the loss

and exposure data of our insurance subsidiaries.

Table of Contents

Our reserving process can be broadly grouped into two areas: the establishment of the reserve for the current accident year (the initial reserve) and the re-estimation of the reserve for prior accident years (development of prior accident years).

Current Accident Year - Initial Reserve

Considerable judgment is required in establishing our initial reserve for any current accident year period, as there is limited data available upon which to base our case reserves. Our process for setting an initial reserve considers the unique characteristics of each product, but in general we rely heavily on the loss assumptions that were used to price business, as our pricing reflects our analysis of loss costs that we expect to incur relative to the insurance product being priced.

Specialty P&C Segment. Professional and medical technology liability loss costs are impacted by many factors, including but not limited to, the nature of the claim, including whether or not the claim is an individual or a mass tort claim, the personal situation of the claimant or the claimant's family, the outcome of jury trials, the legislative and judicial climate where any potential litigation may occur, general economic conditions and, for claims involving bodily injury, the trend of healthcare costs. Within our Specialty P&C segment, for our HCPL business (79% of our consolidated gross reserve for losses and loss adjustment expenses as of December 31, 2015), we set an initial reserve using the average loss ratio used in our pricing, plus an additional provision in consideration of the historical loss volatility we and others in the industry have experienced. For our HCPL business our target loss ratio during recent accident years has approximated 75% and the provision for loss volatility has ranged from 8 to 10 percentage points, producing an overall average initial loss ratio for our HCPL business of approximately 87%. We believe use of a provision for volatility appropriately considers the inherent risks and limitations of our rate development process and the historic volatility of professional liability losses (the industry has experienced accident year loss ratios as high as 163% and as low as 53% over the past 30 years) and produces a reasonable best estimate of the reserve required to cover actual ultimate unpaid losses. A similar practice is followed for our legal professional liability business (5% of our consolidated gross reserve for losses and loss adjustment expenses as of December 31, 2015).

The risks insured in our medical technology liability business (6% of our consolidated gross reserve for losses and loss adjustment expenses as of December 31, 2015) are more varied, and policies are individually priced based on the risk characteristics of the policy. These policies often have significant deductibles or self-insured retentions and the insured risks range from startup operations to large, multinational entities. Premiums are established using our most recently developed actuarial estimates of losses expected to be incurred based on factors which include: results from prior analysis of similar business, industry indications, observed trends and judgment. Claims in this line of business primarily involve bodily injury to individuals and are affected by factors similar to those of our HCPL line of business. For the medical technology liability business, we also establish an initial reserve using a loss ratio approach, including a provision in consideration of historical loss volatility that this line of business has exhibited.

Workers' Compensation Segment. Many factors affect the ultimate losses incurred for our workers' compensation coverages (9% of our consolidated gross reserve for losses and loss adjustment expenses as of December 31, 2015), including, but not limited to, the type and severity of the injury, the age and occupation of the injured worker, the estimated length of disability, medical treatment and related costs, and the jurisdiction and workers' compensation laws of the injury occurrence. We use various actuarial methodologies in developing our workers’ compensation reserve combined with a review of the exposure base generally based upon payroll of the insured. For the current accident year, given the lack of seasoned information, the different actuarial methodologies produce results with significant variability; therefore, more emphasis is placed on supplementing results from the actuarial methodologies with trends in exposure base, medical expense inflation, general inflation, severity, and claim counts, among other things, to select an expected loss ratio.

Development of Prior Accident Years

We re-evaluate the reserve for prior accident years each period based on our most recently available claims data and currently available industry trend information. Changes to previously established reserve estimates are recognized in the current period if management’s best estimate of ultimate losses differs from the estimate previously established. While management considers a variety of variables in determining its best estimate, in general, as claims age, our methodologies give more weight to actual loss costs which, for the majority of our reserves, continue to indicate that

ultimate loss costs will be lower than our previous estimates. The discussion in our Critical Accounting Estimates section in Item 7 of our 2015 Form 10-K includes additional information regarding the methodologies used to evaluate our reserve.

Any change in our estimate of net ultimate losses for prior years is reflected in net income in the period in which such changes are made. In recent years such changes have reduced our estimate of net ultimate losses, resulting in a reduction of reported losses for the period and a corresponding increase in pre-tax income.

Due to the size of our consolidated reserve for losses and the large number of claims outstanding at any point in time, even a small percentage adjustment to our total reserve estimate could have a material effect on our results of operations for the period in which the adjustment is made.

