PROASSURANCE CORP
Form 10-K
February 20, 2014
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United States
Securities and Exchange Commission
Washington, D.C. 20549
FORM 10-K
(Mark One)
ý Annual report pursuant to section 13 or 15(d) of the Securities Exchange Act of 1934 [Fee Required]
for the fiscal year ended December 31, 2013,
or
¨ Transition report pursuant to section 13 or 15(d) of the Securities Exchange Act of 1934 [No Fee Required]
for the transition period from to .
Commission file number: 001-16533
ProAssurance Corporation
(Exact name of registrant as specified in its charter)

Delaware (State of incorporation or organization)	63-1261433 (I.R.S. Employer Identification No.)
100 Brookwood Place, Birmingham, AL (Address of principal executive offices)	35209 (Zip Code)

(205) 877-4400
(Registrant's Telephone Number, Including Area Code)
Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class	Name of Each Exchange On Which Registered
Common Stock, par value $0.01 per share	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act:
None.
Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ý No ¨
Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes ¨ No ý
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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ¨
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 Act). Yes ¨ No ý

The aggregate market value of voting stock held by non-affiliates of the registrant at June 30, 2013 was $3,178,444,502.

As of February 12, 2014, the registrant had outstanding approximately 60,486,816 shares of its common stock.

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Documents incorporated by reference in this Form 10-K

(i) The definitive proxy statement for the 2014 Annual Meeting of the Stockholders of ProAssurance Corporation (File No. 001-16533) is incorporated by reference into Part III of this report.

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General Information

Throughout this report, references to ProAssurance, “we”, “us”, “our” or "the Company" refer to ProAssurance Corporation and its consolidated subsidiaries. Also, as ProAssurance is an insurance holding company and certain terms and phrases common to the insurance industry are used in this report that carry special and specific meanings, we encourage you to read the Glossary of Selected Insurance and Related Financial Terms posted on the Supplemental Information page of our website (www.proassurance.com/InvestorRelations/supplemental.aspx).

Caution Regarding Forward-Looking Statements

Any statements in this Form 10K 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”, “preliminar “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 10K that are identified as giving our outlook on future business.

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

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

- 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 healthcare professional liability insurance entities that could remove or add sizable groups of physicians 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 Financial Accounting Standards Board, the Securities and Exchange Commission (SEC), the Public Company Accounting Oversight Board, or the New York Stock Exchange (NYSE) and that may affect our business;
- changes in laws or government regulations affecting the financial services industry, the property and casualty insurance industry or the particular insurance lines underwritten by our subsidiaries;
- the effects of changes in the healthcare delivery system, including but not limited to the Patient Protection and Affordable Care Act (the Healthcare Reform Act);
- consolidation of healthcare providers resulting in entities that are more likely to self-insure a substantial portion of their healthcare professional liability risk;
- uncertainties inherent in the estimate of loss and loss adjustment expense reserves and reinsurance;
- changes in the availability, cost, quality or collectability of insurance/reinsurance;

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- the results of litigation, including pre- or post-trial motions, trials and/or appeals we undertake;
- allegation 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;
- the availability, integrity and security of our technology infrastructure;
- 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 other states 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 law 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 and 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 adversely affect the integration of Medmarc Mutual Insurance Company, now Medmarc Casualty Insurance Company (Medmarc), and Eastern Insurance Holdings, Inc. (Eastern) into ProAssurance, include but are not limited to the following:

- the outcome of claims that may be asserted by either the policyholders or shareholders of any of these acquired entities relating to payments or other issues associated with the acquisition of the entities and subsequent mergers into ProAssurance;
- the operations of ProAssurance and Medmarc or ProAssurance and Eastern may not be integrated successfully, or such integration may take longer to accomplish than expected;
- cost savings from the transactions may not be fully realized or may take longer to realize than expected; and
- operating costs, customer loss and business disruption following one or both transactions, including adverse effects on relationships with employees, may be greater than expected.

Additional risks that could arise from our membership in the Lloyd's of London market (Lloyd's) and our participation in Lloyd's Syndicate 1729 (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%;
- 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 our annual business plan, or a decision to increase the capital required to continued operations, and by our obligation to pay levies to Lloyd's;
- Lloyd's insurance and reinsurance relationships and distributions 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; and
- rating agencies could downgrade their ratings of Lloyd's as a whole.

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 this report. We caution readers not to place

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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.

PART I

ITEM 1. BUSINESS

Overview

ProAssurance Corporation is a holding company for property and casualty insurance companies. For the year ended December 31, 2013, our net premiums written totaled $525.2 million, and at December 31, 2013 we had total assets of $5.2 billion and $2.4 billion of shareholders' equity. We provide professional liability insurance for healthcare professionals and facilities, professional liability insurance for attorneys, liability insurance for medical technology and life sciences risks, and, effective January 1, 2014, workers' compensation insurance. During 2013, through a wholly owned subsidiary, we became a corporate member of Lloyd's of London and provided a majority of the capital for Syndicate 1729. Syndicate 1729 began writing a range of property and casualty insurance and reinsurance lines effective January 1, 2014.

Our executive offices are located at 100 Brookwood Place, Birmingham, Alabama 35209 and our telephone number is (205) 877-4400. Our stock trades on the NYSE under the symbol “PRA.” Our website is www.ProAssurance.com and we maintain a dedicated Investor Relations section on that website (www.ProAssurance.com/InvestorRelations) to provide specialized resources for investors and others seeking to learn more about us.

As part of our disclosure through the Investor Relations section of our website, we publish our annual report on Form 10K, our quarterly reports on Form 10Q, and our current reports on Form 8K and all other public SEC filings as soon as reasonably practical after filing with the SEC on its EDGAR system. These SEC filings can be found on our website at www.proassurance.com/InvestorRelations/reports_filings.aspx. This section also includes information regarding stock trading by corporate insiders by providing access to SEC Forms 3, 4 and 5 when they are filed with the SEC. In addition to federal filings on our website, we make available other documents that provide important additional information about our financial condition and operations. Documents available on our website include the financial statements we file with state regulators (compiled under Statutory Accounting Principles as required by regulation), news releases that we issue, a listing of our investment holdings, and certain investor presentations. The Governance section of our website provides copies of the charters for our governing committees and many of our governing policies. Printed copies of these documents may be obtained from Frank O’Neil, Senior Vice President, ProAssurance Corporation, either by mail at P.O. Box 590009, Birmingham, Alabama 35259-0009, or by telephone at (205) 877-4400 or (800) 282-6242.

Our History

We were incorporated in Delaware in 2001 as the successor to Medical Assurance, Inc. in conjunction with its merger with Professionals Group, Inc. ProAssurance has a history of growth through acquisitions. Significant acquisitions completed in the most recent five years include:

- Podiatry Insurance Company of America and subsidiaries, (PICA), acquired April 1, 2009,
- American Physicians Service Group, Inc. and subsidiaries, (APS), acquired November 30, 2010,
- Independent Nevada Doctors Insurance Exchange, (IND), acquired November 30, 2012,
- Medmarc Mutual Insurance Company and subsidiaries, (Medmarc), acquired January 1, 2013, and
- Eastern Insurance Holdings, Inc., (Eastern), which was completed January 1, 2014.

Our Strategy

Our business objectives are to generate attractive returns on equity and book value per share growth for our shareholders. We believe we achieve these objectives by executing the following strategies:

- Pursue profitable underwriting opportunities. We pursue a strategy that emphasizes profitability, not market share. Key elements of this strategy are prudent risk selection, appropriate pricing and adjusting our business mix as appropriate to effectively utilize capital and achieve market synergies. We seek to help customers confront uncertainty through innovative loss transfer and loss mitigation solutions for liability risks, with an emphasis on healthcare. Our healthcare focus considers the risk management needs of a broad spectrum of the healthcare provider market. Often, we utilize mergers or acquisitions to expand the products we offer or the types of customers we serve.
- Exercise underwriting and risk management discipline. We believe we exercise underwriting and risk management discipline by adhering to underwriting guidelines across our business lines and fostering a culture that focuses on

enterprise risk management and strong internal controls.

- Assist insureds in reducing risk. We offer training to our insureds to assist them in the use of risk reduction tools and techniques.

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- Manage claims effectively. Our experienced claims teams have industry and insurance expertise that, with our extensive local knowledge, allows us to resolve claims in the most effective manner possible, considering the circumstances of each claim. When practical, we utilize formalized claims management processes and protocols as a means of reducing claim costs.
- Provide superior customer service. Our mission statement, We Exist to Protect Others, goes hand-in-hand with our corporate motto, "Treated Fairly." Both statements speak to our desire to be a strong and trusted partner that helps customers confront uncertainty through innovative loss transfer and loss mitigation solutions for liability risks, with an emphasis on healthcare. Our employees are committed to core values of integrity, respect, involvement of our insureds, collaboration, communication and enthusiasm every day.
- Maintain a conservative investment strategy. We believe that we follow a conservative investment strategy designed to emphasize the preservation of our capital and provide adequate liquidity for the prompt payment of claims. Our investment portfolio consists primarily of investment-grade, fixed-maturity securities of short-to medium-term duration.
- Maintain financial stability. We are committed to maintaining claims paying ratings of "A" or better.

Organization and Segment Information

We operate through multiple insurance organizations with four areas of focus: professional liability insurance, medical technology and life sciences products liability insurance, and beginning January 1, 2014, workers' compensation insurance and international property and casualty insurance and reinsurance. We operated as a single segment in 2013, 2012 and 2011. In 2014 we expect to report our results in four segments: specialty property and casualty, workers' compensation, Lloyd's syndicate and corporate. Our corporate segment includes our investing operations managed at the corporate level, non-premium revenues generated outside of our insurance entities, and corporate expenses.

Gross Premiums Written

Gross premiums written for the years ending December 31, 2013, 2012 and 2011 is provided below.

($ in thousands)	Year Ended December 31								
	2013			2012			2011		
Gross Premiums Written									
Professional liability:									
Physicians (1)	$414,167	73	%	$416,510	78	%	$451,181	80	%
Other healthcare professionals and facilities	69,327	12	%	71,751	13	%	73,729	13	%
Legal professionals	27,060	5	%	17,146	3	%	16,474	3	%
All other (2)	22,803	4	%	31,024	6	%	24,511	4	%
Medical technology and life sciences products liability	34,190	6	%	—	—	%	—	—	%
Total	$567,547	100	%	$536,431	100	%	$565,895	100	%

(1) Primarily comprised of one-year term policies, but includes premium related to policies with a two-year term of $25.6 million in 2013, $13.1 million in 2012 and $22.3 million in 2011.

(2) Includes tail coverage premiums of $20.9 million in 2013, $29.4 million in 2012 and $20.9 million in 2011.

Prior to acquisition of Medmarc on January 1, 2013 we did not have any medical and life sciences products technology premium. As previously discussed, the operating results of our workers' compensation segment will not be included in our consolidated results until 2014. Additional detailed information regarding premium by individual product type is provided in Item 7, Management's Discussion and Analysis, Results of Operations, under the caption "Premiums Written".

Prior to January 1, 2014 all of our premium revenues were written within the United States. As of January 1, 2014 we are writing premium outside of the United States due to our participation in Syndicate 1729, see segment discussion below.

Specialty Property and Casualty Segment

Professional Liability Insurance

Our professional liability business is focused on providing professional liability insurance to healthcare providers and institutions and to attorneys and their firms. Physicians are currently our core customer group, but we target the full spectrum of the healthcare professional liability market. For our legal professional liability product, we target smaller law practices. While most of our business is written in the standard market, we also offer professional liability insurance on an excess and surplus lines basis. We are licensed to do business in every state. For the years ended December 31, 2013, 2012 and 2011 physician coverages represented 73%, 78% and 80%, respectively, of the consolidated gross premiums written.

We utilize independent agencies and brokers as well as an internal sales force to write our healthcare professional liability (HCPL) business. Our legal professional liability business is written almost exclusively through agents and brokers. For the year ended December 31, 2013 approximately 66% of our professional liability gross premiums written were produced through independent insurance agencies or brokers. The agencies and brokerages we use typically sell through professional liability insurance specialists who are able to convey the factors that differentiate our professional liability insurance products. No single agent, broker, brokerage or agency accounts for more than 10% of our total professional liability premiums.

In marketing our professional liability products we emphasize that we offer:

- financial strength,
- liability coverages tailored to meet evolving needs of our insureds,
- excellent claims and underwriting services,
- risk management consultation, loss prevention seminars and other educational programs,
- regular newsletters discussing matters of interest to our insureds, including updates on legislative developments,
- support of legislation that will have a positive effect on healthcare and legal liability issues, and
- involvement in and support for local professional societies and related organizations.

These communications and services demonstrate our understanding of the professional liability insurance needs of our insureds, promote a commonality of interest between us and our insureds and provide opportunities for targeted interactions with potential insureds. We maintain regional underwriting and claims processing centers which permit us to consistently provide a high level of customer service to both small and large accounts.

We maintain internal claims personnel that investigate and monitor the processing of our professional liability claims, and engage experienced, independent litigation attorneys in each venue to assist with the claims process as we believe this practice aids us in providing defense that is aggressive, effective and cost-efficient. We evaluate the merit of each claim and determine the appropriate strategy for resolution of the claim, either seeking a reasonable good faith settlement appropriate for the circumstance of the claim or aggressively defending the claim. As part of the evaluation and preparation process for healthcare professional liability claims, we meet regularly with medical advisory committees in our key markets to examine claims, attempt to identify potentially troubling practice patterns and make recommendations to our staff.

Medical Technology and Life Sciences Insurance

Our Medical Technology and Life Sciences business, acquired January 1, 2013 through the acquisition of Medmarc, offers products liability insurance for medical technology and life sciences companies that manufacture or distribute products that are almost all regulated by the United States Food and Drug Administration. Products insured include imaging and non-invasive diagnostic medical devices, orthopedic implants, pharmaceuticals, clinical lab instruments, medical instruments, dental products, and animal pharmaceuticals and medical devices. We also provide coverage for clinical trials and contract manufacturers.

In underwriting our products liability business, we consider the type of risk, the amount of coverage being sought, the expertise and experience of the applicant, and the expected volume of product sales in making our underwriting decision. Close to 100% of our products liability business is written through independent brokers with our top ten producers generating approximately $16 million of our 2013 gross premiums written. We do not appoint agents for our products liability business.

Our products liability claims are centrally processed in Chantilly, Virginia. We strongly defend these claims, with a negotiated settlement being the most frequent means of resolution.

Competition

For our HCPL business, we compete in a fragmented market comprised of many insurers, ranging from single state mono-line insurers to large national carriers offering multiple product lines. According to 2012 industry gross premiums written data, the top five HCPL writers hold a combined market share of approximately 32% and we are the fourth largest HCPL writer in the United States. Competitive distinctions vary from state-to-state and within areas of healthcare delivery (e.g., individual physicians vs. hospitals and facilities) and include pricing, size, name recognition, service quality, market commitment, market

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conditions, breadth and flexibility of coverage, method of sale, financial stability, ratings assigned by rating agencies and regulatory conditions. Our competitors range from large national insurers whose financial strength and resources may be greater than ours to smaller insurance entities that concentrate on a single state and as a result have an extensive knowledge of the local markets.

We are widely recognized in our HCPL markets for our heritage as a policyholder founded company with a long-term focus on the industry and for strong and effective claims management. Historically, we have principally insured physicians in a solo or small group practice, but in recent years we have increased our focus on offering unique, joint or cooperative insurance programs that are attractive to hospitals or other large groups. Often, these large groups and hospitals choose to manage their HCPL risks through alternative insurance mechanisms such as risk retention groups or self-insurance entities, and we offer insurance programs designed to compete with these mechanisms. In recent years there has been a substantial increase in the number of physicians employed full time by hospitals or large group practices, which industry-wide has reduced the number of physicians insured on an individual or small-group basis. Additionally, many believe that healthcare services in the United States will increasingly be provided by professionals other than physicians and outside of hospital settings. We have addressed these issues by refining our existing hospital/physician insurance programs, developing new insurance mechanisms to meet the needs of hospitals and large practice groups, expanding our coverage of healthcare providers other than physician or hospitals, and by enhancing our customer service capabilities, particularly with regard to larger accounts. We believe that our size, reputation for effective claims management, unique customer service focus, multi-state presence, and experience with a broad spectrum of healthcare professionals will provide us with competitive advantages as the HCPL marketplace changes.

We recognize the importance of providing our products at competitive rates. We base our rates on current loss projections, and targeted new business and renewal retention programs where we consider appropriate based on the risks assumed.

Competition in the legal professional liability market is also varied, with coverage offered by both large national property and casualty providers and smaller specialty providers, including mutual companies affiliated with one or more state legal professional association.

Competition in the products liability market is among national property and casualty insurers, some of which are significantly larger than ProAssurance.

Workers' Compensation Segment

Effective January 1, 2014 ProAssurance acquired Eastern, which offers workers' compensation products in the Mid-Atlantic (primarily in Pennsylvania), Southeast, and Midwest regions of the continental United States. The operating results of Eastern will be included in our consolidated results beginning January 1, 2014.

Our workers' compensation business consists of two major business activities:

- Workers' compensation insurance coverages provided to employers, generally those with 1,000 employees or less. Types of policies offered include guaranteed cost policies, policyholder dividend policies, retrospectively-rated policies, deductible policies, and alternative market products.
- Alternative market workers’ compensation solutions provided to individual companies, groups and associations (referred to hereafter as “cell participants”) whereby policies written are 100% reinsured by related segregated portfolio cells of our subsidiary domiciled in the Cayman Islands. The pool of assets and associated liabilities of each segregated portfolio cell are solely for the benefit of the cell participants, and the pool of assets of one segregated portfolio cell are statutorily protected from the creditors of the others. The underwriting results and investment income of the segregated portfolio cells are shared with the cell participants in accordance with the terms of the cell agreements. We principally receive fee revenue from the cells, and for cells in which we are a cell participant, a percentage of the profit or loss of the cell.

Both groups of workers' compensation products are distributed through a group of appointed independent agents.

We utilize an individual account underwriting strategy for our workers' compensation business that is focused on selecting quality accounts. The goal of our workers’ compensation underwriters is to select a diverse book of business with respect to risk classification, hazard level and geographic location. We target accounts with strong return to work and safety programs in low to middle hazard levels such as clerical office, light manufacturing, healthcare, auto dealers and service industries and maintain a strong risk management unit in order to better serve our customers' needs.

We actively seek to reduce our workers' compensation loss costs by placing an emphasis on early intervention and aggressive disability management, utilizing in-house and third-party specialists for case management, including medical cost management. Strategic vendor relationships have been established to reduce claim costs associated with legal representation and medical costs such as physician and hospital charges, physical therapy services and prescription drugs.

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Competition
As with our professional and product liability business, there is substantial competition for our workers' compensation business. Workers' compensation insurance is subject to significant price competition. In addition to price, competition in the workers' compensation insurance line of business is based on quality of the products, quality and delivery of service, financial strength, ratings, distribution systems and technical expertise. Competitors include both regional specialized providers and large national insurance entities offering a full spectrum of business liability products.
Lloyd's Syndicate Segment
Late in 2013, we completed the process of becoming a corporate member of Lloyd's of London, an internationally recognized specialist insurance market. We are the majority (58%) capital provider to Syndicate 1729, which began writing business as of January 1, 2014. The remaining capital for Syndicate 1729 is provided by unrelated third parties, including private names and other corporate members. We have committed £47.3 million ($78.3 million*) of capital for the first year of Syndicate 1729 operations and have a total capital commitment through 2019 of up to $200 million. Syndicate 1729 will cover a range of property and casualty insurance and reinsurance lines, and has a maximum underwriting capacity of £75 million ($124.2 million*) for the 2014 underwriting year, of which £43.2 million ($71.5 million*) is our allocated underwriting capacity as a corporate member.
Syndicate 1729 faces significant competition from other Lloyd's syndicates, U.S. insurers operating internationally, and international and domestic insurers offering similar coverages. Competition is based on price, types and quality of product offered, and service quality. Syndicate 1729 is led by an experienced Lloyd's insurance and reinsurance underwriter, which we believe provides a competitive advantage.
*$ amounts estimated using the GBP exchange rate as of December 31, 2013.
Corporate Segment
We manage our investments at the corporate level and we apply a consistent management strategy to the entire portfolio. Accordingly, we report our investment results and net realized investment gains and losses within our corporate segment. Our corporate segment also includes certain revenues and expenses which management does not consider in evaluating the financial results of our other operating segments, interest expense and taxes.
Our overall investment strategy is to focus on maximizing current income from our investment portfolio while maintaining safety, liquidity, duration targets and portfolio diversification. The portfolio is generally managed by professional third party asset managers whose results we monitor and evaluate. The asset managers typically have the authority to make investment decisions within the asset classes they are responsible for managing, subject to our investment policy and oversight, including a requirement that securities in a loss position cannot be sold without specific authorization from us. See Note 4 of the Notes to Consolidated Financial Statements for more information on our investments.
Rating Agencies
Our claims paying ability is regularly evaluated and rated by three major rating agencies, A. M. Best, Fitch and Moody's. In developing their claims paying ratings, these agencies make an independent evaluation of an insurer's ability to meet its obligations to policyholders. See "Risk Factors" for a table presenting the claims paying ratings of our principal insurance operations.
Four rating agencies evaluate and rate our ability to service current debt and potential debt. These financial strength ratings reflect each agency's independent evaluation of our ability to meet our obligation to holders of our debt, if any. While financial strength ratings may be of greater interest to investors than our claims paying ratings, these ratings are not evaluations of our equity securities nor a recommendation to buy, hold or sell our equity securities.
Insurance Regulatory Matters
We are subject to regulation under the insurance and insurance holding company statutes of various jurisdictions, including the domiciliary states of our active insurance subsidiaries and other states in which our insurance subsidiaries do business. Our primary active insurance subsidiaries are domiciled in the United States. Our states of domicile include Alabama, Illinois, Michigan, Pennsylvania, and Vermont. We have reinsurance operations based in the Cayman Islands and, through our Lloyd's Syndicate segment, we have insurance operations based in the United Kingdom.
United States

Our insurance subsidiaries are required to file detailed annual statements with the state insurance regulators in each of the states in which they do business. The laws of the various states establish agencies with broad authority to regulate, among other

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things, licenses to transact business, premium rates for certain types of coverage, trade practices, agent licensing, policy forms, underwriting and claims practices, reserve adequacy, transactions with affiliates, and insurer solvency. Such regulations may hamper our ability to meet operating or profitability goals, including preventing us from establishing premium rates for some classes of insureds that adequately reflects the level of risk assumed for those classes. Many states also regulate investment activities on the basis of quality, distribution and other quantitative criteria. States have also enacted legislation regulating insurance holding company systems, including acquisitions, the payment of dividends, the terms of affiliate transactions, and other related matters.

Applicable state insurance laws, rather than federal bankruptcy laws, apply to the liquidation or reorganization of insurance companies.

Insurance companies are also subject to state and federal legislative and regulatory measures and judicial decisions. These could include new or updated definitions of risk exposure and limitations on business practices.

Insurance Regulation Concerning Change or Acquisition of Control

The insurance regulatory codes in each of the domiciliary states of our operating subsidiaries contain provisions (subject to certain variations) to the effect that the acquisition of “control” of a domestic insurer or of any person that directly or indirectly controls a domestic insurer cannot be consummated without the prior approval of the domiciliary insurance regulator. In general, a presumption of “control” arises from the direct or indirect ownership, control or possession with the power to vote or possession of proxies with respect to 10% (5% in Alabama) or more of the voting securities of a domestic insurer or of a person that controls a domestic insurer. Because of these regulatory requirements, any party seeking to acquire control of ProAssurance or any other domestic insurance company, whether directly or indirectly, would usually be required to obtain such approvals.

In addition, certain state insurance laws contain provisions that require pre-acquisition notification to state agencies of a change in control of a non-domestic insurance company admitted in that state. While such pre-acquisition notification statutes do not authorize the state agency to disapprove the change of control, such statutes do authorize certain remedies, including the issuance of a cease and desist order with respect to the non-domestic admitted insurers doing business in the state if certain conditions exist, such as undue market concentration.

Statutory Accounting and Reporting

Insurance companies are required to file detailed quarterly and annual reports with the state insurance regulators in each of the states in which they do business, and their business and accounts are subject to examination by such regulators at any time. The financial information in these reports is prepared in accordance with Statutory Accounting Principles (SAP). Insurance regulators periodically examine each insurer’s adherence to SAP, financial condition, and compliance with insurance department rules and regulations.

In late 2010, the National Association of Insurance Commissioners (the NAIC) adopted the Model Insurance and Holding Company System Regulatory Act and Regulation (“Model Law”). The Model Law, as compared to previous NAIC guidance, increases regulatory oversight of and reporting by insurance holding companies, including reporting related to non-insurance entities, and requires reporting of risks affecting the holding company group. Additionally, in 2012 the NAIC adopted the Risk Management and Own Risk and Solvency Assessment Model Act (ORSA), which requires insurers to maintain a framework for identifying, assessing, monitoring, managing and reporting on the “material and relevant risks” associated with the insurer's (or insurance group's) current and future business plans. ORSA will also require insurers to file an internal assessment of solvency with insurance regulators annually beginning in 2015. Although no specific capital adequacy standard is currently articulated in ORSA, it is possible that such standard will be developed over time. The Model Law and ORSA will be binding only if adopted by state legislatures and/or state insurance regulatory authorities and actual regulations adopted by any state may differ from the Model Law. None of the states in which we are domiciled have adopted the Model Law or ORSA.

Regulation of Dividends and Other Payments from Our Operating Subsidiaries

Our operating subsidiaries are subject to various state statutory and regulatory restrictions that limit the amount of dividends or distributions an insurance company may pay to its shareholders, including our insurance holding company, without prior regulatory approval. Generally, dividends may be paid only out of unassigned earned surplus. In every case, surplus subsequent to the payment of any dividends must be reasonable in relation to an insurance company’s outstanding liabilities and must be adequate to meet its financial needs.

State insurance holding company regulations generally require domestic insurers to obtain prior approval of extraordinary dividends. Insurance holding company regulations that govern our principal operating subsidiaries deem a dividend as extraordinary if the combined dividends and distributions to the parent holding company in any twelve-month period exceed prescribed thresholds. Such thresholds are statutorily prescribed by the state of domicile and currently are based on either net

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income for the prior fiscal year (reduced by realized capital gains in certain domiciliary states) or a percentage of unassigned surplus at the end of the prior fiscal year, depending upon the wording of the statute.

If insurance regulators determine that payment of a dividend or any other payments within a holding company group, (such as payments under a tax-sharing agreement or payments for employee or other services) would, because of the financial condition of the paying insurance company or otherwise, be a detriment to such insurance company's policyholders, the regulators may prohibit such payments that would otherwise be permitted.

Risk-Based Capital

In order to enhance the regulation of insurer solvency, the NAIC specifies risk-based capital requirements for property and casualty insurance companies. At December 31, 2013, all of ProAssurance's insurance subsidiaries substantially exceeded the minimum required risk-based capital levels.

Investment Regulation

Our operating subsidiaries are subject to state laws and regulations that require diversification of investment portfolios and that limit the amount of investments in certain investment categories. Failure to comply with these laws and regulations may cause non-conforming investments to be treated as non-admitted assets for purposes of measuring statutory surplus and, in some instances, would require divestiture of investments. We monitor the practices used by our operating subsidiaries for compliance with applicable state investment regulations and take corrective measures when deficiencies are identified.

Guaranty Funds

Admitted insurance companies are required to be members of guaranty associations which administer state guaranty funds. To fund the payment of claims (up to prescribed limits) against insurance companies that become insolvent, these associations levy assessments on all member insurers in a particular state on the basis of the proportionate share of the premiums written by member insurers in the covered lines of business in that state. Maximum assessments permitted by law in any one year generally vary between 1% and 2% of annual premiums written by a member in that state, although state regulations may permit larger assessments if insolvency losses reach specified levels. Some states permit member insurers to recover assessments paid through surcharges on policyholders or through full or partial premium tax offsets, while other states permit recovery of assessments through the rate filing process. In recent years, participation in guaranty funds has not had a material effect on our results of operations.

