PROASSURANCE CORP
Form 10-Q
August 05, 2010

Table of Contents

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

(Mark One)

þ **Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
For the quarterly period ended June 30, 2010 or ______

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

Commission file number 0-16533
ProAssurance Corporation

(Exact Name of Registrant as Specified in Its Charter)

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

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

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

Indicate by check mark whether the registrant 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 þ No o

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

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

As of July 23, 2010, there were 31,806,389 shares of the registrant s common stock outstanding.

TABLE OF CONTENTS

- ITEM 7. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS
- ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK
- ITEM 4. CONTROLS AND PROCEDURES

PART II. OTHER INFORMATION

- ITEM 1. LEGAL PROCEEDINGS
- ITEM 1A. RISK FACTORS
- ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS
- ITEM 6. EXHIBITS

SIGNATURE
EX-31.1
EX-31.2
EX-32.1
EX-32.2
EX-101 INSTANCE DOCUMENT
EX-101 SCHEMA DOCUMENT
EX-101 CALCULATION LINKBASE DOCUMENT
EX-101 LABELS LINKBASE DOCUMENT
EX-101 PRESENTATION LINKBASE DOCUMENT
EX-101 DEFINITION LINKBASE DOCUMENT

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 , may , optimistic , preliminary , potential , project analogous expressions. There are numerous factors that could cause our actual results to differ materially from those in the forward-looking statements. Thus, sentences and phrases that we use to convey our view of future events and trends are expressly designated as forward-looking statements as are sections of this Form 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 new business, the availability of acceptable reinsurance, actions by regulators and rating agencies, court actions, legislative actions, payment or performance of obligations under indebtedness, payment of dividends, and other matters.

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

- general economic conditions, either nationally or in our market areas, that are different than anticipated;
- 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 malpractice insurance entities that could remove or add sizable groups of physicians from the private insurance market;
- the impact of deflation or inflation;
- changes in the interest rate environment;
- the effect that changes in laws or government regulations affecting the U.S. economy or financial institutions, including the Emergency Economic Stabilization Act of 2008 and the American Recovery and Reinvestment Act of 2009 and the Dodd-Frank Act of 2010, may have on the U.S. economy and our business;
- performance of financial markets affecting the fair value of our investments or making it difficult to determine the value of our investments;
- changes in accounting policies and practices that may be adopted by our regulatory agencies and 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 health care delivery system, including but not limited to the recently passed Patient Protection and Affordable Care Act;

uncertainties inherent in the estimate of loss and loss adjustment expense reserves and reinsurance, and 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;

Table of Contents

- bad faith litigation 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;
- our ability to purchase reinsurance and collect payments from our reinsurers;
- increases in guaranty fund assessments;
- our ability to achieve continued growth through expansion into other states or through acquisitions or business combinations;
- changes to the ratings assigned by rating agencies to our insurance subsidiaries, individually or as a group;
- changes in competition among insurance providers and related pricing weaknesses in our markets; and
- the 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 and employees, increased operating costs or inability to achieve cost savings, and assumption of greater than expected liabilities, among other reasons.

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 Forms 10-Q and 10-K.

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

Table of Contents

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

	June 30 2010 (Unaudited)	December 31 2009 (Audited)
Assets		
Investments		
Fixed maturities, available for sale, at fair value	**$3,457,116**	$3,442,995
Equity securities, available for sale, at fair value	**3,290**	3,579
Equity securities, trading, at fair value	**23,871**	43,826
Short-term investments	**288,921**	187,059
Business owned life insurance	**65,825**	65,003
Investment in unconsolidated subsidiaries	**79,266**	48,502
Other investments	**47,885**	47,258
Total Investments	**3,966,174**	3,838,222
Cash and cash equivalents	**45,287**	40,642
Premiums receivable	**104,441**	116,403
Receivable from reinsurers on paid losses and loss adjustment expenses	**9,697**	16,778
Receivable from reinsurers on unpaid losses and loss adjustment expenses	**265,794**	262,659
Prepaid reinsurance premiums	**13,066**	11,836
Deferred policy acquisition costs	**26,769**	25,493
Deferred taxes	**41,697**	68,806
Real estate, net	**44,286**	44,496
Amortizable intangible assets	**8,842**	9,973
Goodwill	**122,317**	122,317
Other assets	**89,112**	89,789
Total Assets	**$4,737,482**	$4,647,414
Liabilities and Shareholders Equity		
Liabilities		
Policy liabilities and accruals		
Reserve for losses and loss adjustment expenses	**$2,412,343**	$2,422,230
Unearned premiums	**230,980**	244,212
Reinsurance premiums payable	**119,271**	113,994
Total Policy Liabilities	**2,762,594**	2,780,436
Other liabilities	**131,324**	112,180
Long-term debt, $35,479 and $35,463, at amortized cost, respectively; $15,107 and $14,740 at fair value, respectively	**50,586**	50,203
Total Liabilities	**2,944,504**	2,942,819
Shareholders Equity		

Common stock, par value $0.01 per share, 100,000,000 shares authorized, 34,327,303 and 34,223,346 shares issued, respectively	**343**	342
Additional paid-in capital	**529,740**	526,068
Accumulated other comprehensive income (loss), net of deferred tax expense (benefit) of $56,346 and $31,908, respectively	**104,639**	59,254
Retained earnings	**1,274,921**	1,196,428
	1,909,643	1,782,092
Treasury stock, at cost, 2,484,914 shares and 1,811,356 shares, respectively	**(116,665)**	(77,497)
Total Shareholders Equity	**1,792,978**	1,704,595
Total Liabilities and Shareholders Equity	**$4,737,482**	$4,647,414

Table of Contents

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

	Total	**Accumulated Other Comprehensive Income (Loss)**	**Retained Earnings**	**Other Capital Accounts**
Balance at December 31, 2009	**$1,704,595**	**$ 59,254**	**$1,196,428**	**$448,913**
Net income	**78,493**		**78,493**	
Change in net unrealized gains (losses) on investments, after tax, net of reclassification adjustments	**45,385**	**45,385**		
Repurchase of treasury stock	**(39,168)**			**(39,168)**
Common shares issued as compensation and net effect of performance shares issued and stock options exercised	**732**			**732**
Share-based compensation	**2,941**			**2,941**
Balance at June 30, 2010	**$1,792,978**	**$ 104,639**	**$1,274,921**	**$413,418**

	Total	Accumulated Other Comprehensive Income (Loss)	Retained Earnings	Other Capital Accounts
Balance at December 31, 2008	$1,423,585	$ (35,898)	$ 970,891	$488,592
Cumulative effect adjustment for accounting change (see Note 1)		(3,510)	3,510	
Net income	82,248		82,248	
Change in net unrealized gains (losses) on investments, after tax, net of reclassification adjustments	48,753	48,753		
Repurchase of treasury stock	(36,074)			(36,074)
Treasury shares issued in acquisition (see Note 2)	5,161			5,161
Common shares issued as compensation and net effect of performance shares issued and stock options exercised	839			839
Share-based compensation	3,159			3,159
Balance at June 30, 2009	$1,527,671	$ 9,345	$1,056,649	$461,677

Table of Contents

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

	Three Months Ended June 30		Six Months Ended June 30	
	2010	2009	**2010**	2009
Revenues				
Gross premiums written	**$ 98,522**	$111,612	**$255,699**	$266,156
Net premiums written	**$ 88,868**	$100,542	**$234,089**	$242,929
Premiums earned	**$135,933**	$139,182	**$270,204**	$254,736
Premiums ceded	**(10,535)**	(11,438)	**(21,379)**	(23,102)
Net premiums earned	**125,398**	127,744	**248,825**	231,634
Net investment income	**37,081**	39,697	**74,709**	74,266
Equity in earnings (loss) of unconsolidated subsidiaries	**839**	119	**3,825**	(1,309)
Net realized investment gains (losses):				
Other-than-temporary impairment losses (OTTI)	**(4,912)**	(2,436)	**(12,379)**	(7,394)
Portion of OTTI losses recognized in (reclassified from) other comprehensive income (before taxes)	**(2,128)**	172	**6**	172
Net impairment losses recognized in earnings	**(7,040)**	(2,264)	**(12,373)**	(7,222)
Other net realized investment gains (losses)	**3,539**	7,348	**6,468**	4,769
Total net realized investment gains (losses)	**(3,501)**	5,084	**(5,905)**	(2,453)
Other income	**1,683**	2,597	**4,005**	4,071
Total revenues	**161,500**	175,241	**325,459**	306,209
Expenses				
Losses and loss adjustment expenses	**77,170**	75,928	**165,078**	152,635
Reinsurance recoveries	**(8,646)**	(8,903)	**(17,853)**	(16,493)
Net losses and loss adjustment expenses	**68,524**	67,025	**147,225**	136,142
Underwriting, acquisition and insurance expenses	**31,642**	30,013	**62,846**	53,990
Interest expense	**827**	1,203	**1,640**	1,830
Total expenses	**100,993**	98,241	**211,711**	191,962

Income before income taxes	**60,507**	77,000	**113,748**	114,247
Provision for income taxes				
Current expense (benefit)	**23,106**	3,580	**31,925**	9,661
Deferred expense (benefit)	**(2,980)**	19,539	**3,330**	22,338
	20,126	23,119	**35,255**	31,999
Net income	**$ 40,381**	$ 53,881	**$ 78,493**	$ 82,248
Earnings per share:				
Basic	**$ 1.25**	$ 1.64	**$ 2.42**	$ 2.48
Diluted	**$ 1.23**	$ 1.62	**$ 2.40**	$ 2.46
Weighted average number of common shares outstanding:				
Basic	**32,322**	32,914	**32,385**	33,134
Diluted	**32,721**	33,186	**32,743**	33,391

Table of Contents

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

	Three Months Ended June 30		Six Months Ended June 30	
	2010	2009	**2010**	2009
Comprehensive income:				
Net income	**$40,381**	$53,881	**$ 78,493**	$ 82,248
Change in net unrealized gains (losses) on investments, after tax, net of reclassification adjustments	**32,141**	26,660	**45,385**	48,753
Comprehensive income	**$72,522**	$80,541	**$123,878**	$131,001