Table of Contents

We recognized net favorable reserve development of $28.7 million during the three months ended March 31, 2016, of which $27.2 million related to our Specialty P&C segment, $1.1 million related to our Workers' Compensation segment and $0.4 million related to our Lloyd's Syndicate segment. The net favorable development recognized within the Specialty P&C segment was primarily attributable to the favorable resolution of HCPL claims during the period and an evaluation of established case reserves and paid claims data that indicated that the actual severity trend associated with the remaining HCPL claims is less than we had previously estimated. Net favorable development recognized within our Workers' Compensation segment includes amortization of the purchase accounting fair value adjustment of $0.4 million for the three months ended March 31, 2016; the remaining net favorable development of $0.7 million was attributable to our SPCs which are evaluated at the cell level. Because a relatively small number of claims are open per cell, the closing of claims can affect the actuarial projections for the remaining open claims in the cell to an extent that indicates development should be recognized for the cell.

Use of Judgment

Even though the actuarial process is highly technical, it is also highly judgmental, both as to the selection of the data used in the various actuarial methodologies (e.g., initial expected loss ratios and loss development factors) and in the interpretation of the output of the various methods used. Each actuarial method generally returns a different value and for the more recent accident years the variations among the various methodologies can be significant. For each partition of our reserves, the results of the various methods, along with the supplementary statistical data regarding such factors as closed with and without indemnity ratios, claim severity trends, the expected duration of such trends, changes in the legal and legislative environment and the current economic environment, are used to develop a point estimate based upon management's judgment and past experience. The series of selected point estimates is then combined to produce an overall point estimate for ultimate losses.

Given the potential for unanticipated volatility for long-tailed lines of business, we are cautious in giving full credibility to emerging trends that, when more fully mature, may lead to the recognition of either favorable or adverse development of our losses. There may be trends, both positive and negative, reflected in the numerical data both within our own information and in the broader marketplace that mitigate or reverse as time progresses and additional data becomes available. This is particularly true for our HCPL business which has historically exhibited significant volatility as previously discussed.

HCPL. Over the past several years the most influential factor affecting the analysis of our HCPL reserves and the related development recognized has been the change, or lack thereof, in the severity of claims. The severity trend is an explicit component of our pricing models, whereas in our reserving process the severity trend's impact is implicit. Our estimate of this trend and our expectations about changes in this trend impact a variety of factors, from the selection of expected loss ratios to the ultimate point estimates established by management.

Because of the implicit and wide-ranging nature of severity trend assumptions on the loss reserving process it is not practical to specifically isolate the impact of changing severity trends. However, because severity is an explicit component of our HCPL pricing process we can better isolate the impact that changing severity can have on our loss costs and loss ratios as regards our pricing models for this business component. Our current HCPL pricing models assume a severity trend of 2% to 3% in most states and products. If the severity trend were to be higher by 1 percentage point, the impact would be an increase in our expected loss ratio for this business of 3.2 percentage points, based on current claim disposition patterns. An increase in the severity trend of 3 percentage points would result in a 10.1 percentage point increase in our expected loss ratio. Due to the long-tailed nature of our claims and the previously discussed historical volatility of loss costs, selection of a severity trend assumption is a subjective process that is inherently likely to prove inaccurate over time. Given the long tail and volatility, we are generally cautious in making changes to the severity assumptions within our pricing models. Also of note is that all open claims and accident years are generally impacted by a change in the severity trend, which compounds the effect of such a change.

For the 2004 to 2009 accident years, both our internal and consulting actuaries observed an unprecedented reduction in the frequency of HCPL claims (or number of claims per exposure unit) that cannot be attributed to any single factor. Since 2009, claim frequency has been relatively constant, at a lower level than had historically existed. For a number of years, we believed that much of the reduction in claim frequency was the result of a decline in the filing of non-meritorious lawsuits that had historically been dismissed or otherwise resulted in no payment of indemnity on

behalf of our insureds. With fewer non-meritorious claims being filed we expected that the claims that were filed had the potential for greater average losses, or greater severity. To date, however, this effect has not materialized to the extent we anticipated. The uncertainty as to the impact this decline in frequency might ultimately have on the average cost of claims complicated the selection of an appropriate severity trend for our pricing model for these lines. It also made it more challenging to factor severity into the various actuarial methodologies we use to evaluate our reserve. Based on the weighted average of payments, typically 91% of our HCPL claims are resolved after eight years for a given accident year.

