PROASSURANCE CORP
Form 10-Q
May 06, 2013

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q
(Mark One)
ý Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the quarterly period ended March 31, 2013 or
¨ Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the transition period from to
Commission file number 0-16533
ProAssurance Corporation
(Exact Name of Registrant as Specified in Its Charter)

Delaware	63-1261433
(State or Other Jurisdiction of Incorporation or Organization)	(IRS Employer Identification No.)
100 Brookwood Place, Birmingham, AL	35209
(Address of Principal Executive Offices)	(Zip Code)
(205) 877-4400	
(Registrant's Telephone Number, Including Area Code)	(Former Name, Former Address, and Former Fiscal Year, if Changed Since Last Report)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ý No ¨
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter), during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ý No ¨
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No ý
As of April 25, 2013, there were 61,816,938 shares of the registrant's common stock outstanding.

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Forward-Looking Statements

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

Forward-looking statements relating to our business include among other things: statements concerning 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;
- 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 medical professional liability insurance entities that could remove or add sizable groups of physicians from or to the private insurance market;
- the impact of deflation or inflation;
- 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 accounting policies and practices that may be adopted by our regulatory agencies, the Financial Accounting Standards Board, the Securities and Exchange Commission, or the Public Company Accounting Oversight Board;
- changes in laws or government regulations affecting medical professional liability insurance or the financial community;
- the effects of changes in the healthcare delivery system, including but not limited to the Patient Protection and Affordable Care Act;
- consolidation of healthcare providers and entities that are more likely to self insure and not purchase medical professional liability insurance;
- 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;
- 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 of independent agents;
- changes in our organization, compensation and benefit plans;
- our ability to retain and recruit senior management;

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- 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;
- insurance market conditions may alter the effectiveness of our current business strategy and impact our revenues; 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 merger of Independent Nevada Doctors Insurance Exchange, now Independent Nevada Doctors Insurance Company (IND), and Medmarc Mutual Insurance Company, now Medmarc Casualty Insurance Company (Medmarc), into ProAssurance, include but are not limited to the following:

- the outcome of any potential claims from policyholders of Medmarc and IND relating to payments or other issues arising from their respective conversions to stock insurance companies and subsequent mergers into ProAssurance;
- the businesses of ProAssurance and Medmarc or ProAssurance and IND may not be integrated successfully, or such integration may take longer to accomplish than expected;
- cost savings from either transaction may not be fully realized or may take longer to realize than expected;
- operating costs, customer loss and business disruption following either or both transactions, including adverse effects on relationships with employees, may be greater than expected.

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

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

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

	March 31, 2013	December 31, 2012
Assets		
Investments		
Fixed maturities, available for sale, at fair value; amortized cost, $3,415,342 and $3,224,332, respectively	$3,627,080	$3,447,999
Equity securities, trading, at fair value; cost, $222,167 and $187,891, respectively	257,745	202,618
Short-term investments	149,384	71,737
Business owned life insurance	52,850	52,414
Investment in unconsolidated subsidiaries	198,189	121,049
Other investments	33,104	31,085
Total Investments	4,318,352	3,926,902
Cash and cash equivalents	94,830	118,551
Premiums receivable	122,396	106,312
Receivable from reinsurers on paid losses and loss adjustment expenses	2,482	4,517
Receivable from reinsurers on unpaid losses and loss adjustment expenses	251,053	191,645
Prepaid reinsurance premiums	24,804	13,404
Deferred policy acquisition costs	26,342	23,179
Real estate, net	41,490	41,502
Intangible assets	55,577	53,225
Goodwill	161,123	163,055
Other assets	120,297	234,286
Total Assets	$5,218,746	$4,876,578
Liabilities and Shareholders’ Equity		
Liabilities		
Policy liabilities and accruals		
Reserve for losses and loss adjustment expenses	$2,216,874	$2,054,994
Unearned premiums	278,019	233,861
Reinsurance premiums payable	45,160	45,591
Total Policy Liabilities	2,540,053	2,334,446
Deferred tax liability	27,422	14,585
Other liabilities	165,228	131,967
Long-term debt, at amortized cost	125,000	125,000
Total Liabilities	2,857,703	2,605,998
Shareholders’ Equity		
Common shares, par value $0.01 per share, 100,000,000 shares authorized, 62,060,426 and 61,867,034 shares issued, respectively	621	619
Additional paid-in capital	342,590	341,780
Accumulated other comprehensive income (loss), net of deferred tax expense (benefit) of $74,108 and $78,284, respectively	137,626	145,380
Retained earnings	1,880,262	1,782,857
	2,361,099	2,270,636
Treasury shares, at cost, 243,530 shares	(56)	(56)
Total Shareholders’ Equity	2,361,043	2,270,580
Total Liabilities and Shareholders’ Equity	$5,218,746	$4,876,578