7

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

	Six Months Ended June 30	
	2010	2009
Operating Activities		
Net income	**$ 78,493**	$ 82,248
Depreciation and amortization	**13,133**	9,201
Net realized investment (gains) losses	**5,905**	2,453
Share-based compensation	**2,941**	3,159
Deferred income taxes	**3,330**	22,338
Changes in assets and liabilities, net of the effects of acquisitions:		
Premiums receivable	**11,962**	(3,882)
Reserve for losses and loss adjustment expenses	**(9,887)**	(34,571)
Unearned premiums	**(13,232)**	11,584
Reinsurance related assets and liabilities	**7,993**	90
Other liabilities	**(21,069)**	(66,189)
Other assets	**(8,562)**	(5,725)
Other	**4,912**	(7,335)
Net cash provided by operating activities	**75,919**	13,371
Investing Activities		
Purchases of:		
Fixed maturities available for sale	**(458,291)**	(430,752)
Equity securities available for sale		(140)
Equity securities trading	**(8,419)**	(4,886)
Other investments	**(5,255)**	(255)
Cash invested in unconsolidated subsidiaries	**(25,014)**	(2,542)
Proceeds from sale or maturities of:		
Fixed maturities available for sale	**502,769**	330,974
Equity securities available for sale	**14**	1,053
Equity securities trading	**26,812**	2,402
Other investments	**1,242**	1,258
Net sales or maturities (purchases) of short-term investments	**(101,862)**	231,531
Cash paid for acquisitions, net of cash received		(124,495)
Unsettled security transactions, net	**37,815**	31,414
Other	**(2,209)**	(866)
Net cash provided (used) by investing activities	**(32,398)**	34,696
Financing Activities		
Repurchase of treasury stock	**(39,168)**	(36,074)
Excess of tax benefit from options exercised	**1,765**	

Book overdraft		(2,678)
Debt repayment	**(151)**	(119)
Other	**(1,322)**	205
Net cash provided (used) by financing activities	**(38,876)**	(38,666)
Increase (decrease) in cash and cash equivalents	**4,645**	9,401
Cash and cash equivalents at beginning of period	**40,642**	3,459
Cash and cash equivalents at end of period	**$ 45,287**	$ 12,860
Significant Non-cash Transactions:		
Common shares issued in acquisition	**$**	$ 5,161

Table of Contents

ProAssurance Corporation and Subsidiaries
Notes to Condensed Consolidated Financial Statements (Unaudited)
June 30, 2010

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 and six-month periods ended June 30, 2010 are not necessarily indicative of the results that may be expected for the year ending December 31, 2010. The accompanying Condensed Consolidated Financial Statements should be read in conjunction with the Consolidated Financial Statements and notes contained in ProAssurance s December 31, 2009 report on Form 10-K. In connection with its preparation of the Condensed Consolidated Financial Statements, ProAssurance evaluated events that occurred subsequent to June 30, 2010, for recognition or disclosure in its financial statements and notes to financial statements.

Accounting Changes

Fair Value Measurements

Effective for interim and annual reporting periods beginning after December 15, 2009 or December 15, 2010, as specified, the FASB revised GAAP guidance related to fair value measurement to require additional disclosures and to clarify certain existing disclosure requirements. The guidance is intended to improve the disclosures and increase transparency in financial reporting. ProAssurance adopted the revised guidance on January 1, 2010 except for disclosures about purchases, sales, issuances, and settlements in the roll forward of activity in Level 3 fair value measurements which are effective for interim and annual reporting periods beginning on or after December 15, 2010; adoption had no effect on our results of operations or financial position.

Own-Share Lending Arrangements in Contemplation of Convertible Debt Issuance

Effective for interim and annual reporting periods beginning on or after December 15, 2009 for outstanding arrangements and effective otherwise for reporting periods beginning on or after June 15, 2009, the FASB issued guidance related to share-lending arrangements for an entity s own shares executed in contemplation of a convertible debt offering or other financing. ProAssurance adopted the guidance on January 1, 2010; adoption had no effect on ProAssurance s results of operations or financial position.

Consolidation of Variable Interest Entities

Effective at the start of a reporting entity s first fiscal year beginning after November 15, 2009, the FASB revised guidance which changes how a reporting entity determines whether or not to consolidate its interest in an entity that is insufficiently capitalized or is not controlled through voting (or similar) rights. The determination of whether a reporting entity is required to consolidate another entity will now be based on, among other things, the other entity s purpose and design and the reporting entity s ability to direct the activities of the other entity that most significantly impact the other entity s economic performance. The revised guidance also requires the reporting entity to provide additional disclosures about its involvement with variable interest entities and any significant changes in risk exposure due to that involvement. A reporting entity will be required to disclose how its involvement with a variable interest entity affects the reporting entity s financial statements. ProAssurance adopted the revised

Table of Contents

ProAssurance Corporation and Subsidiaries
Notes to Condensed Consolidated Financial Statements (Unaudited)
June 30, 2010

1. Basis of Presentation (continued)

guidance on January 1, 2010; adoption had no effect on ProAssurance s results of operations or financial position.

Transfers and Servicing-Accounting for Transfers of Financial Assets

Effective at the start of a reporting entity s first fiscal year beginning after November 15, 2009, the FASB revised guidance that requires additional disclosure regarding transfers of financial assets, including securitization transactions, where entities have continuing exposure to risks related to the transferred financial assets. ProAssurance adopted the revised guidance on January 1, 2010; adoption had no effect on ProAssurance s results of operations or financial position.

Investments Disclosure Requirements; Other-than-temporary Impairments

Effective for interim and annual reporting periods ending on or after June 15, 2009, the FASB revised GAAP to require expanded disclosures related to investments in debt and equity securities. Guidance regarding other-than-temporary impairments was also revised. Previous investment guidance required that an impairment of a debt security be considered as other-than-temporary unless management could assert both the intent and the ability to hold the impaired security until recovery of value. The revised impairment guidance specifies that an impairment be considered as other-than-temporary unless an entity can assert that it has no intent to sell the security and that it is not more likely than not that the entity will be required to sell the security before recovery of its anticipated amortized cost basis.

The new guidance also establishes the concept of credit loss. Credit loss is defined as the difference between the present value of the cash flows expected to be collected from a debt security and the amortized cost basis of the security. The new guidance states that in instances in which a determination is made that a credit loss exists but the entity does not intend to sell the debt security and it is not more likely than not that the entity will be required to sell the debt security before the anticipated recovery of its remaining amortized cost basis an impairment is to be separated into (a) the amount of the total impairment related to the credit loss and (b) the amount of total impairment related to all other factors. The credit loss component of the impairment is to be recognized in income of the current period. The non-credit component is to be recognized as a part of other comprehensive income (OCI). Transition provisions require a cumulative effect adjustment to reclassify the noncredit component of a previously recognized other-than-temporary impairment from retained earnings to accumulated other comprehensive income if an entity does not intend to sell and it is not more likely than not that the entity will be required to sell the security before recovery of its amortized cost basis . ProAssurance adopted the revised guidance as of the beginning of the quarter ended June 30, 2009. As of April 1, 2009, its debt securities included non-credit impairment losses previously recognized in earnings of approximately $5.4 million. In accordance with the transition provisions of the revised guidance, ProAssurance reclassified these non-credit losses, net of tax, from retained earnings to accumulated comprehensive income as of April 1, 2009 (a $3.5 million increase to retained earnings; a $3.5 million decrease to accumulated other comprehensive income).

Table of Contents

ProAssurance Corporation and Subsidiaries
Notes to Condensed Consolidated Financial Statements (Unaudited)
June 30, 2010

1. Basis of Presentation (continued)

Revenue Recognition-Multiple Deliverable Revenue Arrangements, Milestone Method

Effective prospectively for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010, the FASB issued guidance addressing revenue recognition. New guidance regarding multiple-deliverable arrangements eliminates the residual method of allocation and requires that arrangement consideration be allocated at inception using the relative selling price method. The guidance also establishes a selling price hierarchy and expands required disclosures related to a vendor s multiple-deliverable revenue arrangements. We will adopt this guidance July 1, 2010. New guidance has also been issued defining a milestone and determining when use of the milestone method of revenue recognition is appropriate. Adoption is not expected to have an effect on ProAssurance s results of operations or financial position.

2. Acquisitions

All entities acquired were accounted for in accordance with GAAP relating to business combinations and are considered to be a part of ProAssurance s sole reporting segment, the professional liability segment.

ProAssurance acquired 100% of the outstanding shares of Mid-Continent General Agency, Inc., now ProAssurance Mid-Continent Underwriters, Inc., (Mid-Continent), and Georgia Lawyers Insurance Company (Georgia Lawyers) during the first quarter of 2009 as a means of expanding its professional liability business. Assets acquired and liabilities assumed were recorded based on estimated fair values as of the date of acquisition. The excess of the purchase price over the fair values of the identifiable net assets acquired was recognized as goodwill totaling $13.4 million for the two acquisitions. Approximately $12 million of the goodwill is expected to be tax deductible. The consideration for these acquisitions included 100,533 ProAssurance common shares valued at fair value on the acquisition date ($5.2 million), which were reissued from treasury stock.

On April 1, 2009 ProAssurance acquired Podiatry Insurance Company of America and subsidiaries (PICA) through a cash sponsored demutualization as a means of expanding its professional liability insurance operations. PICA provides professional liability insurance primarily to podiatric physicians, chiropractors and other healthcare providers throughout the United States. Total purchase consideration transferred had a fair value of $133.8 million on the acquisition date, April 1, 2009 and was allocated to the assets acquired and liabilities assumed based on their estimated fair values on the acquisition date. Goodwill of $36.7 million was recognized equal to the excess of the purchase price over the net fair value of the identifiable assets acquired and liabilities assumed. None of the goodwill is expected to be tax deductible.

The following table discloses supplemental pro forma information reflecting the combined results of ProAssurance and PICA as if the acquisition had occurred at the beginning of the prior year annual reporting period (January 1, 2009), adjusted to exclude transaction costs, normalize amortization of deferred policy acquisition costs and include pro forma amortization of certain intangibles recognized in the purchase price allocation.