Shared Markets

State insurance regulations may force us to participate in mandatory property and casualty shared market mechanisms or pooling arrangements that provide certain insurance coverage to individuals or other entities that are otherwise unable to purchase such coverage in the commercial insurance marketplace. Our operating subsidiaries' participation in such shared markets or pooling mechanisms is not material to our business at this time.

Changes in Legislation and Regulation

Tort reforms generally restrict the ability of a plaintiff to recover damages by, among other limitations, eliminating certain claims that may be heard in a court, limiting the amount or types of damages, changing statutes of limitation or the period of time to make a claim, and limiting venue or court selection. A number of states in which we do business, notably Florida, Georgia, Illinois, Missouri, Ohio, Texas, and West Virginia, enacted tort reform legislation in the previous decade as a response to a rapid deterioration in loss trends. These reforms are generally thought to have contributed to the improvement in the overall loss trends in those states, although loss trends have also been favorable in states that did not pass any type of tort reform. In states where these reforms are perceived to have improved the legal climate for liability defendants, we have experienced an increase in competition.

The Missouri tort reform statutes were overturned in 2012, the Illinois and Georgia statutes were overturned in 2010, and challenges to tort reform are underway in most states where tort reforms have been enacted. Other state reforms may also be overturned, although we cannot predict with any certainty how appellate courts will rule. We monitor developments on a state-by-state basis and make business decisions accordingly.

Tort reform proposals are considered from time to time at the Federal level. As in the states, passage of a Federal tort reform package would likely be subject to judicial challenge and we cannot be certain that it would be upheld by the courts.

The Healthcare Reform Act was passed and signed into law in March 2010. Some of the more significant provisions of the Act have not yet become effective, and effects from enacted provisions may gradually increase. We do not expect that the provisions thus far enacted will have a significant direct effect on our business, but specific regulations to implement the law are still being written.

The Healthcare Reform Act is expected to have a significant impact on the practice of medicine in future years and could have unanticipated or indirect effects on our business or alter the risk and cost environments in which we and our insureds operate. These risks include: reduced operating margins that may cause physicians and hospitals to join in larger groupings which are more likely to utilize self-insured solutions for HCPL insurance products; use of electronic medical records may lead to additional medical malpractice litigation or increase the cost of litigation; patient dissatisfaction may increase due to greater strain on the patient-physician relationship; there may be an overall increase in healthcare costs which would increase loss costs for claims involving bodily injury; and additional health conditions may be identified as work-related which could increase the number of workers' compensation claims. Conversely, it is anticipated that there will be growth in the number of ancillary healthcare providers that will become customers for HCPL products. We are unable to predict with any certainty the effect that the Healthcare Reform Act or future related legislation will have on our insureds or our business.

The Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) was passed in July 2010. Although provisions of the Act do not appear to materially affect our business, the Act establishes new regulatory oversight of financial institutions. As detailed regulations are developed to implement the provisions of the Dodd-Frank Act, there may be changes in the regulatory environment that affect the way we conduct our operations or the cost of compliance, or both.

One of the federal government bodies created by the Dodd-Frank Act was the Federal Insurance Office (FIO) which, in December 2013, released a proposal on insurance modernization and improvement of the system of insurance regulation in the United States. Although the FIO is prohibited from directly regulating the business of insurance, it has authority to represent the United States in international insurance matters and has limited power to preempt certain types of state insurance laws. The recent proposal advocates significantly greater federal involvement in insurance regulation and identifies necessary reforms by the states to preclude further consideration of direct federal regulation. While the proposal does not necessarily imply that the federal government will displace state regulation completely, it does recommend more of a hybrid approach to insurance regulation. We cannot predict whether the proposals will be adopted or what impact, if any, such proposals or, if enacted, such laws may have on our business, financial condition or results of operations.

In recent years, the insurance industry has been subject to increased scrutiny by regulators and legislators. The NAIC and a number of state legislatures have considered or adopted legislative proposals that alter and, in many cases, increase the authority of state agencies to regulate insurance companies and insurance holding company systems.

Terrorism Risk Insurance Act

The Federal Terrorism Risk Insurance Act (TRIA) was initially enacted in 2002 to ensure the availability of insurance coverage for certain acts of terrorism, as defined in the TRIA. The Terrorism Risk Insurance Program Reauthorization Act of 2007 (Reauthorization Act) extended the program through December 31, 2014. The Reauthorization Act revised the definition of “Act of Terrorism” to remove the requirement that the act of terrorism be committed by an individual acting on behalf of any foreign person or foreign interest in order to be certified under the Reauthorization Act. The Reauthorization Act requires a $100 million loss event to trigger coverage. The Federal government will reimburse 85% of an insurer’s losses in excess of the insurer’s deductible, up to the maximum annual Federal liability of $100 billion.

Under the Reauthorization Act, we are required to offer terrorism coverage to our commercial policyholders in our workers' compensation line of business, for which we may, when warranted, charge an additional premium. The policyholders may or may not accept such coverage.

International

Workers' Compensation

Our segregated portfolio cell business is reinsured through our subsidiary, Eastern Re Ltd., SPC (Eastern Re), which is organized and licensed as a Cayman Islands unrestricted Class B insurance company. Eastern Re is subject to regulation by the Cayman Islands Monetary Authority (CIMA). Applicable laws and regulations govern the types of policies that the Company can insure or reinsure, the amount of capital that it must maintain and the way it can be invested, and the payment of dividends without approval by the CIMA. Eastern Re is required to maintain minimum capital of approximately $120,000 and must receive approval from the CIMA before it can pay any dividends.

Lloyd's Syndicate 1729

Syndicate 1729 is regulated in the United Kingdom by the Prudential Regulation Authority and the Financial Conduct Authority. All Lloyd's syndicates must also comply with the bylaws and regulations established by the Council of Lloyd's including submission and approval of an annual business plan and maintenance of stipulated capital levels. Also, the Council of

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Lloyd's may call or assess a percentage of a member's underwriting capacity (currently a maximum of 3%) as a contribution to Lloyd's Central Fund, which, similar to state guaranty funds in the United States, meets policyholder obligations if a Lloyd's member is otherwise unable to do so.

The European Union's executive body, the European Commission, is implementing new capital adequacy and risk management regulations called Solvency II that would apply to businesses within the European Union. Solvency II is currently required to be implemented on January 1, 2016, and certain interim transition measures are required for 2014 and 2015. We expect to comply with the requirements in accordance with the timetable set out by the Council of Lloyd's.

Enterprise Risk Management

As a large property and casualty insurance provider, we are exposed to many risks. These risks, whether taken intentionally or unintentionally, are a function of the environment within which we operate. Since certain risks can be correlated with other risks, an event or a series of events can impact multiple areas of the Company simultaneously and have a material effect on the Company's results of operations, financial position and/or liquidity. In response to these exposures we have implemented an Enterprise Risk Management (ERM) program. Our ERM program consists of numerous processes and controls that have been designed by our senior management, with oversight by our Board of Directors, and have been implemented across our organization. We utilize ERM to identify potential risks from all aspects of our operations and to evaluate these risks in manner that is both prudent and balanced. Our primary objective is to develop a risk appetite that creates and preserves value for all of our stakeholders.

Employees

At January 1, 2014, upon completion of our merger with Eastern, we had 962 employees, none of whom were represented by a labor union. We consider our employee relations to be good.

ITEM 1A. RISK FACTORS.

There are a number of factors, many beyond our control, which may cause results to differ significantly from our expectations. Some of these factors are described below. Any factor described in this report could by itself, or together with one or more other factors, have a negative effect on our business, results of operations and/or financial condition. There may be factors not described in this report that could also cause results to differ from our expectations.

Insurance market conditions may alter the effectiveness of our current business strategy and impact our revenues.

The property and casualty insurance business is highly competitive. We compete in a fragmented market comprised of many insurers, ranging from smaller single state mono-line insurers who have an extensive knowledge of local markets to large national insurers who offer multiple product lines and whose financial strength and resources may be greater than ours. In many instances, coverage we offer is also available through mutual entities whose return on equity objectives may be lower than ours. Also, there are many opportunities for self-insurance and for participation in an alternative risk transfer mechanism, such as captive insurers or risk retention groups.

Competition in the property and casualty insurance business is based on many factors, including premiums charged and other terms and conditions of coverage, services provided, financial ratings assigned by independent rating agencies, claims services, reputation, geographic scope, local presence, agent and client relationships, financial strength and the experience of the insurance company in the line of insurance to be written. Actions of competitors could adversely affect our ability to attract and retain business at current premium levels, impact our market share and reduce the profits that would otherwise arise from operations.

Because we are a property and casualty insurer, our business may suffer as a result of unforeseen catastrophe losses.

As a property and casualty insurer we are exposed to claims arising out of catastrophes, primarily through our workers' compensation and Syndicate 1729 operations. Catastrophes can be caused by various events, including hurricanes, tsunamis, tornadoes, windstorms, earthquakes, hailstorms, explosions, flooding, severe winter weather and fires and may include man-made events, such as terrorist attacks or a wide-spread financial crisis. The incidence, frequency and severity of catastrophes are inherently unpredictable. While we use historical data and modeling tools to assess our potential exposure to catastrophic losses under various conditions and probability scenarios, such assessments do not necessarily accurately predict future losses or accurately measure our potential exposure. The extent of losses from a catastrophe is a function of both the total amount of insured exposure in the area affected by the event and the severity of the event.

Insurance companies are not permitted to reserve for a catastrophe until it has occurred. Although we purchase reinsurance protection for risks we believe bear a significant level of catastrophe exposure, actual losses resulting from a

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catastrophic event or events may exceed our reinsurance protection. It is therefore possible that a catastrophic event or multiple catastrophic events could have a material adverse effect on our financial position, results of operations and liquidity.

Our results of operations and financial condition may be affected if actual insured losses differ from our loss reserves or if actual amounts recoverable under reinsurance agreements differ from our estimated recoverables.

We establish reserves as balance sheet liabilities representing our estimates of amounts needed to resolve reported and unreported losses and pay related loss adjustment expenses. Our largest liability is our reserve for loss and loss adjustment expenses. Due to the size of our reserve for loss and loss adjustment expenses, even a small percentage adjustment to our reserve can have a material effect on our results of operations for the period in which the change is made.

The process of estimating loss reserves is complex. Significant periods of time often elapse between the occurrence of an insured loss, the reporting of the loss by the insured and payment of that loss. Ultimate loss costs, even for claims with similar characteristics, can vary significantly depending upon 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, and the personal situation of the claimant or the claimant's family, the outcome of jury trials, the legislative and judicial climate where the insured event occurred, general economic conditions and, for claims involving bodily injury, the trend of healthcare costs. Consequently, the loss cost estimation process requires actuarial skill and the application of judgment, and such estimates require periodic revision. As part of the reserving process, we review the known facts surrounding reported claims as well as historical claims data and consider the impact of various factors such as:

- for reported claims, the nature of the claim and the jurisdiction in which the claim occurred;
- trends in paid and incurred loss development;
- trends in claim frequency and severity;
- emerging economic and social trends;
- trend of healthcare costs for claims involving bodily injury;
- inflation and levels of employment; and
- changes in the regulatory legal and political environment.

This process assumes that past experience, adjusted for the effects of current developments and anticipated trends, is an appropriate, but not necessarily accurate, basis for predicting future events. There is no precise method for evaluating the impact of any specific factor on the adequacy of reserves, and actual results are likely to differ from original estimates. We evaluate our reserves each period and increase or decrease reserves as necessary based on our estimate of future claims payments. An increase to reserves has a negative effect on our results of operations in the period of increase; a reduction to reserves has a positive effect on our results of operations in the period of reduction.

Our loss reserves also may be affected by court decisions that expand liability of our policies after they have been issued and priced. In addition, a significant jury award, or series of awards, against one or more of our insureds could require us to pay large sums of money in excess of our reserved amounts. Due to uncertainties inherent in the jury system, any case that is litigated to a jury verdict has the potential to incur a loss that has a material adverse effect on our results of operations.

We purchase reinsurance to mitigate the effect of large losses. Our receivable from reinsurers on unpaid losses and loss adjustment expenses represents our estimate of the amount of our reserve for losses that will be recoverable under our reinsurance programs. We base our estimate of funds recoverable upon our expectation of ultimate losses and the portion of those losses that we estimate to be allocable to reinsurers based upon the terms and conditions of our reinsurance agreements. Given the uncertainty of the ultimate amounts of our losses, our estimates of losses and related amounts recoverable may vary significantly from the eventual outcome. Also, we estimate premiums ceded under reinsurance agreements wherein the premium due to the reinsurer, subject to certain maximums and minimums, is based in part on losses reimbursed or to be reimbursed under the agreement. Due to the size of our reinsurance balances, changes to our estimate of the amount of reinsurance that is due to us could have a material effect on our results of operations in the period for which the change is made.

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We are exposed to and may face adverse developments involving mass tort products liability claims arising from allegedly defective medical products, including medical devices, biotechnology and diagnostic products, prescription and non-prescription pharmaceuticals, personal care products or animal healthcare products.

Establishing claim and claim adjustment expense reserves for mass tort claims is subject to uncertainties due to many factors, including expanded theories of liability, geographical location and jurisdiction of the lawsuits and the number of manufacturers and/or distributors involved. Moreover, it is difficult to estimate our ultimate liability for such claims due to evolving judicial interpretations of various tort theories of liability and defense theories, such as federal preemption and joint and several liability, as well as the application of insurance coverage to these claims.

If market conditions cause reinsurance to be more costly or unavailable, we may be required to bear increased risk or reduce the level of our underwriting commitments.

As part of our overall risk and capacity management strategy, we purchase reinsurance for significant amounts of risk underwritten by our insurance company subsidiaries. Market conditions beyond our control determine the availability and cost of the reinsurance. We may be unable to maintain current reinsurance coverage or to obtain other reinsurance coverage in adequate amounts and at favorable rates. If we are unable to renew our expiring coverage or to obtain new reinsurance coverage, either our net exposure to risk would increase or, if we are unwilling to bear an increase in net risk exposures, we would need to reduce the amount of our underwritten risk.

We cannot guarantee that our reinsurers will pay in a timely fashion or at all, and, as a result, we could experience losses.

We transfer part of our risks to reinsurance companies in exchange for part of the premium we receive in connection with the risk. Although our reinsurance agreements make the reinsurer liable to us to the extent the risk is transferred, our liability to our policyholders remains our responsibility. Reinsurers may periodically dispute our demand for reimbursement from them based upon their interpretation of the terms of our agreements or may fail to pay us for financial or other reasons. If reinsurers refuse or fail to pay us or fail to pay on a timely basis, our financial results and/or cash flows would be adversely affected and could have a material effect on our results of operations in the period in which uncollectible amounts are identified.

At December 31, 2013 our Receivable from reinsurers on unpaid losses is $247.5 million and our Receivable from reinsurers on paid losses is $3.2 million. As of December 31, 2013 the estimated net amount due from four of our reinsurers exceeded $20 million, on an individual basis, with the largest estimated amount due from an individual reinsurer being $26.0 million. A table listing significant reinsurers is provided in Item 7. Management's Discussion and Analysis, as a part of the Liquidity section, under the caption "Reinsurance".

Our claims handling could result in a bad faith claim against us.

We have been, from time to time, sued for allegedly acting in bad faith during our handling of a claim. The damages claimed in actions for bad faith may include amounts owed by the insured in excess of the policy limits as well as consequential and punitive damages. Awards above policy limits are possible whenever a case is taken to trial. These actions have the potential to have a material adverse effect on our financial condition and results of operations.

Changes in healthcare policy could have a material effect on our operations.

The Healthcare Reform Act was passed and signed into law in March 2010. While the primary provisions of the Healthcare Reform Act do not appear to directly affect our business, specific regulations to implement the law are still being written.

The Healthcare Reform Act is expected to have a significant impact on the practice of medicine in future years and could have unanticipated or indirect effects on our business or alter the risk and cost environments in which we and our insureds operate. These risks include: reduced operating margins that may cause physicians and hospitals to join in larger groupings which are more likely to utilize self-insured solutions for HCPL insurance products; use of electronic medical records may lead to additional medical malpractice litigation or increase the cost of litigation; patient dissatisfaction may increase due to greater strain on the patient-physician relationship; there may be an overall increase in healthcare costs which would increase loss costs for claims involving bodily injury; and additional health conditions may be identified as work-related which could increase the number of workers' compensation claims. Conversely, it is anticipated that there will be growth in the number of ancillary healthcare providers that will become customers for HCPL products. We are unable to predict with any certainty the effect that the Healthcare Reform Act or future related legislation will have on our insureds or our business.

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Changes due to financial reform legislation could have a material effect on our operations.

The Dodd-Frank Act was passed and signed into law in July 2010. The provisions of the bill do not appear to materially affect our operations; however, the bill establishes new regulatory oversight of financial institutions and regulations to implement the Act remain in the process of development. As detailed regulations are developed to implement the provisions of the bill, there may be changes in the regulatory environment that affect the way we conduct our operations or the cost of regulatory compliance, or both. We are unable to predict with any certainty the effect that the Dodd-Frank Act will have on our business.

One of the federal government bodies created by the Dodd-Frank Act was the Federal Insurance Office (FIO) which, in December 2013, released a proposal on insurance modernization and improvement of the system of insurance regulation in the United States. Although the FIO is prohibited from directly regulating the business of insurance, it has authority to represent the United States in international insurance matters and has limited powered to preempt certain types of state insurance laws. The recent proposal advocates significantly greater federal involvement in insurance regulation and identifies necessary reforms by the states to preclude further consideration of direct federal regulation. While the proposal does not necessarily imply that the federal government will displace state regulation completely, it does recommend more of a hybrid approach to insurance regulation. We cannot predict whether the proposals will be adopted or what impact, if any, such proposals or, if enacted, such laws may have on our business, financial condition or results of operations.

The passage of tort reform or other legislation, and the subsequent review of such laws by the courts could have a material impact on our operations.

Tort reforms generally restrict the ability of a plaintiff to recover damages by, among other limitations, eliminating certain claims that may be heard in a court, limiting the amount or types of damages, changing statutes of limitation or the period of time to make a claim, and limiting venue or court selection. A number of states in which we do business, notably Florida, Georgia, Illinois, Missouri, Ohio, Texas, and West Virginia, enacted tort reform legislation in the previous decade as a response to a rapid deterioration in loss trends.

Challenges to tort reform are underway in most states where tort reforms have been enacted. The statutes in Missouri were overturned in 2012; those in Georgia and Illinois were overturned in 2010. We cannot predict with any certainty how other state appellate courts will rule on these laws. While the effects of tort reform have been generally beneficial to our business in states where these laws have been enacted, there can be no assurance that such reforms will be ultimately upheld by the courts. Further, if tort reforms are effective, the business of providing professional liability insurance may become more attractive, thereby causing an increase in competition. In addition, the enactment of tort reforms could be accompanied by legislation or regulatory actions that may be detrimental to our business because of expected benefits which may or may not be realized. These expectations could result in regulatory or legislative action limiting the ability of professional liability insurers to maintain rates at adequate levels.

Coverage mandates or other expanded insurance requirements could also be imposed. States may also consider state-sponsored insurance entities that could remove our potential insureds from the private insurance market.

We continue to monitor developments on a state-by-state basis, and make business decisions accordingly.

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Our performance is dependent on the business, economic, regulatory and legislative conditions of states where we have a significant amount of business.

Our top five states, Alabama, Ohio, Texas, Florida and Michigan, represented 43% of our gross premiums written for the year ended December 31, 2013. Moreover, on a combined basis, Alabama, Ohio and Texas accounted for 30%, 32%, and 33% of our gross premiums written for the years ended December 31, 2013, 2012 and 2011, respectively. Additionally, although Eastern will not be a part of our consolidated results until January 1, 2014, a significant portion of Eastern's total gross premium written for the year ended December 31, 2013 was in the state of Pennsylvania. Unfavorable business, economic or regulatory conditions in any of these states could have a disproportionately greater effect on us than they would if we were less geographically concentrated.

We may be unable to identify future strategic acquisitions or expected benefits from completed and proposed acquisitions may not be achieved or may be delayed longer than expected.

Our corporate strategy anticipates growth through the acquisition of other companies or books of business. However, such expansion is opportunistic and sporadic, and there is no guarantee that we will be able to identify strategic acquisition targets in the future. Additionally, if we are able to identify a strategic target for acquisition, state insurance regulation concerning change or acquisition of control could delay or prevent us from growing through acquisitions. State insurance regulatory codes provide that the acquisition of “control” of a domestic insurer or of any person that directly or indirectly controls a domestic insurer cannot be consummated without the prior approval of the domiciliary insurance regulator. There is no assurance that we will receive such approval from the respective insurance regulator or that such approvals will not be conditioned in a manner that materially and adversely affects the aggregate economic value and business benefits expected to be obtained and cause us to not complete the acquisition. The Company performs thorough due diligence before agreeing to a merger or acquisition, however there is no guarantee that the procedures we perform will adequately identify all potential weaknesses or liabilities of the target company or potential risks to the consolidated entity.

There is also no guarantee that our recent acquisitions of Medmarc and Eastern, or acquisitions or businesses acquired in the future will be successfully integrated. Ineffective integration of our businesses and processes may result in substantial costs or delays and adversely affect our ability to compete. The process of integrating an acquired company or business can be complex and costly, and may create unforeseen operating difficulties and expenditures. Potential problems that may arise include, among other reasons, business disruption, loss of customers and employees, the ineffective integration of underwriting, claims handling and actuarial practices, the increase in the inherent uncertainty of reserve estimates for a period of time until stable trends reestablish themselves within the combined organization, diversion of management time and resources to acquisition integration challenges, the cultural challenges associated with integrating employees, increased operating costs, assumption of greater than expected liabilities, or inability to achieve cost savings. Furthermore, claims may be asserted by either the policyholders or shareholders of any acquired entity related to payments or other issues associated with the acquisition and merger into the consolidated entity. Such claims may prove costly or difficult to resolve or may have unanticipated consequences.

If we are unable to maintain favorable financial strength ratings, it may be more difficult for us to write new business or renew our existing business.

Independent rating agencies assess and rate the claims-paying ability and the financial strength of insurers based upon criteria established by the agencies. Periodically the rating agencies evaluate us to confirm that we continue to meet the criteria of previously assigned ratings. The financial strength ratings assigned by rating agencies to insurance companies represent independent opinions of financial strength and ability to meet policyholder and debt obligations and are not directed toward the protection of equity investors.

Our principal operating subsidiaries hold favorable claims paying ratings with A.M. Best, Fitch and Moody’s. Claims paying ratings are used by agents and customers as an important means of assessing the financial strength and quality of insurers. If our financial position deteriorates or the rating agencies significantly change the rating criteria that are used to determine ratings, we may not maintain our favorable financial strength ratings from the rating agencies. A downgrade or involuntary withdrawal of any such rating could limit or prevent us from writing desirable business.

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The following table, which includes both our investment in Syndicate 1729 as of January 1, 2014 and subsidiaries acquired January 1, 2014, presents the claims paying ratings of our core insurance subsidiaries as of February 12, 2014.

	Rating Agency (1)		
	A.M. Best (www.ambest.com)	Fitch (www.fitchratings.com)	Moody's (www.moodys.com)
ProAssurance Indemnity Company, Inc.	A+ (Superior)	A (Strong)	A2
ProAssurance Casualty Company	A+ (Superior)	A (Strong)	A2
ProAssurance Specialty Insurance Company, Inc.	A+ (Superior)	A (Strong)	NR
Podiatry Insurance Company of America	A (Excellent)	A (Strong)	A2
PACO Assurance Company, Inc.	A- (Excellent)	A (Strong)	NR
Noetic Specialty Insurance Company	A (Excellent)	A (Strong)	NR
Medmarc Casualty Insurance Company	A (Excellent)	A (Strong)	NR
Lloyd's Syndicate 1729 (2)	A (Excellent)	A+ (Strong)	A+ (Strong)
Eastern Alliance Insurance Company	A (Excellent)	NR	NR
Allied Eastern Indemnity Company	A (Excellent)	NR	NR
Eastern Advantage Assurance Company	A (Excellent)	NR	NR
Eastern Re Ltd., SPC	A (Excellent)	NR	NR

(1) NR indicates that the subsidiary has not been rated by the listed rating agency.
(2) Rating provided is the rating applicable to all Lloyd's syndicates.

Four rating agencies evaluate and rate our ability to service current debt and potential debt. These financial strength ratings reflect each agency's independent evaluation of our ability to meet our obligation to holders of our debt, if any. While these ratings may be of greater interest to investors than our claims paying ratings, these are not ratings of our equity securities nor a recommendation to buy, hold or sell our equity securities.

Our business could be adversely affected by the loss or consolidation of independent agents, agencies, or brokers or brokerage firms.

We depend in part on the services of independent agents and brokers in the marketing of our insurance products. We face competition from other insurance companies for their services and allegiance. These agents and brokers may choose to direct business to competing insurance companies.

Our success is dependent upon our ability to effectively design and execute our business strategy and to adequately and appropriately serve our customers.

The Company depends upon the skill and work product of our officers and employees in executing our business strategy. While management and the Board of Directors ("the Board" or "our Board") monitor the strategic direction of the Company, strategic changes could be made that are not supportable by our capital base. In addition, our business could potentially be impacted if we are unable to align our strategy with the expectations of our stakeholders. The operations of the Company are also heavily dependent upon the delivery of superior customer service across a broad customer base, by which negative feedback from agents, insureds or internal staff could result in a loss of revenue for the Company.

Our business could be affected by the loss of one or more of our senior executives.

We are heavily dependent upon our senior management, and the loss of services of our senior executives could adversely affect our business. Our success has been, and will continue to be, dependent on our ability to retain the services of existing key employees and to attract and retain additional qualified personnel in the future. The loss of the services of key employees or senior managers, or the inability to identify, hire and retain other highly qualified personnel in the future, could adversely affect the quality and profitability of our business operations.

Our Board regularly reviews succession planning relating to our Chief Executive Officer as well as other senior officers. Mr. Starnes, our Chief Executive Officer and President, has indicated to the Board that he has no immediate plans for retirement.

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Provisions in our charter documents, Delaware law and state insurance law may impede attempts to replace or remove management or may impede a takeover, which could adversely affect the value of our common stock.

Our certificate of incorporation, bylaws and Delaware law contain provisions that may have the effect of inhibiting a non-negotiated merger or other business combination. We currently have no preferred stock outstanding, and no present intention to issue any shares of preferred stock. In addition, our Corporate Governance Principles provide that the Board, subject to its fiduciary duties, will not issue any series of preferred stock for any defense or anti-takeover purpose, for the purpose of implementing any stockholders rights plan, or with features intended to make any acquisition more difficult or costly without obtaining stockholder approval. However, because the rights and preferences of any series of preferred stock may be set by the Board in its sole discretion, the rights and preferences of any such preferred stock may be superior to those of our common stock and thus may adversely affect the rights of the holders of common stock.

The voting structure of common stock and other provisions of our certificate of incorporation are intended to encourage a person interested in acquiring us to negotiate with, and to obtain the approval of, the Board in connection with a transaction. However, certain of these provisions may discourage our future acquisition, including an acquisition in which stockholders might otherwise receive a premium for their shares. As a result, stockholders who might desire to participate in such a transaction may not have the opportunity to do so.

In addition, state insurance laws provide that no person or entity may directly or indirectly acquire control of an insurance company unless that person or entity has received approval from the insurance regulator. An acquisition of control of ProAssurance would be presumed if any person or entity acquires 10% (5% in Alabama) or more of our outstanding common stock, unless the applicable insurance regulator determines otherwise. These provisions apply even if the offer may be considered beneficial by stockholders.

We are a holding company and are dependent on dividends and other payments from our operating subsidiaries, which are subject to dividend restrictions.

We are a holding company whose principal source of funds is cash dividends and other permitted payments from operating subsidiaries. If our subsidiaries are unable to make payments to us, or are able to pay only limited amounts, we may be unable to make payments on our indebtedness, meet other holding company financial obligations, or pay dividends to shareholders. The payment of dividends by these operating subsidiaries is subject to restrictions set forth in the insurance laws and regulations of their respective states of domicile, as discussed under the caption "Insurance Regulatory Matters".