See accompanying notes.

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

	Common Stock	Additional Paid-in Capital	Accumulated Other Comprehensive Income (Loss)	Retained Earnings	Treasury Stock	Total
Balance at December 31, 2012	$619	$341,780	$ 145,380	$1,782,857	$(56)	$2,270,580
Common shares issued for compensation	—	1,939	—	—	—	1,939
Share-based compensation	—	2,282	—	—	—	2,282
Net effect of restricted and performance shares issued and stock options exercised	2	(3,411)	—	—	—	(3,409)
Dividends to shareholders	—	—	—	(15,445)	—	(15,445)
Other comprehensive income (loss)	—	—	(7,754)	—	—	(7,754)
Net income	—	—	—	112,850	—	112,850
Balance at March 31, 2013	$621	$342,590	$ 137,626	$1,880,262	$(56)	$2,361,043

	Common Stock	Additional Paid-in Capital	Accumulated Other Comprehensive Income (Loss)	Retained Earnings	Treasury Stock	Total
Balance at December 31, 2011	$346	$538,625	$ 130,037	$1,699,853	$(204,408)	$2,164,453
Common shares issued for compensation	—	1,654	—	—	—	1,654
Share-based compensation	—	2,130	—	—	—	2,130
Net effect of restricted and performance shares issued and stock options exercised	—	(2,440)	—	—	—	(2,440)
Dividends to shareholders	—	—	—	(7,663)	—	(7,663)
Other comprehensive income (loss)	—	—	3,012	—	—	3,012
Net income	—	—	—	55,645	—	55,645
Balance at March 31, 2012	$346	$539,969	$ 133,049	$1,747,835	$(204,408)	$2,216,791

See accompanying notes.

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

	Three Months Ended March 31	
	2013	2012
Revenues		
Net premiums earned	$134,578	$136,659
Net investment income	32,126	33,492
Equity in earnings (loss) of unconsolidated subsidiaries	(223)	(2,066)
Net realized investment gains (losses):		
Other-than-temporary impairment (OTTI) losses	—	(1,206)
Portion of OTTI losses recognized in (reclassified from) other comprehensive income before taxes	—	—
Net impairment losses recognized in earnings	—	(1,206)
Other net realized investment gains (losses)	26,680	11,883
Total net realized investment gains (losses)	26,680	10,677
Other income	1,813	1,809
Total revenues	194,974	180,571
Expenses		
Losses and loss adjustment expenses	60,887	78,305
Reinsurance recoveries	(3,261)	(8,106)
Net losses and loss adjustment expenses	57,626	70,199
Underwriting, policy acquisition and operating expenses	37,285	34,398
Interest expense	371	825
Total expenses	95,282	105,422
Gain on acquisition	35,492	—
Income before income taxes	135,184	75,149
Provision for income taxes		
Current expense (benefit)	7,775	16,981
Deferred expense (benefit)	14,559	2,523
Total income tax expense (benefit)	22,334	19,504
Net income	$112,850	$55,645
Other comprehensive income, after tax, net of reclassification adjustments (see Note 10)	(7,754)	3,012
Comprehensive income	$105,096	$58,657
Earnings per share:		
Basic	$1.83	$0.91
Diluted	$1.82	$0.90

Weighted average number of common shares outstanding:		
Basic	61,708	61,177
Diluted	61,963	61,703
Cash dividends declared per common share	$0.25	$0.13

See accompanying notes.