	Actual PICA Results Included in ProAssurance Consolidated Results Six Months Ended June 30	Supplemental Pro forma Combined Results Six Months Ended June 30
(In thousands)	**2009**	**2009**
Revenue	$ 28,993	$ 329,960
Earnings	$ 4,879	$ 88,744

Table of Contents

ProAssurance Corporation and Subsidiaries
Notes to Condensed Consolidated Financial Statements (Unaudited)
June 30, 2010

2. Acquisitions (continued)

For additional information regarding the acquisitions, see Note 3 of the Notes to the Consolidated Financial Statements in ProAssurance s 2009 Form 10-K.

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/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, and adjustments to externally quoted prices that are based on management judgment or estimation.

The following tables present information about ProAssurance s assets and liabilities that are measured at fair value on a recurring basis as of June 30, 2010 and December 31, 2009, and indicate the fair value hierarchy of the valuation techniques utilized to determine such value. 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. ProAssurance s assessment of the significance of a particular input to the fair value measurement requires judgment, and considers factors specific to the assets being valued.

Table of Contents

ProAssurance Corporation and Subsidiaries
Notes to Condensed Consolidated Financial Statements (Unaudited)
June 30, 2010

3. Fair Value Measurement (continued)

Assets and liabilities measured at fair value on a recurring basis as of June 30, 2010 and December 31, 2009, including financial instruments for which ProAssurance has elected fair value accounting, are as follows:

	June 30, 2010 Fair Value Measurements Using			
(In thousands)	Level 1	Level 2	Level 3	Total Fair Value
Assets:				
Fixed maturities, available for sale				
U.S. Treasury obligations	$	$ 209,390	$	$ 209,390
U.S. Agency obligations		64,484		64,484
State and municipal bonds		1,317,858	9,401	1,327,259
Corporate bonds		1,110,960	25,660	1,136,620
Residential mortgage-backed securities		558,330		558,330
Commercial mortgage-backed securities		108,136		108,136
Other asset-backed securities		52,897		52,897
Equity securities, available for sale				
Financial	503			503
Energy	187			187
Consumer cyclical	421			421
Consumer non-cyclical	630			630
Technology	638			638
Industrial	566			566
Communications	113			113
All Other	232			232
Equity securities, trading				
Financial	6,619			6,619
Energy	4,687			4,687
Consumer cyclical	759			759
Consumer non-cyclical	3,307			3,307
Technology	1,619			1,619
Industrial	886			886
Communications	1,088			1,088
All Other	4,906			4,906
Short-term investments(1)	205,164	83,757		288,921
Investment in unconsolidated subsidiaries			79,266	79,266
Other investments(2)		10,672	930	11,602
Total assets	$232,325	$3,516,484	$115,257	$3,864,066
Liabilities:				
2019 Note Payable	$	$	$ 15,107	$ 15,107
Interest rate swap agreement			4,284	4,284

Total liabilities	$	$	$ 19,391	$ 19,391

13

ProAssurance Corporation and Subsidiaries
Notes to Condensed Consolidated Financial Statements (Unaudited)
June 30, 2010

3. Fair Value Measurement (continued)

	December 31, 2009			
	Fair Value Measurements Using			
(In thousands)	Level 1	Level 2	Level 3	Total Fair Value
Assets:				
Fixed maturities, available for sale				
U.S. Treasury obligations	$	$ 153,544	$	$ 153,544
U.S. Agency obligations		67,026		67,026
State and municipal bonds		1,439,154	9,495	1,448,649
Corporate bonds		1,049,677	24,335	1,074,012
Residential mortgage-backed securities		556,863		556,863
Commercial mortgage-backed securities		91,627	940	92,567
Other asset-backed securities		50,334		50,334
Equity securities, available for sale				
Financial	488			488
Energy	182			182
Consumer cyclical	425			425
Consumer non-cyclical	638			638
Technology	780			780
Industrial	598			598
Communications	134			134
All Other	334			334
Equity securities, trading				
Financial	8,831			8,831
Energy	7,781			7,781
Consumer cyclical	3,222			3,222
Consumer non-cyclical	8,889			8,889
Technology	4,085			4,085
Industrial	3,560			3,560
Communications	4,063			4,063
All Other	3,395			3,395
Short-term investments(1)	168,060	18,999		187,059
Investment in unconsolidated subsidiaries			48,502	48,502
Other investments(2)			10,932	10,932
Total assets	$215,465	$3,427,224	$94,204	$3,736,893
Liabilities:				
2019 Note Payable	$	$	$14,740	$ 14,740
Interest rate swap agreement			2,937	2,937
Total liabilities	$	$	$17,677	$ 17,677

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

(2) Other investments also includes investments accounted for using the cost method of $36.3 million at both June 30, 2010 and December 31, 2009 that are not included in the table above.

The fair values for securities included in the Level 2 category, with the few exceptions described below, have been developed by third party, nationally recognized pricing services. These services use complex methodologies to determine values for securities and have internal processes whereby the values developed are cross verified for accuracy. The services collect and utilize a lengthy list of inputs, although not all inputs are used for every security type or given the same priority in every evaluation. Inputs considered include: benchmark yields, reported trades, broker/dealer quotes, issuer spreads, two-sided markets, benchmark securities, bids, and offers. The services also consider credit ratings, where appropriate, including ratings updates and information available in appropriate market research publications. Management reviews service-provided values for reasonableness by comparing market yields indicated by the supplied value to yields observed in the market place. If a value does not appear reasonable, the valuation is discussed with the service that provided the value and will be adjusted, if

3. Fair Value Measurement (continued)

necessary; although, no such adjustments have been necessary in 2010 or 2009. Below is a summary description of the valuation methodologies primarily used by the pricing services for securities in the Level 2 category, by security type:

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

U. S. government and agency obligations, and Corporate Bonds (exclusive of privately placed debt) are valued using pricing models that consider current and historical market data, normal trading conventions, credit ratings, and the particular structure and characteristics of the security being valued, such as yield to maturity, redemption options, and contractual cash flows. Adjustments to model inputs or model results are included in the valuation process when necessary to reflect recent events, such as regulatory, government or corporate actions or significant economic, industry or geographic events that would affect the security s fair value.

Municipal securities are valued using a series of matrices that consider the credit ratings, the structure of the security, the sector in which the security falls, yields, and contractual cash flows. Valuations are further adjusted, when necessary, to reflect recent events, such as significant economic or geographic events or ratings changes that would affect the security s fair value.

Mortgage backed securities. Agency pass through securities are valued by a matrix, considering the issuer type, coupon rate and longest cash flows outstanding. The matrix is developed daily based on available market information. Both agency and non-agency collateralized mortgage obligations are valued using models that consider the structure of the security, current and historical information regarding prepayment speeds, ratings and ratings updates, and current and historical interest rate and interest rate spread data. Evaluations of Alt-A and subprime mortgages include a review of collateral performance data, which is generally updated monthly.

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

Privately placed corporate debt is valued by an outside vendor rather than a third party pricing service. The valuation is prepared based on a widely available matrix that is produced daily by a leading seller of secondary private placements. The matrix considers the market sector, issuer credit ratings and the remaining loan term and is developed from market data such as interest rate yield curves, credit spreads, quoted market prices for comparable securities and other applicable market data.

Bank loans are also valued by an outside vendor. The valuation is based upon a widely distributed, loan-specific listing of average bid and ask prices published daily by an investment industry group. The publisher of the listing derives the averages from data received from multiple market-makers for bank loans.

Short term securities, primarily U. S. Treasury securities and commercial paper maturing within one year, are carried at cost which approximates the fair value of the security due to the short term to maturity.

Table of Contents

ProAssurance Corporation and Subsidiaries
Notes to Condensed Consolidated Financial Statements (Unaudited)
June 30, 2010

3. Fair Value Measurement (continued)

Level 3 assets in the above tables consist of the following:

Auction rate municipal bonds, rated A or better, that have been valued internally using a model based on discounted cash flows using yields currently available on fixed rate securities with a similar term and collateral, adjusted to consider the effect of a floating rate and a premium for illiquidity.

Private placement senior notes, rated A+ or better, unconditionally guaranteed by large regional banks, that have been valued internally using a model based on discounted cash flows using yields currently available on securities that are similar in term, payment features, and issuer credit rating.

Asset-backed bonds, held in a private investment fund and classified as a part of Other Investments, that are valued using a broker dealer quote.

Interests in private investment funds that are accounted for under the equity method, valued using the net asset value provided by the fund.

Interests in Tax Credit Partnerships. The interests in these funds are carried at the equity value of the partnership interest, which approximates the present value of future cash flows that will be associated with the tax benefits transferred by the partnership.

The following table provides additional information regarding investments in private funds valued using the net asset value provided by the fund:

(In thousands)	Fair Value	Unfunded Commitments	Fund Description
Private fund primarily invested in high yield asset-backed securities	$ 33,041	None	(1)
Private fund primarily invested in long/short equities	18,398	None	(2)
Private fund primarily invested in non-public equities, including other private funds	6,049	$3,500	(3)
	$ 57,488		

(1) The fund primarily holds high yield asset-backed debt securities but also holds other investments expected to offer high yields. The fund dissolved in July 2010, and distributed cash of $28.8 million and securities having a fair

value of $3.0 million.

(2) The fund holds both long and short U.S. and North American equities, and targets absolute returns using a strategy designed to take advantage of event-driven market opportunities. Redemptions are allowed with a notice requirement of up to 45 days and are paid within 30 days of the redemption date, unless the redemption request is for 90% or more of the requestor s capital balance. Redemptions at the 90% and above level will be paid at 90%, with the remainder paid after the fund s annual audit.

(3) The fund is structured to provide capital appreciation through diversified investments in private equity, including investments in buyout, venture

capital, mezzanine, distressed debt and other private equity-oriented funds. Redemptions are not allowed, except by special permission of the fund. Fund proceeds are to be periodically distributed at the discretion of the fund over an anticipated time frame that spans 3 to 5 years.

Table of Contents

ProAssurance Corporation and Subsidiaries
Notes to Condensed Consolidated Financial Statements (Unaudited)
June 30, 2010

3. Fair Value Measurement (continued)

There were no transfers between Level 1 and Level 2 for the three and six months ended June 30, 2010. All transfers were to or from Level 2, unless otherwise specified. Transfers are as of the end of the period.

The following tables present summary information regarding changes in the fair value of assets and liabilities measured at fair value using Level 3 inputs, including financial instruments for which ProAssurance has elected fair value accounting.