Although we remain uncertain regarding the ultimate severity trend to project into the future due to the long-tailed nature of our business, we have given consideration to observed loss costs in setting our rates. For our HCPL business this practice has resulted in rate reductions in recent years. For example, on average, excluding our podiatry business acquired in 2009, we have

Table of Contents

gradually reduced the premium rates we charge on our standard physician renewal business (our largest HCPL line) by approximately 17% from the beginning of 2006 to March 31, 2016. Loss ratios for the current accident years have thus remained fairly constant because expected loss reductions have been reflected in our rates.
Workers' Compensation. The projection of changes in claim severity trend has not historically been an influential factor affecting our workers' compensation analysis of reserves, as claims are typically resolved more quickly than the industry norm. As previously mentioned, the determination and calculation of loss development factors requires considerable judgment. In particular the selection of tail factors, used to extend the projection of losses beyond historical data, requires considerable judgment. These factors are determined in the absence of direct loss development history and thus require reliance upon industry data which may not be representative of the Company’s data and experience.
Investment Valuations
We record the majority of our investments at fair value as shown in the table below. At March 31, 2016 the distribution of our investments based on GAAP fair value hierarchies (levels) was as follows:

	Distribution by GAAP Fair Value Hierarchy				
	Level 1	Level 2	Level 3	Not Categorized	Total Investments
Investments recorded at:					
Fair value	13%	75%	1%	4%	93%
Other valuations					7%
Total Investments					100%

Fair value is defined 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. All of our fixed maturity and equity security investments are carried at fair value. Our short-term securities are carried at amortized cost, which approximates fair value.
Because of the number of securities we own and the complexity of developing accurate fair values, we utilize multiple independent pricing services to assist us in establishing the fair value of individual securities. The pricing services provide fair values based on exchange traded prices, if available. If an exchange traded price is not available, the pricing services, if possible, provide a fair value that is based on multiple broker/dealer quotes or that has been developed using pricing models. Pricing models vary by asset class and utilize currently available market data for securities comparable to ours to estimate a fair value for our security. The pricing services scrutinize market data for consistency with other relevant market information before including the data in the pricing models. The pricing services disclose the types of pricing models used and the inputs used for each asset class. Determining fair values using these pricing models requires the use of judgment to identify appropriate comparable securities and to choose a valuation methodology that is appropriate for the asset class and available data.
The pricing services provide a single value per instrument quoted. We review the values provided for reasonableness each quarter by comparing market yields generated by the supplied value versus market yields observed in the market place. We also compare yields indicated by the provided values to appropriate benchmark yields and review for values that are unchanged or that reflect an unanticipated variation as compared to prior period values. We utilize a primary pricing service for each security type and compare provided information for consistency with alternate pricing services, known market data and information from our own trades, considering both values and valuation trends. We also review weekly trades versus the prices supplied by the services. If a supplied value appears unreasonable, we discuss the valuation in question with the pricing service and make adjustments if deemed necessary. To date, our review has not resulted in any changes to the values supplied by the pricing services. The pricing services do not provide a fair value unless an exchange traded price or multiple observable inputs are available. As a result, the pricing services may provide a fair value for a security in some periods but not others, depending upon the level of recent market activity for the security or comparable securities.
Level 1 Investments

Fair values for a majority of our equity securities and portions of our corporate debt, short-term and convertible securities are determined using exchange traded prices. There is little judgment involved when fair value is determined using an exchange traded price. In accordance with GAAP, for disclosure purposes we classify securities valued using an exchange traded price as Level 1 securities.

Table of Contents

Level 2 Investments

Most fixed income securities do not trade daily, and thus exchange traded prices are generally not available for these securities. However, market information (often referred to as observable inputs or market data, including but not limited to, last reported trade, non-binding broker quotes, bids, benchmark yield curves, issuer spreads, two sided markets, benchmark securities, offers and recent data regarding assumed prepayment speeds, cash flow and loan performance data) is available for most of our fixed income securities. We determine fair value for a large portion of our fixed income securities using available market information. In accordance with GAAP, for disclosure purposes we classify securities valued based on multiple market observable inputs as Level 2 securities.

Level 3 Investments

When a pricing service does not provide a value for one of our fixed maturity securities, management estimates fair value using either a single non-binding broker quote or pricing models that utilize market based assumptions which have limited observable inputs. The process involves significant judgment in selecting the appropriate data and modeling techniques to use in the valuation process. For disclosure purposes we classify securities valued using limited observable inputs as Level 3 securities.