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

	Three Months Ended March 31	
	2013	2012
Operating Activities		
Net income	$112,850	$55,645
Adjustments to reconcile income to net cash provided by operating activities:		
Depreciation and amortization	12,318	10,382
Gain on acquisition	(35,492)	—
Net realized investment gains	(26,680)	(10,677)
Share-based compensation	2,282	2,130
Deferred income taxes	14,559	2,523
Policy acquisition costs, net amortization (net deferral)	(3,163)	(922)
Other	(6,304)	(2,588)
Other changes in assets and liabilities, excluding effect of business combinations:		
Premiums receivable	(13,098)	(10,090)
Reinsurance related assets and liabilities	9,099	2,831
Other assets	(26,119)	(1,998)
Reserve for losses and loss adjustment expenses	(37,064)	(13,014)
Unearned premiums	20,025	22,689
Other liabilities	(36,320)	(28,811)
Net cash provided (used) by operating activities	(13,107)	28,100
Investing Activities		
Purchases of:		
Fixed maturities, available for sale	(100,826)	(247,622)
Equity securities, trading	(26,983)	(26,678)
Other investments	(3,616)	(158)
Funding of tax credit limited partnerships	(30,167)	(12,236)
Investment in unconsolidated subsidiaries, net	(6,614)	—
Proceeds from sales or maturities of:		
Fixed maturities, available for sale	173,007	252,234
Equity securities, trading	26,509	16,039
Other investments	1,364	486
Net sales or maturities (purchases) of short-term investments	(76,697)	(13,143)
Cash received from acquisitions	22,780	—
Unsettled security transactions, net	18,478	4,403
Cash received (paid) for other assets	(1,047)	(1,358)
Net cash provided (used) by investing activities	(3,812)	(28,033)
Financing Activities		
Dividends to shareholders	—	(7,622)
Other	(6,802)	(2,415)
Net cash provided (used) by financing activities	(6,802)	(10,037)
Increase (decrease) in cash and cash equivalents	(23,721)	(9,970)
Cash and cash equivalents at beginning of period	118,551	130,400
Cash and cash equivalents at end of period	$94,830	$120,430

Significant non-cash transactions

Deposit transferred as consideration for acquisition	$153,700	$—

See accompanying notes.

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ProAssurance Corporation and Subsidiaries
Notes to Condensed Consolidated Financial Statements (Unaudited)
March 31, 2013

1. Basis of Presentation

The accompanying unaudited Condensed Consolidated Financial Statements include the accounts of ProAssurance Corporation and its consolidated subsidiaries (ProAssurance or PRA). The financial statements have been prepared in accordance with U.S. Generally Accepted Accounting Principles (GAAP) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and notes required by GAAP for complete financial statements. In the opinion of management, all adjustments considered necessary for a fair presentation, consisting of normal recurring adjustments, have been included. ProAssurance's results for the three-month period ended March 31, 2013 are not necessarily indicative of the results that may be expected for the year ending December 31, 2013. The accompanying Condensed Consolidated Financial Statements should be read in conjunction with the Consolidated Financial Statements and Notes contained in ProAssurance's December 31, 2012 report on Form 10-K. In connection with its preparation of the Condensed Consolidated Financial Statements, ProAssurance evaluated events that occurred subsequent to March 31, 2013 for recognition or disclosure in its financial statements and notes to financial statements.

Stock Split

The Board of Directors of ProAssurance Corporation (the Board) declared a two-for-one stock split effected December 27, 2012 in the form of a stock dividend. All share and per share information provided in this report reflects the effect of the split for all periods presented.