	June 30, 2010						
	Level 3 Fair Value Measurements Assets						
(In thousands)	State and Municipal Bonds	Corporate Bonds	Asset-backed Securities	Equity Securities	Investment in Unconsolidated Subsidiaries	Other Investments	Total
Assets							
Balance March 31, 2010	$9,590	$25,173	$ 1,000	$	$ 51,488	$ 11,134	$ 98,385
Total gains (losses) realized and unrealized:							
Included in earnings, as a part of:							
Equity in earnings of unconsolidated subsidiaries					854		854
Realized investment gains (losses)						(8,755)	(8,755)
Included in other comprehensive income	(114)	14				9,494	9,394
Purchases, sales or settlements	(75)	322			10,000	(271)	9,976
Transfers in		151			16,924		17,075
Transfers out			(1,000)			(10,672)	(11,672)
Balance June 30, 2010	$9,401	$25,660	$	$	$ 79,266	$ 930	$115,257
Change in unrealized gains (losses) included in earnings for the above period for Level 3 assets held at period-end	$	$	$	$	$ 854	$ (8,755)	$ (7,901)

	June 30, 2010						
	Level 3 Fair Value Measurements Assets						
(In thousands)	State and Municipal Bonds	Corporate Bonds	Asset-backed Securities	Equity Securities	Investment in Unconsolidated Subsidiaries	Other Investments	Total
Assets							
Balance January 1, 2010	$9,495	$24,335	$ 940	$	$ 48,502	$ 10,932	$ 94,204
Total gains (losses) realized and unrealized:							
Included in earnings, as a part of:							

Equity in earnings of unconsolidated subsidiaries					3,840		3,840
Realized investment gains (losses)						(10,698)	(10,698)
Included in other comprehensive income	81	24	60			11,879	12,044
Purchases, sales or settlements	(175)	1,311			10,000	(511)	10,625
Transfers in		151			16,924		17,075
Transfers out		(161)	(1,000)			(10,672)	(11,833)
Balance June 30, 2010	$9,401	$25,660	$	$	$ 79,266	$ 930	$115,257
Change in unrealized gains (losses) included in earnings for the above period for Level 3 assets held at period-end	$	$	$	$	$ 3,840	$(10,698)	$ (6,858)

Table of Contents

ProAssurance Corporation and Subsidiaries
Notes to Condensed Consolidated Financial Statements (Unaudited)
June 30, 2010

3. Fair Value Measurement (continued)

Transfers into Level 3 for the three and six months ended June 30, 2010 include:

A corporate bond valued at $151,000. Multiple observable inputs were not available for use in valuing the bonds at June 30, 2010. Such information was available for valuing the bonds at March 31, 2010.

Tax credit limited partnerships valued at $16.9 million, previously accounted for on a cost basis, were reclassified to Investments in Unconsolidated Subsidiaries. Multiple observable inputs were not available for use in valuing these investments at June 30, 2010.

Transfers from Level 3 for the three and six months ended June 30, 2010 include:

A corporate bond valued at $161,000. There was no active market for the bond or a nearly identical bond during 2009. Market activity increased during the first quarter of 2010, which provided multiple observable inputs that could be used to value the bond.

A commercial mortgage-backed security valued at $1 million. Multiple observable inputs were available for use in valuing the securities at June 30, 2010. Such information was not available for valuing the bonds at March 31, 2010.

Beneficially owned asset-backed securities held in a private investment fund were previously 100% categorized as Level 3 because valuations were determined by the fund manager using various methodologies, not all of which were based on multiple observable inputs. During the second quarter of 2010 the fund manager provided additional information regarding the valuation methodologies followed, and assets (having a combined fair value of $10.7 million) valued using multiple observable inputs were transferred to the Level 2 category.

	June 30, 2009 Level 3 Fair Value Measurements Assets						
(In thousands)	State and Municipal Bonds	Corporate Bonds	Asset-backed Securities	Equity Securities	Investment in Unconsolidated Subsidiaries	Other Investments	Total
Assets							
Balance March 31, 2009	$9,581	$28,303	$ 760	$ 72	$ 45,229	$13,173	$97,118
Total gains (losses) realized and unrealized:							
Included in earnings, as a part of:							
Equity in earnings of unconsolidated subsidiaries					119		119
Realized investment gains (losses)							
Included in other comprehensive income	(577)	(170)	(1)			837	89
Purchases, sales or settlements	(50)	(4,914)			407	72	(4,485)
Transfers in							

Transfers out		(169)					(169)
Balance June 30, 2009	$8,954	$23,050	$ 759	$ 72	$ 45,755	$14,082	$92,672
Change in unrealized gains (losses) included in earnings for the above period for Level 3 assets held at period-end	$	$	$	$	$ 119	$	$ 119

Table of Contents

ProAssurance Corporation and Subsidiaries
Notes to Condensed Consolidated Financial Statements (Unaudited)
June 30, 2010

3. Fair Value Measurement (continued)

	June 30, 2009 Level 3 Fair Value Measurements Assets						
(In thousands)	State and Municipal Bonds	Corporate Bonds	Asset-backed Securities	Equity Securities	Investment in Unconsolidated Subsidiaries	Other Investments	Total
Assets							
Balance January 1, 2009	$	$ 36,472	$ 1,327	$ 357	$	$ 14,576	$ 52,732
Total gains (losses), realized and unrealized:							
Included in earnings, as a part of:							
Equity in earnings of unconsolidated subsidiaries					119		119
Realized investment gains (losses)		(327)		(285)		(536)	(1,148)
Included in other comprehensive income	(1,021)	(231)	(32)			76	(1,208)
Purchases, sales or settlements	(50)	(10,695)	(21)		407	(34)	(10,393)
Transfers in	10,025	2,000			45,229		57,254
Transfers out		(4,169)	(515)				(4,684)
Balance June 30, 2009	$ 8,954	$ 23,050	$ 759	$ 72	$ 45,755	$ 14,082	$ 92,672
Change in unrealized gains (losses) included in earnings for the above period for Level 3 assets held at period-end	$	$ (327)	$	$ (285)	$ 119	$ (536)	$ (1,029)

Transfers into Level 3 for the three and six months ended June 30, 2009 include:

A corporate bond valued at $2 million. The bond was valued using multiple observable inputs at December 31, 2008. At March 31, 2009 and June 30, 2009, such information was not available and the bond was valued using a single broker dealer quote.

Municipal bonds totaling $10 million. The bonds were valued using multiple observable inputs at December 31, 2008. Such inputs were unavailable in 2009 and the bonds were valued using a pricing model at March 31, 2009 and June 30, 2009.

Interests in private investment funds accounted for under the equity method. The interests were not included in the fair value table at December 31, 2008, but were included as of March 31, 2009 and June 30, 2009 in order to comply with GAAP guidance issued in 2009 specifying that such valuation constitutes valuation at fair value. At both March 31, 2009 and June 30, 2009 the interests were valued using the net asset value provided

by fund management.

Transfers from Level 3 for the three and six months ended June 30, 2009 include:

A private placement bond valued at $4 million that was a new issue during 2008. There was no active market for the security or nearly identical security during the latter portion of 2008. Market activity increased in 2009, which provided multiple observable inputs that could be used to value the security.

A corporate bond valued at $169,000. The bond was valued using a pricing model at both December 31, 2008 and March 31, 2009 due to the unavailability of multiple observable inputs. Multiple observable inputs were available at June 30, 2009 for use in valuing the bond.

Asset-backed securities having a value of $515,000. There was no active market for the securities during the latter portion of 2008. Market activity increased in 2009, which provided multiple observable inputs that could be used to value the securities.

Table of Contents

ProAssurance Corporation and Subsidiaries
Notes to Condensed Consolidated Financial Statements (Unaudited)
June 30, 2010

3. Fair Value Measurement (continued)

	June 30, 2010		
	Level 3 Fair Value Measurements		Liabilities
(In thousands)	2019 Note Payable	Interest rate swap agreement	Total
Liabilities			
Balance March 31, 2010	$15,296	$3,175	$18,471
Total (gains) losses realized and unrealized:			
Included in earnings as a part of net realized investment (gains) losses	(113)	1,109	996
Included in other comprehensive income			
Purchases, sales or settlements	(76)		(76)
Transfers in			
Transfers out			
Balance June 30, 2010	$15,107	$4,284	$19,391
Change in unrealized (gains) losses included in earnings for the above period for Level 3 liabilities outstanding at period-end	$ (113)	$1,109	$ 996

	June 30, 2010		
	Level 3 Fair Value Measurements		Liabilities
(In thousands)	2019 Note Payable	Interest rate swap agreement	Total
Liabilities			
Balance January 1, 2010	$14,740	$2,937	$17,677
Total (gains) losses realized and unrealized:			
Included in earnings as a part of net realized investment (gains) losses	518	1,347	1,865
Included in other comprehensive income			
Purchases, sales or settlements	(151)		(151)
Transfers in			
Transfers out			
Balance June 30, 2010	$15,107	$4,284	$19,391
Change in unrealized (gains) losses included in earnings for the above period for Level 3 liabilities outstanding at period-end	$ 518	$1,347	$ 1,865

20

Table of Contents

ProAssurance Corporation and Subsidiaries
Notes to Condensed Consolidated Financial Statements (Unaudited)
June 30, 2010

3. Fair Value Measurement (continued)

	June 30, 2009 Level 3 Fair Value Measurements		Liabilities
(In thousands)	2019 Note Payable	Interest rate swap agreement	Total
Liabilities			
Balance March 31, 2009	$	$	$
Total gains (losses) realized and unrealized:			
Included in earnings as a part of net realized investment gains (losses)	(1,297)	1,388	91
Included in other comprehensive income			
Purchases, sales or settlements	(12,606)	(4,689)	(17,295)
Transfers in			
Transfers out			
Balance June 30, 2009	$(13,903)	$(3,301)	$(17,204)
Change in unrealized (gains) losses included in earnings for the above period for Level 3 liabilities outstanding at period-end	$ (1,297)	$ 1,388	$ 91