Fair Values Not Categorized

We hold interests in certain LPs/LLCs that are investment funds which measure fund assets at fair value on a recurring basis and provide us with a NAV for our interest. As a practical expedient, we consider the NAV provided to approximate the fair value of the interest. In accordance with GAAP, we do not categorize these investments within the fair value hierarchy.

Investments - Other Valuation Methodologies

Certain of our investments, in accordance with GAAP for the type of investment, are measured using methodologies other than fair value. At March 31, 2016 these investments represented approximately 7% of total investments and are detailed in the following table. Additional information about these investments is provided in Notes 2 and 3 of the Notes to Condensed Consolidated Financial Statements.

(In millions)	Carrying Value	GAAP Measurement Method
Other investments:		
Investments in LPs	$ 46.7	Cost
Other, principally FHLB capital stock	3.5	Cost
	50.2	
Investment in unconsolidated subsidiaries:		
Investments in tax credit partnerships	127.4	Equity
Equity method LPs/LLCs	22.7	Equity
	150.1	
BOLI	57.7	Cash surrender value
Total investments - Other valuation methodologies	$ 258.0	

Investment Impairments

We evaluate our investments on at least a quarterly basis for declines in fair value that represent OTTI. We consider an impairment to be an OTTI if we intend to sell the security or if we believe we will be required to sell the security before we fully recover the amortized cost basis of the security. Otherwise, we consider various factors in our evaluation, as discussed below.

For debt securities, we consider whether we expect to fully recover the amortized cost basis of the security, based upon consideration of some or all of the following:

- third party research and credit rating reports;
- the current credit standing of the issuer, including credit rating downgrades;
- the extent to which the decline in fair value is attributable to credit risk specifically associated with the security or its issuer;

Table of Contents

- our internal assessments and those of our external portfolio managers regarding specific circumstances surrounding a security, which can cause us to believe the security is more or less likely to recover its value than other securities 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;
- failure of the issuer of the security to make scheduled interest or principal payments;
- any changes to the rating of the security by a rating agency; and
- recoveries or additional declines in fair value subsequent to the balance sheet date.

In assessing whether we expect to recover the cost basis of debt securities, particularly asset-backed securities, we must make a number of assumptions regarding the cash flows that we expect to receive from the security in future periods. These judgments are subjective in nature and may subsequently be proved to be inaccurate.

We evaluate our cost method interests in LPs/LLCs for OTTI by considering whether there has been a decline in fair value below the recorded value, which involves assumptions and estimates. We receive a report from each of the LPs/LLCs at least quarterly which provides us a NAV for our interest. The NAV is based on the fair values of securities held by the LP/LLC as determined by the LP/LLC manager. We consider the most recent NAV provided, the performance of the LP/LLC relative to the market, the stated objectives of the LP/LLC, the cash flows expected from the LP/LLC and audited financial statements of the entity, if available, in considering whether an OTTI exists.

Our investments in tax credit partnerships are evaluated for OTTI by considering both qualitative and quantitative factors which include: whether cash flows, primarily tax benefits, currently expected from the investment equal or exceed the carrying value of the investment, whether currently expected cash flows are less than those expected at the time the investment was acquired, and our ability and intent to hold the investment until the recovery of its carrying value.

We also evaluate our holdings of FHLB securities for impairment. We consider the current capital status of the FHLB, whether the FHLB is in compliance with regulatory minimum capital requirements, and the FHLB’s most recently reported operating results.

Deferred Policy Acquisition Costs

Policy acquisition costs (primarily commissions, premium taxes and underwriting salaries) which are directly related to the successful acquisition of new and renewal premiums are capitalized as DPAC and charged to expense, net of ceding commissions earned, as the related premium revenue is recognized. We evaluate the recoverability of our DPAC at the segment level each reporting period, and any amounts estimated to be unrecoverable are charged to expense in the current period. As of March 31, 2016 we have not determined that any amounts are unrecoverable.

Estimation of Taxes / Tax Credits

For interim periods, we determine our provision for income taxes based on our current estimate of our annual effective tax rate. Items which are unusual, infrequent, or that cannot be reliably estimated are considered in the effective tax rate in the period in which the item is included in income. In calculating our estimated annual effective tax rate, we include the estimated benefit of tax credits for the annual period based on the most recently available information provided by the tax credit partnership; the actual amounts of credits provided by the tax credit partnerships may prove to be different than our estimates. The effect of such differences is recognized in the period identified.