Accounting Changes Not Yet Adopted

Liabilities-Obligations Resulting from Joint and Several Liability Arrangements

Effective for fiscal years beginning after December 15, 2013, the Financial Accounting Standards Board (FASB) revised guidance related to obligations resulting from joint and several liability arrangements. The new guidance requires an entity to recognize, measure and disclose obligations resulting from joint and several liability arrangements for which the total amount of the obligation is fixed at the reporting date, except for obligations already addressed within existing GAAP guidance. The new guidance requires retrospective application to all prior periods presented for any such arrangements that exist at the beginning of the fiscal year of adoption. ProAssurance plans to adopt the guidance beginning January 1, 2014. Adoption of this guidance is not expected to have a material effect on ProAssurance's results of operations or financial position.

Accounting Changes Adopted

Intangibles-Goodwill and Other

Effective for fiscal years beginning after September 15, 2012, the FASB revised guidance related to impairment testing of indefinite-lived intangible assets. The new guidance permits an entity to assess qualitative factors to determine whether the existence of events and circumstances indicates that it is more likely than not that an indefinite-lived intangible asset is impaired. Quantitative impairment testing is required only if the assessment of qualitative factors indicates it is more likely than not that impairment exists. ProAssurance adopted the guidance on January 1, 2013. Adoption of this guidance had no material effect on ProAssurance's results of operations or financial position.

Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income

Effective for interim and annual reporting periods beginning after December 15, 2012, the FASB revised guidance related to the disclosure of amounts reclassified out of accumulated other comprehensive income. The most significant provisions of the new guidance require entities to present additional disclosure, either on the face of the income statement or in the notes, regarding significant amounts reclassified, in their entirety, from accumulated other comprehensive income to net income. ProAssurance adopted the guidance on January 1, 2013. Adoption of this guidance had no material effect on ProAssurance's results of operations or financial position as it impacts disclosures only.

Disclosures About Offsetting Assets and Liabilities

Effective for fiscal years beginning on or after January 1, 2013, the FASB revised guidance related to disclosures about certain assets and liabilities in an entity’s financial statements. The guidance requires disclosures related to the net and gross positions of certain financial instruments and transactions that are either eligible for offset in accordance with existing GAAP guidance or subject to an agreement that requires such offset. The guidance must be applied retrospectively for all prior periods presented. ProAssurance adopted the guidance on January 1, 2013. Adoption of this guidance had no material effect on ProAssurance’s results of operations or financial position as it impacts disclosures only.

2. Acquisitions

All entities acquired in 2013 and 2012 were accounted for in accordance with GAAP relating to business combinations.

On January 1, 2013, ProAssurance completed the acquisition of Medmarc Mutual Insurance Company, now Medmarc Casualty Insurance Company (Medmarc), through a sponsored demutualization. Medmarc is based in Chantilly, Virginia and provides products liability insurance for medical technology and life sciences companies and also provides legal professional liability insurance. ProAssurance acquired Medmarc for cash of $153.7 million, including the funding of future policy credits for eligible members of $7.5 million. ProAssurance transferred all of the cash required to complete the transaction to a third-party conversion agent for the benefit of Medmarc eligible members on December 27, 2012; the deposit was classified as a part of Other Assets at December 31, 2012. ProAssurance incurred expenses related to the purchase of approximately $1.4 million during the first three months of 2013 and approximately $1.0 million during 2012. These expenses were included as a part of operating expenses in the periods incurred.

During 2012, ProAssurance completed an acquisition of a reciprocal exchange that converted to a stock insurance company upon acquisition. The acquisition was not material to ProAssurance.

The purchase consideration for Medmarc was allocated to the assets acquired and liabilities assumed based on their estimated fair values on the acquisition date, as shown in the table below. A $35.5 million gain on the acquisition was recognized on the date of acquisition because the purchase consideration was less than the estimated fair value of the net assets acquired. ProAssurance believes it was able to acquire Medmarc for less than the fair value of its net assets due to Medmarc's declining premium base and its small capital position relative to other insurers in the medical technology and life sciences products liability insurance market.