Regulatory requirements or changes to regulatory requirements could have a material effect on our operations.

Our insurance businesses are subject to extensive regulation by state insurance authorities in each state in which they operate. Regulation is intended for the benefit of policyholders rather than shareholders. In addition to the amount of dividends and other payments that can be made to a holding company by insurance subsidiaries, these regulatory authorities have broad administrative and supervisory power relating to:

- licensing requirements;
- trade practices;
- capital and surplus requirements;
- investment practices; and
- rates charged to insurance customers.

These regulations may impede or impose burdensome conditions on rate changes or other actions that we may desire to take in order to enhance our results of operations. In addition, we may incur significant costs in the course of complying with regulatory requirements. Most states also regulate insurance holding companies like us in a variety of matters such as acquisitions, changes of control and the terms of affiliated transactions.

Also, certain states sponsor insurance entities which affect the amount and type of liability coverages purchased in the sponsoring state. Changes to the number of state sponsored entities of this type could result in a large number of insureds changing the amount and type of coverage purchased from private insurance entities such as ProAssurance.

As a result of our acquisition of Eastern, we own a subsidiary domiciled in the Cayman Islands and subject to the laws of the Cayman Islands and regulations promulgated by the CIMA. Failure to comply with these laws, regulations and requirements could result in consequences ranging from a regulatory examination to a regulatory takeover of our Cayman subsidiary, which could potentially impact profitability of the workers' compensation alternative market solutions offered through this subsidiary.

Syndicate 1729 is regulated in the United Kingdom by the Prudential Regulation Authority and the Financial Conduct Authority. All Lloyd's syndicates must also comply with the bylaws and regulations established by the Council of Lloyd's. Failure to comply with bylaws and regulations could affect our ability to underwrite as a Lloyd's Syndicate in the future and therefore affect our profitability. Changes in bylaws and regulations could also affect the profitability of the operations.

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The European Union's executive body, the European Commission, is implementing new capital adequacy and risk management regulations called Solvency II that would apply to businesses within the European Union. Solvency II is currently required to be implemented on January 1, 2016, and certain interim transition measures are required for 2014 and 2015. We are unable to predict with any certainty the effect that such regulations will have on the profitability of Lloyd's or Syndicate 1729.

As a member of the Lloyd's market and a capital provider to Lloyd's Syndicate 1729 we are subject to certain risks which could materially and adversely affect us.

As a member of the Lloyd's market we are obligated to contribute to the Lloyd's Central Fund and to pay levies to Lloyd's as well as our ongoing exposure to levies and charges in order to underwrite at Lloyd's. Whenever a member of Lloyd's is unable to pay its policyholder obligations, such obligations may be payable by the Lloyd's Central Fund. If Lloyd's determines that the Central Fund needs to be increased, it has the power to assess premiums levies on current Lloyd's members up to 3% of a member's underwriting capacity in any one year. We do not believe that any assessment is likely in the foreseeable future and have not provided an allowance for such an assessment. However, based on our 2014 estimated underwriting capacity at Lloyd's of £43.2 million ($71.5 million), the December 31, 2013 exchange rate of 1.6557 dollars per GBP and assuming the maximum 3% assessment, we could be assessed up to $2.1 million in 2014.

As a participant in Lloyd's of London, Syndicate 1729 is subject to certain risks and uncertainties, including the following:

- its reliance on insurance and reinsurance brokers and distribution channels to distribute and market its products;
- its obligation to pay levies to Lloyds;
- its obligations to maintain funds to support its underwriting activities; its risk-based capital requirement being assessed periodically by Lloyd's and being subject to variation;
- its reliance on ongoing approvals from Lloyd's and various regulators to conduct its business, including a requirement that its Annual Business Plan be approved by Lloyd's before the start of underwriting for each account year;
- its financial strength rating is derived from the rating assigned to Lloyd's, although it has limited ability to directly affect the overall Lloyd's rating; and
- its reliance on Lloyd's trading licenses in order to underwrite business outside the United Kingdom.

The guaranty fund assessments that we are required to pay to state guaranty associations may increase or our participation in mandatory risk retention pools could be expanded and our results of operations and financial condition could suffer as a result.

Each state in which we operate has separate insurance guaranty fund laws requiring admitted property and casualty insurance companies doing business within their respective jurisdictions to be members of their guaranty associations. These associations are organized to pay covered claims (as defined and limited by the various guaranty association statutes) under insurance policies issued by insurance companies that have become insolvent. Most guaranty association laws enable the associations to make assessments against member insurers to obtain funds to pay covered claims after a member insurer becomes insolvent. These associations levy assessments (up to prescribed limits) on all member insurers in a particular state on the basis of the proportionate share of the premiums written by member insurers in the covered lines of business in that state. Maximum assessments generally vary between 1% and 2% of annual premiums written by a member in that state. Some states permit member insurers to recover assessments paid through surcharges on policyholders or through full or partial premium tax offsets, while other states permit recovery of assessments through the rate filing process. In 2013 and 2012, net guaranty fund assessments totaled less than $0.1 million and approximately $0.3 million, respectively. Our practice is to accrue for insurance insolvencies when notified of assessments. We are not able to reasonably estimate assessments or develop a meaningful range of possible assessments prior to notice because the guaranty funds do not provide sufficient information for development of such estimates or ranges.

Certain states have established risk pooling mechanisms that offer insurance coverage to individuals or entities who are otherwise unable to purchase coverage from private insurers. Authorized property and casualty insurers in these states are generally required to share in the underwriting results of these pooled risks, which are typically adverse. Should our mandatory participation in such pools be increased or if the assessments from such pools increased, our results of operations and financial condition would be negatively affected, although that was not the case in 2013, 2012 or 2011.

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Our investment results will fluctuate as interest rates change.

Our investment portfolio is primarily comprised of interest-earning assets, marked to market each period. Thus, prevailing economic conditions, particularly changes in market interest rates, may significantly affect our results of operations. Significant movements in interest rates potentially expose us to lower yields or lower asset values. Changes in market interest rate levels generally affect our net income to the extent that reinvestment yields are different than the yields on maturing securities. Changes in interest rates also can affect the value of our interest-earning assets, which are principally comprised of fixed and adjustable-rate investment securities. Generally, the values of fixed-rate investment securities fluctuate inversely with changes in interest rates. Interest rate fluctuations could adversely affect our stockholders' equity, income and/or cash flows.

Our investments are subject to credit, prepayment risk and other risks.

A significant portion of our total assets ($3.9 billion or 77%) at December 31, 2013 are financial instruments whose value can be significantly affected by economic and market factors beyond our control including, among others, the unemployment rate, the strength of the domestic housing market, the price of oil, changes in interest rates and spreads, consumer confidence, investor confidence regarding the economic prospects of the entities in which we invest, corrective or remedial actions taken by the entities in which we invest, including mergers, spin-offs and bankruptcy filings, the actions of the U.S. government, and global perceptions regarding the stability of the U.S. economy. Adverse economic and market conditions could cause investment losses or other-than-temporary impairments of our securities, which could affect our financial condition, results of operations, or cash flows.

At December 31, 2013 approximately 10% of our investment portfolio is invested in mortgage and asset-backed securities. We utilize ratings determined by Nationally Recognized Statistical Rating Organizations (NRSROs) (Moody's, Standard & Poor's, and Fitch) as an element of our evaluation of the credit worthiness of our securities. The ratings are subject to error by the agencies; therefore, we may be subject to additional credit exposure should the rating be misstated.

Our asset-backed securities are also subject to prepayment risk. A prepayment is the unscheduled return of principal. When rates decline, the propensity for refinancing may increase and the period of time we hold our asset-backed securities may shorten due to prepayments. Prepayments may cause us to reinvest cash proceeds at lower yields than the retired security. Conversely, as rates increase, and motivations for prepayments lessen, the period of time we hold our asset-backed securities may lengthen, causing us to not reinvest cash flows at the higher available yields.

At December 31, 2013 the fair value of our state/municipal portfolio was $1.2 billion (amortized cost basis of $1.1 billion). While our state/municipal portfolio had a high credit rating (AA on average) which indicates a strong ability to pay, there is no assurance that there will not be a credit related event which would cause fair values to decline. The economic downturn in preceding years lessened tax receipts and other revenues in many states and their municipalities and the frequency of credit downgrades of these entities has increased.

Our tax credit partnership interests are subject to risks related to the potential forfeiture of the tax credits and all or a portion of the previously claimed tax credits. Loss of the tax credits might occur if the property owner fails to meet the specified requirements of planning, constructing and operating the property or if the property fails to generate the projected tax credits. At December 31, 2013 the carrying value of our tax credit partnership interests was approximately $142.2 million.

U.S. Government debt rating.

U.S Government securities are no longer rated with the highest possible rating by one of the major rating agencies, and there is potential for a further downgrade or for additional rating agencies to also downgrade U. S. Government securities. The rating agencies have also indicated that debt instruments of issuers dependent upon federal support and distributions, including state and local municipalities, may also be downgraded, but this has not yet occurred to any widespread extent except with respect to U.S. Agency debt or U.S. Agency guaranteed debt. If ratings downgrades occur, the average credit rating of our investment portfolio will be reduced. Due to the unpredictable nature of this situation, we are unable to provide a reliable estimate regarding the extent to which our portfolio might be affected. As of December 31, 2013 debt securities represented 79% of our total investments and included U.S. Government debt, U.S. Agency debt, and U.S. Agency guaranteed debt having a combined fair value of $462 million and state and municipal securities having a combined fair value of $1.2 billion.

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

In accordance with applicable GAAP, we value 94% of our investments at fair value and the remaining 6% at cost, equity, or cash surrender value. See Notes 1, 3 and 4 of the Notes to Consolidated Financial Statements for additional information.

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We determine the fair value of our investments using quoted exchange or over-the-counter (OTC) prices, when available. At December 31, 2013, we valued approximately 13% of our investments in this manner. When exchange or OTC quotes are not available, we estimate fair values based on broker dealer quotes and various other valuation methodologies, which may require us to choose among various input assumptions and which requires us to utilize judgment. At December 31, 2013 approximately 81% of our investments were valued in this manner. When markets exhibit significant volatility, there is more risk that we may utilize a quoted market price, broker dealer quote, valuation technique or input assumption that results in a fair value estimate that is either over or understated as compared to actual amounts received upon disposition or maturity of the security.

Our Board may decide that our financial condition does not allow the continued payment of a quarterly cash dividend, or requires that we reduce the amount of our quarterly cash dividend.

Our Board approved a cash dividend policy in September 2011, most recently paid at $0.30 per share for the three months ended December 31, 2013. However, any decision to pay future cash dividends is subject to the Board’s final determination after a comprehensive review of the Company’s financial performance, future expectations and other factors deemed relevant by the Board.

Our ability to issue additional debt or letters of credit or other types of indebtedness on terms consistent with current debt is subject to market conditions, economic conditions at the time of proposed issuance, and the results of ratings reviews. Also, our current credit agreement requires that our debt to capital ratio be 0.35 to 1.0 or less, and the issuance of debt by one of our insurance subsidiaries requires regulatory approval, both of which may limit or prohibit the issuance of additional debt.

During 2013 we were able to issue $250 million of unsecured Senior Notes Payable due in 2023 at a 5.3% interest rate, and we obtained a secured letter of credit for £41.9 million (approximately $69.3 million at December 31, 2013 at a rate of prime plus 400 basis points. There is no guarantee that additional debt could be issued on similar terms in the future as rates available to us may change due to changes in the economic climate or shifts in the yield curve may occur or an increase in our level of debt may result in rating agencies lowering our debt rating. Also, our insurance subsidiaries must obtain regulatory approval before incurring additional debt. A further restriction is that our credit facility agreement requires that our consolidated debt to capital ratio (0.10 to 1.0 at December 31, 2013) be 0.35 to 1.0 or less.

Resolution of uncertain tax matters and changes in tax laws or taxing authority interpretations of tax laws could result in actual tax benefits or deductions that are different than we have estimated, both with regard to amounts recognized and the timing of recognition. Such differences could affect our results of operations or cash flows.

Our provision for income taxes, our recorded tax liabilities and net deferred tax assets, including any valuation allowances, are recorded based on estimates. These estimates require us to make significant judgments regarding a number of factors, including, among others, the applicability of various federal and state laws, the interpretations given to those tax laws by taxing authorities, courts and ProAssurance, the timing of future income and deductions, and our expected levels and sources of future taxable income. We believe our tax positions are supportable under tax laws and that our estimates are prepared in accordance with GAAP. Additionally, from time to time there are changes to tax laws and interpretations of tax laws which could change our estimates of the amount of tax benefits or deductions expected to be available to us in future periods. In either case, changes to our prior estimates would be reflected in the period changed and could have a material effect on our effective tax rate, financial position, results of operations and cash flow. The reinsurance portion of our workers' compensation business is domiciled in the Cayman Islands. Changes in Cayman Island tax laws could result in the loss of profitability of that business.

We are subject to U.S. federal and various state income taxes. We are periodically under routine examination by various federal, state and local authorities regarding income tax matters and our tax positions could be successfully challenged; the costs of defending our tax positions could be considerable. Our estimate of our potential liability for known uncertain tax positions is reflected in our financial statements and considers the Notice of Proposed Adjustment (NOPA) received in 2012, as discussed in the following paragraph. As of December 31, 2013 we had a federal income tax receivable of approximately $27 million. We also had a liability for unrecognized current tax benefits of $4.8 million, and we had net deferred tax assets of approximately $1.8 million. Unrecognized tax benefits at December 31, 2013, if recognized, would not affect the effective tax rate but would accelerate the payment of tax.

In December 2012 we received a Notice of Proposed Adjustment (NOPA) from the IRS which disallows a substantial portion of the loss and loss adjustment expense deductions taken for the 2009 and 2010 fiscal years and would thereby increase our current tax liability by approximately $130 million. In January 2013 we submitted a comprehensive written protest of the NOPA to the IRS Office of Appeals regarding certain issues within the NOPA, all of which related to the timing of deductions. During the fourth quarter of 2013, we reached a tentative settlement of all contested Federal income tax issues for the related

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tax years which will result in no additional tax liability for us. Other non-contested issues addressed by the NOPA are expected to result in a net federal income tax refund, exclusive of statutory interest, of approximately $9.6 million. We believe that our tentative terms of settlement with the IRS will be documented and finalized during 2014. In January 2013 we made a $20.6 million protective tax payment to the IRS in order to reduce potential interest assessments. We expect the protective payment to also be refunded once the settlement is finalized.

New or changes in existing accounting standards, practices and/or policies, as well as subjective assumptions, estimates and judgments by management related to complex accounting matters could significantly affect our financial results or our ability to maintain investor confidence and shareholder value.

U.S. generally accepted accounting principles (GAAP) and related accounting pronouncements, implementation guidelines and interpretations with regard to a wide range of matters that are relevant to our business, such as revenue recognition, estimation of losses, determination of fair value, asset impairment (particularly investment securities and goodwill) and tax matters, are highly complex and involve many subjective assumptions, estimates and judgments. Changes in these rules or their interpretation or changes in underlying assumptions, estimates, or judgments could significantly change our reported or expected financial performance or financial condition. See Note 1 of the Notes to Consolidated Financial Statements for a description of our significant accounting policies.

ProAssurance is primarily a holding company of insurance subsidiaries which are required to comply with statutory accounting principles (SAP). SAP and its components are subject to review by the NAIC and state insurance departments. The NAIC Accounting Practices and Procedures Manual provides that a state insurance department may allow insurance companies that are domiciled in that state to depart from SAP by granting them permitted non-SAP accounting practices. This permission may permit a competitor or competitors to use a more favorable accounting policy.

It is uncertain whether or how SAP might be revised or whether any revisions will have a positive or negative effect. It is also uncertain whether any changes to SAP or its components or any permitted non-SAP accounting practices granted to our competitors will negatively affect our financial results or operations. See the Insurance Regulatory Matters section in Item 1 for the full discussion on regulatory matters.

Our interpretation, integration and/or compliance with new or changes to existing pronouncements by GAAP or SAP could materially impact us as a publicly traded company as it relates to investor confidence and shareholder value.

We are subject to numerous NYSE and SEC regulations including insider trading regulations, Regulation FD, and regulations requiring timely and accurate reporting of our operating results as well as certain events and transactions. Non-compliance with these regulations could subject us to enforcement actions by the NYSE or the SEC, and could affect the value of our shares and our ability to raise additional capital.

The Company carefully adheres to NYSE and SEC requirements as the loss of trading privileges on the NYSE or an SEC enforcement action could have a significant financial impact on the Company. Failure to comply with various SEC reporting and record keeping requirements could result in a decline in the value of our stock or a decline in investor confidence which could directly impact our ability to efficiently raise capital. Failure to adhere to NYSE requirements could result in fines, trading restriction or delisting.

The operations of the Company are heavily reliant upon the Company's reputation as an ethical business organization providing needed services to its customers.

The Company's positive reputation is critical to its role as an insurance provider and as a publicly traded company. The Board adopted a Code of Ethics and Conduct and management is heavily focused on the integrity of our employees and third party suppliers, agents or brokers. Illegal, unethical or fraudulent activities perpetrated by an employee or one of our third party agencies or brokers for personal gain could expose the Company to a potential financial loss.

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A natural disaster or pandemic event, or closely related series of events, could cause loss of lives or a substantial loss of property or operational ability at one or more of the Company's facilities.

The Company's disaster preparedness encompasses our Business Continuity Plan, Disaster Recovery Plan, Operations Plan, and Pandemic Response Plan. Our disaster preparedness is focused on maintaining the continuity of the Company's data processing and telephone capabilities as well as the use of alternate and temporary facilities in the event of a natural disaster or medical event. The Company's plans are reviewed during the insurance department examinations of the statutory insurance companies. While the Company has plans in place to respond to both short- and long-term disaster scenarios, the loss of certain key operating facilities or data processing capabilities could have a significant impact on Company operations.

The operations of the Company are dependent upon the availability, integrity and security of our internal technology infrastructure and that of certain third parties. Any significant disruption of these infrastructures could result in unauthorized access to Company data or reduce our ability to conduct business effectively, or both.

The Company is dependent upon its technology infrastructure and that of certain third parties to operate and report financial and other Company information accurately and timely. The Company has focused resources on securing and preserving the integrity of our data processing systems and related data. Additionally, the Company evaluates the integrity and security of the technology infrastructure of third parties that process or store data that the Company considers to be significant. However, there is no guarantee that measures taken to date will completely prevent unauthorized access to our technological infrastructure or that of our third party service providers or our data. Should such unauthorized access occur, our normal operations could be disrupted or unauthorized internal or external knowledge or misuse of confidential Company data could occur, all of which could be harmful to the Company from both a financial and reputational perspective.

ITEM 1B. UNRESOLVED STAFF COMMENTS.

None.

ITEM 2. PROPERTIES.

We own five office properties, all of which are unencumbered:

Property Location	Square Footage of Properties Occupied by ProAssurance	Leased or Available for Lease	Total
Birmingham, AL (*)	104,000	61,000	165,000
Franklin, TN	52,000	51,000	103,000
Okemos, MI	53,000	—	53,000
Madison, WI	38,000	—	38,000
Las Vegas, NV	4,640	—	4,640

(*) Corporate Headquarters

ITEM 3. LEGAL PROCEEDINGS.

Our insurance subsidiaries are involved in various legal actions, a substantial number of which arise from claims made under insurance policies. While the outcome of all legal actions is not presently determinable, management and its legal counsel are of the opinion that these actions will not have a material adverse effect on our financial position or results of operations. See Note 9 of the Notes to Consolidated Financial Statements included herein.

EXECUTIVE OFFICERS OF PROASSURANCE CORPORATION

The executive officers of ProAssurance Corporation (ProAssurance) serve at the pleasure of the Board. We have a knowledgeable and experienced management team with established track records in building and managing successful insurance operations. Following is a brief description of each executive officer of ProAssurance, including their principal occupation, and relevant background with ProAssurance and former employers.

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W. Stancil Starnes	Mr. Starnes was appointed as Chief Executive Officer and President of ProAssurance in 2007 and has served as the Chairman of the Board since 2008. Mr. Starnes previously served as President, Corporate Planning and Administration of Brasfield & Gorrie, Inc., a large national commercial contractor. Prior to 2006, Mr. Starnes served as the Senior and Managing Partner of the law firm of Starnes & Atchison, LLP, where he was extensively involved with ProAssurance and its predecessors in the defense of healthcare professional liability claims for over 25 years. Mr. Starnes currently serves as a director of Infinity Property and Casualty Corporation, a public insurance holding company, where he serves on the audit, compensation and executive committees. He formerly served as a director of Alabama National Bancorporation. (Age 65)
Howard H. Friedman	Mr. Friedman was appointed as President of our Healthcare Professional Liability Group in 2014, and is also our Chief Underwriting Officer and Chief Actuary. Mr. Friedman has previously served as a Co-President of our Professional Liability Group, Chief Financial Officer, Corporate Secretary, and as the Senior Vice President of Corporate Development. Mr. Friedman joined our predecessor in 1996. Mr. Friedman is an Associate of the Casualty Actuarial Society and a member of the American Academy of Actuaries. (Age 55)
Jeffrey P. Lisenby	Mr. Lisenby was appointed as an Executive Vice President in 2014 and is also our General Counsel, Corporate Secretary and head of the corporate Legal Department. Mr. Lisenby has previously served as Senior Vice President. Prior to joining ProAssurance, Mr. Lisenby practiced law privately in Birmingham, Alabama. Mr. Lisenby is a member of the Alabama State Bar and the United States Supreme Court Bar and is a Chartered Property Casualty Underwriter. (Age 45)
Edward L. Rand, Jr.	Mr. Rand was appointed as an Executive Vice President in 2014 and is also our Chief Financial Officer. Mr. Rand previously served as our Senior Vice President of Finance upon joining ProAssurance in 2004. Prior to joining ProAssurance Mr. Rand was the Chief Accounting Officer and Head of Corporate Finance for PartnerRe Ltd. Prior to that time Mr. Rand served as the Chief Financial Officer of Atlantic American Corporation. Mr. Rand is a Certified Public Accountant. (Age 47)
Frank B. O’Neil	Mr. O’Neil was appointed as our Senior Vice President and Chief Communications Officer in 2001. Mr. O’Neil has previously served as our Senior Vice President of Corporate Communications, having joined our predecessor in 1987. (Age 60)
Michael L. Boguski	Mr. Boguski is President of our Eastern subsidiary. Prior to the acquisition of Eastern, Mr. Boguski served as President and Chief Executive Officer of Eastern, and first joined Eastern in 1997. Mr. Boguski has 26 years of insurance industry experience. (Age 51)
Mary Todd Peterson	Ms. Peterson is President of our Medmarc subsidiary. Prior to the acquisition of Medmarc, Ms. Peterson served as Medmarc's President and CEO. She previously served as Medmarc's Senior Vice President and Chief Operating Officer as well as its Senior Vice President, Chief Financial Officer and Treasurer. Ms. Peterson has 19 years of insurance industry experience and 18 years of public accounting experience. Ms. Peterson serves on the Board of Governors for the Property Casualty Insurance Association of America where she chairs the Investment Committee and serves on the

	Executive and Finance Committees. Ms. Peterson also serves on the Board of Directors of The Community Financial Corporation where she chairs the Audit Committee. (Age 59)
Ross E. Taubman	Dr. Taubman is President and Chief Medical Officer of our PICA subsidiary. Prior to joining PICA Dr. Taubman practiced podiatry for 26 years. During that time, Dr. Taubman served as Treasurer, Vice-President and President of the Maryland Podiatric Medical Association. Dr. Taubman is a diplomate in the American Board of Podiatric Surgery. (Age 56)
Kelly B. Brewer	Ms. Brewer was appointed as our Chief Accounting Officer in 2014 and has served as our Vice President of Finance since joining ProAssurance in 2008. Prior to joining ProAssurance Ms. Brewer was a Senior Manager for PricewaterhouseCoopers for four years. Prior to that time Ms. Brewer served financial services clients in audit and forensic accounting engagements for five years. Ms. Brewer is a Certified Public Accountant. (Age 38)

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We have adopted a Code of Ethics and Conduct that applies to our directors and executive officers, including but not limited to our principal executive officers, principal financial officer, and principal accounting officer. We also have share ownership guidelines in place to ensure that management maintains a significant portion of their personal investments in the stock of ProAssurance. Both our Code of Ethics and Conduct and our Share Ownership Guidelines are available on the Governance section of our website. Printed copies of these documents may be obtained from Frank O'Neil, Senior Vice President, ProAssurance Corporation, either by mail at P.O. Box 590009, Birmingham, Alabama 35259-0009, or by telephone at (205) 877-4400 or (800) 282-6242.

ITEM 4. MINE SAFETY DISCLOSURES.

Not applicable.

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES.

At February 12, 2014, ProAssurance Corporation (PRA) had 2,973 stockholders of record and 60,486,816 shares of common stock outstanding. ProAssurance's common stock currently trades on the NYSE under the symbol "PRA".

	2013		2012	
Quarter	High	Low	High	Low
First	$47.92	$43.06	$45.00	$39.35
Second	52.73	47.11	45.06	41.94
Third	55.28	45.06	46.29	43.80
Fourth	49.38	42.70	46.49	42.17

	Dividends Declared		Dividends Paid	
Quarter	2013	2012	2013	2012
First	$0.250	$0.125	$—	$0.125
Second	0.250	0.125	0.250	0.125
Third	0.250	0.125	0.250	0.125
Fourth*	0.300	2.750	0.250	2.875

* Includes a special dividend of $2.50 per common share in 2012.

The Board initiated a regular quarterly dividend in September 2011 and on December 5, 2012 declared a special dividend of $2.50 per common share that was paid December 27, 2012. Any decision to pay regular or special cash dividends in the future is subject to the Board's final determination after a comprehensive review of financial performance, future expectations and other factors deemed relevant by the Board.

ProAssurance's insurance subsidiaries are subject to restrictions on the payment of dividends to the parent. Information regarding restrictions on the ability of the insurance subsidiaries to pay dividends is incorporated by reference from the paragraphs under the caption "Insurance Regulatory Matters–Regulation of Dividends and Other Payments from Our Operating Subsidiaries" in Item 1 of this 10-K.

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Securities Authorized for Issuance Under Equity Compensation Plans

The following table provides information regarding ProAssurance's equity compensation plans as of December 31, 2013.

Plan Category	Number of securities to be issued upon exercise of outstanding options, warrants and rights	Weighted-average exercise price of outstanding options, warrants and rights	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a))
	(a)	(b)	(c)
Equity compensation plans approved by security holders	828,328	$ 23.00 *	2,960,052
Equity compensation plans not approved by security holders	—	—	—

*Applicable only to approximately 18,000 outstanding options. Other outstanding share units have no exercise price.

Issuer Purchases of Equity Securities

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Approximate Dollar Value of Shares that May Yet Be Purchased Under the Plans or Programs * (in thousands)
October 1 - 31, 2013	—	—	—	127,119
November 1 - 30, 2013	—	—	—	127,119
December 1 - 31, 2013	507,192	48.26	507,192	202,629
Total	507,192	48.26	507,192	

* Under its current plan begun in November 2010, the ProAssurance Board of Directors has authorized $300 million for the repurchase of common shares or the retirement of outstanding debt, including $100 million authorized in December 2013. This is ProAssurance's only plan for the repurchase of common shares, and the plan has no expiration date.

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ITEM 6. SELECTED FINANCIAL DATA.