	June 30, 2009 Level 3 Fair Value Measurements		Liabilities
(In thousands)	2019 Note Payable	Interest rate swap agreement	Total
Liabilities			
Balance January 1, 2009	$	$	$
Total gains (losses) realized and unrealized:			
Included in earnings as a part of net realized investment gains (losses)	(1,297)	1,388	91
Included in other comprehensive income			
Purchases, sales or settlements	(12,606)	(4,689)	(17,295)
Transfers in			
Transfers out			
Balance June 30, 2009	$(13,903)	$(3,301)	$(17,204)
	$ (1,297)	$ 1,388	$ 91

Change in unrealized (gains) losses included in earnings for the above period for Level 3 liabilities outstanding at period-end

Table of Contents

ProAssurance Corporation and Subsidiaries
Notes to Condensed Consolidated Financial Statements (Unaudited)
June 30, 2010

3. Fair Value Measurement (continued)

Fair Value Option Elections

ProAssurance accounts for the 2019 Note Payable at fair value, see Note 9 of the Notes to the Condensed Consolidated Financial Statements. The 2019 Note Payable has a related interest rate swap intended to mitigate the market risk of future interest rate changes on the 2019 Note Payable. The interest rate swap is carried at fair value with changes in fair value recorded in net realized gains (losses). Electing the fair value option allows ProAssurance to account for the note payable at fair value, which is more consistent with management s view of the underlying economics and reduces the inconsistency that would otherwise result from carrying the note payable on an amortized cost basis and the interest rate swap at fair value. As of June 30, 2010, the 2019 Note Payable had a fair value of $15.1 million recorded in Long-term Debt and an outstanding principal balance of $17.6 million. During the second quarter of 2010, the fair value of the 2019 Note Payable decreased by $113,000 and the fair value of the interest rate swap liability increased by $1.1 million; on a net basis, a loss of $996,000 was recognized related to the changes in fair value. Year-to-date in 2010, the fair value of the 2019 Note Payable increased by $518,000 and the fair value of the interest rate swap liability increased by $1.3 million; on a net basis, a loss of $1.9 million was recognized related to the changes in fair value. Gains or losses from changes in the fair value of the 2019 Note Payable and related interest rate swap are included in net realized investments gains (losses) on the ProAssurance income statement.

4. Investments

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

	June 30, 2010			
(In thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Fixed maturities				
U.S. Treasury obligations	$ 201,195	$ 8,267	$ (72)	$ 209,390
U.S. Agency obligations	60,107	4,382	(5)	64,484
State and municipal bonds	1,267,808	60,231	(780)	1,327,259
Corporate bonds	1,079,402	60,945	(3,727)	1,136,620
Residential mortgage-backed securities	533,228	32,242	(7,140)*	558,330
Commercial mortgage-backed securities	105,440	2,994	(298)	108,136
Other asset-backed securities	51,345	1,641	(89)	52,897
	3,298,525	170,702	(12,111)	3,457,116
Equity securities	2,572	883	(165)	3,290
	$3,301,097	$171,585	$(12,276)	$3,460,406

Table of Contents

ProAssurance Corporation and Subsidiaries
Notes to Condensed Consolidated Financial Statements (Unaudited)
June 30, 2010

4. Investments (continued)

	December 31, 2009			
(In thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Fixed maturities				
U.S. Treasury obligations	$ 149,937	$ 4,874	$ (1,267)	$ 153,544
U.S. Agency obligations	64,837	2,371	(182)	67,026
State and municipal bonds	1,400,293	51,977	(3,621)	1,448,649
Corporate bonds	1,040,896	38,871	(5,755)	1,074,012
Residential mortgage-backed securities	545,687	22,183	(11,007)*	556,863
Commercial mortgage-backed securities	93,941	1,074	(2,448)	92,567
Other asset-backed securities	48,761	1,749	(176)	50,334
	3,344,352	123,099	(24,456)	3,442,995
Equity securities	2,572	1,028	(21)	3,579
	$3,346,924	$124,127	$(24,477)	$3,446,574

* Includes other-than-temporary impairments recognized in accumulated other comprehensive income of $5.6 million at both June 30, 2010 and December 31, 2009.

The recorded cost basis and estimated fair value of available-for-sale securities at June 30, 2010, by contractual maturity, are shown below. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties. ProAssurance uses the call date as the contractual maturity for pre-refunded state and municipal bonds which are 100% backed by U.S. Treasury obligations.

(In thousands)	Amortized Cost	Due in one year or less	Due after one year through five years	Due after five years through ten years	Due after ten years	Total Fair Value

Fixed maturities, available for sale						
U.S. Treasury obligations	$ 201,195	$ 22,581	$ 98,340	$ 84,838	$ 3,631	$ 209,390
U.S. Agency obligations	60,107	1,213	41,507	21,058	706	64,484
State and municipal bonds	1,267,808	39,289	288,884	637,487	361,599	1,327,259
Corporate bonds	1,079,402	106,492	645,113	362,814	22,201	1,136,620
Residential mortgage-backed securities	533,228					558,330
Commercial mortgage-backed securities	105,440					108,136
Other asset-backed securities	51,345					52,897
	3,298,525					3,457,116
Equity securities, available for sale	2,572					3,290
	$ 3,301,097					$ 3,460,406

Business Owned Life Insurance (BOLI)

ProAssurance holds BOLI policies on management employees that were purchased at a cost of approximately $51 million. The primary purpose of the program is to offset future employee benefit expenses through earnings on the cash value of the policies. ProAssurance is the owner and principal beneficiary of these policies.

Table of Contents

ProAssurance Corporation and Subsidiaries
Notes to Condensed Consolidated Financial Statements (Unaudited)
June 30, 2010

4. Investments (continued)

Other Investments

ProAssurance has Other Investments comprised of the following:

(In millions)	**June 30 2010**	December 31 2009
Equity interests in private investment funds, at cost; estimated fair value of $32.6 and $27.0, respectively	**$30.7**	$ 29.1
Federal Home Loan Bank (FHLB) capital stock, at cost	**5.2**	5.2
High yield asset-backed securities, at fair value (amortized cost of $9.9 and $19.4, respectively)	**11.6**	10.9
Other, at cost	**0.4**	2.1
Other Investments, total	**$47.9**	$ 47.3

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

At both June 30, 2010 and December 31, 2009 ProAssurance had a direct beneficial interest in certain high yield asset-backed securities held in a separate interest of a private investment fund; the securities had previously been directly owned by ProAssurance. The fund dissolved in July 2010 and returned the securities to ProAssurance. Management has concluded that the securities will be sold. Accordingly, during the three months ended June 30, 2010 ProAssurance recognized impairment losses related to the securities of $4.9 million and reclassified against earnings impairment losses of $2.1 million related to the securities that had previously been recognized in OCI. As of June 30, 2010 no unrealized losses are carried in OCI related to the securities.

ProAssurance Corporation and Subsidiaries
Notes to Condensed Consolidated Financial Statements (Unaudited)
June 30, 2010

4. Investments (continued)

The following table provides summarized information with respect to investments held in an unrealized loss position at June 30, 2010, including the length of time the investment has been held in a continuous unrealized loss position.

	June 30, 2010					
	Total		Less than 12 months		More than 12 months	
(In thousands)	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
Fixed maturities, available for sale						
U.S. Treasury obligations	$ 13,025	$ (72)	$ 11,135	$ (60)	$ 1,890	$ (12)
U.S. Agency obligations	1,416	(5)	710	(1)	706	(4)
State and municipal bonds	35,530	(780)	22,410	(314)	13,120	(466)
Corporate bonds	68,210	(3,727)	47,123	(810)	21,087	(2,917)
Residential mortgage-backed securities	43,117	(7,140)	17,485	(1)	25,632	(7,139)
Commercial mortgage-backed securities	8,409	(298)	6,767	(2)	1,642	(296)
Other asset-backed securities	699	(89)			699	(89)
	$170,406	$(12,111)	$105,630	$(1,188)	$64,776	$(10,923)
Equity securities, available for sale	$ 885	$ (165)	$ 741	$ (142)	$ 144	$ (23)
Equity interests in private investment funds, included in Other Investments, carried at cost of $19.7 million	$ 16,511	$ (3,189)	$	$	$16,511	$ (3,189)

Management does not intend to sell and believes ProAssurance will not be required to sell any of the fixed maturity securities held in an unrealized loss position before their anticipated recovery.

As of June 30, 2010, there are 144 debt securities (6% of all available-for-sale fixed maturity securities held) in an unrealized loss position representing 121 issuers. Management has evaluated the securities and has concluded that the securities have not suffered an other-than-temporary impairment in value. The single greatest unrealized loss position is approximately $2.0 million; the second greatest unrealized loss position is approximately $1.1 million. The unrealized losses shown in the table are primarily attributable to higher market yields relative to the book yields of the securities. Each fixed maturity security has paid all scheduled contractual payments and was assessed as to whether it

would continue to do so. Asset-backed securities were modeled to determine if they would maintain assumed cash flows using six-month historical performance data from the collateral (loans) underlying the security, if available, or sector based assumptions if not.

Management has evaluated the equity interests in private investment funds for impairment. These interests are not considered to have suffered an other-than-temporary impairment in value because management expects the future cash flows from the equity interest to equal or exceed the carrying value of the equity interest. Management does not intend to sell and believes ProAssurance will not be required to sell the equity interests held in an unrealized loss position before their anticipated recovery.

The following table presents a roll forward of cumulative credit losses recorded in earnings related to impaired debt securities for which the non-credit portion of the other-than-temporary impairment is recorded in Other Comprehensive Income.