(In thousands)	
Fixed maturities, available for sale	$269,529
Equity securities, trading	30,976
Cash and short-term investments	24,008
Other investments	5,340
Premiums receivable	2,986
Receivable from reinsurers on unpaid losses and LAE	73,107
Intangible assets	3,630
Other assets	14,614
Reserve for losses and loss adjustment expenses	(201,072)
Unearned premiums	(16,937)
Deferred tax liabilities	(2,453)
Other liabilities	(14,536)
Fair value of net assets acquired	$189,192
Gain on Acquisition	(35,492)
Total purchase consideration	$153,700

Intangible assets acquired principally consist of non-compete agreements, which are amortizable over their useful life of two years, and insurance licenses, which have an indefinite useful life and are not amortized.

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March 31, 2013

ProAssurance believes that all contractual cash flows related to acquired receivables will be collected. The fair value of reserves for losses and loss adjustment expenses and related reinsurance recoverables were estimated based on the present value of the expected underlying net cash flows, including a 5% profit margin and a 5% risk premium, and were determined to be materially the same as the recorded cost basis acquired.
The following table provides Pro Forma Consolidated Results for the three months ended March 31, 2013 and 2012 as if the Medmarc transaction had occurred on January 1, 2012. ProAssurance Actual Consolidated Results have been adjusted by the following, net of related tax effects, to reflect the Pro Forma Consolidated Results below.

- For the three months ended March 31, 2012, the inclusion of Medmarc operating results as ProAssurance 2012 Actual Consolidated Results did not include Medmarc. ProAssurance Actual Consolidated Results for the three months ended March 31, 2013 included Medmarc operating results (Revenue of $12.9 million and Earnings of $3.2 million).
- Certain costs included in ProAssurance actual results for the three months ended March 31, 2013 have been reported in the Pro Forma Consolidated Results as if the costs had been incurred for three months ended March 31, 2012. Such costs include direct transaction costs and certain compensation costs directly related to the integration of Medmarc operations.
- Prior to the acquisition date, Medmarc reported on a statutory basis and expensed policy acquisition costs associated with successful contracts as incurred. After the acquisition date, in accordance with GAAP, Medmarc policy acquisition costs associated with successful contracts were capitalized and amortized to expense as the related premium revenues were earned, but no amortization was recognized for Medmarc policies written prior to the acquisition date. The Pro Forma Consolidated Results for both 2013 and 2012 have been adjusted to reflect policy acquisition costs as if Medmarc had followed GAAP guidance for these costs in pre-acquisition periods.
- Earnings for the three months ended March 31, 2012, were reduced to reflect amortization of intangible assets and debt security premiums and discounts recorded as a part of the Medmarc purchase price allocation.
- The gain on the acquisition of $35.5 million that was included in ProAssurance Actual Consolidated Results for the three months ended March 31, 2013 has been reported in the Pro Forma Consolidated Results as being recognized during the three months ended March 31, 2012.

	Three months ended March 31, 2013		Three months ended March 31, 2012	
(In thousands)	ProAssurance Pro Forma Consolidated Results	ProAssurance Actual Consolidated Results	ProAssurance Pro Forma Consolidated Results	ProAssurance Actual Consolidated Results
Revenue	$194,974	$194,974	$190,678	$180,571
Earnings	$77,095	$112,850	$92,777	$55,645

3. Fair Value Measurement

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

Level 1:	quoted (unadjusted) market prices in active markets for identical assets and liabilities. For ProAssurance, Level 1 inputs are generally quotes for debt or equity securities actively traded in exchange or over-the-counter markets.
Level 2:	market data obtained from sources independent of the reporting entity (observable inputs). For ProAssurance, Level 2 inputs generally include quoted prices in markets that are not active, quoted prices for similar assets or liabilities, and results from pricing models that use observable inputs such as interest rates and yield curves that are generally available at commonly quoted intervals.
Level 3:	the reporting entity’s own assumptions about market participant assumptions based on the best information available in the circumstances (non-observable inputs). For ProAssurance, Level 3 inputs are used in situations where little or no Level 1 or 2 inputs are available or are inappropriate given the particular circumstances. Level 3 inputs include results from pricing models for which some or all of the inputs are not observable, discounted cash flow methodologies, single non-binding broker quotes and adjustments to externally quoted prices that are based on management judgment or estimation.