Deferred Taxes

Deferred federal income taxes arise from the recognition of temporary differences between the bases of assets and liabilities determined for financial reporting purposes and the bases determined for income tax purposes. Our temporary differences principally relate to our loss reserve, unearned premiums, compensation recognition, deferred policy acquisition costs, unrealized investment gains (losses), intangibles, and basis differences on investment assets. Deferred tax assets and liabilities are measured using the enacted tax rates expected to be in effect when such benefits are realized. We review our deferred tax assets quarterly for impairment. If we determine that it is more likely than not that some or all of a deferred tax asset will not be realized, a valuation allowance is recorded to reduce the carrying value of the asset. In assessing the need for a valuation allowance, management is required to make certain judgments and assumptions about our future operations based on historical experience and information as of the measurement

period regarding reversal of existing temporary differences, carryback capacity, future taxable income (including its capital and operating characteristics) and tax planning strategies.

Table of Contents

Unrecognized Tax Benefits

We evaluate tax positions taken on tax returns and recognize positions in our financial statements when it is more likely than not that we will sustain the position upon resolution with a taxing authority. If recognized, the benefit is measured as the largest amount of benefit that has a greater than fifty percent probability of being realized. We review uncertain tax positions each period, considering changes in facts and circumstances, such as changes in tax law, interactions with taxing authorities and developments in case law, and make adjustments as we consider necessary. Adjustments to our unrecognized tax benefits may affect our income tax expense, and settlement of uncertain tax positions may require the use of cash. No significant adjustments were considered necessary during the first quarters of 2016 or 2015. At March 31, 2016, our liability for unrecognized tax benefits approximated $8.3 million.

Goodwill

We review goodwill for impairment annually on October 1 and whenever events or changes in circumstances indicate the carrying amount of goodwill may not be recoverable. Goodwill is tested for impairment at the reporting unit level. Our reporting units are consistent with the reportable segments identified in Note 12 of the Notes to Condensed Consolidated Financial Statements. Of the four reporting units, two have goodwill - Specialty P&C and Workers' Compensation. As of October 1, 2015, we performed a quantitative goodwill impairment test for both the Specialty P&C and Workers' Compensation units. As of October 1, 2015 fair values for both the Specialty P&C and Workers' Compensation reporting units exceeded the carrying amounts, and no goodwill impairment was recorded. There have been no events or changes in circumstances since that evaluation date that would indicate the carrying amount of goodwill is not recoverable. Additional information regarding our goodwill evaluation at the segment level is included in Note 1 of the Notes to Consolidated Financial Statements included in ProAssurance's December 31, 2015 Form 10-K.

Intangibles

Intangible assets with definite lives are amortized over the estimated useful life of the asset. Amortizable intangible assets primarily consist of agency and policyholder relationships, renewal rights and trade names. Intangible assets with an indefinite life, primarily state licenses, are not amortized. Intangible assets are evaluated for impairment on an annual basis. Additional information regarding intangible assets is included in Note 1 of the Notes to Consolidated Financial Statements included in ProAssurance's December 31, 2015 Form 10-K.

Audit Premium

Workers' compensation premiums are determined based upon the payroll of the insured, applicable premium rates and an experience based modification factor, where applicable. An audit of the policyholders' records is conducted after policy expiration to make a final determination of applicable premiums. Audit premium due from or due to a policyholder as a result of an audit is reflected in net premiums written and earned when billed. We track, by policy, the amount of additional premium billed in final audit invoices as a percentage of payroll exposure and use this information to estimate the probable additional amount of EBUB premium as of the balance sheet date. We include changes to the EBUB premium estimate in net premiums written and earned in the period recognized.

Accounting Changes

We are not aware of any accounting changes not yet adopted as of March 31, 2016 that would have a material effect on our results of operations or financial position. Note 1 of the Notes to Condensed Consolidated Financial Statements provides additional detail regarding accounting changes.

Table of Contents

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. The holding company has no substantial external revenues other than its investment revenues, and dividends from its operating subsidiaries represent a significant source of funds for its obligations, including debt service and shareholder dividends. At March 31, 2016, we held cash and liquid investments of approximately $196.1 million outside our insurance subsidiaries that were available for use without regulatory approval or other restriction. Our holding company also has an additional $100 million in permitted borrowings under its Revolving Credit Agreement, and an accordion feature, which if subscribed successfully, would allow another $50 million in available funds as discussed in this section under the heading "Debt."