	Year Ended December 31				
	2013	2012	2011	2010	2009
	(In thousands except per share data)				
Selected Financial Data (1)					
Gross premiums written	$567,547	$536,431	$565,895	$533,205	$553,922
Net premiums earned	527,919	550,664	565,415	519,107	497,543
Net investment income	129,265	136,094	140,956	146,380	150,945
Equity in earnings (loss) of unconsolidated subsidiaries	7,539	(6,873)	(9,147)	1,245	1,438
Net realized investment gains (losses)	67,904	28,863	5,994	17,342	12,792
Other revenues	7,551	7,106	13,566	7,991	9,965
Total revenues	740,178	715,854	716,784	692,065	672,683
Net losses and loss adjustment expenses	224,761	179,913	162,287	221,115	231,068
Net income (2)	$297,523	$275,470	$287,096	$231,598	$222,026
Net income per share (3):					
Basic	$4.82	$4.49	$4.70	$3.64	$3.38
Diluted	$4.80	$4.46	$4.65	$3.60	$3.35
Weighted average shares outstanding (3):					
Basic	61,761	61,342	61,140	63,576	65,696
Diluted	62,020	61,833	61,684	64,351	66,300
Balance Sheet Data (as of December 31)					
Total investments	$3,941,045	$3,926,902	$4,090,541	$3,990,431	$3,838,222
Total assets	5,150,891	4,876,578	4,998,878	4,875,056	4,647,414
Reserve for losses and loss adjustment expenses	2,072,822	2,054,994	2,247,772	2,414,100	2,422,230
Long-term debt	250,000	125,000	49,687	51,104	50,203
Total liabilities	2,756,477	2,605,998	2,834,425	3,019,193	2,942,819
Total capital	$2,394,414	$2,270,580	$2,164,453	$1,855,863	$1,704,595
Total capital per share of common stock outstanding (3)	$39.13	$36.85	$35.42	$30.17	$26.30
Common stock outstanding, period end (3)	61,197	61,624	61,107	61,506	64,824

(1) Includes acquired entities since date of acquisition only.

(2) Includes a loss on extinguishment of debt of $2.2 million and $2.8 million for the years ended December 31, 2012 and 2009, respectively.

(3) For all periods presented, share and per share amounts reflect the effect of the two-for-one stock split effected in the form of a stock dividend that was effective December 27, 2012.

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ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.

The following discussion should be read in conjunction with the 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 “Forward-Looking Statements”, our actual financial condition and operating results could differ significantly from these forward-looking statements.

ProAssurance Overview

We are an insurance holding company and our operating results are primarily derived from the operations of our insurance subsidiaries, which provide professional liability insurance for healthcare professionals and facilities, professional liability insurance for attorneys, liability insurance for medical technology and life sciences risks, and, effective January 1, 2014, workers' compensation insurance. We are also a 58% capital provider to Syndicate 1729, which began underwriting and reinsuring a range of property and casualty insurance lines effective January 1, 2014.

Critical Accounting Estimates

Our Consolidated Financial Statements are prepared in conformity with U.S. generally accepted accounting principles (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 “loss 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 estimates of the reserve established for losses of prior periods.

As of December 31, 2013 our reserves are almost entirely comprised of long-tail risk exposures. The estimation of long-tailed insurance losses is inherently difficult and is subject to significant judgment on the part of management. Loss costs, even for claims with similar characteristics, can vary significantly depending upon 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. Long-tailed insurance is characterized by the extended period of time typically required to resolve claims, often five years or more. The combination of changing conditions and the extended time required for claim resolution results in a loss cost estimation process that requires actuarial skill and the application of significant judgment, and such estimates require periodic revision.

Our reserves are established by management after taking into consideration a variety of factors including premium rates, claims frequency, historical paid and incurred loss development trends, the 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. We partition our reserves by accident year, which is the year in which the claim becomes our liability. As claims are incurred (reported) and claim payments are made, they are aggregated by accident year for analysis purposes. We also partition our reserves by reserve type: case reserves and IBNR reserves. Case reserves are established by our claims department based upon the particular circumstances of each reported claim and represent our estimate of the future loss costs (often referred to as expected losses) that will be paid on reported claims. Case reserves are decremented as claim payments are made and are periodically adjusted upward or downward as estimates regarding the amount of future losses are revised; reported loss is the case reserve at any point in time plus the claim payments that have been made to date. IBNR reserves represent our estimate of losses that have been incurred but not reported to us and future developments on losses that have been reported to us.

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At a high level our reserving process can be broadly grouped into two areas: the establishment of initial or current accident year reserves and the re-estimation of reserves for prior accident years. A summary of the activity in our net reserve for losses during 2013, 2012 and 2011 is provided in the Liquidity and Capital Resources and Financial Condition section that follows.

Initial Reserve Estimates-Current Accident Year

Considerable judgment is required in establishing our initial reserves for any current accident year period, as there is limited open or closed claims data available for a current accident year period at the time reserves for that period are estimated. Accordingly, in establishing our initial reserves for an accident year, in general we rely heavily on the loss assumptions that were used to price business during the accident year, as our pricing reflects our analysis of loss costs that we expect to incur relative to the business being priced. For our HCPL business (89% of our gross written premiums in 2013, 96% in 2012 and 97% in 2011) we set initial reserves at the average loss ratio used in our pricing, plus an additional margin 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 margin for loss volatility has ranged from 8 to 10 percentage points, producing an overall average initial loss ratio for our HCPL business of approximately 85%. We believe use of a margin for volatility considers inherent risks associated with 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 reserves required to cover actual ultimate unpaid losses. A similar practice is followed for our professional legal liability business. Our medical technology and life sciences products liability business is more varied, and policies are individually priced based on the risk characteristics of the policy. Therefore, for this business we establish initial reserves 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. The products liability line of business exhibits similar volatility to HCPL, and the actuarial estimate includes a provision for volatility.

Severity is defined as the average cost of resolving claims and the severity trend is the increase or decrease in severity from period to period. 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 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 December 31, 2013. Loss ratios for the current accident years have thus remained fairly constant because expected loss reductions have been reflected in our rates.

Re-estimation of Prior Years' Loss Reserves

Process

The foundation of our reserve re-estimation process is an actuarial analysis that is performed by both our internal and consulting actuaries. The very detailed analysis projects ultimate losses on a line of business, geographic, coverage layer and accident year basis. The procedure is intended to balance the use of the most representative data for each partition, capturing its unique patterns of development and trends. In all there are over 140 different partitions of our business for purposes of this analysis. We believe that the use of consulting actuaries provides an independent view of our loss data as well as a broader perspective on industry loss trends.

The analysis performed by the consulting actuaries analyzes each partition of our business in a variety of ways and uses multiple actuarial methodologies in performing these analyses, including:

- Bornhuetter-Ferguson (Paid and Reported) Method
- Paid Development Method
- Reported Development Method
- Average Paid Value Method
- Average Reported Value Method
- Backward Recursive Development Method
- The Adjusted Reported and the Adjusted Paid Methods

A brief description of each method follows.

Bornhuetter-Ferguson Method. We use both the Paid and the Reported Bornhuetter-Ferguson methods. The Paid method assigns partial weight to initial expected losses for each accident year (initial expected losses being the first established case

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and IBNR reserves for a specific accident year) and partial weight to paid to-date losses. The Reported method assigns partial weight to the initial expected losses and partial weight to current expected losses. The weights assigned to the initial expected losses decrease as the accident year matures.

Paid Development and Reported Development Method. These methods use historical, cumulative losses (paid losses for the Paid Development Method, reported losses for the Reported Development Method) by accident year and develop those actual losses to estimated ultimate losses based upon the assumption that each accident year will develop to estimated ultimate cost in a manner that is analogous to prior years, adjusted as deemed appropriate for the expected effects of known changes in the claim payment environment (and case reserving environment for the Reported Development Method), and, to the extent necessary, supplemented by analyses of the development of broader industry data.

Average Paid Value and Average Reported Value Methods. In these methods, average claim cost data (paid claim cost for the Average Paid Value Method and reported claim cost for the Reported Value Method) is developed to an ultimate average cost level by report year based on historical data. Claim counts are similarly developed to an ultimate count level. The average claim cost (after rounding and adjustment, if necessary, to accommodate report year data that is not considered to be predictive) is then multiplied by the ultimate claim counts by report year to derive ultimate loss and ALAE.

Backward Recursive Development Method. This method is an extrapolation of the movements in case reserve adequacy in order to estimate unpaid loss costs. Historical data showing incremental changes to case reserves over progressive time periods is used to derive factors that represent the ratio of case reserve values at successive maturities. Historical claims payment data showing the additional payments in progressive time periods is used to derive factors that represent the portion of a case reserve paid in the following period. Starting from the most mature period, after which all of the case reserve is paid and the case reserve is exhausted, the next prior ultimate development factor for the prior case reserve can be calculated as the case factor times the established ultimate development factor plus the paid factor. For each successive prior maturity, the ultimate development factor is calculated similarly. The result of multiplying the ultimate development factor times the case reserve is the total indicated unpaid amount.

The Adjusted Reported and the Adjusted Paid Methods. These methods are based on the premise that the relative change in a given accident year's adjusted reported loss estimates (Adjusted Reported Method) or adjusted paid losses (Adjusted Paid Method) from one evaluation point to the next is similar to changes observed for earlier accident years at the same evaluation points. In the Adjusted Reported Method reported loss estimates are adjusted to reflect a common case reserve adequacy basis. In the Adjusted Paid Method, the historical paid loss experience is adjusted to reflect a common claim settlement rate basis. We principally use these methods to evaluate reserves for our legal liability coverages.

Generally, methods such as the Bornhuetter-Ferguson method are used on more recent accident years where we have less data on which to base our analysis. As time progresses and we have an increased amount of data for a given accident year, we begin to give more confidence to the development and average methods, as these methods typically rely more heavily on our own historical data. These methods emphasize different aspects of loss reserve estimation and provide a variety of perspectives for our decisions.

Certain of the methodologies utilized to estimate the ultimate losses for each partition of our reserves consider the actual amounts paid. Paid data is particularly influential when a large portion of known claims have been closed, as is the case for older accident years. In selecting a point estimate for each partition, management considers the extent to which trends are emerging consistently for all partitions and known industry trends. Thus, actual, rather than estimated severity trends are given consideration. When actual severity trends are lower than those estimated at the time that reserves were previously established, the recognition of favorable development is indicated. This is particularly true for older accident years where our actuarial methodologies give more weight to actual loss costs (severity).

The various actuarial methods discussed above are applied in a consistent manner from period to period. In addition, we perform statistical reviews of claims data such as claim counts, average settlement costs and severity trends when establishing our reserves.

We utilize the selected point estimates of ultimate losses to develop estimates of ultimate losses recoverable from reinsurers, based on the terms and conditions of our reinsurance agreements. An overall estimate of the amount receivable from reinsurers is determined by combining the individual estimates. Our net reserve estimate is the gross reserve point estimate less the estimated reinsurance recovery.

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 process of selecting the point estimate is based upon the judgment of management taking into consideration the actuarial methods and other environmental factors discussed previously. For each partition of our reserves, we select a point estimate with due regard for the age, characteristics and volatility of the subset of the business, the volume of data available for review and past experience with respect to the accuracy of estimates. 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.

Over the past several years the most influential factor affecting our analysis of reserves and the development recognized has been the change, or lack thereof, in the severity of claims, particularly for our HCPL claims. Severity is defined as the average cost of resolving claims. The severity trend assumption is a key assumption for both pricing models and actuarial estimation of reserves. 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 model assumes a severity trend of 2% to 3% in most states and lines of business. If the severity trend were to be higher by 1 percentage point, the impact would be an increase in our expected loss ratio of 3.2 percentage points. 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 this long-tail and the previously discussed historical volatility of loss costs, 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.

From 2004 to 2009 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, which has complicated the selection of an appropriate severity trend for our pricing models for these lines. It has also made it more challenging to factor severity into the various actuarial methodologies discussed above. We believe that much of the reduction in claim frequency is the result of a decline in the filing of frivolous lawsuits that have historically been dismissed or otherwise result in no payment of indemnity on the part of our insureds. With fewer frivolous claims being filed we expect that the claims that are filed have the potential for greater average losses, or greater severity. As a result, we cannot be certain as to the impact this decline will ultimately have on the average cost of claims. Based on a weighted average of payments, only 85% are resolved after eight years for a given accident year. Due to this long tail, we continue to be uncertain of the full impact of the observed decline in frequency and whether there is a related increase in severity.

Loss Development

We recognized net favorable development related to prior accident years of $222.7 million for the year ended December 31, 2013 (including favorable development of $6.9 million related to reserves acquired in the January 1, 2013 Medmarc acquisition), $272.0 million for the year ended December 31, 2012, and $325.9 million for the year ended December 31, 2011.

In support of our concern that the decline in frequency will result in a higher severity trend, we saw our closed-with-indemnity-payment ratio (i.e., the number of claims closed with an indemnity or loss payment as compared to the total number of closed claims) for our claims increase from 7% in 2005 to 15% in 2013 (percentages exclude Medmarc claims). While this trend has been in keeping with our expectations, the anticipated increase in severity incorporated into our loss assumptions has not occurred. Rather, we have experienced lower than expected severity which has been the primary driver of the favorable development recognized in recent years.

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The following tables present additional information about our loss development, excluding the development recognized with respect to Medmarc reserves acquired in 2013:

Estimated Ultimate Losses, Net of Reinsurance ("established ultimates"):

(In thousands)	2013	2012	2011*
2013	$427,562	N/A	N/A
2012	464,395	$459,567	N/A
2011	478,227	489,892	$494,781
2010	453,890	481,342	494,954
2009	410,915	455,980	480,358
2008	373,742	412,373	468,032
2007	357,682	391,768	442,815
2006	327,193	348,970	387,678
2005	357,405	371,637	396,598
2004	347,694	355,275	374,192
Prior to 2004	5,545,412	5,565,624	5,605,492

*Amounts shown for 2011 have been adjusted to include ultimates associated with the reserves assumed in 2012 due to a business combination.

Reserve Development, (favorable) unfavorable:

(In thousands)	2013	2012	2011
2012	$4,828	N/A	N/A
2011	(11,665)	$(4,889)	N/A
2010	(27,452)	(13,612)	$(3,293)
2009	(45,065)	(24,378)	(22,090)
2008	(38,631)	(55,659)	(51,562)
2007	(34,086)	(51,047)	(61,663)
2006	(21,777)	(38,708)	(58,795)
2005	(14,232)	(24,961)	(36,100)
2004	(7,581)	(18,917)	(39,288)
Prior to 2004	(20,212)	(39,868)	(53,074)

An extended period of time is required to get a clear estimate of the loss cost for a given accident year. As an example, looking at the 2008 accident year, we had resolved 83.1% of the known claims by the end of 2011, 90.3% of the known claims by the end of 2012, and 94.6% of the known claims by the end of 2013. These statistics are based on the number of reported claims; since many non-meritorious claims are resolved early, percentages of ultimate loss payments known at the same points in time are considerably lower. A similar pattern can be seen in each open accident year as demonstrated in the table below.

Historically we have resolved more than 85% of our physician and hospital professional liability claims with no indemnity payment and generally these claims are the first to be resolved. As an accident year matures, the number of claims resolved with indemnity payments progressively increases. In a similar fashion, we typically expend more in loss adjustment expenses (legal fees) as claims mature.

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The following table represents the percentage of known HCPL claims closed:

	December 31		
Accident Year	2013	2012	2011
2013	18.7%	N/A	N/A
2012	46.6%	13.5%	N/A
2011	69.5%	45.0%	13.2%
2010	82.4%	68.8%	45.3%
2009	89.0%	80.6%	67.7%
2008	94.6%	90.3%	83.1%
2007	97.2%	93.9%	89.5%
2006	98.5%	97.1%	94.7%
2005	99.0%	98.4%	96.9%
2004	99.4%	99.1%	98.3%

Based upon the additional claims closed during 2013, 2012 and 2011, as shown above, and the continuation of better than expected severity trends, management reduced its expected ultimate losses in each of these years resulting in the recognition of corresponding amounts of favorable development in the income statements of those periods. At December 31, 2012 and 2011 management reserve estimates for the three most recent prior accident years (which have closed claim percentages below 85%) were influenced by the initial reserves estimates set for these years, moderated to reflect consideration of better than anticipated claims experience observed during the periods. Estimates for older accident years with higher percentages of closed claims were more heavily influenced by the more moderate severity trend observed during the periods, particularly with regard to claims closed during the periods. Management continued to reflect approximately the same level of consideration of the moderated trend in its estimate of the reserve required at December 31, 2013; however, the effect was not as pronounced as that recorded in 2012 and 2011.
This can be seen in looking at both the absolute amount of favorable reserve development recognized for the less developed accident years as well as the size of such development when compared to established ultimates for those same accident years at the end of the preceding calendar year. The following table provides this information for years ended December 31, 2013, 2012 and 2011 with respect to the three then most recent prior accident years:

($ in millions)	2013	2012	2011
Prior accident years	2010-2012	2009-2011	2008-2010
Net favorable development recognized for the specified years	$34.3	$42.9	$76.9
Development as a % of established ultimates, prior calendar year end	2.4%	2.9%	5.1%

We recognized $6.9 million of development related to the reserves acquired from Medmarc, representing a 2.0% reduction to the ultimates for accident years 2004 to 2012 as of January 1, 2013, the date of acquisition. The development recognized related primarily to product liability reserves established for 2005 to 2010 accident years, and reflects improved claims experience during 2013 as compared that anticipated by the actuarial methodologies used to established ultimates as of January 1, 2013.

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Variability of Loss Reserves

As previously noted, the number of data points and variables considered and the subjective process followed in establishing our loss reserve makes it impractical to isolate individual variables and demonstrate their impact on our estimate of loss reserves. However, to provide a better understanding of the potential variability in our reserves, we have modeled implied reserve ranges around our single point net reserve estimates for our professional liability business assuming different confidence levels. The ranges have been developed by aggregating the expected volatility of losses across partitions of our business to obtain a consolidated distribution of potential reserve outcomes. The aggregation of this data takes into consideration the correlation among our geographic and specialty mix of business. The result of the correlation approach to aggregation is that the ranges are narrower than the sum of the ranges determined for each partition.

We have used this modeled statistical distribution to calculate an 80% and 60% confidence interval for the potential outcome of our net reserve for losses. The high and low end points of the distributions are as follows:

	Low End Point	Carried Net Reserve	High End Point
80% Confidence Level	$1.407 billion	$1.825 billion	$2.300 billion
60% Confidence Level	$1.520 billion	$1.825 billion	$2.105 billion

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. Over the past several years such changes have been to reduce our estimate of net ultimate losses, resulting in a reduction of reported losses for the period and a corresponding increase in income.

Due to the size of our 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.

Acquired Reserves

The acquisition of Medmarc increased our loss reserves by $201.1 million, which represented the fair value of Medmarc's loss reserves at the time of the acquisition. The estimated fair value was calculated as the present value of the expected underlying net cash flows, including a 5% profit margin and a 5% risk premium. Expected net cash flows were derived from the expected loss payment patterns included in an actuarial analysis of Medmarc reserves performed as of December 31, 2012. Approximately 85% of the reserves assumed in the Medmarc acquisition are products liability reserves and approximately 15% are professional liability reserves.

Reinsurance

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

We 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, volume of business, level of experience with a particular set of claims and our analysis of the potential underwriting results. We purchase reinsurance from a number of companies to mitigate concentrations of credit risk. We utilize a reinsurance broker to assist us in the placement of our 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.

We evaluate each of our ceded reinsurance contracts at inception to confirm that there is sufficient risk transfer to allow the contract to be accounted for as reinsurance under current accounting guidance. At December 31, 2013, all ceded contracts were accounted for as risk transferring contracts.

Our receivable from reinsurers on unpaid losses and loss adjustment expenses represents our estimate of the amount of our reserve for losses that will be recoverable under our reinsurance programs. We base our estimate of funds recoverable upon our expectation of ultimate losses and the portion of those losses that we estimate to be allocable to reinsurers based upon the terms and conditions of our reinsurance agreements. Our assessment of the collectability of the recorded amounts receivable from reinsurers considers the payment history of the reinsurer, publicly available financial and rating agency data, our interpretation of the underlying contracts and policies, and responses by reinsurers.

Given the uncertainty inherent in our estimates of losses and related amounts recoverable from reinsurers, these estimates may vary significantly from the ultimate outcome.

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Under the terms of certain of our reinsurance agreements, the amount of premium that we cede to our reinsurers is based in part on the losses we recover under the agreements. Therefore we make an estimate of premiums ceded under these reinsurance agreements subject to certain maximums and minimums. Any adjustments to our estimates of losses recoverable under our reinsurance agreements or the premiums owed under our agreements are reflected in then-current operations. Due to the size of our reinsurance balances, an adjustment to these estimates could have a material effect on our results of operations for the period in which the adjustment is made.

The financial strength of our reinsurers and their ability to pay us may change in the future due to forces or events we cannot control or anticipate. We have not experienced significant collection difficulties due to the financial condition of any reinsurer as of December 31, 2013; however, reinsurers may periodically dispute our demand for reimbursement from them based upon their interpretation of the terms of our agreements. We have established appropriate reserves for any balances that we believe may not be ultimately collected. Should future events lead us to believe that any reinsurer will not meet its obligations to us, adjustments to the amounts recoverable would be reflected in the results of current operations. Such an adjustment has the potential to be material to the results of operations in the period in which it is recorded; however, we would not expect such an adjustment to have a material effect on our capital position or our liquidity.

Investment Valuations

We record the majority of our investments at fair value as shown in the table below. The distribution of our investments based on GAAP fair value hierarchies (levels) was as follows:

	Distribution by GAAP Fair Value Hierarchy			December 31, 2013
	Level 1	Level 2	Level 3	Total Investments
Investments recorded at:				
Fair value	13%	78%	3%	94%
Other valuations				6%
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 and cost 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 the 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. In addition, we compare provided information for consistency with our other 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.

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Level 1 Investments

Fair values for our equity and a portion of our short-term 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.

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 fixed maturity securities valued using limited observable inputs as Level 3 securities.

We also classify as Level 3 our investment interests that are carried at fair value based on a fund-provided net asset value (NAV) for our interest. All investments valued in this manner are LP or LLC interests that hold debt and equity securities. At December 31, 2013 interests valued using a fund-provided NAV totaled $72.1 million, or 2% of total investments, and were classified as part of our Investment in Unconsolidated Subsidiaries.

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 December 31, 2013 these investments had a carrying value of approximately $248.8 million, which represented approximately 6% of total investments, as shown in the following table. Additional information about these investments is provided in Notes 3 and 4 of the Notes to Consolidated Financial Statements.

(In millions)	Carrying Value	GAAP Measurement Method
Other investments:		
Investments in LPs, at cost	$47.3	Cost
Federal Home Loan Bank (FHLB) capital stock	3.4	Cost
Other	1.5	Amortized cost
Total other investments	$52.2	
Investment in unconsolidated subsidiaries:		
Investments in tax credit partnerships	$142.2	Equity
Business owned life insurance	$54.4	Cash surrender value
Total investments - Other valuation methodologies	$248.8	

Investment Impairments

We evaluate our investments on at least a quarterly basis for declines in fair value that represent other than temporary impairment (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;

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- the extent to which the decline in fair value is attributable to credit risk specifically associated with the security or its issuer;
- 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;
- recoveries or additional declines in fair value subsequent to the balance sheet date; and
- our intent to sell and whether it is more likely than not we will be required to sell the security before the recovery of its amortized cost basis.

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 currently expected from the investment, primarily tax benefits, 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 deferred policy acquisition costs and charged to expense as the related premium revenue is recognized. We evaluate the recoverability of our deferred policy acquisition costs each reporting period, and any amounts estimated to be unrecoverable are charged to expense in the current period. As of December 31, 2013 we have not determined that any amounts are unrecoverable. Prior to our adoption of the new Financial Accounting Standards Board (FASB) guidance on January 1, 2012, we capitalized all internal selling agent and underwriter salary and benefit costs, including costs associated with unsuccessful contract efforts. Adoption of the new guidance had no material effect on our results of operations or financial position.

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 loss reserves, unearned premiums, deferred policy acquisition costs, and unrealized investment gains (losses). 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. We did not have any significant valuation allowances as of December 31, 2013.

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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. At December 31, 2013, our liability for unrecognized tax benefits approximated \$4.8 million, and related accrued interest approximated \$1.3 million.

Goodwill

Management evaluates the carrying value of goodwill annually during the fourth quarter. If, at any time during the year, events occur or circumstances change that would more likely than not reduce the fair value below the carrying value, we also evaluate goodwill at that time. We evaluate goodwill as one reporting unit because we operate as a single operating segment and our segment components are economically similar. We estimate the fair value of our reporting unit on the evaluation date based on market capitalization and an expected premium that would be paid to acquire control of our Company (a control premium). We then perform a sensitivity analysis using a range of historical stock prices and control premiums. We concluded as of our last evaluation date, October 1, 2013, that the fair value of our reporting unit exceeded the carrying value and no adjustment to impair goodwill was necessary. Goodwill is recognized in conjunction with acquisitions as the excess of the purchase consideration for the acquisition over the fair value of identifiable assets acquired and liabilities assumed. The fair value of identifiable assets and liabilities, and thus goodwill, is subject to redetermination within a measurement period of up to one year following completion of an acquisition. During 2013 goodwill was reduced by \$1.9 million primarily related to the after tax effect of the re-determination of the fair value of the reserve for losses associated with a business combination completed in late 2012.

Accounting Changes

We did not adopt any accounting changes during 2013 that had a material effect on our results of operations nor are we aware of any accounting changes not yet adopted as of December 31, 2013 that would have a material effect on our results of operations or financial position. Note 1 of the Notes to Consolidated Financial Statements provides additional detail regarding accounting changes.

Key Performance Measures

We have sustained our financial stability during difficult market conditions through responsible pricing and loss reserving practices and through conservative investment practices. We are committed to maintaining prudent operating and financial leverage and to conservatively investing our assets. We recognize the importance that our customers and producers place on the financial strength of our principal insurance subsidiaries and we manage our business to protect our financial security.

We consider a number of performance measures, including the following:

- The net loss ratio is calculated as net losses incurred divided by net premiums earned and is a component of underwriting profitability.
- The underwriting expense ratio is calculated as underwriting, policy acquisition and operating expenses incurred divided by net premiums earned and is a component of underwriting profitability.
- The combined ratio is the sum of the underwriting expense ratio and the net loss ratio and measures underwriting profitability.
- The investment income ratio is calculated as net investment income divided by net premiums earned and measures the contribution investment earnings provides to our overall profitability.
- The operating ratio is the combined ratio, less the investment income ratio. This ratio provides the combined effect of investment income and underwriting profitability.
- The tax ratio is calculated as total income tax expense divided by income (loss) before income taxes and measures our effective tax rate.
-

Return on equity (ROE) is calculated as net income for the period divided by the average of beginning and ending shareholders' equity. This ratio measures our overall after-tax profitability and shows how efficiently invested capital is being used.

- Growth in book value. Book value per share is calculated as total shareholders' equity at the balance sheet date divided by the total number of common shares outstanding. This ratio measures the net worth of the company to shareholders on a per-share basis. Growth in book value per share is an indicator of overall profitability.

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We particularly focus on our combined ratio and investment returns, both of which directly affect our ROE and growth of our book value. Historically we targeted a long-term average ROE of 12% to 14%. Given the persistent low interest rate environment which prevails in the United States and the soft pricing environment for our products, the realization of this long-term ROE target in the next few years will likely prove difficult.

Our emphasis on rate adequacy, selective underwriting, effective claims management and prudent investments is a key factor in our achievement of our ROE target. We closely monitor premium revenues, losses and loss adjustment costs, and underwriting and policy acquisition expenses. Our overall investment strategy is to focus on maximizing current income from our investment portfolio while maintaining safety, liquidity, duration and portfolio diversification. While we engage in activities that generate other income, such activities, principally insurance agency services, do not constitute a significant use of our resources or a significant source of revenues or profits.

Growth Opportunities and Outlook

We expect our long-term growth to come through controlled expansion of our existing operations and through the acquisition of other specialty insurance companies or books of business. Growth through acquisition is often opportunistic and cannot be predicted.

We operate in very competitive markets and face strong competition from other insurance companies for all of our insurance products. Healthcare professional liability insurance represents a substantial portion of our gross premiums written (89% in 2013) and the healthcare market has been trending toward the formation of larger medical practice groups, and the employment of physicians by hospitals. Large medical groups and facilities frequently manage their health care professional liability exposure outside of the traditional insurance marketplace using self-insured mechanisms and other risk sharing arrangements. In response to these trends, we offer products designed to provide greater risk sharing options to hospitals and large physician groups.