(In thousands)	**Three Months Ended June 30, 2010**	**Six Months Ended June 30, 2010**
Balance beginning of period	$ 3,368	$ 2,068
Additional credit losses recognized during the period, related to securities for which:		
No OTTI has been previously recognized		17
OTTI has been previously recognized	2,127	3,410
Reductions due to:		
Securities sold during the period (realized)		
Securities which will be sold in coming periods	(3,410)	(3,410)
Securities for which it has become more likely than not that the security will be required to be sold prior to anticipated recovery of amortized cost basis		
Accretion recognized during the period related to cash flows that are expected to exceed the amortized cost basis of the security		
Balance June 30, 2010	$ 2,085	$ 2,085

Table of Contents

ProAssurance Corporation and Subsidiaries
Notes to Condensed Consolidated Financial Statements (Unaudited)
June 30, 2010

4. Investments (continued)

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

	Three Months Ended June 30		Six Months Ended June 30	
(In thousands)	**2010**	2009	**2010**	2009
Total other-than-temporary impairment losses[1]:				
Residential mortgage-backed securities	**$**	$ (247)	**$ (23)**	$ (2,703)
Corporate bonds		(2,189)		(3,733)
Equities				(422)
Equity interest in a private investment fund			**(3,373)**	
High yield asset-backed securities, beneficially owned	**(4,912)**		**(8,983)**	(536)
Portion recognized in (reclassified from) Other Comprehensive Income:				
Residential mortgage-backed securities		172	**6**	172
High yield asset-backed securities, beneficially owned	**(2,128)**			
Net impairment losses recognized in earnings	**(7,040)**	(2,264)	**(12,373)**	(7,222)
Gross realized gains, available-for-sale securities[3]	**7,981**	3,806	**10,097**	6,556
Gross realized (losses), available-for-sale securities[3]	**(141)**	(855)	**(201)**	(1,441)
Net realized gains (losses) sales of short-term		10		10
Reserve for loss on investment receivable [2]				(3,090)
Net realized gains (losses), trading securities	**4,092**	82	**4,900**	(17)
Change in unrealized holding gains (losses), trading securities	**(7,397)**	4,214	**(6,462)**	2,660
Increase in the fair value of liabilities carried at fair value	**(996)**	91	**(1,866)**	91
Net realized investment gains (losses)	**$ (3,501)**	$ 5,084	**$ (5,905)**	$ (2,453)

(1) In accordance with GAAP, all OTTI losses prior to April 1, 2009 were recognized in earnings.

(2) Relates to amounts due

from Reserve Primary Fund. Subsequent recoveries from the Reserve Primary Fund exceeded estimated amounts, and the loss was reversed in the fourth quarter of 2009.

(3) Reclassified from OCI, net of tax at a 35% rate.

As previously discussed, ProAssurance recognized impairment losses in earnings during the three months ended June 30, 2010 totaling $7.0 million (including $2.1 reclassified from OCI) related to certain high-yield asset-backed securities because Management intends to sell the securities. Impairment losses recognized related to these securities totaled $9.0 million for the six months ended June 30, 2010.

ProAssurance recognized an impairment of $3.4 million in the first six months of 2010 related to its interest in a private investment fund, accounted for on a cost basis. The fund has reported realized losses on the sale of securities, and ProAssurance has reduced the carrying value of its interest in the fund in recognition of its pro rata share of those losses.

Proceeds from the sales of available-for-sale securities during the six months ended June 30, 2010 and 2009 are $393.3 million and $157.3 million, respectively. Purchases of available-for-sale securities were $458.3 million and $435.1 million during the six months ended June 30, 2010 and 2009, respectively.

5. Income Taxes

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

ProAssurance Corporation and Subsidiaries
Notes to Condensed Consolidated Financial Statements (Unaudited)
June 30, 2010

6. Deferred Policy Acquisition Costs

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

Amortization of deferred policy acquisition costs are $14.7 million and $29.0 million for the three and six months ended June 30, 2010, respectively, and $12.2 million and $23.7 million for the three and six months ended June 30, 2009, respectively.

7. Reserve for Losses and Loss Adjustment Expenses

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

ProAssurance recognized favorable net loss development of $37.5 million and $62.5 million related to previously established reserves for the three and six months ended June 30, 2010, respectively. The favorable net loss development reflects reductions in the Company s estimates of claims severity, principally for the 2004 through 2008 accident years.

For the three and six months ended June 30, 2009, ProAssurance recognized favorable net loss development of $37.0 million and $55.5 million, respectively, to reflect reductions in estimated claim severity principally for accident years 2004 through 2007.

8. Commitments and Contingencies

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

ProAssurance Corporation and Subsidiaries
Notes to Condensed Consolidated Financial Statements (Unaudited)
June 30, 2010

9. Long-term Debt

ProAssurance s outstanding long-term debt consists of the following:

	(In thousands)	
	June 30 2010	December 31 2009
Trust Preferred Securities/ Trust Preferred Subordinated Debentures due 2034, unsecured. Bears interest at a variable rate of LIBOR plus 3.85%, adjusted quarterly (4.3% at June 30, 2010). Estimated fair value at June 30, 2010 is $23.0 million.	**$22,992**	$22,992
Surplus Notes due May 2034, unsecured. Bears interest at a variable rate of LIBOR plus 3.85%, adjusted quarterly (4.3% at June 30, 2010). Estimated fair value at June 30, 2010 is $12.0 million.	**12,000**	12,000
Note Payable due February 2019, carried at fair value, principal of $17.6 million. Secured by available-for-sale securities having a fair value at June 30, 2010 of approximately $27.1 million. Bears interest at a variable rate of LIBOR plus 0.7%. See information below regarding the associated interest rate swap.	**15,107**	14,740
Surplus Note due February 2012, unsecured, principal of $517,000 net of an unamortized discount of $30,000 at June 30, 2010 and $46,000 at December 31, 2009. Bears interest at the U.S. prime rate, paid and adjusted quarterly (3.3% at June 30, 2010). Estimated fair value at June 30, 2010 is $515,000.	**487**	471
	$50,586	$50,203

Credit Facility

ProAssurance s PICA subsidiary has a revolving credit facility with a bank in the amount of $3.0 million which expired on August 1, 2010, and was not renewed.

Interest Rate Swap

ProAssurance, through its PICA subsidiary, is party to an interest rate swap agreement (the swap) with the 2019 Note Payable issuing bank, the purpose of which is to reduce the market risk from changes in future interest rates relative to the 2019 Note Payable. The swap fixes the interest rate related to the 2019 Note Payable at 6.6%. The swap will terminate February 1, 2019. The notional amount of the swap corresponds directly to the unamortized portion of the debt being hedged each month. Under the swap agreement, PICA agrees to exchange, at monthly intervals, the difference between the fixed-rate and LIBOR variable rate by reference to the notional principal amount. The fair value of the interest rate swap at June 30, 2010 is $4.3 million and is classified within Other Liabilities.

Fair Values

The fair values stated in the schedule above are based on the present value of expected underlying cash flows of the debt, discounted at rates available at June 30, 2010 for similar debt issued by entities with a similar credit standing to ProAssurance or, if issued by an insurance subsidiary, the subsidiary issuing the debt.

Additional Information

For additional information regarding the terms of ProAssurance s outstanding long-term debt, see Note 10 of the Notes to the Consolidated Financial Statements included in ProAssurance s December 31, 2009 Form 10-K.

28

ProAssurance Corporation and Subsidiaries
Notes to Condensed Consolidated Financial Statements (Unaudited)
June 30, 2010

10. Shareholders Equity

At June 30, 2010 and December 31, 2009, ProAssurance had 100 million shares of authorized common stock and 50 million shares of authorized preferred stock. The Board of Directors of ProAssurance Corporation (the Board) has the authority to determine provisions for the issuance of preferred shares, including the number of shares to be issued, the designations, powers, preferences and rights, and the qualifications, limitations or restrictions of such shares. At June 30, 2010, the Board has not approved the issuance of preferred stock.

At June 30, 2010, prior authorizations from the Board for the repurchase of common shares or the retirement of outstanding debt of approximately $76.2 million remain available for use. The timing and quantity of purchases depends upon market conditions and changes in ProAssurance s capital requirements and is subject to limitations that may be imposed on such purchases by applicable securities laws and regulations, and the rules of the New York Stock Exchange.

ProAssurance repurchased approximately 674,000 common shares, having a total cost of $39.2 million, during the six months ended June 30, 2010, all in the second quarter. ProAssurance repurchased approximately 840,000 common shares, having a total cost of $36.1 million during the six months ended June 30, 2009 (including approximately 397,000 shares at a total cost of $17.4 million during the three months ended June 30, 2009). ProAssurance reissued 100,533 treasury shares, having a cost basis of approximately $5.0 million, during the first quarter of 2009 as part of the consideration for acquisitions in the quarter.

Share-based compensation expense is $1.5 million and $2.9 million for the three and six months ended June 30, 2010, respectively, and $1.8 million and $3.2 million for the three and six months ended June 30, 2009, respectively. Related tax benefits are $520,000 and $1.0 million for the three and six months ended June 30, 2010, respectively, and $646,000 and $1.1 million for the three and six months ended June 30, 2009, respectively.

ProAssurance granted approximately 28,000 shares of restricted stock units to employees in February 2010. The awards 100% vest three years from the grant date, based on a service requirement. The fair value of each unit was estimated at $53.32, equal to the market value of a ProAssurance common share on the date of grant.

ProAssurance granted approximately 95,000 (target) Performance Shares awards to employees in February 2010. The Performance Shares 100% vest at the end of a three-year period based upon requirements for continued service and achievement of specified performance goals. The number of shares ultimately awarded can vary from 75% to 125% of the target award depending upon the degree to which goals are achieved. The fair value of each Performance Share was estimated at $53.32, equal to the market value of a ProAssurance common share on the date of grant. ProAssurance issued approximately 52,000 common shares to employees in February 2010 related to performance share awards granted in 2007. The awards were issued at the maximum level (125% of target) based on performance levels achieved. Cash was given in lieu of shares sufficient to satisfy required tax withholdings.

ProAssurance issued approximately 40,000 and 37,000 common shares to employees in February 2010 and 2009, respectively, as bonus compensation, as approved by the Compensation Committee of the Board. The shares issued were valued at fair value (the market price of a ProAssurance common share on the date of award).

ProAssurance Corporation and Subsidiaries
Notes to Condensed Consolidated Financial Statements (Unaudited)
June 30, 2010

11. Variable Interest Entities

ProAssurance holds passive interests in a number of limited partnerships/limited liability companies that are considered to be Variable Interest Entities (VIEs) under GAAP guidance. ProAssurance has not consolidated these entities because it has either very limited or no power to control the activities that most significantly affect the economic performance of these entities and is thus not the primary beneficiary of any of the entities. ProAssurance s involvement with each entity is limited to its direct ownership interest in the entity. ProAssurance has no arrangements or agreements with any of the entities to provide other financial support to or on behalf of the entity. ProAssurance s maximum loss exposure relative to these investments is limited to the carrying value of ProAssurance s investment in the entity.