In the aggregate, our domestic insurance subsidiaries would be permitted to pay dividends of approximately $165 million over the remainder of 2016 without the prior approval of state insurance regulators. The payment of any dividend requires prior notice to the insurance regulator in the state of domicile, and the regulator may reduce or prevent the dividend if, in its judgment, payment of the dividend would have an adverse effect on the surplus of the insurance subsidiary. We make the decision to pay dividends from an insurance subsidiary based on the capital needs of that subsidiary, and may pay less than the permitted dividend or may also request permission to pay an additional amount (an extraordinary dividend).

Operating Activities and Related Cash Flows

The principal components of our operating cash flows are the excess of premiums collected and net investment income over losses paid and operating costs, including income taxes. Timing delays exist between the collection of premiums and the payment of losses associated with the premiums. 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 any associated reinsurance recoveries.

Operating cash flows compare as follows:

	Operating Cash Flow Three Months Ended March 31	
(In millions)	2016	2015
Cash provided by operating activities	$57.0	$36.8

Change in Operating Cash Flows	2016 vs 2015	2015 vs 2014
Cash provided by operating activities, prior year	$36.8	$30.4
Increase (decrease) in operating cash flows attributable to:		
Premium receipts	(3.3)	6.7
Payments to reinsurers	(4.3)	5.6
Losses paid, net of reinsurance recoveries	7.3	(10.7)
Cash received from investments	(2.6)	(4.1)
Cash paid for other expenses	7.3	—
Federal and state income tax payments	14.9	2.1
Cash flows produced by Lloyd's Syndicate operations	0.8	6.8
Other amounts not individually significant, net	0.1	—
Cash provided by operating activities, current year	$57.0	$36.8

Premium receipts. The decrease in premium receipts for 2016 was attributable to lower overall premium volume for our Specialty P&C segment. The increase in premium receipts for 2015 was primarily attributable to higher premium

volume as compared to 2014, primarily within our Workers' Compensation segment, which more than offset the decline in our Specialty P&C segment.

Table of Contents

Payments to reinsurers. Reinsurance contracts are generally for premiums written in a specific annual period, but, absent a commutation agreement, remain in effect until all claims under the contract have been resolved. Some contracts require annual settlements while others require settlement only after a number of years have elapsed, thus the amounts paid can vary widely from period to period.

Payments to reinsurers (increased) decreased as compared to the prior period as shown below:

(In millions)	Three Months Ended March 31 2016 vs 2015	2015 vs 2014
Change in payments to reinsurers, exclusive of Syndicate 1729	$(4.5)	$8.9
Change in reinsurance paid to Syndicate 1729	0.2	(3.3)
	$(4.3)	$5.6

Exclusive of the effect of our quota share reinsurance agreement with Syndicate 1729, payments to reinsurers increased in 2016 as compared to 2015 but decreased in 2015 as compared to 2014. Cash flows resulting from premium adjustments on our excess of loss reinsurance arrangements can vary widely depending on the nature of changes to the estimated premium owed under these arrangements, at times resulting in the receipt of cash and other times resulting in cash disbursements. During both 2016 and 2015 such adjustments resulted in the receipt of cash, but receipts in 2015 were much more substantial than in 2016. In addition, only a portion of the 2016 adjustment has been received. In 2015 payments to reinsurers, exclusive of the effect of our quota share reinsurance agreement with Syndicate 1729, decreased as compared to 2014 primarily due to the expansion of our shared risks arrangements. Payments to Syndicate 1729 were relatively flat in 2016 and increased in 2015 as compared to 2014 as 2014 was the initial year of the reinsurance program and no activity was reported during the first quarter 2014. Net operating cash flows of our Syndicate 1729 operations reflects the receipt of these payments, but are reported pro rata (58%) and on a one quarter delay.

Losses paid, net of reinsurance recoveries. The timing of our net loss payments varies from period to period because the process for resolving claims is complex and occurs at an uneven pace depending upon the circumstances of the individual claim.

(In millions)	Three Months Ended March 31 2016 vs 2015	2015 vs 2014
Change in losses paid	$(13.0)	$(13.4)
Change in reinsurance recoveries	4.3	2.7
Cash received for reinsurance commutation	16.0	—
	$7.3	$(10.7)

During the first quarter 2016 we commuted the 2014 calendar year quota share reinsurance arrangement between our Specialty P&C segment and Syndicate 1729 which resulted in a cash receipt from Syndicate 1729 during the period and is reflected in the above table. Due to the delay in reporting Syndicate 1729 results, our pro rata (58%) share of the cash payment by Syndicate 1729 will be reflected in our operating cash flows in the second quarter of 2016.