We believe our emphasis on fair treatment of our insureds and other important stakeholders through our commitment to “Treated Fairly” has enhanced our market position and differentiated us from other insurers. We will continue to practice the values of “Treated Fairly” in all of our activities, and we believe that as we reach more customers with this message we will continue to improve retention and add new insureds.

We have expanded our lines of business in new directions by acquiring Medmarc, an underwriter of products liability insurance for medical technology and life sciences companies, on January 1, 2013, and Eastern, a provider of workers' compensation insurance, on January 1, 2014. We have also been a consistent acquirer of other physician insurers, most recently IND in 2012, APS in 2010 and PICA in 2009. Other 2009 acquisitions included an insurer focused on the legal professional liability market and an agency largely focused on the professional liability needs of allied healthcare providers. We continue to see new opportunities from each of the acquisitions and believe each will provide organic growth through expansion in their existing markets and relationships. Had Eastern been a part of ProAssurance during 2013, the composition of our gross premiums written, excluding Eastern segregated portfolio cell premiums, would have been as follows: 69% healthcare professional liability, 22% workers' compensation, 5% products liability and 4% legal professional liability. Eastern's segregated portfolio cells business primarily generated earnings from fee revenues, which totaled $7.2 million for 2013.

Eastern is a holding company specializing in workers' compensation insurance products and services, including its segregated portfolio cell business. Eastern profits from the segregated portfolio cell business are principally from service fees. Eastern's consolidated net assets totaled $136.8 million at December 31, 2013.

Late in 2013, we completed the process of becoming a corporate member of Lloyd's of London, an internationally recognized specialist insurance market. We are the majority (58%) capital provider to Syndicate 1729, which began underwriting and reinsuring business as of January 1, 2014. The remaining capital for Syndicate 1729 is provided by unrelated third parties, including private names and other corporate members. We have committed £47.3 million ($78.3 million at December 31, 2013) of capital for the first year of Syndicate 1729 operations and have a total capital commitment through 2019 of up to $200 million. Syndicate 1729 will cover a range of property and casualty insurance and reinsurance lines, and has a maximum underwriting capacity of £75 million ($124.2 million at December 31, 2013) for the 2014 underwriting year, of which £43.2 million ($71.5 million at December 31, 2013) is our allocated underwriting capacity as a corporate member.

Liquidity and Capital Resources and Financial Condition

Overview

ProAssurance Corporation is a holding company and is a legal entity separate and distinct from its subsidiaries. Because the holding company has no other business operations, dividends from its operating subsidiaries represent a significant source of funds for its obligations, including debt service and shareholder dividends. At December 31, 2013, we held cash and liquid investments of approximately $400.2 million outside our insurance subsidiaries that were available for use without regulatory approval. Our holding company also has $150 million available under a revolving credit agreement, as discussed in this section

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under the heading "Debt." During 2013, our insurance subsidiaries paid dividends of $298 million, including extraordinary dividends of $5 million. Our insurance subsidiaries, in aggregate, are permitted to pay dividends of approximately $243 million over the course of 2014 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 prevent the dividend if, in its judgment, payment of the dividend would have an adverse effect on the surplus of the insurance subsidiary.

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. Our operating activities provided positive cash flows of approximately $38.6 million, $91.3 million, and $159.4 million for the years ended December 31, 2013, 2012 and 2011, respectively.

Operating cash flows for 2013 and 2012 compare as follows:

(In millions)	Operating Cash Flow	
Cash provided by operating activities for the year ended December 31, 2012	$91	
Increase (decrease) in operating cash flows:		
Decrease in premium receipts (1)	(33	)
Decrease in payments to reinsurers (2)	3	
Increase in losses paid, net of reinsurance recoveries (3)	(3	)
Decrease in cash received from investments	(9	)
Increase in Federal and state income tax payments (4)	(3	)
Net cash provided (used) by acquisitions (5)	(6	)
Cash paid for start-up expenses related to Syndicate 1729 (6)	(3	)
Other amounts not individually significant, net	2	
Cash provided by operating activities for the year ended December 31, 2013	$39	

(1) The reduction in premium receipts reflected lower premium volume in 2013 exclusive of acquisitions as well as the effect of the timing of premium receipts on several large policies.

(2) 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.

(3) 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.

(4) The net increase in tax payments during 2013 was attributable to:

- A $20.6 million protective tax payment made in 2013 related to a dispute with the Internal Revenue Service (IRS), as discussed in further detail in this section under the heading "Taxes."
- An $8.3 million decrease in the final tax payments made during 2013 for the prior fiscal year.
- A $3.4 million decrease in estimated tax payments during 2013 for current fiscal year.
- GAAP requires that excess tax benefits recognized when shares are issued under stock compensation plans be reflected as a reduction to operating cash flows and as an increase to financing cash flows in the period the shares are issued. Such excess tax benefits were $4.9 million lower in 2013 as compared to 2012.

(5) Net cash used by acquisitions reflected the payments of transaction costs, loss payments made by the acquired companies related to prior accident years, and normal expense payments of the acquired companies for which the timing of the payment differs from the recognition of the expense.

(6) Cash paid for expenses related to the start-up of Syndicate 1729, which were principally professional fees.

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Operating cash flows for 2012 and 2011 compare as follows:

(In millions)	Operating Cash Flow
Cash provided by operating activities for the year ended December 31, 2011	$ 159
Increase (decrease) in operating cash flows:	
Decrease in premium receipts (1)	(12)
Increase in payments to reinsurers (2)	(8)
Increase in losses paid, net of reinsurance recoveries (3)	(35)
Decrease in cash received from investments	(8)
Decrease in cash paid for other expenses (4)	13
Increase in Federal and state income tax payments (5)	(18)
Cash provided by operating activities for the year ended December 31, 2012	$ 91

(1) The reduction in premium receipts reflected lower premium volume in 2012, exclusive of a volume decline related to twenty-four month term policies and a volume increase related to tail policies. The premium from two-year term policies is included in gross written premium in the period in which the policy is written, but has little effect on timing of premium receipts since half of the written amount is billed in the second term. Tail policies are typically collected in the period written.

(2) 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.

(3) 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. The increase in loss payments for 2012 primarily reflected a greater number of claims resolved with large indemnity payments, a portion of which was recovered under existing reinsurance agreements. The additional loss payments were not isolated to any one state or to any specific risk groups. Loss payments made during 2012 were included in the data considered by our actuaries and by our Management in determining their best estimate of losses incurred during 2012.

(4) The decrease in cash paid for other expenses was principally attributable to non-recurring payments of APS integration costs, primarily compensation-related, during 2011.

(5) The net increase in tax payments during 2012 was attributable to:

- A $7.4 million increase in the final payments for the prior fiscal year, partially offset by a $4.8 million decrease in estimated tax payments for the current year.
- There were no Federal tax refunds in 2012. In 2011 refunds approximated $17.3 million.
- GAAP requires that excess tax benefits recognized when shares are issued under stock compensation plans be reflected as a reduction to operating cash flows and an increase to financing cash flows in the period the shares are issued. Such excess tax benefits were $5.3 million greater in 2012 as compared to 2011.
- The above increases to tax related outflows were offset by:
- Payments of $5.9 million made in 2011 for the 2008 and 2007 tax years as a result of Federal tax return audits conducted by the Internal Revenue Service. The payments reduced tax liabilities recognized prior to January 1, 2011 and did not increase or decrease 2011 tax expense.
- A reduction in state and other tax payments of $1.8 million.

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Operating cash flows for 2011 and 2010 compare as follows:

(In millions)	Operating Cash Flow	
Cash provided by operating activities for the year ended December 31, 2010	$139	
Increase (decrease) in operating cash flows during 2011:		
Decrease in premium receipts, exclusive of APS (1)	(22	)
Increase in payments to reinsurers, exclusive of APS (2)	(3	)
Decrease in losses paid, net of reinsurance recoveries, exclusive of APS (3)	27	
Increase in Federal and state income tax payments (4)	(6	)
Cash flows attributable to operations acquired from APS (exclusive of tax payments or refunds)	25	
Other amounts not individually significant, net	(1	)
Cash provided by operating activities for the year ended December 31, 2011	$159	

(1) The decline in premium receipts is primarily attributable to reduced premium volume. Exclusive of twenty-four month term policies and the business acquired from APS, gross written premiums were lower in 2011.

(2) 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.

(3) 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. Net loss payments are also subject to reinsurance recoveries under existing reinsurance agreements.

(4) The increase in tax payments primarily reflects:

- An increase in estimated tax payments of $16.1 million during 2011 as compared to 2010.
- Payments of $5.9 million made in 2011 for the 2008 and 2007 tax years as a result of Federal tax return audits conducted by the Internal Revenue Service. The payments reduced tax liabilities recognized prior to January 1, 2011 and did not increase or decrease 2011 tax expense.
- The above increases to tax payments were partially offset by greater Federal tax refunds in 2011 of $15.9 million. Principally, refunds from capital loss carry backs were higher in 2011 than in 2010 and a refund associated with the APS 2010 pre-acquisition period was received in 2011.

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Losses

The following table, known as the Analysis of Reserve Development, presents information over the preceding ten years regarding the payment of our losses as well as changes to (the development of) our estimates of losses during that time period. As noted in the table, ProAssurance has completed various acquisitions over the ten year period which have affected original and re-estimated gross and net reserve balances as well as loss payments.

The table includes losses on both a direct and an assumed basis and is net of anticipated reinsurance recoverables. The gross liability for losses before reinsurance, as shown on the balance sheet, and the reconciliation of that gross liability to amounts net of reinsurance are reflected below the table. We do not discount our reserve for losses to present value. Information presented in the table is cumulative and, accordingly, each amount includes the effects of all changes in amounts for prior years. The table presents the development of our balance sheet reserve for losses; it does not present accident year or policy year development data. Conditions and trends that have affected the development of liabilities in the past may not necessarily occur in the future. Accordingly, it is not appropriate to extrapolate future redundancies or deficiencies based on this table.

The following may be helpful in understanding the Analysis of Reserve Development:

- The line entitled “Reserve for losses, undiscounted and net of reinsurance recoverables” reflects our reserve for losses and loss adjustment expense, less the receivables from reinsurers, each as reported in our consolidated financial statements at the end of each year (the Balance Sheet Reserves).
- The section entitled “Cumulative net paid, as of” reflects the cumulative amounts paid as of the end of each succeeding year with respect to the previously recorded Balance Sheet Reserves.
- The section entitled “Re-estimated net liability as of” reflects the re-estimated amount of the liability previously recorded as Balance Sheet Reserves that includes the cumulative amounts paid and an estimate of the remaining net liability based upon claims experience as of the end of each succeeding year (the Net Re-estimated Liability).
- The line entitled “Net cumulative redundancy (deficiency)” reflects the difference between the previously recorded Balance Sheet Reserve for each applicable year and the Net Re-estimated Liability relating thereto as of the end of the most recent fiscal year.

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Analysis of Reserve Development
(in thousands)
December 31,

	2003	2004	2005 (1)	2006 (2)	2007	2008	2009 (3)	2010 (4)	201
Reserve for losses, undiscounted and net of reinsurance recoverables	$1,298,458	$1,544,981	$1,896,743	$2,236,385	$2,232,596	$2,111,112	$2,159,571	$2,136,664	$2,(
Cumulative net paid, as of:									
One Year Later	200,314	199,617	242,608	331,295	312,348	278,655	291,654	264,597	300
Two Years Later	378,036	384,050	503,271	600,500	550,042	468,277	476,682	491,657	526
Three Years Later	526,867	578,455	697,349	787,347	694,113	584,410	614,369	639,220	
Four Years Later	680,470	728,582	825,139	897,814	777,114	666,105	706,091		
Five Years Later	794,870	805,270	901,644	955,728	833,471	724,377			
Six Years Later	852,985	861,512	937,984	995,921	874,479				
Seven Years Later	894,355	888,065	959,870	1,022,273					
Eight Years Later	915,964	901,867	980,665						
Nine Years Later	927,805	919,840							
Ten Years Later	941,991								
Re-estimated net liability as of:									
End of Year	1,298,458	1,544,981	1,896,743	2,236,385	2,232,596	2,111,112	2,159,571	2,136,664	2,00
One Year Later	1,289,744	1,522,000	1,860,451	2,131,400	2,047,344	1,903,812	1,925,581	1,810,799	1,72
Two Years Later	1,282,920	1,479,773	1,764,076	1,955,903	1,829,140	1,665,832	1,615,603	1,543,650	1,49
Three Years Later	1,259,802	1,418,802	1,615,125	1,747,459	1,596,508	1,383,189	1,362,538	1,324,906	
Four Years Later	1,250,110	1,340,061	1,450,275	1,548,605	1,357,126	1,154,552	1,172,091		
Five Years Later	1,230,105	1,234,223	1,330,039	1,366,793	1,185,051	1,019,407			
	1,156,614	1,158,590	1,225,114	1,249,234	1,084,422				

Six Years Later									
Seven Years Later	1,111,795	1,092,186	1,148,102	1,180,804					
Eight Years Later	1,079,383	1,040,035	1,104,687						
Nine Years Later	1,041,880	1,012,643							
Ten Years Later	1,022,413								
Net cumulative redundancy (deficiency)	$276,045	$532,338	$792,056	$1,055,581	$1,148,174	$1,091,705	$987,480	$811,758	$50
Original gross liability - end of year	$1,634,749	$1,818,635	$2,224,436	$2,607,148	$2,559,707	$2,379,468	$2,422,230	$2,414,100	$2,2
Less: reinsurance recoverables	(336,291)	(273,654)	(327,693)	(370,763)	(327,111)	(268,356)	(262,659)	(277,436)	(247
Original net liability - end of year	$1,298,458	$1,544,981	$1,896,743	$2,236,385	$2,232,596	$2,111,112	$2,159,571	$2,136,664	$2,0
Gross re-estimated liability - latest	$1,317,628	$1,301,011	$1,443,004	$1,562,820	$1,352,411	$1,199,801	$1,328,867	$1,494,942	$1,6
Re-estimated reinsurance recoverables	(295,215)	(288,368)	(338,317)	(382,016)	(267,989)	(180,394)	(156,776)	(170,036)	(180
Net re-estimated liability - latest	$1,022,413	$1,012,643	$1,104,687	$1,180,804	$1,084,422	$1,019,407	$1,172,091	$1,324,906	$1,4
Gross cumulative redundancy (deficiency)	$317,121	$517,624	$781,432	$1,044,328	$1,207,296	$1,179,667	$1,093,363	$919,158	$56

(1) Reserves for 2005 and thereafter include gross and net reserves acquired in 2005 business combinations of $183.2 million and $139.7 million, respectively.

(2) Reserves for 2006 and thereafter include gross and net reserves acquired in 2006 business combinations of $228.4 million and $171.2 million, respectively.

(3) Reserves for 2009 and thereafter include gross and net reserves acquired in 2009 business combinations of $169.4 million and $163.9 million, respectively.

(4) Reserves for 2010 and thereafter include gross and net reserves acquired in 2010 business combinations of $88.1 million and $82.2 million, respectively.

(5) Reserves for 2012 and thereafter include gross and net reserves acquired in 2012 business combinations of $21.8 million and $19.2 million, respectively, which considers reductions of $3.6 million and $3.3 million, respectively, recorded in 2013 due to the re-estimation of the fair value of the acquired reserves.

(6) Reserves for 2013 include gross and net reserves acquired in 2013 business combinations of $201.1 million and $126.0 million, respectively.

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In each year reflected in the table, we have estimated our reserve for losses utilizing the management and actuarial processes discussed in Critical Accounting Estimates. Factors that have contributed to the variation in loss development are primarily related to the extended period of time required to resolve professional liability claims and include the following:

- The HCPL legal environment deteriorated in the late 1990's and severity began to increase at a greater pace than anticipated in our rates and reserve estimates. We addressed the adverse severity trends through increased rates, stricter underwriting and modifications to claims handling procedures. The expectation of increased claim severity was also considered in establishing our initial reserves for subsequent years.
- These adverse severity trends later moderated with that moderation becoming more pronounced beginning in 2009. We have been cautious in giving full recognition to indications that the pace of severity increase has slowed, but have given measured recognition of the improving trends in our reserve estimates, as discussed more fully under "Critical Accounting Estimates—Reserve for Losses and Loss Adjustment Expenses (reserve for losses or reserve)." The favorable development was most pronounced for years 2004 to 2008, as the initial reserves for these accident years were established prior to substantial indication that severity trends were moderating. We give stronger recognition to a lower severity trend as time elapses and the percentage of closed claims increases.
- A general decline in claim frequency has also been a contributor to favorable loss development. A significant portion of our policies through 2003 were issued on an occurrence basis, and a smaller portion of our ongoing business results from the issuance of extended reporting endorsements which have occurrence-like exposure. As claim frequency declined, the number of reported claims related to these coverages was less than originally expected.

Activity in our net reserve for losses during 2013, 2012 and 2011 is summarized below:

	Year Ended December 31		
(In thousands)	2013	2012	2011
Balance, beginning of year	$2,054,994	$2,247,772	$2,414,100
Less reinsurance recoverables on unpaid losses and loss adjustment expenses	191,645	247,658	277,436
Net balance, beginning of year	1,863,349	2,000,114	2,136,664
Reserves acquired from acquisitions (1)	126,007	22,464	—
Incurred related to:			
Current year	447,510	451,951	488,152
Favorable development of reserves established in prior years, net	(222,749)	(272,038)	(325,865)
Total incurred	224,761	179,913	162,287
Paid related to:			
Current year	(43,616)	(38,439)	(34,240)
Prior years (2)	(345,197)	(300,703)	(264,597)
Total paid	(388,813)	(339,142)	(298,837)
Net balance, end of year	1,825,304	1,863,349	2,000,114
Plus reinsurance recoverables on unpaid losses and loss adjustment expenses	247,518	191,645	247,658
Balance, end of year	$2,072,822	$2,054,994	$2,247,772

(1) Includes a net reserve reduction of $3.3 million for 2013 due to the re-estimation of reserves acquired in a 2012 business combination.

(2) Includes prior year paid losses of 33.4 million for 2013 attributable to reserves acquired in a business combination completed in 2013.

At December 31, 2013 our gross reserve for losses included case reserves of approximately $1.1 billion and IBNR reserves of approximately $0.9 billion. Our consolidated gross reserve for losses on a GAAP basis exceeds the combined gross reserves of our insurance subsidiaries on a statutory basis by approximately $0.1 billion, which is principally due to the portion of the GAAP reserve for losses that is reflected for statutory accounting purposes as unearned premiums. These unearned premiums are applicable to extended reporting endorsements (“tail” coverage) issued without a premium charge upon death, disability or retirement of an insured who meets certain qualifications.

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Reinsurance

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. 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 have a number of reinsurance arrangements in place. We generally reinsure professional liability risks under annual treaties (our primary reinsurance arrangements) pursuant to which the reinsurer agrees to assume all or a portion of all risks that we insure above our individual risk retention of $1 million per claim, up to the maximum individual limit offered. Historically, the professional liability per claim retention level has varied between 90% and 100% of the first $1 million and between 0% and 5% of claims exceeding those levels depending on the coverage year and the state in which business was written. 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 fronting and quota share arrangements that apply to certain groups of HCPL policies, generally those associated with a group of affiliated insureds or with a large practice group or facility. Gross and net written premium associated with such arrangements approximated $37.5 million and $20.2 million, respectively, during the year ended December 31, 2013. Medical technology and life sciences products coverages are separately reinsured, generally with 100% retention on the first $1 million of coverage and between 5% and 33% of coverage exceeding those levels, with additional loss participation if specified limits are exceeded. When we complete an acquisition, the acquired company's existing reinsurance agreements continue until the expiration date of the agreement, typically less than a one year period, and reimbursement under the agreements continues until all of the claims covered by the agreements are resolved. The structure of these pre-existing arrangements typically reflects a lower retention level than our primary arrangements.

Our primary reinsurance agreements are negotiated and renewed annually at October 1. There was no significant change in the cost or structure of the agreements renewed on October 1, 2013.

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, volume of business, level of experience with a particular set of claims and our analysis of the potential underwriting results. We purchase reinsurance from a number of companies to mitigate concentrations of credit risk. We utilize a reinsurance broker to assist us in the placement of our reinsurance program 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.

The following table identifies those reinsurers for which our recoverables for both paid and unpaid claims (net of amounts due to the reinsurer) and our prepaid balances are aggregately $20 million or more as of December 31, 2013:

Reinsurer	Domiciliary Country	A.M. Best Company Rating	Net Amounts Due From Reinsurer
(In thousands)			
Everest Reinsurance Company	United States	A+	$25,954
Hannover Rueckversicherung AG	Germany	A+	$24,382
Aspen Insurance UK, Ltd.	United Kingdom	A	$20,915
Transatlantic Reinsurance Company	United States	A	$20,849

Taxes

In December 2012 we received a Notice of Proposed Adjustment (NOPA) from the IRS which disallows a substantial portion of the loss and loss adjustment expense deductions taken for the 2009 and 2010 fiscal years and would thereby increase our current tax liability by approximately $130 million. In January 2013 we submitted a comprehensive written protest of the NOPA to the IRS Office of Appeals regarding certain issues within the NOPA, all of which related to the timing of deductions. During the fourth quarter of 2013, we reached a tentative settlement of all contested Federal income tax issues for the related tax years which will result in no additional tax liability for us. Other non-contested issues addressed by the NOPA are expected to result in a net federal income tax refund, exclusive of statutory interest, of approximately $9.6 million. We believe that our tentative terms of settlement with the IRS will be documented and finalized during 2014. In January 2013 we made a $20.6 million protective tax payment to the IRS in order to reduce potential interest assessments. We expect the protective payment to also be refunded once the settlement is finalized.

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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 under "Critical Accounting Estimates – Reserve for Losses and Loss Adjustment Expenses (reserve for losses or reserve)." 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 December 31, 2013 there were no significant reserves established for corporate legal actions.

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Investing Activities and Related Cash Flows

Investment Exposures

The following table provides summarized information regarding our investments as of December 31, 2013:

($ in thousands)	Carrying Value	Included in Carrying Value: Unrealized Gains	Unrealized Losses	Average Rating (1)		% Total Investments
Fixed Maturities						
Government						
U.S. Treasury	$170,714	$6,118	$(1,519)	AA+	(2)	4%
U.S. Government-sponsored enterprise	32,768	2,251	(425)	AA+	(2)	1%
Total government	203,482	8,369	(1,944)	AA+	(2)	5%
State and Municipal Bonds						
Pre-refunded	167,631	6,861	(47)	AA		4%
General obligation	321,532	14,477	(1,236)	AA+		8%
Special revenue	665,503	25,195	(6,644)	AA		17%
Total state and municipal bonds	1,154,666	46,533	(7,927)	AA		29%
Corporate Debt						
Financial institutions	396,564	13,957	(4,030)	A		10%
Consumer oriented	275,708	15,428	(4,796)	BBB+		7%
Utilities/Energy	279,535	12,519	(3,193)	BBB+		7%
Industrial	399,180	10,945	(1,668)	BBB		10%
Other	10,166	210	(57)	A		<1%
Total corporate debt	1,361,153	53,059	(13,744)	BBB+		35%
Securities backed by:						
Agency mortgages	230,660	7,564	(2,629)	AA+	(2)	6%
Non-agency mortgages	4,939	44	(226)	AA-		<1%
Alt -A mortgages	15	—	—	AA+		<1%
Agency commercial mortgages	27,475	343	(136)	AA+	(2)	1%
Subprime home equity loans	3,889	17	(237)	BBB+		<1%
Other commercial mortgages	61,390	2,491	(167)	AAA		2%
Credit card loans	10,252	274	(9)	AAA		<1%
Automobile loans	41,959	126	(20)	AAA		1%
Other asset loans	18,169	70	(58)	AA		<1%
Total asset-backed securities	398,748	10,929	(3,482)	AAA		10%
Total fixed maturities	3,118,049	118,890	(27,097)	A+		79%
Equities						
Financial	81,536	—	—			2%
Utilities/Energy	32,350	—	—			1%
Industrial	57,262	—	—			1%
Consumer oriented	66,461	—	—			2%
All Other	15,932	—	—			<1%
Total equities	253,541	—	—			6%
Short-Term	248,605	—	—			6%
Business-owned life insurance (BOLI)	54,374	—	—			1%
Investment in Unconsolidated Subsidiaries						
Investment in tax credit partnerships	142,174	—	—			4%
Investment in LPs, carried at NAV	72,062	—	—			2%
Total investment in unconsolidated subsidiaries	214,236	—	—			5%

Other Investments				
FHLB capital stock	3,449	—	—	<1%
Investments in LPs, carried at cost	47,258	—	—	1 %
Other	1,533	—	—	<1%
Total other investments	52,240	—	—	1 %
Total Investments	$3,941,045	$118,890	$(27,097)	100 %

(1) A weighted average rating is calculated using available ratings from Standard & Poor's, Moody's and Fitch. The table presents the Standard & Poor's rating that is equivalent to the computed average.

(2) The rating presented is the Standard & Poor's rating rather than the average. The Moody's rating is Aaa and the Fitch rating is AAA.

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A detailed listing of our investment holdings as of December 31, 2013 is presented in an Investor Supplement we make available in the Investor Relations section of our website, www.proassurance.com, or directly at www.proassurance.com/investorrelations/supplemental.aspx.

We manage our investments to ensure that we will have sufficient liquidity to meet our obligations, taking into consideration the timing of cash flows from our investments, including interest payments, dividends and principal payments, as well as the expected cash flows to be generated by our operations. In addition to the interest and dividends we will receive, we anticipate that between $40 million and $60 million of our investments will mature (or be paid down) each quarter of the next year and become available, if needed, to meet our cash flow requirements. The primary outflow of cash at our insurance subsidiaries is related to paid losses and operating costs, including income taxes. The payment of individual claims cannot be predicted with certainty; therefore, we rely upon the history of paid claims in estimating the timing of future claims payments. To the extent that we may have an unanticipated shortfall in cash we may either liquidate securities or borrow funds under existing borrowing arrangements through our credit facility and the FHLB system. In December 2012 we elected to partially fund our acquisition of Medmarc by borrowing $125.0 million from our existing credit facility on a fully secured basis as this allowed us to continue to hold rather than liquidate certain higher yielding securities. We repaid the borrowing during September 2013. Currently, $150 million of the credit facility is available for use. Given the duration of our investments, we do not foresee a shortfall that would require us to meet operating cash needs through additional borrowings. Additional information regarding the credit facility is detailed in Note 10 of the Notes to Consolidated Financial Statements.

Our investment portfolio continues to be primarily composed of high quality fixed income securities with approximately 93% of our fixed maturities being investment grade securities as determined by national rating agencies. The weighted average effective duration of our fixed maturity securities at December 31, 2013 was 3.9 years; the weighted average effective duration of our fixed maturity securities combined with our short-term securities was 3.6 years. Net unrealized gains related to our fixed income securities decreased approximately $131.9 million during 2013. As interest rates have improved, the value of our fixed income securities has declined.

The carrying value of our tax credit partnerships at December 31, 2013, 2012 and 2011 was approximately $142.2 million, $87.3 million and $86.8 million, respectively. Carrying value reflects our total commitments (both funded and unfunded) to the partnerships, less amortization, since our initial investment. These investments are comprised of separate limited partner interests designed to generate investment returns by providing tax benefits to investors in the form of project operating losses and tax credits. The related properties are principally low income housing properties. We fund these investments based on funding schedules maintained by the partnerships. During 2013, 2012 and 2011 we funded approximately $63.5 million, $35.7 million and $29.2 million, respectively. Approximately $22.4 million, $20.5 million and $49.3 million of our total commitments to the tax credit partnerships had not yet been funded as of December 31, 2013, 2012 and 2011, respectively.

During 2013, 2012 and 2011, the total carrying value of our investment fund LPs/LLCs was approximately $119.3 million, $58.8 million and $56.6 million, respectively, all of which has been funded. The 2013 carrying value includes $10.5 million related to our portion of an LP's accumulated earnings that were recorded as a result of a change from the cost to equity method. During 2013, 2012 and 2011, we funded investment LP/LLCs, net of capital returned, in the amount of $37.8 million, $18.5 million, and $4.7 million, respectively. As of December 31, 2013, we had total active commitments to investment fund LP/LLCs of approximately $203.0 million, of which $140.9 million is unfunded. The unfunded commitments will be paid over a period of approximately 5 years as requested by the fund managers.