Fair values of assets and liabilities measured at fair value on a recurring basis as of March 31, 2013 and December 31, 2012, including financial instruments for which ProAssurance has elected fair value, are shown in the following tables. The tables also indicate the fair value hierarchy of the valuation techniques utilized to determine those fair values. For some assets, the inputs used to measure fair value may fall into different levels of the fair value hierarchy. When this is the case, the asset is categorized based on the level of the most significant input to the fair value measurement. Assessments of the significance of a particular input to the fair value measurement requires judgment and consideration of factors specific to the assets being valued.

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ProAssurance Corporation and Subsidiaries
Notes to Condensed Consolidated Financial Statements (Unaudited)
March 31, 2013

	March 31, 2013			
	Fair Value Measurements Using			Total
(In thousands)	Level 1	Level 2	Level 3	Fair Value
Assets:				
Fixed maturities, available for sale				
U.S. Treasury obligations	$—	$231,004	$—	$231,004
U.S. Government-sponsored enterprise obligations	—	59,553	—	59,553
State and municipal bonds	—	1,285,353	7,175	1,292,528
Corporate debt, multiple observable inputs	—	1,544,040	—	1,544,040
Corporate debt, limited observable inputs:				
Private placement senior notes	—	—	342	342
Other corporate debt, NRSRO ratings available	—	—	8,406	8,406
Other corporate debt, NRSRO ratings not available	—	—	914	914
Residential mortgage-backed securities	—	295,347	—	295,347
Agency commercial mortgage-backed securities	—	47,436	—	47,436
Other commercial mortgage-backed securities	—	74,369	—	74,369
Other asset-backed securities	—	66,065	7,076	73,141
Equity securities				
Financial	80,312	—	—	80,312
Utilities/Energy	39,315	—	—	39,315
Consumer oriented	64,467	—	—	64,467
Technology	14,611	—	—	14,611
Industrial	39,558	—	—	39,558
All other	15,452	4,030	—	19,482
Short-term investments	141,802	7,582	—	149,384
Financial instruments carried at fair value, classified as a part of:				
Investment in unconsolidated subsidiaries	—	—	47,540	47,540
Total assets	$395,517	$3,614,779	$71,453	$4,081,749

	December 31, 2012			
	Fair Value Measurements Using			Total
(In thousands)	Level 1	Level 2	Level 3	Fair Value
Assets:				
Fixed maturities, available for sale				
U.S. Treasury obligations	$—	$205,857	$—	$205,857
U.S. Government-sponsored enterprise obligations	—	56,947	—	56,947
State and municipal bonds	—	1,212,804	7,175	1,219,979
Corporate debt, multiple observable inputs	—	1,455,333	—	1,455,333
Corporate debt, limited observable inputs:				
Private placement senior notes	—	—	346	346
Other corporate debt, NRSRO ratings available	—	—	13,835	13,835
Other corporate debt, NRSRO ratings not available	—	—	1,010	1,010
Residential mortgage-backed securities	—	289,850	—	289,850
Agency commercial mortgage-backed securities	—	59,464	—	59,464
Other commercial mortgage-backed securities	—	74,106	—	74,106
Other asset-backed securities	—	67,237	4,035	71,272
Equity securities				
Financial	70,900	—	—	70,900
Utilities/Energy	31,383	—	—	31,383
Consumer oriented	51,100	—	—	51,100
Technology	11,495	—	—	11,495
Industrial	18,200	—	—	18,200
All other	19,540	—	—	19,540