The entities are all private investment funds, most of which were formed for the purpose of achieving diversified equity and debt returns; a few are private investment funds formed to provide investment returns through the transfer of tax credits. In those instances where ProAssurance holds a minor interest in the fund, ProAssurance accounts for its interest on a cost basis. Cost basis investments are included in Other Investments and have a carrying value of $31.1 million at both June 30, 2010 and December 31, 2009. In those instances where ProAssurance holds a greater than minor interest, ProAssurance accounts for its interest using the equity method. Equity method investments are included in Investment in Unconsolidated Subsidiaries and have a carrying value of $79.3 million at June 30, 2010 and $48.5 million at December 31, 2009.

At June 30, 2010 and December 31, 2009 ProAssurance held a direct and beneficial interest in certain high yield asset-backed bonds contributed to an investment fund created for the purpose of managing such investments. Under GAAP, this interest was considered to represent an interest in a separate VIE (commonly referred to as a silo), of which ProAssurance was the primary beneficiary. ProAssurance therefore consolidated its interest in these securities. The securities were included in Other Investments at fair value ($11.6 million and $10.9 million at June 30, 2010 and December 31, 2009, respectively). See Note 4 of the Notes to the Condensed Consolidated Financial Statements.

12. Earnings Per Share

Diluted weighted average shares is calculated as basic weighted average shares plus the effect, calculated using the treasury stock method, of assuming that dilutive stock options have been exercised and that performance share awards and restricted stock units have vested.

Stock options are not dilutive when the option exercise price exceeds the average price of a common share during the period or when the result from assuming an option is exercised is a net decrease to outstanding shares. All outstanding options were considered to be dilutive during the three months ended June 30, 2010. During the three months ended June 30, 2009 approximately 491,000 outstanding options were not considered to be dilutive. Approximately 116,000 and 491,000 of ProAssurance s outstanding options, on average, were not considered to be dilutive during the six-month periods ended June 30, 2010 and 2009, respectively.

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

The following discussion should be read in conjunction with the unaudited Condensed Consolidated Financial Statements and Notes to those statements which accompany this report as well as our 2009 Form 10-K. A glossary of insurance terms and phrases is available on the investor section of our website. Throughout the discussion, references to ProAssurance, PRA, 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.

Critical Accounting Estimates

Our Condensed 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 (reserve for losses or reserve)

The largest component of our liabilities is our reserve for losses, and the largest component of expense for our operations is incurred losses. Incurred losses 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.

The estimation of professional liability losses is inherently difficult. 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 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 medical professional liability, the trend of health care costs. Professional liability claims are typically resolved over an extended period of time, often five years or more. The combination of changing conditions and the extended time required for claim resolution results in a loss cost estimation process that requires actuarial skill and the application of judgment, and such estimates require periodic revision. 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 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. Our internal 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 also engage external actuaries to review our data semi-annually and provide us with their observations regarding our data and the adequacy of our established reserve, believing that the external actuaries provide an independent view of our loss data as well as a broader perspective on industry loss trends.

Table of Contents

Any adjustments resulting from our review process are reflected in the then-current operations. Due to the size of our reserve for losses, even a small percentage adjustment to these estimates could have a material effect on our results of operations for the period in which the adjustment is made, as has been the case in 2010 and 2009.

Reinsurance

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

We evaluate each of our ceded reinsurance contracts at inception to confirm that there is sufficient risk transfer to allow the contract to be accounted for as reinsurance under current accounting guidance. At June 30, 2010 all ceded contracts are accounted for as risk transferring contracts.

Our receivable from reinsurers on unpaid losses and loss adjustment expenses represents our estimate of the amount of our reserve for losses that will be recoverable under our reinsurance programs. We base our estimate of funds recoverable upon our expectation of ultimate losses and the portion of those losses that we estimate to be allocable to reinsurers based upon the terms of our reinsurance agreements. 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. Appropriate reserves are established for any balances we believe may not be collected.

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

Investment Valuations

We value a substantial portion of our investments at fair value as shown in the table below. The table also provides the distribution of our investments based on GAAP fair value hierarchies.

	Level 1	Level 2	Level 3	Total Investments
Fair Value	6%	89%	3%	98%
Cost or cash surrender value				2%
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, equity and short-term securities investments are carried at fair value.

Because of the number of securities we own and the complexity and cost of developing accurate fair values internally, we utilize independent pricing services to assist us in establishing fair values. The pricing services provide fair values based on exchange traded prices, if an exchange price is available. If an exchange traded price is not available, the pricing services, if possible, provide a fair value that is based on multiple 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 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 price versus market yields observed in the market place. If a supplied value is deemed unreasonable, we discuss the valuation in question with the pricing service and will make adjustments if deemed necessary. To date, we have not adjusted any 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.

As of June 30, 2010, fair values for our equity and a portion of our short-term securities have been determined using an exchange traded price. 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.

With the exception of certain government bonds, 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. A large portion of our fixed income securities are valued at fair value using available market information. In accordance with GAAP, for disclosure purposes we classify any security that has been valued based on multiple market observable inputs as a Level 2 security.

When a pricing service does not provide a value, 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. In accordance with GAAP, for disclosure purposes we classify securities that are valued using limited observable inputs as Level 3 securities.

We hold interests in private investment funds (non-public investment partnerships and limited liability companies) some of which are accounted for under the cost method and some of which are accounted for under the equity method, depending on our presumed degree of influence over the operating and financial policies of the fund. We value these interests, which at June 30, 2010 total $57.5 million or 1% of total investments, based on quarterly net asset values provided to us by fund managers, which approximate fair value. In accordance with GAAP, for disclosure purposes we classify interests valued in this manner as Level 3 securities.

We also hold interests in tax credit partnerships. Tax credit partnerships are established for the purpose of investing in projects eligible for tax credits (principally low-income housing) and the primary return on the investment is in the form of tax credits. We have invested $21.8 million in tax credit partnerships which are accounted for under the equity method.

Our investments that are not valued at fair value include:

- Interests in private investment funds having a carrying value of $36.3 million at June 30, 2010; valued at cost.

- Business owned life insurance policies having a carrying value of $65.8 million at June 30, 2010, valued at cash surrender value.

Table of Contents

Investment Impairments

We evaluate all our investments on at least a quarterly basis for declines in fair value that represent other-than-temporary impairments (OTTI). In all instances we consider an impairment to be an other-than-temporary impairment 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, depending upon the type of security, as discussed below.

For equity securities, we consider the following:

- the length of time for which the fair value of the investment has been less than its recorded basis;
- the financial condition and near-term prospects of the issuer underlying the investment, taking into consideration the economic prospects of the issuer s industry and geographical region, to the extent that information is publicly available;
- the historical and implied volatility of the fair value of the security;
- our ability and intent to hold the investment for a period of time sufficient to allow for any anticipated recovery in fair value.

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
- extent to which the decline in fair value is attributable to credit risk specifically associated with an investment or its issuer;
- our internal assessments and those of our external portfolio managers regarding specific circumstances surrounding an investment, which can cause us to believe the investment is more or less likely to recover its value than other investments with a similar structure;
- for asset-backed securities, the origination date of the underlying loans, the remaining average life, the probability that credit performance of the underlying loans will deteriorate in the future, and our assessment of the quality of the collateral underlying the loan;
- 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 ability and intent to hold the investment for a period of time sufficient to allow for any anticipated recovery in fair value.

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 matters that will affect 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 investments in private investment funds for OTTI by considering whether there has been a decline in fair value below the recorded value. We receive reports from the funds at least quarterly which provide us a net

asset value (NAV) for our interest in the fund. The NAV is based on the fair values of securities held by the fund as determined by the fund manager. Determining whether there has been a decline in fair value involves assumptions and estimates. We consider the most recent NAV provided, the performance of the fund relative to the market, the stated objectives of the fund, and cash flows expected from the fund and audit results in considering whether an OTTI exists.

Our investment in tax credit partnerships are evaluated for OTTI by comparing cash flow projections of future operating results of the underlying projects generating the tax credits to our recorded basis, and considering our ability to utilize the tax credits from the investments.

Table of Contents

We also evaluate our holdings of Federal Home Loan Bank (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 reported operating results of the current period.

Deferred Policy Acquisition Costs

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

Deferred Taxes

Deferred federal income taxes arise from the recognition of temporary differences between the basis of assets and liabilities determined for financial reporting purposes and the basis determined for income tax purposes. Our temporary differences principally relate to loss reserves, unearned premiums, deferred policy acquisition costs, unrealized investment gains (losses) and investment impairments. 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.

Goodwill

We make at least an annual assessment as to whether the value of our goodwill asset is impaired. Management evaluates the carrying value of goodwill annually during the fourth quarter and before the annual evaluation if events occur or circumstances change that would more likely than not reduce the fair value below the carrying value. We operate in a single operating segment. Our segment components are economically similar, and we consider ProAssurance to be one reporting unit for the purposes of evaluating goodwill. We estimate the fair value of our reporting unit on the evaluation date based on ProAssurance s market capitalization and an expected premium that would be paid to acquire control of the company (a control premium). We then perform a sensitivity analysis using a range of historical stock prices and control premiums. We did not record any impairment of goodwill as of our last evaluation date, October 1, 2009, and do not believe there has been any event or change of circumstances that would indicate that a re-evaluation of goodwill is required as of June 30, 2010.

Accounting Changes

Investments Disclosure Requirements; Other-than-temporary Impairments

Effective for interim and annual reporting periods ending on or after June 15, 2009, the FASB revised GAAP to require expanded disclosures related to investments in debt and equity securities. Guidance regarding other-than-temporary impairments was also revised. Previous investment guidance required that an impairment of a debt security be considered as other-than-temporary unless management could assert both the intent and the ability to hold the impaired security until recovery of value. The revised impairment guidance specifies that an impairment be considered as other-than-temporary unless an entity can assert that it has no intent to sell the security and that it is not more likely than not that the entity will be required to sell the security before recovery of its anticipated amortized cost basis.