European Debt Exposure

We have no direct European sovereign debt exposure. We have indirect exposure through our investments in debt securities and through our reinsurance receivables. Issuers of our debt or equity securities and our reinsurers may hold European sovereign debt or have counterparty exposure to European banks or European corporations or may have a reliance on Eurocurrency denominated business. Should Europe suffer a severe recession or the Euro-zone or Eurocurrency fail, issuers may suffer credit or profitability losses or may experience a credit downgrade by rating agencies.

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Our debt securities at December 31, 2013 included investments of $124.7 million (3% of our total investments) where the issuer is domiciled in Europe or the underlying revenue stream supporting the security is European. Of our European issuers, we believe those in the financial sector are most likely to suffer loss in the event of a European economic crisis. A summary of these debt securities by country follows (country designation is based on the underlying revenue stream of the security):

	European Debt Exposure by Country and Industry Type			
(in millions)	Total Exposure	Financial Institutions	Industrial & Utilities	Energy & Communication
United Kingdom	$57.4	$23.5	$21.6	$12.3
Netherlands	20.6	5.0	6.8	8.8
France	10.8	3.6	—	7.2
Switzerland	10.0	10.0	—	—
Luxembourg	9.5	—	4.3	5.2
Sweden	3.6	3.6	—	—
Ireland	3.3	0.1	1.2	2.0
Norway	3.2	1.3	1.2	0.7
Spain	2.2	—	—	2.2
Denmark	1.8	1.8	—	—
Austria	1.3	—	1.3	—
Germany	1.0	—	1.0	—
	$124.7	$48.9	$37.4	$38.4

Our reinsurers typically operate globally and have large investment portfolios which may be linked directly or indirectly to the European economy. As of December 31, 2013, two of our largest reinsurers were domiciled in Europe; our net receivables with these reinsurers totaled approximately $45 million. Net amounts due from reinsurers approximated $237.9 million at December 31, 2013.

Business Combinations and Ventures

We paid cash of approximately $205 million to acquire Eastern on January 1, 2014 and cash of $153.7 million to acquire Medmarc on January 1, 2013. Funds for both transactions were deposited with a third-party agent several days prior to the close dates; the deposits were included in Other Assets on our Consolidated Balance Sheet at December 31, 2013 and 2012.

As a member of Lloyd's and a capital provider to Syndicate 1729 we are required to provide capital, referred to as Funds at Lloyd's (FAL), to support Syndicate 1729. In order to meet these FAL requirements, we provided a standby letter of credit of £41.9 million (approximately $69.3 million at December 31, 2013) and cash deposits of $8.7 million. The FAL deposit is included in Other Assets on our December 31, 2013 Consolidated Balance Sheet. We collateralized the standby letter of credit with cash of $78.0 million; the collateral is reflected as Restricted Cash on our December 31, 2013 Consolidated Balance Sheet. We also entered into a revolving credit agreement (the Credit Agreement) with Syndicate 1729 to provide operating funds of up to £10 million (approximately $17 million at December 31, 2013). Draws under the Credit Agreement will earn interest at 8.5% per annum, and be repayable on demand but no later than December 31, 2016. At December 31, 2013, £1.0 million ($1.7 million) had been drawn under the Credit Agreement.

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Financing Activities and Related Cash Flows

Treasury Shares

Treasury share activity for 2013, 2012 and 2011 was as follows:

	Year Ended December 31		
(in thousands)	2013	2012	2011
Treasury shares at the beginning of the period	244	7,996	7,332
Shares reissued in conjunction with stock split	—	(7,729)	—
Shares reacquired, at cost of $32 million, $0 million and $21 million, respectively	681	—	682
Shares reissued to the ProAssurance 2011 Employee Stock Ownership Plan, fair value of $1 million, $1 million and $0.7 million, respectively	(25)	(23)	(18)
Treasury shares at the end of the period	900	244	7,996

In December of 2013 our Board increased its authorization for the repurchase of common shares or the retirement of outstanding debt by $100 million.

As of February 12, we had reacquired an additional 710,000 common shares during 2014 at a cost of approximately $33 million, which reduced our Board authorizations for the repayment of debt or repurchase of common shares to approximately $169.8 million.

Shareholder Dividends

Our Board of Directors has declared cash dividends quarterly since the third quarter of 2011. Initially, dividends were $0.125 per share but were increased to $0.25 in the fourth quarter of 2012 and increased to $0.30 per share in the fourth quarter of 2013. With the exception of our fourth quarter 2012 dividend that was accelerated and paid in December 2012, each quarterly dividend was paid in the month following the end of the quarter. Our Board also declared and paid a special dividend of $2.50 per share during December 2012. Any decision to pay future cash dividends is subject to the Board’s final determination after a comprehensive review of financial performance, future expectations and other factors deemed relevant by the Board.

Debt

On November 21, 2013, we issued $250 million of unsecured senior notes, which will be used for general purposes, including contributions to the capital of insurance subsidiaries, repayment of debt and other capital management activity. The notes bear interest at 5.3% annually and are due in 2023 although they may be redeemed in whole or part prior to maturity. There are no financial covenants associated with these notes.

We have a revolving credit agreement (the "Agreement") that allows us to borrow up to $150 million for general corporate purposes, including, but not limited to, short-term working capital, share repurchases as authorized by the Board, and support for other activities we enter into in the normal course of business. The Agreement expires in April 2016. We had an outstanding borrowing under the Agreement of $125 million from November 2012 to September 2013. We are in compliance with the financial covenants of the Agreement.

During 2012, we repaid all then-outstanding long-term debt totaling $57.7 million, including a note payable that was carried at fair value. We recognized a loss on the repayment of the note payable of $2.2 million.

Additional information regarding our debt is provided in Note 10 of the Notes to Consolidated Financial Statements.

We are a member of a number of FHLBs. Through membership, we have access to secured cash advances which can be used for liquidity purposes or other operational needs. To date, we have not established a FHLB line of credit or materially utilized our membership.

Off-Balance Sheet Arrangements/Guarantees

We have a standby letter of credit (the LOC) in the amount of £41.9 million ($69.3 million at December 31, 2013) that guarantees the performance of Syndicate 1729. The LOC expires four years from the date it is terminated. We also have a revolving credit agreement with Syndicate 1729 to provide operating funds of up to £10.0 million ($17.0 million at December 31, 2013), of which £9.0 million ($14.9 million) had not yet been funded as of December 31, 2013. The revolving credit agreement expires on December 31, 2016. See Note 9 of the Notes to Consolidated Financial Statement for more

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information on these arrangements. We have no other significant off-balance sheet arrangements or guarantees and do not expect these arrangements to have a material effect on our financial position.

Contractual Obligations

A schedule of our non-cancellable contractual obligations at December 31, 2013 follows:

	Payments due by period				
(In thousands)	Total	Less than 1 year	1-3 years	3-5 years	More than 5 years
Loss and loss adjustment expenses	$2,072,822	$557,769	$688,077	$410,891	$416,085
Eastern acquisition	205,000	205,000	—	—	—
Long-term debt obligations including interest	382,316	14,722	26,500	26,500	314,594
Revolving credit agreement fees	591	263	328	—	—
Operating lease obligations	19,911	3,039	5,303	4,553	7,016
Funding commitments primarily related to non-public investment entities	164,182	49,604	68,940	26,838	18,800
Total	$2,844,822	$830,397	$789,148	$468,782	$756,495

We believe that our operating cash flow and funds from our investment portfolio are adequate to meet our contractual obligations.

The above table presumes no borrowings under our revolving credit agreement and standby letter of credit through expiration of the agreements, though borrowings could occur. For more information regarding these agreements see Note 10 of the Notes to Consolidated Financial Statements.

The anticipated payout of loss and loss adjustment expenses is based upon our historical payout patterns. Both the timing and amount of these payments may vary from the payments indicated. Our operating lease obligations are primarily for the rental of office space and office equipment.

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Overview of Results–Years Ended December 31, 2013 and 2012

Net income and Operating income

	Year Ended December 31	
(In millions, except per share data)	2013	2012
Net income	$297.5	$275.5
Operating income	$221.1	$257.2
Net income per diluted share	$4.80	$4.46
Operating income per diluted share	$3.56	$4.16

The increase in Net income in 2013 reflects a non-taxable gain on our acquisition of Medmarc of $32.3 million and a $39.0 million increase in net realized investment gains, partially offset by lower operating profits due to lower earned premium, lower prior year favorable loss reserve development and a smaller reduction to ceded premium for prior accident years. Operating income, which is a non-GAAP financial measure, decreased as it does not include net realized investment gains or the acquisition gain. A reconciliation of Operating income to Net income follows under the heading "Non-GAAP Financial Measures".

Results for the years ended December 31, 2013 and 2012 compare as follows:

Revenues

Net premiums earned decreased during 2013 by approximately $22.7 million or 4.1%. Our acquisitions of Medmarc and IND contributed $38.1 million of additional net premiums earned during 2013. In addition, reductions to ceded premium attributable to the favorable emergence of losses ceded to our reinsurers under the variable components of our reinsurance arrangements were approximately $17.9 million lower for 2013. Excluding acquired entities, losses of premium attributable to non-renewals were greater than premium gains from new business in 2013 and there was a reduced amount of premium from tail policies.

Our net investment result (which includes both net investment income and earnings from unconsolidated subsidiaries) increased $7.6 million or 5.9%. Net investment income decreased during 2013, primarily due to reduced earnings on our fixed income portfolio, partially offset by increased earnings from our equities portfolio and distributions received from a cost method investment LP in 2013. Earnings from unconsolidated subsidiaries increased $14.4 million in 2013. Earnings from unconsolidated subsidiaries principally reflects earnings recognized as a result of a change of an LP from the cost method to the equity method in the fourth quarter of 2013 as well as higher earnings from a private equity LP, slightly offset by higher tax credit partnership amortization.

Net realized investment gains in 2013 were approximately $39.0 million higher than in 2012. The improvement was principally attributable to an increase in our average equity trading portfolio investment and improved stock market yields. Impairments were nominal for 2013 and were $1.8 million for 2012.

Expenses

The calendar year net loss ratio for 2013 was 42.6%, a 9.9 percentage point increase as compared to 2012. The increase was principally attributable to lower favorable loss development in 2013 as compared to 2012 by $49.3 million. Our current accident year net loss ratio increased by 2.7 percentage points for 2013 primarily due to a reduced effect from prior accident year ceded premiums.

Our underwriting expense ratio increased 3.4 percentage points for 2013. The expense ratio is impacted by a number of factors that potentially distort a run rate expense ratio. In particular, start-up expenses associated with Syndicate 1729 and transaction expenses associated with our acquisitions increased our ratio in 2013. Also, ceded premiums related to prior accident years decreased our ratio in both 2013 and 2012, but had a greater effect on the 2012 ratio.

Operating Ratio and Return on Equity

Our operating ratio (calculated as our combined ratio, less our investment income ratio) increased by 13.5 percentage points in 2013. The increase primarily reflected both a higher net loss ratio and a higher underwriting expense ratio. Return on equity was 11.4% in 2013, and 12.4% in 2012. Our calculation of return on equity for 2013 excluded the effect of the $32.3 million gain on acquisition.

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Book Value per Share

Our book value per share at December 31, 2013 as compared to December 31, 2012 is shown in the following table. The past growth rates of our book value per share do not necessarily predict similar future results.

	Book Value Per Share
Book Value Per Share at December 31, 2012	$36.85
Increase (decrease) to book value per share during the year ended December 31, 2013 attributable to:	
Net income	4.82
Decline in accumulated other comprehensive income	(1.40)
Dividends declared	(1.05)
Other	(0.09)
Book Value Per Share at December 31, 2013	$39.13

Non-GAAP Financial Measures

Operating income is a non-GAAP financial measure that is widely used to evaluate performance within the insurance sector. In calculating operating income, we have excluded the after-tax effects of net realized investment gains or losses, guaranty fund assessments or recoupments, loss on extinguishment of debt, gain on acquisition and the effect of confidential settlements that do not reflect normal operating results. We believe operating income presents a useful view of the performance of our insurance operations, but should be considered in conjunction with net income computed in accordance with GAAP.

The following table is a reconciliation of Net income to Operating income:

	Year Ended December 31	
(In thousands, except per share data)	2013	2012
Net income	$297,523	$275,470
Items excluded in the calculation of operating income:		
(Gain) loss on extinguishment of debt	—	2,163
Net realized investment (gains) losses	(67,904)	(28,863)
Guaranty fund assessments (recoupments)	40	345
Gain on acquisition	(32,314)	—
Effect of confidential settlements, net	—	(1,694)
Pre-tax effect of exclusions	(100,178)	(28,049)
Tax effect, at 35%, exclusive of non-taxable gain on acquisition	23,752	9,817
Operating income	$221,097	$257,238
Per diluted common share:		
Net income	$4.80	$4.46
Effect of exclusions	(1.24)	(0.30)
Operating income per diluted common share	$3.56	$4.16

Results of Operations–Year Ended December 31, 2013 Compared to Year Ended December 31, 2012

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

	Year Ended December 31		
($ in thousands, except per share data)	2013	2012	Change
Revenues:			
Net premiums earned	$527,919	$550,664	$(22,745)
Net investment income	129,265	136,094	(6,829)
Equity in earnings (loss) of unconsolidated subsidiaries	7,539	(6,873)	14,412
Net investment result	136,804	129,221	7,583
Net realized investment gains (losses)	67,904	28,863	39,041
Other income	7,551	7,106	445
Total revenues	740,178	715,854	24,324
Expenses:			
Losses and loss adjustment expenses	243,015	161,726	81,289
Reinsurance recoveries	(18,254)	18,187	(36,441)
Net losses and loss adjustment expenses	224,761	179,913	44,848
Underwriting, policy acquisition and operating expenses	147,817	135,631	12,186
Interest expense	2,755	2,181	574
Loss on extinguishment of debt	—	2,163	(2,163)
Total expenses	375,333	319,888	55,445
Gain on acquisition	32,314	—	32,314
Income before income taxes	397,159	395,966	1,193
Income taxes	99,636	120,496	(20,860)
Net income	$297,523	$275,470	$22,053
Earnings per share:			
Basic	$4.82	$4.49	$0.33
Diluted	$4.80	$4.46	$0.34
Net loss ratio	42.6 %	32.7 %	9.9
Underwriting expense ratio	28.0 %	24.6 %	3.4
Combined ratio	70.6 %	57.3 %	13.3
Operating ratio	46.1 %	32.6 %	13.5
Effective tax rate	25.1 %	30.4 %	(5.3)
Return on equity*	11.4 %	12.4 %	(1.0)

* Gain on acquisition is excluded from the calculation of return on equity.

In all tables that follow, the abbreviation “nm” indicates that the percentage change is not meaningful.

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Premiums Written

Changes in our premium volume are driven by four primary factors: (1) the amount of new business generated both as a result of acquisitions and through our existing books of business, (2) our retention of existing business, (3) the premium charged for business that is renewed, which is affected by rates charged and by the amount and type of coverage an insured chooses to purchase, and (4) the timing of premium written through multi-period policies. In addition, premium volume may periodically be affected by shifts in the timing of renewals between periods. The healthcare professional liability market remains competitive as physicians continue joining hospitals or larger group practices and thus no longer purchasing insurance in the standard market. In addition, some competitors have chosen to compete primarily on price; both factors impact our ability to write new business and retain existing business.

Gross, ceded and net premiums written were as follows:

	Year Ended December 31			
($ in thousands)	2013	2012	Change	
Gross premiums written	$567,547	$536,431	$31,116	5.8 %
Ceded premiums written	(42,365)	(8,133)	(34,232)	>100%
Net premiums written	$525,182	$528,298	$(3,116)	(0.6 %)

Gross Premiums Written

Gross premiums written by component were as follows:

	Year Ended December 31			
($ in thousands)	2013	2012	Change	
Professional liability				
Physicians:				
Twelve month term	$388,583	$403,429	$(14,846)	(3.7 %)
Twenty-four month term	25,584	13,081	12,503	95.6 %
Total Physicians	414,167	416,510	(2,343)	(0.6 %)
Other healthcare providers	43,125	43,492	(367)	(0.8 %)
Healthcare facilities	26,202	28,259	(2,057)	(7.3 %)
Legal professionals	27,060	17,146	9,914	57.8 %
Tail coverages	20,920	29,394	(8,474)	(28.8 %)
Total professional liability	531,474	534,801	(3,327)	(0.6 %)
Medical technology and life sciences products liability	34,190	—	34,190	nm
Other	1,883	1,630	253	15.5 %
Total	$567,547	$536,431	$31,116	5.8 %

The above table includes gross written premium for 2013 that was attributable to IND and Medmarc, as shown in the following table. Neither acquisition contributed premium in 2012.

	Year Ended December 31
($ in thousands)	2013
Gross premiums written:	
Professional liability	
Physicians, twelve month term	$10,474
Other healthcare providers	280
Legal professionals	9,418
Total professional liability	20,172
Medical technology and life sciences products liability	34,190
Total	$54,362

Our retention rate for our standard physician business was approximately 89% for 2013, as compared to 90% for 2012. We calculate our retention rate as retained premium divided by all premium subject to renewal. Retention rates are affected by a

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number of factors. We may lose insureds to competitors or to alternative insurance mechanisms such as risk retention groups or self-insurance entities (often when physicians join hospitals or large group practices) or due to pricing or other issues. We may choose not to renew an insured as a result of our underwriting evaluation. Insureds may also terminate coverage because they have left the practice of medicine for various reasons, principally for retirement but also for personal reasons or due to disability or death.

The pricing of our renewed physician business remained relatively flat with expiring premiums during 2013. The pricing of our business includes the effects of filed rates, surcharges and discounts. We continue to base our pricing on expected losses, as indicated by our historical loss data and available industry loss data. We are committed to a rate structure that will allow us to fulfill our obligations to our insureds, while generating competitive returns for our shareholders.

Physician policies were our greatest source of premium revenues in both 2013 and 2012. In addition to the effects of retention and renewal pricing discussed above, our 2013 twelve month term physician premium volume reflected the following:

- The acquisition of IND contributed approximately $10.5 million of physician premium to 2013.
- In addition to premium contributed by IND, we wrote new physician business of approximately $18 million in 2013.

We offer twenty-four month term policies to our physician insureds in one selected jurisdiction. The premium associated with both years is included in written premium in the period the policy is written; comparison of gross written premium between successive years reflects volume differences that have no effect on earned premium. Thus, twenty-four month term policies subject to renewal in 2013 were previously written in 2011 rather than in 2012, as is the case for our twelve-month term policies. There was no significant volume change associated with twenty-four month policies during 2013.

Our other healthcare providers are primarily dentists, chiropractors and allied health professionals. The decline in premium volume for these coverages during 2013 was primarily attributable to the 2012 discontinuation of a program that offered coverage to optometrists.

Our healthcare facilities premium (which includes hospitals, surgery centers and other facilities) declined in 2013, principally due to retention losses. The competitive pressures that affect our physician business also affect our facilities business.

The increase in legal professionals premium for 2013 is principally attributable to our acquisition of Medmarc. Our legal professionals policies are offered throughout the United States, principally through agent and brokerage arrangements.

We offer extended reporting endorsement or “tail” coverage to insureds who discontinue their claims-made coverage with us, and we also periodically offer “tail” coverage through custom policies. The amount of tail coverage premium written can vary widely from period to period. The decrease in tail premium for 2013 was principally due to a large single custom policy issued in the first quarter of 2012 for which there was no counterpart in 2013.

All medical technology and life sciences products liability premium is attributable to our acquisition of Medmarc. Our medical technology and life sciences products liability (products liability) business is marketed throughout the United States; coverage is offered on a primary basis, within specified limits, to manufacturers and distributors of medical technology and life sciences products.

Ceded Premiums Written

Ceded premiums written compare as follows:

	Year Ended December 31			
($ in thousands)	2013	2012	Change	
Primary reinsurance arrangements (1)	16,177	21,997	(5,820)	(26.5%)
Secondary reinsurance arrangements (2)	17,279	9,116	8,163	89.5%
Reduction in premiums owed under reinsurance agreements, prior accident years, net (3)	(16,403)	(34,328)	17,925	(52.2%)
Premiums ceded associated with acquired entities	14,308	—	14,308	nm
Other ceded premiums written	$ 11,004	$ 11,348	$ (344)	(3.0%)
Total ceded premiums written	$ 42,365	$ 8,133	$ 34,232	>100%

Ceded premiums represent the amounts owed to our reinsurers for their assumption of a portion of our losses. In general we retain the first $1 million in risk insured by us and cede any coverages in excess of this amount. We pay our reinsurers a ceding premium in exchange for their accepting the risk, the ultimate amount of which is determined by the loss experience of the business ceded, subject to certain minimum and maximum amounts.

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Ceded premiums for 2013 and 2012 compare as follows:

(1) As discussed previously, the premium that we cede under our reinsurance arrangements is determined, in part, by the losses ceded under these arrangements. Ceded premiums decreased due to lower premiums in 2013, and beginning with the second quarter of 2012, we projected (estimated) lower losses for our ceded coverages and reduced our estimate of the associated ceded premium for the current accident year. The year ended December 31, 2013 reflected those lower projections for the full period in 2013 as compared to two quarters in 2012.

(2) We have secondary arrangements with certain large healthcare groups that include quota share, fronting and other risk sharing arrangements. Growth in these arrangements increased ceded premium in 2013 as compared to 2012. These arrangements are primarily comprised of the following:

- We share risk of loss for policies written or renewed under the Ascension Health (Ascension) Certitude program with an Ascension affiliate under a quota share arrangement.
- We have entered into fronting arrangements with certain large healthcare groups. Under the arrangements we provide specified underwriting, claims and risk management services but cede a large portion of the risk of the coverages provided back to the group or affiliates of the group. Volume under such arrangements can vary between periods.
- During 2013, we entered into quota share arrangements under which we share the risk of loss with captive insurers affiliated with one of our agents.

(3) Given the length of time that it takes to resolve our claims, many years may elapse before all losses recoverable under a reinsurance agreement are known. As a part of the process of estimating our loss reserves we also make estimates regarding the amounts recoverable under our reinsurance agreements. As previously discussed, the amounts ultimately owed under our reinsurance agreements are subject to the losses ceded under the agreements. In both 2013 and 2012, on a net basis, we reduced our estimate of expected losses and associated recoveries for prior year ceded losses, as well as our estimate of ceded premiums owed to reinsurers. The reductions were substantially less in 2013 than in 2012. The net reduction for 2013 includes an offsetting increase of $1.6 million that was attributable to loss reserves acquired in business combinations. In 2012 we also revised the expected amount receivable under certain older reinsurance agreements for which there were limited remaining open items. Changes to estimates of premiums ceded related to prior accident years are fully earned in the period the change in estimates occur.

Ceded Premiums Ratio

As shown in the table below, our ceded premium ratio was significantly affected in both 2013 and 2012 by revisions to our estimate of premiums owed to reinsurers related to coverages provided in prior accident years.

	Year Ended December 31		
	2013	2012	Change
Ceded premiums ratio, as reported	7.5 %	1.5 %	6.0
Less the effect of reduction in premiums owed under reinsurance agreements, prior accident years (as previously discussed)*	(2.9 %)	(6.4 %)	3.5
Ratio, current accident year	10.4 %	7.9 %	2.5

* Effect shown for 2013 is net of an increase to the ratio of approximately 0.3 percentage points attributable to business combinations.

The increase in the ceded premium ratio, current accident year, for 2013 as compared to 2012 is attributable to the following:

	Increase (decrease) 2013 versus 2012
Effect on ceded premium ratio, current accident year:	
Secondary reinsurance arrangements, increased volume	1.3
Acquisitions	1.6
Other	(0.4)
Net increase in ratio	2.5

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Net Premiums Earned

Net premiums earned were as follows:

($ in thousands)	Year Ended December 31 2013	2012	Change	
Gross premiums earned	$569,433	$558,316	$11,117	2.0 %
Premiums ceded	(41,514)	(7,652)	(33,862)	>100%
Net premiums earned	$527,919	$550,664	$(22,745)	(4.1 %)

Net premiums earned consist of gross premiums earned less the portion of earned premiums that we cede to our reinsurers for their assumption of a portion of our losses. Because premiums are generally earned pro rata over the entire policy period, fluctuations in premiums earned tend to lag those of premiums written. Generally, our policies carry a term of one year, but as discussed above, we renew certain policies with a twenty-four month term, and certain of our medical technology and life sciences products liability policies carry a multi-year term. Tail coverage premiums are generally 100% earned in the period written because the policies insure only incidents that occurred in prior periods and are not cancellable. Additionally, ceded premium changes due to changes to estimates of premiums owed under reinsurance agreements are fully earned in the period of change.

Gross premiums earned in 2013 reflected additional premiums contributed by acquisitions of approximately $53.9 million offset by the pro-rata effect of lower physician premiums written by our other subsidiaries during the preceding twelve months, and a decline in tail premium of $8.9 million. Our 2013 gross premiums earned includes approximately $25.1 million in gross premiums earned associated with Medmarc and IND policies written prior to our acquisition of these operations. We expect Medmarc and IND policies written pre-acquisition to contribute gross premiums earned of approximately $3.0 million in 2014 and beyond.

The increase in premiums ceded during 2013 reflected ceded premium reductions related to prior accident years, exclusive of acquisitions, that were $16.3 million lower in 2013 than in 2012, as previously discussed, and contributions from our acquisitions of approximately $15.8 million.

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

Net Investment Income

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

Net investment income by investment category was as follows:

	Year Ended December 31			
($ in thousands)	2013	2012	Change	
Fixed maturities	$122,065	$133,088	$(11,023)	(8.3%)
Equities	9,454	6,947	2,507	36.1%
Short-term investments and Other invested assets	2,584	660	1,924	>100%
Business owned life insurance	1,960	2,008	(48)	(2.4%)
Investment fees and expenses	(6,798)	(6,609)	(189)	2.9%
Net investment income	$129,265	$136,094	$(6,829)	(5.0%)

Fixed Maturities

The decrease in our income from fixed maturity securities was primarily due to both lower average yields and average investment balances (exclusive of acquisitions) as compared to 2012. Although we added fixed securities valued at $314 million to our portfolio in 2013 as a result of the Medmarc and IND mergers, we reduced the size of our fixed portfolio in 2013 in order to repay debt, pay dividends and invest in other asset classes. On an overall basis our average investment in fixed securities was approximately 3% lower in 2013 as compared to 2012.

Average yields for our fixed maturity portfolio were generally lower in 2013, as shown in the table below.

	Year Ended December 31	
	2013	2012
Average income yield	3.7%	3.9%
Average tax equivalent income yield	4.3%	4.5%

Yields on fixed maturity securities acquired in the Medmarc and IND transactions were lower than our average yield in 2012, which reduced our 2013 average consolidated tax equivalent yield by approximately 15 basis points. Yields for 2013 also reflected lower income from Treasury Inflation-Protected Securities of $1.0 million. The remaining decline in yield is primarily attributable to market conditions. Throughout 2012 and to a declining degree in 2013, in order to maintain the quality and duration of our portfolio, we have reinvested maturities, paydowns and proceeds from sales in our fixed income portfolio at yields that were lower than the average yield on our portfolio.

Equities

Income from our equity portfolio increased in 2013 as compared to 2012 due to average investment balances that were approximately 59% higher in 2013. Given the challenge in finding compelling returns in the fixed income portfolio as discussed above and the sensitivity of the value of the fixed income portfolio to rising interest rates, we have increased our allocation to dividend yielding equities and other non-fixed income investments.

Short-term Investments and Other Invested Assets

The increased income from our short-term investments and other invested assets in 2013 principally reflected distributions received from an interest in an LP that we account for using the cost method. No distributions were received from this investment in 2012.