Cash received from investments. Receipts from fixed income securities have declined due to a smaller fixed income portfolio. Also, the timing of dividend receipts and income distributions from our investment LPs/LLCs is uneven.

Cash paid for other expenses. The decrease in cash paid for other expenses in 2016 as compared to 2015 is primarily attributable to lower commissions and lower compensation related payments in the first quarter 2016 as well as the timing of certain cash payments for other expenses.

Table of Contents

Federal and state income tax payments. Net tax payments (increased) decreased as compared to the prior period as shown below:

(In millions)	Three Months Ended March 31	
	2016 vs 2015	2015 vs 2014
Change in amount of tax payments made for the prior tax year	$4.0	$(3.0)
Change in amount of excess tax benefits associated with share-based compensation	(0.2)	1.0
Refunds related to prior tax year	11.1	4.1
	$14.9	$2.1

Cash flows produced by Lloyd's Syndicate Operations. This represents our 58% share of Syndicate 1729 operating cash flows, reported on a one quarter delay. The large increase in operating cash flows in 2015 as compared to 2014 is due to nominal cash flow activity in 2014.

Table of Contents

Reinsurance

Within our Specialty P&C segment, we use insurance and reinsurance (collectively, “reinsurance”) to provide capacity to write larger limits of liability, to provide reimbursement for losses incurred under the higher limit coverages we offer and to provide protection against losses in excess of policy limits. We also use risk sharing reinsurance arrangements, which provide custom insurance solutions for large customer groups, and have a quota share arrangement with Lloyd's Syndicate 1729 established to provide an initial premium base for Syndicate 1729. Within our Workers' Compensation segment, we use reinsurance to reduce our net liability on individual risks, to mitigate the effect of significant loss occurrences (including catastrophic events), to stabilize underwriting results, and to increase underwriting capacity by decreasing leverage. In both the Specialty P&C and Workers' Compensation segments, we use reinsurance in risk sharing arrangements, to align our objectives with those of our strategic business partners and to provide custom insurance solutions for large customer groups. 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 pay our reinsurers a premium in exchange for reinsurance of the risk. For our excess of loss arrangements, the premium due to the reinsurer is determined by the loss experience of the business reinsured, subject to certain minimum and maximum amounts. Until all loss amounts are known, we estimate the premium due to the reinsurer. Changes to the estimate of premium owed under reinsurance agreements related to prior periods are recorded in the period in which the change in estimate occurs and can have a significant effect on net premiums earned.

We generally reinsure risks under treaties (our excess of loss reinsurance arrangements) pursuant to which the reinsurers agree to assume all or a portion of all risks that we insure above our individual risk retention levels, up to the maximum individual limits offered. These arrangements are negotiated and renewed annually. Renewal dates for our professional liability, medical technology liability and workers' compensation treaties are October 1, January 1 and May 1, respectively. As of October 1, 2015 our professional liability treaty renewed with more favorable terms and pricing than the previous agreement. Our workers' compensation and medical technology liability treaties also renewed at a more favorable rate than the previous agreements upon the latest renewal of each. The significant terms of our excess of loss reinsurance arrangements are detailed in the following table.

Excess of Loss Reinsurance Agreements

Professional Liability	Medical Technology & Life Sciences Products	Workers' Compensation - Traditional