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Equity in Earnings (Loss) of Unconsolidated Subsidiaries

Equity in earnings (loss) of unconsolidated subsidiaries is derived from our investment interests accounted for under the equity method. Results were as follows:

	Year Ended December 31		
(In thousands)	2013	2012	Change
Investment LPs	$17,673	$278	$17,395
Business LLC interest	—	(728)	728
Tax credit partnerships	(10,134)	(6,423)	(3,711)
Equity in earnings (loss) of unconsolidated subsidiaries	$7,539	$(6,873)	$14,412

We hold interests in certain LPs that generate earnings from trading portfolios, secured debt, and private equity investments. The improved results for 2013 principally reflect earnings recognized as a result of a change of an LP from the cost method to the equity method as well as higher earnings from a private equity LP. When there is a change from the cost to the equity method, GAAP requires retroactive recording of accumulated earnings since the origination of the investment. As the amounts are not material in the current period or any of the prior periods affected, prior period financial statements have not been restated. Earnings included our portion of the LP's accumulated earnings from the date of initial investment, which totaled $10.5 million, $8.4 million of which was related to prior periods.

Our business LLC interest was a non-controlling interest in a startup entity, which produced operating losses in 2012. We dissolved our interest in the entity during 2013.

Our tax credit investments are designed to generate returns by providing tax benefits in the form of tax credits and tax-deductible project operating losses. We account for our tax credit investments on the equity method and record amortization of our investment each period based on our allocable portion of the projected operating losses of the underlying properties. Amortization is adjusted periodically as actual operating results of the underlying properties become available. The increase in tax credit partnership amortization during 2013 reflects an overall increase in our investment in these partnerships, the increasing maturity of the underlying projects, and reductions to amortization during 2012 that were attributable to the re-estimation of inception-to-date amortization of certain partnership interests.

The tax benefits received from our tax credit partnerships, which are not reflected in our investment results above, reduced our tax expenses in 2013 and 2012 as follows:

	Year Ended December 31	
(In thousands)	2013	2012
Tax credits recognized during the period	$17,888	$10,005
Deferred tax benefit of amortization	$3,547	$2,248

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Non-GAAP Financial Measure – Tax Equivalent Investment Result

We believe that to fully understand our investment returns it is important to consider the current tax benefits associated with certain investments as the tax benefit received represents a portion of the return provided by our tax-exempt bonds, BOLI, common and preferred stocks, and tax credit partnership investments (our tax-preferred investments). We impute a pro-forma tax-equivalent result by estimating the amount of fully-taxable income needed to achieve the same after-tax result as is currently provided by our tax-preferred investments. We believe this better reflects the economics behind our decision to invest in certain asset classes that are either taxed at lower rates and/or result in reductions to our current federal income tax expense. Our pro forma tax-equivalent investment result is shown in the table that follows as is a reconciliation of our tax equivalent result to our GAAP net investment result.

	Year Ended December 31	
(In thousands)	2013	2012
GAAP net investment result:		
Net investment income	$129,265	$136,094
Equity in earnings (loss) of unconsolidated subsidiaries	7,539	(6,873)
GAAP net investment result	$136,804	$129,221
Pro forma tax-equivalent investment results	$184,628	$165,632
Reconciliation of pro forma and GAAP tax-equivalent investment results:		
Pro forma tax-equivalent investment results	$184,628	$165,632
Taxable equivalent adjustments, calculated using the 35% federal statutory tax rate:		
State and municipal bonds	(17,590)	(18,482)
BOLI	(1,056)	(1,081)
Dividends received	(1,674)	(1,456)
Tax credit partnerships	(27,504)	(15,392)
GAAP net investment result	$136,804	$129,221

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Net Realized Investment Gains (Losses)

The following table provides detailed information regarding our net realized investment gains (losses).

	Year Ended December 31	
(In thousands)	2013	2012
Other-than-temporary impairment losses, total:		
State and municipal bonds	$(71)	$—
Residential mortgage-backed securities	—	(557)
Corporate debt	—	(878)
Other investments	—	(131)
Portion recognized in (reclassified from) Other Comprehensive Income:		
Residential mortgage-backed securities	—	(201)
Net impairment losses recognized in earnings	(71)	(1,767)
Gross realized gains, available-for-sale securities	18,130	18,645
Gross realized (losses), available-for-sale securities	(7,031)	(2,076)
Net realized gains (losses), trading securities	20,444	1,485
Change in unrealized holding gains (losses), trading securities	35,507	12,673
Decrease (increase) in the fair value of liabilities carried at fair value	—	(1,245)
Other	925	1,148
Net realized investment gains (losses)	$67,904	$28,863

All impairments of debt securities recognized during 2013 and 2012 were credit-related.

The impairment recognized as part of Other investments related to an interest in an LLC which converted to a public fund during 2012.

Realized losses on sales of available-for-sale securities in 2013 and 2012 related to securities which we carried either at no loss or a small loss, relative to the amortized cost basis of the security, at the end of the prior reporting period. Further, at the end of the prior reporting period, we had no intent to sell the securities nor did we expect to be required to sell the securities prior to recovery of their amortized cost basis. Approximately $5.3 million of the 2013 realized loss related to securities sold in the third quarter of 2013 to meet cash needs for the purchase of Eastern, terms of which were agreed upon late in the third quarter. Unrealized losses on these securities at the end of the second quarter were less than 3% of their amortized cost basis.

We substantially increased the size of our equity trading portfolio during the first quarter of 2013 and last three quarters of 2012. Unrealized trading portfolio gains in 2013 reflected both higher average balances and improved stock market valuations in 2013 as compared to 2012.

Gains (losses) from changes in the fair value of liabilities in 2012 were entirely attributable to our note payable due 2019 and related interest rate swap, both of which we repaid in July 2012.

Losses and Loss Adjustment Expenses

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

Accident year refers to the accounting period in which the insured event becomes a liability of the insurer. For claims-made policies, which represent over 90% of the Company’s business, the insured event generally becomes a liability when the event is first reported to the insurer. For occurrence policies the insured event becomes a liability when the event takes place. We believe that measuring losses on an accident year basis is the best measure of the underlying profitability of the premiums earned in that period, since it associates policy premiums earned with the estimate of the losses incurred related to those policy premiums.

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The following table summarizes calendar year net loss ratios by separating losses between the current accident year and all prior accident years. Additionally, the table shows our current accident year net loss ratio was significantly affected by revisions to our estimate of premiums owed to reinsurers related to coverages provided in prior accident years. Our current accident year net loss ratios for December 31, 2013 and 2012 compare as follows:

	Net Loss Ratios (1)		
	Year Ended December 31		
	2013	2012	Change
Calendar year net loss ratio	42.6 %	32.7 %	9.9
Less prior accident year net loss ratio	(42.2 %)	(49.4 %)	7.2
Current accident year net loss ratio, as reported	84.8 %	82.1 %	2.7
Less estimated ratio increase (decrease) attributable to:			
Ceded premium reductions, prior accident years, net (2)	(2.7 %)	(5.4 %)	2.7
Current accident year net loss ratio, less ceded premium effect above (3)	87.5 %	87.5 %	—

(1) Net losses as specified divided by net premiums earned.

(2) Reductions to premiums owed under reinsurance agreements for prior accident years increased net earned premiums (the denominator of the current accident year ratio) in both 2013 and 2012. The net increase to the ratio in 2013 reflects an offset of 0.3 percentage points that is attributable to loss reserves acquired in business combinations. See the discussion under the heading “Ceded Premiums Written” for additional information.

(3) In addition to the effect of ceded premiums associated with prior accident years, the loss ratio for the current period reflects an increase due to higher unallocated loss adjustment expenses in 2013, the effect of which was offset by decreases to the ratio attributable to a lower amount of tail premium in 2013, a greater benefit from current accident year reinsurance in 2013, and lower average loss ratios for the business acquired from Medmarc and IND. The amount of tail premium affects the average ratio because we generally expect higher losses from tail coverages.

We recognized favorable loss development related to previously established reserves, on a gross basis, of $248.5 million in 2013 and $321.5 million in 2012. On a net basis, we recognized favorable development of $222.7 million in 2013 and $272.0 million in 2012. The net basis reflects the favorable development recognized with respect to our ceded coverage layers. A detailed discussion of factors influencing our recognition of loss development recognized is included in the Critical Accounting Estimates section of Item 7, under the caption "Reserve for Losses and Loss Adjustment Expenses." Information provided includes the amount of development recognized by accident year and the factors considered and judgments made to determine the amount of development recognized.

Assumptions used in establishing our reserve are regularly reviewed and updated by management as new data becomes available. Any adjustments necessary are reflected in the current operations. Due to the size of our reserve, even a small percentage adjustment to the assumptions can have a material effect on our results of operations for the period in which the change is made, as was the case in both 2013 and 2012.

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Underwriting, Policy Acquisition and Operating Expenses

The table below provides a comparison of 2013 and 2012 underwriting, policy acquisition and operating expenses:

	Year Ended December 31			
($ in thousands)	2013	2012	Change	
Underwriting, policy acquisition and operating expenses	$147,817	$135,631	$12,186	9.0 %

The following table highlights the items affecting expenses for the years ended December 31, 2013 and 2012.

(In millions)	Expense Increase (Decrease) 2013 versus 2012
Expenses of operations from acquired entities (1)	$12.8
Higher compensation costs during 2013, principally attributable to incentive compensation	3.1
Increase in compensation costs allocated to ULAE or capitalized as deferred policy acquisition costs during 2013	(9.1)
Amortization of deferred policy acquisition costs reflects a reduction in 2013 attributable to lower premium volume and a reduction attributable to the adoption of new accounting guidance at the beginning of 2012. The effect of lower premium volume was somewhat offset in 2013 by underwriting compensation costs which were higher in 2013 than in 2012.	(2.6)
Variances attributable to discrete events of 2013 or 2012:	
Eastern transaction-related costs, principally professional fees (2)	0.9
Syndicate 1729 start-up costs, principally professional fees (3)	3.0
Medmarc and IND transaction-related costs, principally professional fees and one time compensation costs	3.1
Compensation costs associated with employee relocation and severance, principally related to the enhancement of our customer service capabilities in 2012	(0.7)
Recoveries received in 2012 related to the settlement of litigation	1.7
Net change in expenses	$12.2

(1) The impact of purchase accounting related to deferred policy acquisition costs reduced the reported expenses by approximately $4.4 million in 2013.

(2) As discussed previously in ProAssurance Overview, we acquired Eastern Insurance Holding, Inc. effective January 1, 2014. We anticipate additional expenses directly related to our merger with Eastern of approximately $3.3 million, of which $1.3 million is expected to be incurred during the first six months of 2014. The remainder consists of retention and severance costs that we expect to incur fairly evenly over the next three years.

(3) Also, as discussed in ProAssurance Overview, we completed the process of becoming a corporate member of Lloyd's of London late in 2013. We do not expect to incur significant expenses in 2014 related to the start-up of Syndicate 1729; additional costs will primarily be incurred by Syndicate 1729.

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Underwriting Expense Ratio (the Expense Ratio)

Our expense ratio was affected in both 2013 and 2012 by ceded premium reductions related to prior accident years, as discussed under the heading "Ceded Premiums Written", and by expenses associated with business expansion and discrete events (see table above):

	Underwriting Expense Ratio				
	Year Ended December 31				
	2013		2012		Change
Underwriting expense ratio, as reported	28.0	%	24.6	%	3.4
Less estimated ratio increase (decrease) attributable to:					
Net ceded premium reductions, prior accident years*	(0.8	%)	(1.6	%)	0.8
Syndicate 1729 start-up costs	0.6	%	—	%	0.6
Expenses associated with other discrete events (see table above)	1.0	%	0.1	%	0.9
Underwriting expense ratio, less listed effects	27.2	%	26.1	%	1.1

* Effect shown for 2013 is net of an increase to the ratio of approximately 0.1 percentage points attributable to business combinations.

As compared to 2012, our 2013 underwriting expense ratio was also affected by the following:

	Increase (decrease), 2013 versus 2012	
Estimated ratio increase (decrease) attributable to:		
Lower net earned premiums, exclusive of acquisitions	1.9	
Acquisitions, see discussion below	0.4	
Increased compensation costs	0.5	
Increase in costs allocated to ULAE or capitalized as deferred policy acquisition costs	(1.6	)
Other	(0.1	)
Net increase/(decrease) in ratio	1.1	

The operating expenses of Medmarc and IND, exclusive of transaction costs, had a minor effect on our 2013 ratio as these entities also increased net premium earned. However, as previously discussed, recorded deferred policy acquisition cost amortization for these entities was lower in 2013 than would be considered normal due to the application of GAAP purchase accounting rules. Normalizing these costs increases our 2013 ratio by approximately 0.8 percentage points.

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Interest Expense

Interest expense increased during 2013 as compared to 2012. The increase reflects higher average outstanding debt in 2013 but lower average rates. Our weighted average outstanding debt approximated $119 million for 2013, while our average outstanding debt approximated $29 million for 2012.

Interest expense for 2013 and 2012 is provided in the following table:

	Year Ended December 31		
(In thousands)	2013	2012	Change
Senior notes due 2023	$1,502	$—	$1,502
Revolving credit agreement (including fees and amortization)	1,187	630	557
Letter of credit fees	58	—	58
Other debt instruments, principally long-term debt repaid in 2012	8	1,551	(1,543)
	$2,755	$2,181	$574

Taxes

Factors affecting our effective tax rate include the following:

	Year Ended December 31	
	2013	2012
Statutory rate	35.0%	35.0%
Tax-exempt income	(3.7%)	(3.7%)
Tax credits	(4.5%)	(2.5%)
Non-taxable gain on acquisition	(2.8%)	—%
Other	1.1%	1.6%
Effective tax rate	25.1%	30.4%

Our effective tax rates for both 2013 and 2012 were different from the statutory Federal income tax rate primarily because a portion of our investment income and the 2013 gain on acquisition are not taxable and because we utilized tax credit benefits transferred from our tax credit partnership investments.

Tax benefits recognized, related to the tax credits, approximated $17.9 million and $10.0 million in 2013 and 2012, respectively.

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Overview of Results–Years Ended December 31, 2012 and 2011

Net income and Operating income (a non-GAAP financial measure, see reconciliation below) were as follows:

(In millions, except per share data)	Year Ended December 31 2012	2011
Net income	$275.5	$287.1
Operating income	$257.2	$278.5
Net income per diluted share	$4.46	$4.65
Operating income per diluted share	$4.16	$4.52

Results from the years ended December 31, 2012 and 2011 compare as follows:

Revenues

Net premiums earned decreased during 2012 by approximately $14.8 million or 2.6%. The decrease principally reflects the effects of a competitive market place, but also reflected a net decrease of approximately $1.9 million related to ceded premium owed to reinsurers for prior year coverages.

Our net investment result (which includes both net investment income and earnings from unconsolidated subsidiaries) decreased $2.6 million or 2.0%. Net investment income decreased during 2012, primarily due to lower yields on our fixed income portfolio and lower average fixed income investment balances. Approximately $0.8 million of the decrease is due to increased amortization of tax credit investments in 2012.

Net realized investment gains in 2012 were approximately $22.9 million higher than in 2011. The improvement was principally attributable to our equity trading portfolio, but also reflected additional gains from sales of fixed maturity securities and lower impairment losses in 2012.

Other income decreased by $6.5 million in 2012. The decrease is primarily attributable to $4.9 million of other income in 2011 that resulted from the confidential settlement of litigation with a service provider.

Expenses

Current accident year net losses decreased by $36.2 million or 7.4% in 2012 as compared to 2011. The decline was principally attributable to a reduction in the number of insured risks, but also reflected lower expected losses for our death, disability and retirement coverages, and the effect of a commutation recorded in 2011. We reduced net losses by $272.0 million and $325.9 million in 2012 and 2011, respectively, as a result of our review of our estimate of net losses incurred for prior accident years.

Underwriting, policy acquisition and operating expenses decreased by $0.8 million or 0.6% in 2012 as compared to 2011, which reflected lower costs associated with the operations we acquired from APS, offset by additional expense due to recently closed merger transactions, higher compensation costs and the effect of adopting new FASB guidance regarding policy acquisition costs.

We recognized losses of $2.2 million in 2012 related to the repayment of the 2019 Note Payable which was carried at fair value.

Ratios

Our current accident year net loss ratio decreased 4.2 percentage points in 2012 due to changes in the mix of insured risks. Our calendar year net loss ratio was 32.7% for 2012 as compared to 28.7% for 2011, with the increase reflecting the emergence of a smaller amount of favorable development in 2012.

Our underwriting expense ratio increased 0.6 percentage points in 2012, principally reflecting the effect of lower net premiums earned in 2012.

Our operating ratio increased by 4.8 percentage points in 2012, reflecting higher net loss and expense ratios and a lower investment ratio in 2012.

Return on equity was 12.4% in 2012 and 14.3% in 2011.

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Book Value per Share

Our book value per share at December 31, 2012 was $36.85 compared to $35.42 at December 31, 2011. The increase primarily reflected the effect of our 2012 comprehensive income, partially offset by dividends declared during 2012 which reduced our book value by $3.13 per share. Due to the size of our Shareholders' Equity (approximately $2.3 billion at December 31, 2012), the growth rate of our book value per share may slow. The past growth rates of our book value per share do not necessarily predict similar future results.

Non-GAAP Financial Measures

Operating income is a non-GAAP financial measure that is widely used to evaluate the performance of insurance entities. Operating income excludes the after-tax effects of net realized investment gains or losses, guaranty fund assessments, debt retirement gain or loss and the effect of confidential settlements that do not reflect normal operating results. We believe operating income presents a useful view of the performance of our insurance operations, but should be considered in conjunction with net income computed in accordance with GAAP.

The following table is a reconciliation of Net income to Operating income:

	Year Ended December 31	
(In thousands, except per share data)	2012	2011
Net income	$275,470	$287,096
Items excluded in the calculation of operating income:		
(Gain) loss on extinguishment of debt	2,163	—
Net realized investment (gains) losses	(28,863)	(5,994)
Guaranty fund assessments (recoupments)	345	(66)
Effect of confidential settlements, net	(1,694)	(7,143)
Pre-tax effect of exclusions	(28,049)	(13,203)
Tax effect, at 35%	9,817	4,621
Operating income	$257,238	$278,514
Per diluted common share:		
Net income	$4.46	$4.65
Effect of exclusions	(0.30)	(0.13)
Operating income per diluted common share	$4.16	$4.52

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Results of Operations–Year Ended December 31, 2012 Compared to Year Ended December 31, 2011

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

($ in thousands, except share data)	Year Ended December 31 2012	2011	Change
Revenues:			
Net premiums earned	$550,664	$565,415	$(14,751)
Net investment income	136,094	140,956	(4,862)
Equity in earnings (loss) of unconsolidated subsidiaries	(6,873)	(9,147)	2,274
Net investment result	129,221	131,809	(2,588)
Net realized investment gains (losses)	28,863	5,994	22,869
Other income	7,106	13,566	(6,460)
Total revenues	715,854	716,784	(930)
Expenses:			
Losses and loss adjustment expenses	161,726	151,270	10,456
Reinsurance recoveries	18,187	11,017	7,170
Net losses and loss adjustment expenses	179,913	162,287	17,626
Underwriting, policy acquisition and operating expenses	135,631	136,421	(790)
Interest expense	2,181	3,478	(1,297)
Loss on extinguishment of debt	2,163	—	2,163
Total expenses	319,888	302,186	17,702
Income before income taxes	395,966	414,598	(18,632)
Income taxes	120,496	127,502	(7,006)
Net income	$275,470	$287,096	$(11,626)
Earnings per share:			
Basic	$4.49	$4.70	$(0.21)
Diluted	$4.46	$4.65	$(0.19)
Net loss ratio	32.7%	28.7%	4.0
Underwriting expense ratio	24.4%	23.8%	0.6
Combined ratio	57.1%	52.5%	4.6
Operating ratio	32.4%	27.6%	4.8
Tax ratio	30.4%	30.8%	(0.4)
Return on equity	12.4%	14.3%	(1.9)

In all tables that follow, the abbreviation “nm” indicates that the percentage change is not meaningful.

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Premiums Written

Changes in our premium volume are driven by four primary factors: (1) our retention of existing business, (2) the premium charged for business that is renewed, which is affected by rates charged and by the amount and type of coverage an insured chooses to purchase, (3) the timing of premium written through multi-period policies, and (4) the amount of new business we generate. The professional liability market remains competitive with some competitors choosing to compete primarily on price.

Gross, ceded and net premiums written were as follows:

	Year Ended December 31			
($ in thousands)	2012	2011	Change	
Gross premiums written	$536,431	$565,895	$(29,464)	(5.2%)
Ceded premiums written	(8,133)	(7,388)	(745)	10.1%
Net premiums written	$528,298	$558,507	$(30,209)	(5.4%)

Gross Premiums Written

Gross premiums written by component were as follows:

	Year Ended December 31			
($ in thousands)	2012	2011	Change	
Gross premiums written:				
Physician, traditional term policies	$403,429	$428,928	$(25,499)	(5.9%)
Physician, two-year term policies *	13,081	22,253	(9,172)	(41.2%)
Total Physician	416,510	451,181	(34,671)	(7.7%)
Non-physician healthcare providers	42,864	45,641	(2,777)	(6.1%)
Hospital and facility	28,259	28,088	171	0.6%
Other	18,778	17,961	817	4.5%
Non-continuing	626	2,078	(1,452)	(69.9%)
Tail coverage premiums, all policy types	29,394	20,946	8,448	40.3%
Total	$536,431	$565,895	$(29,464)	(5.2%)

* We offer two- year term policies to our physician insureds in one selected jurisdiction. The premium associated with both years is included in written premium in the period the policy is written; comparison of gross written premium between successive years reflect volume differences that have no effect on earned premium. A comparison to 2010 is more meaningful; gross written premium for two-year term policies in 2010 was $10.9 million.

As compared to 2011, physician premiums declined in 2012. The expected timing differences associated with two-year policies accounted for more than 25% of the total physician premium decrease.

Our retention rate for our standard physician business was 90% for 2012, as compared to 89% for 2011. We calculate our retention rate as retained premium divided by all premium subject to renewal. Retention rates are affected by a number of factors. We may lose insureds to competitors or to alternative insurance mechanisms such as risk retention groups or self-insurance entities (often when physicians join hospitals or large group practices) or due to pricing or other issues. We may choose not to renew an insured as a result of our underwriting evaluation. Insureds may also terminate coverage because they have left the practice of medicine for various reasons, principally for retirement but also for personal reasons or due to disability or death.

Charged rates for our renewed physician business averaged 1% higher than the expiring premiums during 2012. Our charged rates include the effects of filed rates, surcharges and discounts. Despite competitive pressures, we continue to base our rates on expected losses, as indicated by our historical loss data and available industry loss data. We are committed to a rate structure that will allow us to fulfill our obligations to our insureds, while generating competitive returns for our shareholders.

New physician business written in 2012 was approximately $9 million.

Our non-physician healthcare providers are primarily dentists, chiropractors and allied health professionals. The 2012 decline in premium volume for these coverages was primarily attributable to allied health professionals.

Our hospital and facility premiums remained relatively flat in 2012.

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Our “other” premiums are primarily legal professional liability premiums which increased in 2012 due to a greater number of insureds.

Our non-continuing premiums consist of premiums derived from optometry coverages discontinued in early 2012 and certain miscellaneous liability coverages which were discontinued in 2010 but that continued to produce small amounts of written premium in 2011 and 2012.

We offer extended reporting endorsement or “tail” coverage to insureds that are discontinuing their claims-made coverage with us, and we also periodically offer “tail” coverage through custom policies. The amount of tail coverage premium written can vary widely from period to period. A large portion of the increase in tail premium in 2012 was attributable to a single custom policy issued to a hospital that terminated its self insurance arrangement.

Ceded Premiums Written

Ceded premiums written compared as follows:

	Year Ended December 31			
($ in thousands)	2012	2011	Change	
Primary reinsurance agreement, current accident year	$23,213	$25,479	$(2,266)	(8.9%)
Reduction in premiums owed under reinsurance agreements	(34,328)	(30,584)	(3,744)	12.2%
Ascension Health Certitude program	7,308	5,027	2,281	45.4%
Commutation	—	(5,634)	5,634	nm
Other premiums ceded	11,940	13,100	(1,160)	(8.9%)
Total ceded premiums written	$8,133	$7,388	$745	10.1%

Ceded premiums represent the amounts owed to our reinsurers for their assumption of a portion of our losses. The ultimate amount owed under certain of our reinsurance agreements is variable and is determined by the loss experience of the business ceded, subject to minimums and maximums. Losses incurred for our higher limit coverages are almost fully reinsured and were estimated to be lower for the 2012 accident year than for the 2011 accident year. As a result, our estimate of ceded premium owed under our primary reinsurance agreements for the current accident year was lower in 2012.

Many years may elapse before all losses recoverable under a reinsurance agreement are known. In the intervening periods, amounts owed are estimated. Premiums ceded for the current period includes both our estimate of premiums owed under reinsurance agreements of the current period and changes to our previous estimate of premiums owed under reinsurance agreements of prior periods. In both 2012 and 2011, we reduced our estimates of prior accident year gross losses within our reinsured layers of coverage, as well as the related reinsurance recoveries and premiums ceded.

We share the risk of loss for policies written or renewed under the Ascension Health (Ascension) Certitude program with an Ascension affiliate under a quota share agreement. Growth in the program increased ceded premium in 2012 as compared to 2011.

During 2011, we commuted (terminated) certain of our reinsurance agreements with Colisee Re (formerly AXA Reassurance S.A.) in return for approximately $4.3 million in cash. The commutation reduced Ceded Premium, on both a written and an earned basis, by $5.6 million and reduced Reinsurance Recoveries by approximately $4.0 million.

We reinsure most of our MPL coverages under a single reinsurance agreement that is renewed annually (referred to as our primary reinsurance agreement). Professional liability offered to dentists, allied health professionals, certain smaller facilities as well as higher limit MPL coverages were reinsured under separately negotiated contracts until October 1, 2012, but thereafter are covered by our primary reinsurance agreement. Amounts due to reinsurers under these separate contracts are included along with legal professional liability in the preceding table as "Other premiums ceded."

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Ceded Premiums Ratio

The principal components of the change in our ceded premiums ratio (ceded premiums written as a percentage of gross premiums written) are shown in the following table:

	Year Ended December 31		
	2012	2011	Change
Ceded premiums ratio, as reported	1.5 %	1.3 %	0.2
Less estimated ratio increase (decrease) attributable to:			
Reduction in premiums owed under reinsurance agreements	(6.6 %)	(6.1 %)	(0.5)
Ascension Certitude program	1.4 %	1.0 %	0.4
Commutation	— %	(1.1 %)	1.1
Ceded premiums ratio, excluding other listed factors	6.7 %	7.5 %	(1.0)

Net Premiums Earned

Net premiums earned were as follows:

	Year Ended December 31			
($ in thousands)	2012	2011	Change	
Premiums earned	$558,316	$571,045	$(12,729)	(2.2 %)
Premiums ceded	(7,652)	(5,630)	(2,022)	35.9 %
Net premiums earned	$550,664	$565,415	$(14,751)	(2.6 %)

Net premiums earned consist of gross premiums earned less the portion of earned premiums that we cede to our reinsurers for their assumption of a portion of our losses. Because premiums are generally earned pro rata over the entire policy period, fluctuations in premiums earned tend to lag those of premiums written. Generally, our policies carry a term of one year, but as discussed above, we renew certain policies with a two-year term. Tail coverage premiums are generally 100% earned in the period written because the policies insure only incidents that occurred in prior periods and are not cancellable. Additionally, ceded premium changes due to commutations or changes to estimates of premiums owed under reinsurance agreements are fully earned in the period of change.

Premiums earned were lower in 2012, as compared to 2011, principally due to the pro-rata effect of lower non-tail physician premiums written during the preceding twelve months, partially offset by higher tail premiums written and earned in 2012.

Components of the change in premiums ceded earned during 2012 are detailed in the following table:

($ in thousands)	Ceded Premiums Earned Increase (Decrease) 2012 versus 2011 Year Ended December 31
Primary reinsurance agreement, current accident year*	$(2,576)
Reduction in premiums owed under reinsurance agreements*	(3,744)
Ascension Health Certitude program*	3,063
Commutation*	5,634
All other factors	(355)
Net increase (decrease)	$2,022

* See discussions under “Ceded Premiums Written” for further information.