(1) Historically, retention has ranged from 5% to 32.5%

(2) Historically, retention has been as high as $2M

47

Table of Contents

Large professional liability risks that are above the limits of our basic reinsurance treaties are reinsured on a facultative basis, whereby the reinsurer agrees to insure a particular risk up to a designated limit. We also have in place a number of risk sharing arrangements that apply to the first $1 million of losses for certain large healthcare systems and other insurance entities and with certain insurance agencies that produce business for us.
During the three months ended March 31, 2016, we wrote workers' compensation policies in our alternative market business generating premium of approximately $22.7 million under custom programs whereby the policies written are fully reinsured under 100% quota share agreements to the SPCs of our wholly owned subsidiary, Eastern Re, domiciled in the Cayman Islands, net of a ceding commission. The remaining premium written in our alternative market business of $3.7 million for the 2016 three-month period is 100% ceded to unaffiliated captive insurers.
Each SPC has preferred shareholders and the underwriting profit or loss of each cell accrues fully to these preferred shareholders. We participate as a preferred shareholder in certain SPCs. Our ownership interest in the SPCs for which we participate is as low as 25% and as high as 77.5%.
Each SPC has in place its own reinsurance arrangements, which are illustrated in the table below.
Segregated Portfolio Cell Reinsurance
Per Occurrence Coverage   Aggregate Coverage
(1) ProAssurance assumes 100% of aggregate losses in excess of an aggregate attachment point with a maximum loss limit of $100K.
(2) The attachment point is based on a percentage of premium (average is 89%) and varies by cell.
Each SPC maintains a loss fund initially equal to the difference between premium assumed by the cell and the ceding commission. The external owners of each cell provide a letter of credit to us that is equal to the difference between the loss fund of the SPC (amount of funds available to pay losses after deduction of ceding commission) and the aggregate attachment point of the reinsurance.
Within our Lloyd's Syndicate segment, Syndicate 1729 purchases reinsurance to limit its liability on individual risks and to protect against catastrophic loss. The level of reinsurance that the Syndicate purchases is dependent on a number of factors, including its underwriting risk appetite for catastrophic exposure, the specific risks inherent in each line or class of business written and the pricing, coverage and terms and conditions available from the reinsurance market. Both quota share reinsurance and excess of loss reinsurance are utilized to manage the net loss exposure. The Syndicate may still be exposed to loss that exceeds the level of reinsurance purchased, as well as to reinstatement premiums triggered by losses exceeding specified levels.

Table of Contents

For all of our segments, we make a determination of the amount of insurance risk we choose to retain based upon numerous factors, including our risk tolerance and the capital we have to support it, the price and availability of reinsurance, the volume of business, our level of experience with a particular set of claims and our analysis of the potential underwriting results. We purchase excess of loss reinsurance to limit the amount of risk we retain and we do so from a number of companies to mitigate concentrations of credit risk. We utilize reinsurance brokers to assist us in the placement of these reinsurance programs and in the analysis of the credit quality of our reinsurers. The determination of which reinsurers we choose to do business with is based upon an evaluation of their then-current financial strength, rating and stability. 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.

Litigation

We are involved in various legal actions related to insurance policies and claims handling including, but not limited to, claims asserted against us by policyholders. These types of legal actions arise in the ordinary course of business and, in accordance with GAAP for insurance entities, are generally considered as a part of our loss reserving process, which is described in detail in our Critical Accounting Estimates section under the heading "Reserve for Losses and Loss Adjustment Expenses." We also have other direct actions against the Company unrelated to our claims activity which we evaluate and account for as a part of our other liabilities. For these corporate legal actions, we evaluate each case separately and establish what we believe is an appropriate reserve based on GAAP guidance related to contingent liabilities. As of March 31, 2016 there were no material reserves established for corporate legal actions.

Table of Contents

Investing Activities and Related Cash Flows

Our investments at March 31, 2016 and December 31, 2015 are comprised as follows:

($ in thousands)	March 31, 2016			December 31, 2015		
	Carrying Value	% of Total Investment		Carrying Value	% of Total Investment	
Fixed Maturities, Available for Sale						
U.S. Treasury obligations	$148,307	4	%	$123,892	3	%
U.S. Government-sponsored enterprise obligations	26,478	1	%	26,334	1	%
State and municipal bonds	902,329	24	%	940,635	26	%
Corporate debt	1,274,100	34	%	1,291,686	35	%
Residential mortgage-backed securities	263,834	7	%	238,387	7	%
Commercial mortgage-backed securities	39,954	1	%	41,133	1	%
Other asset-backed securities	100,207	3	%	98,220	3	%
Total fixed maturities securities, available for sale	2,755,209	74	%	2,760,287	76	%
Equity securities, trading	328,472	9	%	322,353	9	%
Short-term investments	148,355	4	%	119,236	3	%
BOLI	57,672	2	%	57,213	2	%
Investment in unconsolidated subsidiaries	327,867	9	%	311,908	9	%
Other investments	80,700	2	%	79,133	1	%
Total Investments	$3,698,275	100	%	$3,650,130	100	%

The distribution of our investments in fixed-maturity securities by rating were as follows:

($ in thousands)	March 31, 2016			December 31, 2015		
Rating	Carrying Value	% of Fixed Maturities		Carrying Value	% of Fixed Maturities	
AAA	$740,785	27	%	$688,449	25	%
AA+	216,708	8	%	224,956	8	