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

Net Investment Income

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

Net investment income by investment category was as follows:

($ in thousands)	Year Ended December 31 2012	2011	Change	
Fixed maturities	$133,088	$140,897	$(7,809)	(5.5%)
Equities	6,947	1,808	5,139	>100%
Short-term investments	132	100	32	32.0%
Other invested assets	528	2,712	(2,184)	(80.5%)
Business owned life insurance	2,008	2,017	(9)	(0.4%)
Investment fees and expenses	(6,609)	(6,578)	(31)	0.5%
Net investment income	$136,094	$140,956	$(4,862)	(3.4%)

Fixed Maturities

As compared to 2011, earnings from fixed maturity investments declined in 2012. Our average investment in fixed maturities decreased by approximately 3% in 2012. In 2012 a portion of the proceeds from sales and maturities of our fixed maturities were not reinvested but instead were utilized for other corporate purposes which included payment of shareholder dividends, repayment of debt and partial funding of acquisitions. Yields for our fixed maturity portfolio were generally lower in 2012. As securities matured, were paid down or sold, in order to maintain the asset quality and duration of our portfolio, most funds reinvested were at lower rates, although we did add certain higher yielding fixed maturities to our portfolio in 2012 as a means of improving overall yields. Yields for 2012 also reflected lower income from Treasury Inflation-Protected Securities of $1.0 million. Average yields for our fixed maturity securities during the years ended December 31, 2012 and 2011 were as follows:

	Year Ended December 31 2012	2011
Average income yield	3.9%	4.0%
Average tax equivalent income yield	4.5%	4.6%

Equities and Other Invested Assets

Income from our equity portfolio increased in 2012 as compared to 2011 and primarily reflects higher average investment balances in 2012. A portion of the increased investment is attributable to an interest in a private investment LLC, classified as a part of Other investments during 2011, that was converted into publicly traded equity securities during 2012. The 2012 income decline for Other invested assets was principally attributable to this conversion.

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Equity in Earnings (Loss) of Unconsolidated Subsidiaries

Equity in earnings (loss) of unconsolidated subsidiaries is derived from our investment interests accounted for under the equity method. Results were as follows:

	Year Ended December 31		
(In thousands)	2012	2011	Change
Investment LPs	$278	$(1,077)	$1,355
Business LLC interest	(728)	(2,479)	1,751
Tax credit partnerships	(6,423)	(5,591)	(832)
Equity in earnings (loss) of unconsolidated subsidiaries	$(6,873)	$(9,147)	$2,274

We hold interests in certain LPs that generate earnings from trading portfolios. The performance of the LPs is affected by the volatility of equity and credit markets.

Our business LLC interest is a non-controlling interest in an entity that began active business in 2011. We recognize quarterly our allocable portion of the operating results reported by the LLC. The entity was slower to produce positive operating returns than initially anticipated and losses recognized in 2012 have reduced the carrying amount of our interest to zero.

Our tax credit investments are designed to generate investment returns by providing tax benefits to fund investors in the form of project operating losses and tax credits. Our tax credit partnerships reduced our tax expenses by approximately $10.0 million during the year ended December 31, 2012, while we recognized $6.4 million of pre-tax amortization ($4.2 million after tax) on these investments as noted in the table above.

Non-GAAP Financial Measure – Tax Equivalent Investment Result

We believe that to fully understand our investment returns it is important to consider the current tax benefits associated with certain investments; therefore, we impute a pro forma tax-equivalent investment result by adjusting the current tax benefit into the amount of investment income a taxable investment would need to produce to fairly compare to an investment with preferential tax treatment. We believe this better reflects the economics of our decision to invest in certain asset classes that are either taxed at lower rates and/or result in reductions to our current federal income tax expense.

	Year Ended December 31	
(In thousands)	2012	2011
Net investment income, as reported for GAAP	$136,094	$140,956
Taxable equivalent adjustments, calculated using the 35% federal statutory tax rate:		
State and municipal bonds	18,482	19,949
BOLI	1,081	1,086
Dividends received	1,456	579
Pro forma tax-equivalent net investment income	157,113	162,570
Equity in earnings (loss) of unconsolidated subsidiaries, as reported for GAAP	(6,873)	(9,147)
Taxable equivalent adjustment, calculated using the 35% federal statutory tax rate:		
Tax credit partnerships	15,392	8,698
Pro forma tax-equivalent equity in earnings (loss) of unconsolidated subsidiaries	8,519	(449)
Pro forma tax-equivalent investment results	$165,632	$162,121

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Net Realized Investment Gains (Losses)

The following table provides detailed information regarding our net realized investment gains (losses).

	Year Ended December 31	
(In thousands)	2012	2011
Other-than-temporary impairment losses, total:		
Residential mortgage-backed securities	$(557)	$(782)
Corporate debt	(878)	(505)
Other investments	(131)	(3,827)
High yield asset-backed securities	—	(75)
Portion recognized in (reclassified from) Other Comprehensive Income:		
Residential mortgage-backed securities	(201)	(823)
Net impairment losses recognized in earnings	(1,767)	(6,012)
Gross realized gains, available-for-sale securities	18,645	14,625
Gross realized (losses), available-for-sale securities	(2,076)	(1,754)
Net realized gains (losses), trading securities	1,485	2,212
Change in unrealized holding gains (losses), trading securities	12,673	(3,188)
Decrease (increase) in the fair value of liabilities carried at fair value	(1,245)	111
Other	1,148	—
Net realized investment gains (losses)	$28,863	$5,994

All impairments of debt securities recognized during 2012 were credit-related.

We recognized impairments of $0.1 million and $3.8 million during the years ended December 31, 2012 and 2011, respectively, related to an interest in an LLC classified as a part of Other investments which we accounted for using the cost method. The LLC announced in 2011 that it planned to convert to a publicly traded investment fund and we impaired the investment to the NAV reported by the fund. The conversion occurred during the second quarter of 2012.

We substantially increased the size of our equity trading portfolio over the previous year. Unrealized trading portfolio gains reflect higher average balances in our portfolio and an overall improvement in stock market yields.

Gains (losses) from changes in the fair value of liabilities were entirely attributable to our 2019 Note Payable and related interest rate swap, both of which we repaid in July 2012. For more information, see Note 3 and Note 10 of the Notes to Consolidated Financial Statements.

Other Income

Other Income is comprised primarily of commission and fee income from our agency operations, other fee revenues, rental income and other miscellaneous revenues. The revenue is not a principal source of income and often varies among periods. The decrease in 2012 as compared to 2011 primarily reflected other income of $4.9 million recognized in 2011 related to a confidential settlement of litigation with a service provider and a gain of approximately $0.8 million recognized on the sale of a building in 2011.

Losses and Loss Adjustment Expenses

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

Accident year refers to the accounting period in which the insured event becomes a liability of the insurer. For claims-made policies, which represent over 90% of the Company’s business, the insured event generally becomes a liability when the event is first reported to the insurer. For occurrence policies the insured event becomes a liability when the event takes place. We believe that measuring losses on an accident year basis is the best measure of the underlying profitability of the premiums earned in that period, since it associates policy premiums earned with the estimate of the losses incurred related to those policy premiums.

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The following table summarizes calendar year net losses and net loss ratios for the years ended December 31, 2012 and 2011 by separating losses between the current accident year and all prior accident years.

	Net Losses Year Ended December 31			Net Loss Ratios* Year Ended December 31		
($ in millions)	2012	2011	Change	2012	2011	Change
Current accident year	$452.0	$488.2	$(36.2)	82.1 %	86.3 %	(4.2)
Prior accident years	(272.0)	(325.9)	53.9	(49.4 %)	(57.6 %)	8.2
Calendar year	$180.0	$162.3	$17.7	32.7 %	28.7 %	4.0

* Net losses as specified divided by net premiums earned.

Our current accident year net loss ratios for the years ended December 31, 2012 and 2011 compare as follows:

	Year Ended December 31		
	2012	2011	Change
Current accident year net loss ratio, as reported	82.1 %	86.3 %	(4.2)
Less estimated ratio increase (decrease) attributable to:			
Change in our estimate of the reserve for death, disability and retirement	(0.3 %)	3.7 %	(4.0)
Reduction in premiums owed under reinsurance agreements	(5.6 %)	(4.9 %)	(0.7)
Commutation	—%	(0.1 %)	0.1
Tail coverages	1.9 %	1.7 %	0.2
Current accident year net loss ratio, excluding other listed factors	86.1 %	85.9 %	0.2

The 2012 decrease in our current accident year net loss ratio reflects the following:

- In 2012 we decreased our loss reserves related to death, disability and retirement (DDR) coverage endorsements provided to our insureds while in 2011 we increased loss reserves for this coverage. The reserve for DDR is actuarially estimated and is affected by changes in the number of insureds expected to benefit from the coverage endorsement.
- Net earned premium in both 2012 and 2011 was increased by reductions to amounts owed under reinsurance agreements (see "Net Premiums Earned"). The reductions had a greater effect on the net loss ratio in 2012.
- A commutation recorded in 2011 increased the 2011 net loss ratio; no commutation was recorded in 2012.
- More of our net earned premium was from tail coverages in 2012. This increases our average net loss ratio because we expect higher losses for tail coverages than for our other professional liability coverages.

We recognized favorable loss development related to prior accident years of $272.0 million for the year ended December 31, 2012 and $325.9 million for the year ended December 31, 2011. A detailed discussion of factors influencing our recognition of loss development recognized is included in the Critical Accounting Estimates section of Item 7, under the caption “Reserve for Losses and Loss Adjustment Expenses.” Information provided includes the amount of development recognized by accident year and the factors considered and judgments made to determine the amount of development recognized.

Assumptions used in establishing our reserve are regularly reviewed and updated by management as new data becomes available. Any adjustments necessary are reflected in the current operations. Due to the size of our reserve, even a small percentage adjustment to the assumptions can have a material effect on our results of operations for the period in which the change is made, as was the case in both 2012 and 2011.

Recoveries

We recognized favorable prior accident year loss development of approximately $49.4 million in 2012 and $39.9 million in 2011 related to our reinsured coverage layers (generally, losses exceeding $1 million) and recognized offsetting reductions to loss recoveries of $49.4 million in 2012 and $39.9 million in 2011. Because the reductions exceed other recoveries during each year, recoveries increased rather than decreased net losses for the years ended December 31, 2012 and 2011.

We similarly reduced our estimates of the premium due to reinsurers by $34.3 million and $30.6 million in 2012 and 2011, respectively, because the premium due to reinsurers is based in part on amounts recovered.

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Underwriting, Policy Acquisition and Operating Expenses

The table below provides a comparison of 2012 and 2011 underwriting, policy acquisition and operating expenses:

	Year Ended December 31			
($ in thousands)	2012	2011	Change	
Insurance operation expenses	$134,393	$134,342	$51	nm
Agency expenses	1,238	2,079	(841)	(40.5%)
	$135,631	$136,421	$(790)	(0.6%)

Insurance Operation Expenses

Insurance operation expenses in 2012 as compared to 2011 primarily reflected the net effect of the following:

- We incurred expenses related to the mergers of IND and Medmarc of approximately $1.5 million in 2012.
- As discussed in Notes 1 and 7 of the Notes to Consolidated Financial Statements, we adopted, on a prospective basis, new FASB guidance related to the deferral of policy acquisition costs. The new guidance affects the timing, but not the amount of acquisition costs ultimately expensed, as the decrease in the expense deferral reduces amortization of policy acquisition costs by the same amount, recognized over the term of the associated successful policies. Our 2012 expenses reflect a net increase of approximately $1.9 million in 2012 due to adoption of the new guidance, as we expensed approximately $4.2 million of policy acquisition costs that under prior guidance would have been deferred to later periods but also recognized amortization expense that was approximately $2.3 million lower than would have been recognized under previous guidance.
- Exclusive of the effect of the new FASB guidance, amortization of deferred policy acquisition costs was $0.3 million lower in 2012 than in 2011. While amortization was lower in 2012 consistent with the decline in net premiums earned, amortization in 2011 was reduced by approximately $1.5 million related to the acquisition of APS in November 2010. Due to the application of GAAP purchase accounting rules, no asset for deferred policy acquisition costs was recognized as a part of the purchase price allocation of APS; consequently, amortization of deferred policy acquisition costs in 2011 was reduced.
- On a sporadic basis our expenses are reduced by recoveries related to the settlement of litigation. Recoveries in 2012 were approximately $0.5 million lower (and thus expenses on a net basis were higher) than in 2011.
- Costs associated with the operations acquired from APS, primarily compensation costs, were approximately $3.7 million lower in 2012 as compared to 2011.
- Higher stock compensation and bonus costs in 2012 as compared to 2011 as well as additional costs incurred related to the enhancement of our customer service capabilities increased our 2012 expenses by approximately $5.0 million. We relocated a number of positions in order to create centralized customer service centers. Relocation benefits were provided to affected employees as well as termination benefits for employees unable to relocate. Expenses of $1.6 million related to a deferred compensation agreement with a former senior executive increased our expenses in 2011; there were no comparable expenses in 2012.
- Various other operating costs were collectively lower by approximately $3.2 million in 2012.

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Underwriting Expense Ratio (the Expense Ratio)

	Underwriting Expense Ratio * Year Ended December 31		
	2012	2011	Change
Underwriting expense ratio, as reported	24.4 %	23.8 %	0.6
Less estimated ratio increase (decrease) attributable to:			
Reduction in premiums owed under reinsurance agreements	(1.5 %)	(1.4 %)	(0.1)
Commutation	— %	(0.2 %)	0.2
Underwriting expense ratio, excluding listed factors	25.9 %	25.4 %	0.5

* Our expense ratio computations exclude agency expenses as discussed below.

The increase in our consolidated underwriting expense ratio for 2012 was primarily attributable to the decline in gross premiums earned. Our ratio in both 2012 and 2011 was reduced due to increases in net earned premium resulting from the re-estimation of ceded premiums for prior accident year coverages; however, the effect in both periods was comparable. A commutation recorded in 2011 decreased our 2011 expense ratio; no commutation was recorded in 2012.

Agency Expenses

We maintain limited agency operations that both generate premium revenues for our insurance subsidiaries and earn external commission and service fee revenues. Agency operations that are associated with the generation of premium revenues by our insurance subsidiaries are included in insurance operation expenses in the above table. Expenses of agency operations that are directly associated with external commission and service fee revenues are included in agency expenses in the above table. Agency expenses for 2011 included non-recurring expenses associated with the dissolution of certain agency operations.

Interest Expense

Interest expense declined during 2012 as compared to 2011, primarily because we repaid debt during 2012, as discussed in Liquidity and Capital Resources and Financial Condition. Interest expense by debt obligation is provided in the following table:

	Year Ended December 31		
(In thousands)	2012	2011	Change
Trust preferred securities due 2034	$635	$970	$(335)
Surplus notes due May 2034	342	509	(167)
2019 note payable	571	1,157	(586)
Credit facility fees and amortization	630	442	188
Other	3	400	(397)
	$2,181	$3,478	$(1,297)

Taxes

Factors affecting our effective tax rate include the following:

	Year Ended December 31	
	2012	2011
Statutory rate	35.0 %	35.0 %
Tax-exempt income	(3.4 %)	(3.2 %)
Tax credits	(2.5 %)	(1.4 %)
Other	1.3 %	0.4 %
Effective tax rate	30.4 %	30.8 %

Our effective tax rate decreased in 2012 as compared to 2011, primarily due to an increase in the expected tax benefit from tax credits transferred to us by our tax credit partnership investments. We recognized tax benefits of approximately $10.0 million during 2012, related to the credits, compared to tax benefits of $5.7 million during 2011.

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ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.

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

Interest Rate Risk

Our fixed maturities portfolio is exposed to interest rate risk. Fluctuations in interest rates have a direct impact on the market valuation of these securities. As interest rates rise, market values of fixed income portfolios fall and vice versa. Certain of the securities are held in an unrealized loss position; we do not intend to sell and believe we will not be required to sell any of the debt securities held in an unrealized loss position before its anticipated recovery.

The following table summarizes estimated changes in the fair value of our available-for-sale fixed maturity securities for specific hypothetical changes in interest rates by asset class at December 31, 2013 and December 31, 2012. There are principally two factors that determine interest rates on a given security: market interest rates and credit spreads. As different asset classes can be affected in different ways by movements in those two factors, we have broken out our portfolio by asset class in the following table.

	Interest Rate Shift in Basis Points				
	December 31, 2013				
	(200)	(100)	Current	100	200
Fair Value (in millions):					
U.S. Treasury obligations	$176	$174	$171	$168	$165
U.S. Government-sponsored enterprise obligations	34	34	33	32	30
State and municipal bonds	1,220	1,195	1,155	1,107	1,061
Corporate debt	1,453	1,413	1,361	1,308	1,257
Asset-backed securities	410	406	398	385	371
All fixed maturity securities	$3,293	$3,222	$3,118	$3,000	$2,884
Duration:					
U.S. Treasury obligations	3.85	3.81	3.77	3.72	3.68
U.S. Government-sponsored enterprise obligations	2.82	3.07	3.15	3.12	3.07
State and municipal bonds	3.61	3.84	4.07	4.20	4.25
Corporate debt	4.10	4.13	4.09	4.03	3.96
Asset-backed securities	2.08	2.55	3.12	3.57	3.80
All fixed maturity securities	3.60	3.80	3.90	4.00	4.00
	December 31, 2012				
Fair Value (in millions):					
U.S. Treasury obligations	$210	$209	$206	$202	$197
U.S. Government-sponsored enterprise obligations	58	58	57	55	53
State and municipal bonds	1,269	1,258	1,220	1,170	1,122
Corporate debt	1,533	1,521	1,471	1,409	1,350
Asset-backed securities	498	499	494	481	466
All fixed maturity securities	$3,568	$3,545	$3,448	$3,317	$3,188
Duration:					
U.S. Treasury obligations	2.92	2.89	2.84	2.77	2.70
U.S. Government-sponsored enterprise obligations	2.89	2.90	2.98	3.08	3.08
State and municipal bonds	3.78	3.91	4.06	4.17	4.26

Corporate debt	4.26	4.27	4.27	4.22	4.15
Asset-backed securities	1.81	1.82	2.35	3.06	3.66
All fixed maturity securities	3.65	3.70	3.81	3.93	4.01

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

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

Our cash, restricted cash and short-term investment portfolio at December 31, 2013 was carried on a cost basis which approximates its fair value. Our portfolio lacks significant interest rate sensitivity due to its short duration.

Credit Risk

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

As of December 31, 2013, 93% of our fixed maturity securities were rated investment grade as determined by Nationally Recognized Statistical Rating Organizations (NRSROs), such as Fitch, Moody’s and Standard & Poor’s. We believe that this concentration in investment grade securities reduces our exposure to credit risk on our fixed income investments to an acceptable level. However, investment grade securities, in spite of their rating, can rapidly deteriorate and result in significant losses. Ratings published by the NRSROs are one of the tools used to evaluate the credit worthiness of our securities. The ratings reflect the subjective opinion of the rating agencies as to the credit worthiness of the securities, and therefore, we may be subject to additional credit exposure should the rating prove to be unreliable.

We also have exposure to credit risk related to our receivables from reinsurers. Our receivables from reinsurers (with regard to both paid and unpaid losses) approximated $251 million at December 31, 2013 and $196 million at December 31, 2012, with the 2013 increase primarily attributable to acquisitions. We monitor the credit risk associated with our reinsurers using publicly available financial and rating agency data.

Equity Price Risk

At December 31, 2013 the fair value of our investment in common stocks was $254 million. These securities are subject to equity price risk, which is defined as the potential for loss in fair value due to a decline in equity prices. The weighted average beta of this group of securities was 0.96. Beta measures the price sensitivity of an equity security or group of equity securities to a change in the broader equity market, in this case the S&P 500 Index. If the value of the S&P 500 Index increased by 10%, the fair value of these securities would be expected to increase by 9.6% to $278 million. Conversely, a 10% decrease in the S&P 500 Index would imply a decrease of 9.6% in the fair value of these securities to $229 million. The selected hypothetical changes of plus or minus 10% do not reflect what could be considered the best or worst case scenarios and are used for illustrative purposes only.

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ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA.
Index to Consolidated Financial Statements

The Supplementary Financial Information required by Item 302 of Regulation S-K is included in Note 17 of the Notes to Consolidated Financial Statements of ProAssurance and its subsidiaries.

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE.

Not Applicable.

ITEM 9A. CONTROLS AND PROCEDURES.

Disclosure Controls

Under the supervision and with the participation of management, including the Chief Executive Officer and Chief Financial Officer, the Company has evaluated the effectiveness of the design and operation of our disclosure controls and procedures as of the end of the fiscal year ended December 31, 2013. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer have concluded that these controls and procedures are effective. Disclosure controls and procedures are defined in Exchange Act Rule 13a-15(e) and include the Company’s controls and other procedures that are designed to ensure that information, required to be disclosed by the Company in the reports that it files or submits under the Exchange Act, is accumulated and communicated to management, including the Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

Management’s Report on Internal Control over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Exchange Act Rules 13a-15(f) and 15d-15(f). Under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, we conducted an evaluation of the effectiveness of our internal control over financial reporting as of December 31, 2013 based on the framework in Internal Control–Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Based on that evaluation, our management concluded that our internal control over financial reporting was effective as of December 31, 2013 and that there was no change in the Company’s internal controls during the fiscal year then ended that has materially affected, or is reasonably likely to materially affect, the Company’s internal control over financial reporting.

On January 1, 2013 we completed the acquisition of Medmarc Mutual Insurance Company, now Medmarc Casualty Insurance Company (Medmarc). Our management excluded Medmarc's systems and processes from the scope of ProAssurance's assessment of internal control over financial reporting as of December 31, 2013 in reliance on the guidance set forth in Question 3 of a "Frequently Asked Questions" interpretive release issued by the staff of the Securities and Exchange Commission's Office of the Chief Accountant and the Division of Corporation Finance in September 2004 (and revised on October 6, 2004). We are excluding Medmarc from that scope because we expect substantially all of its significant systems and processes to be converted to those of ProAssurance during 2014. At December 31, 2013 Medmarc represented $413.3 million or 8.0% of total assets, and $46.5 million or 6.3% of total revenues for the year then ended.

Ernst & Young LLP, an independent registered public accounting firm, has audited the effectiveness of our internal controls over financial reporting as of December 31, 2013 as stated in their report which is included elsewhere herein.

ITEM 9B. OTHER INFORMATION

None.

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Report of Independent Registered Public Accounting Firm

The Board of Directors and Shareholders of ProAssurance Corporation

We have audited ProAssurance Corporation and subsidiaries' internal control over financial reporting as of December 31, 2013, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (1992 framework) (the COSO criteria). ProAssurance Corporation and subsidiaries' management is responsible for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying Management's Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions or that the degree of compliance with the policies or procedures may deteriorate.

As indicated in the accompanying Management's Report on Internal Control over Financial Reporting, management's assessment of and conclusion on the effectiveness of internal control over financial reporting did not include the internal controls of Medmarc Mutual Insurance Company, now Medmarc Casualty Insurance Company (Medmarc), which is included in the 2013 consolidated financial statements of ProAssurance Corporation and subsidiaries and constituted 8.0% total assets as of December 31, 2013 and 6.3% of total revenues for the year then ended. Our audit of internal control over financial reporting of ProAssurance Corporation and subsidiaries also did not include an evaluation of the internal control over financial reporting of Medmarc.

In our opinion, ProAssurance Corporation and subsidiaries maintained, in all material respects, effective internal control over financial reporting as of December 31, 2013, based on the COSO criteria.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets as of December 31, 2013 and 2012, and the related consolidated statements of changes in capital, income and comprehensive income and cash flows for each of the three years in the period ended December 31, 2013, of ProAssurance Corporation and subsidiaries and our report dated February 20, 2014 expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP

Birmingham, Alabama

February 20, 2014

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PART III

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE OF THE REGISTRANT.

The information required by this Item regarding executive officers is included in Part I of the Form 10K in accordance with Instruction 3 of the Instructions to Paragraph (b) of Item 401 of Regulation S-K.

The information required by this Item regarding directors is incorporated by reference pursuant to General Instruction G (3) of Form 10K from ProAssurance’s definitive proxy statement for the 2014 Annual Meeting of its Stockholders to be filed with the Securities and Exchange Commission pursuant to Regulation 14A on or about April 16, 2014.

ITEM 11. EXECUTIVE COMPENSATION.

The information required by this Item is incorporated by reference pursuant to General Instruction G (3) of Form 10K from ProAssurance’s definitive proxy statement for the 2014 Annual Meeting of its Stockholders to be filed with the Securities and Exchange Commission pursuant to Regulation 14A on or about April 16, 2014.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS.

The information required by this Item is incorporated by reference pursuant to General Instruction G (3) of Form 10K from ProAssurance’s definitive proxy statement for the 2014 Annual Meeting of its Stockholders to be filed with the Securities and Exchange Commission pursuant to Regulation 14A on or about April 16, 2014.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE.

The information required by this Item is incorporated by reference pursuant to General Instruction G (3) of Form 10K from ProAssurance’s definitive proxy statement for the 2014 Annual Meeting of its Stockholders to be filed with the Securities and Exchange Commission pursuant to Regulation 14A on or about April 16, 2014.

ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES.

The information required by this Item is incorporated by reference pursuant to General Instruction G (3) of Form 10K from ProAssurance’s definitive proxy statement for the 2014 Annual Meeting of its Stockholders to be filed with the Securities and Exchange Commission pursuant to Regulation 14A on or about April 16, 2014.

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PART IV

ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES.

(a) Financial Statements. The following consolidated financial statements of ProAssurance Corporation and subsidiaries are included herein in accordance with Item 8 of Part II of this report.

Report of Registered Public Accounting Firm
Consolidated Balance Sheets – December 31, 2013 and 2012
Consolidated Statements of Changes in Capital – years ended December 31, 2013, 2012 and 2011
Consolidated Statements of Income and Comprehensive Income – years ended December 31, 2013, 2012 and 2011
Consolidated Statements of Cash Flows – years ended December 31, 2013, 2012 and 2011
Notes to Consolidated Financial Statements

Financial Statement Schedules. The following consolidated financial statement schedules of ProAssurance Corporation and subsidiaries are included herein in accordance with Item 14(d):

Schedule I – Summary of Investments – Other than Investments in Related Parties
Schedule II – Condensed Financial Information of ProAssurance Corporation (Registrant Only)
Schedule III – Supplementary Insurance Information
Schedule IV – Reinsurance

All other schedules to the consolidated financial statements required by Article 7 of Regulation S-X are not required under the related instructions or are inapplicable and therefore have been omitted.

(b) The exhibits required to be filed by Item 15(b) are listed herein in the Exhibit Index.

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SIGNATURES

Pursuant to the requirements of Section 13 of 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized, on this the 20th day of February 2014.

PROASSURANCE CORPORATION

By: /S/ W. STANCIL STARNES
W. Stancil Starnes

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

Name	Title	Date
/S/ W. STANCIL STARNES, J.D.	Chairman of the Board, Chief Executive Officer	February 20, 2014
W. Stancil Starnes, J.D.	(Principal Executive Officer) and President	
/S/ EDWARD L. RAND, JR. Edward L. Rand, Jr.	Chief Financial Officer	February 20, 2014
/S/ KELLY B. BREWER Kelly B. Brewer	Chief Accounting Officer	February 20, 2014
/S/ LUCIAN F. BLOODWORTH Lucian F. Bloodworth	Director	February 20, 2014
/S/ SAMUEL A. DI PIAZZA, JR. Samuel A. Di Piazza, Jr.	Director	February 20, 2014
/S/ ROBERT E. FLOWERS, M.D. Robert E. Flowers, M.D.	Director	February 20, 2014
/S/ M. JAMES GORRIE M. James Gorrie	Director	February 20, 2014
/S/ WILLIAM J. LISTWAN, M.D. William J. Listwan, M.D.	Director	February 20, 2014