The new guidance also establishes the concept of credit loss. Credit loss is defined as the difference between the present value of the cash flows expected to be collected from a debt security and

Table of Contents

the amortized cost basis of the security. The new guidance states that in instances in which a determination is made that a credit loss exists but the entity does not intend to sell the debt security and it is not more likely than not that the entity will be required to sell the debt security before the anticipated recovery of its remaining amortized cost basis an impairment is to be separated into (a) the amount of the total impairment related to the credit loss and (b) the amount of total impairment related to all other factors. The credit loss component of the impairment is to be recognized in income of the current period. The non-credit component is to be recognized as a part of other comprehensive income (OCI). Transition provisions require a cumulative effect adjustment to reclassify the noncredit component of a previously recognized other-than-temporary impairment from retained earnings to accumulated other comprehensive income if an entity does not intend to sell and it is not more likely than not that the entity will be required to sell the security before recovery of its amortized cost basis . We adopted the revised guidance as of the beginning of the quarter ended June 30, 2009. As of April 1, 2009, our debt securities included non-credit impairment losses previously recognized in earnings of approximately $5.4 million. In accordance with the transition provisions of the revised guidance, we reclassified these non-credit losses, net of tax, from retained earnings to accumulated comprehensive income as of April 1, 2009 (a $3.5 million increase to retained earnings; a $3.5 million decrease to accumulated other comprehensive income).

Liquidity and Capital Resources and Financial Condition

Overview

ProAssurance Corporation is a holding company and is a legal entity separate and distinct from its subsidiaries. Because it has no other business operations, dividends from its operating subsidiaries represent a significant source of funds for its obligations, including debt service. Our insurance subsidiaries, in aggregate, are permitted to pay dividends of approximately $228 million during 2010 without prior approval. However, 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. As of June 30, 2010, $61 million of the permitted dividends have been paid and another $8 million was paid in July 2010. Additionally, we have requested approval for one of our insurance subsidiaries to pay a $17 million extraordinary dividend. At June 30, 2010, we held cash and investments of approximately $236.0 million outside of our insurance subsidiaries that are available for use without regulatory approval.

Acquisitions

In the first quarter of 2009 we acquired 100% of the outstanding shares of Mid-Continent General Agency, Inc., now ProAssurance Mid-Continent Underwriters, Inc., (Mid-Continent), and Georgia Lawyers Insurance Company (Georgia Lawyers), since merged with our subsidiary ProAssurance Casualty Company, as a means of expanding our professional liability business. These acquisitions were not material to ProAssurance individually or in the aggregate.

On April 1, 2009 we acquired Podiatry Insurance Company of America and subsidiaries (PICA) through a cash sponsored demutualization as a means of expanding our professional liability insurance operations. PICA provides professional liability insurance primarily to podiatric physicians, chiropractors and other healthcare providers throughout the United States. We purchased all of PICA s outstanding stock created in the demutualization for $135 million in cash, of which $15 million was a surplus contribution to be used to provide renewal premium credits to eligible policyholders over a three year period beginning in 2010.

See Note 3 of the Notes to the Consolidated Financial Statements in our 2009 Form 10-K for detailed information regarding the PICA transaction, including a summarized listing of the assets acquired and liabilities assumed.

Cash Flows

The principal components of our operating cash flows are the excess of net investment income and premiums collected over net losses paid and operating costs, including income taxes. Timing delays exist between the collection of premiums and the 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 $75.9 million and $13.4 million for the six months ended June 30, 2010 and 2009, respectively. Operating cash flows for 2010 and 2009 compare as follows:

(In millions)		**Cash Flow Increase (Decrease)**
Cash provided by operating activities six months ended June 30, 2009	**$**	**13**
Increase (decrease) in operating cash flows during 2010:		
Increase in premium receipts [(1)]		**12**
Decrease in losses paid [(2)]		**21**
Increase in reinsurance recoveries [(3)]		**5**
Decrease in Federal and state income tax payments [(4)]		**17**
Other amounts not individually significant, net		**8**
Cash provided by operating activities six months ended June 30, 2010	**$**	**76**

(1) The increase in premium receipts reflects an increase of approximately $22 million due to an additional three months of PICA activity in 2010 partially offset by a decline of approximately $10 million that is due to lower written premiums at our other subsidiaries.

(2) The decrease in losses reflect lower paid losses at our subsidiaries

other than PICA of approximately $36 million offset by an increase in PICA losses paid of $16 million that is principally due to an additional three months of PICA activity in 2010. The timing of our 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.

(3) The timing of reinsurance recoveries varies from period to period and can depend upon the terms of the applicable reinsurance agreement, the nature of the underlying claim and the timing and amount of underlying losses.

(4) In both years, tax payments consisted

primarily of the final estimated tax payment for the prior tax year. In 2008 a large portion of taxable income for the year was earned in the fourth quarter; in 2009 taxable income was earned more ratably throughout the year. Consequently, the final estimated tax payment for the 2008 tax year was larger than the final estimated tax payment for the 2009 tax year.

Investment Exposures

The following table provides summarized information regarding our investments as of June 30, 2010:

(In thousands)	Carrying Value	Gross Unrealized Gains	Gross Unrealized Losses	Average Rating	% Total Investments
Fixed Maturities					
Government					
U.S. Treasury	$ 209,390	$ 8,267	$ (72)	AAA	5%
U.S. Agency	64,484	4,382	(5)	AAA	2%
Total government	273,874	12,649	(77)	AAA	7%
State and Municipal Bonds	1,327,259	60,231	(780)	AA	33%
Corporate Bonds					
Financial institutions	265,291	11,089	(1,559)	A+	7%
FDIC insured	66,538	1,405		AAA	2%
Communications	61,777	3,734	(100)	A-	2%
Utilities	87,708	5,858	(517)	A	2%
Energy	36,337	3,420	(111)	BBB+	1%
Industrial	538,221	32,535	(824)	A	14%
Transportation	27,107	1,900		A-	1%
Other	53,641	1,004	(616)	BBB-	1%
Total corporate bonds	1,136,620	60,945	(3,727)	A	29%
Asset-backed Securities					
Agency mortgage-backed securities	506,568	28,634	(1)	AAA	13%
Non-agency mortgage-backed securities	34,375	2,703	(1,611)	BBB	1%
Subprime[(1)]	8,145		(2,217)	see note	
Alt-A[(2)]	9,242	905	(3,311)	see note	
Commercial mortgage-backed securities	108,136	2,994	(298)	AAA	3%
Credit card	24,586	861		AAA	1%
Automobile	16,108	221		AAA	
Other	12,203	559	(89)	AA+	
Total asset-backed securities	719,363	36,877	(7,527)	AA+	18%
Total fixed maturities	3,457,116	170,702	(12,111)	AA-	87%
Equities					
Equity-common only					
Financial	7,122	145	(13)		
Energy	4,874	57			
Consumer cyclical	1,180	87	(13)		

Consumer non-cyclical	3,937	199	(3)		
Technology	2,257	98	(62)		
Industrial	1,452	279			
Communications	1,201	3			
All Other	5,138	15	(74)		
Total equities	27,161	883	(165)		1%
Short-Term	288,921				7%
BOLI	65,825	n/a	n/a	AA-	2%
Investment in Unconsolidated Subsidiaries					
Investment in tax credit partnerships	21,778	n/a	n/a		1%
Private fund primarily invested in high yield asset-backed securities[3]	33,041				1%
Private fund primarily invested in long/short equities	18,398				
Private fund primarily invested in non-public equities	6,049				
Total investment in unconsolidated subsidiaries	79,266				2%
Other Investments					
High yield asset-backed securities, held in a private investment fund[4]	11,602	1,680			
Federal Home Loan Bank capital stock	5,190	n/a	n/a		
Private fund primarily invested in distressed debt	19,700	n/a	n/a		
Private fund primarily invested in long/short equities	11,010	n/a	n/a		
Other	383	n/a	n/a		
Total other investments	47,885	1,680			1%
Total Investments	**$3,966,174**	**$173,265**	**$(12,276)**		**100%**

(1) 2% AAA, 36% AA, 24% A, 38% BBB or below

(2) 18% are AAA rated, 2% are AA, 8% are A, 72% are CCC or

below

(3) Includes subprime securities with a fair value of $2.9 million

(4) Includes subprime securities with a fair value of $740,000 (recorded cost basis of $650,000; average rating of BBB)

A detailed listing of our investment holdings as of June 30, 2010 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. We anticipate that between $75 million and $90 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 net paid losses and operating costs, including income taxes. The payment of individual claims cannot be predicted with certainty; therefore, we rely upon the history of paid claims in estimating the timing of future claims payments. To the extent that we have an unanticipated shortfall in cash we may either liquidate securities or borrow funds under previously established borrowing arrangements. However, given the relatively short duration of our investments, we do not foresee any such shortfall.

We held cash and short-term securities of $334.2 million at June 30, 2010 as compared to $227.7 million at December 31, 2009. We have elected to increase our liquidity in order to have more flexibility in allocating capital among our insurance and holding company subsidiaries. A portion of the increase in cash balances was achieved by reducing our investment in state and municipal bonds by approximately $150 million in the later half of the second quarter.

We sold approximately $20 million of our trading portfolio equity securities, principally those acquired in the PICA transaction, during the second quarter of 2010. We increased our investment in certain private investment funds by $10 million in order to take advantage of specific investment strategies that have proved to be successful in the past.

We have invested $20 million in tax credit limited partnerships during 2010. These partnerships are designed to provide returns via the transfer of tax operating losses and tax credits to their partners. All of the interests will be accounted for using the equity method. Our pro rata share of partnership operating losses will be included in earnings each period as a part of equity in unconsolidated subsidiaries; our pro rata share of tax credits and the tax benefits associated with the operating loss will be recognized as a reduction of tax expense. We plan to increase our investment in tax credit partnerships by up to an additional $30 million during the remainder of 2010.

Our investment portfolio continues to be composed of high quality fixed income securities with approximately 97% 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 June 30, 2010 is 4.1 years; the weighted average effective duration of our fixed maturity securities combined with our short-term securities is 3.8 years.

At June 30, 2010 we directly held asset-backed securities with a fair value of $719.4 million (recorded cost basis of $690 million). In performing our OTTI assessment of asset-backed securities, management projects expected cash flows, making assumptions regarding expected default rates and the value of collateral available to recover losses. If estimated cash flows project a loss, an OTTI is realized for the difference between the book value and present value of the anticipated cash flows in accordance with generally accepted accounting principles. Our judgments about future default rates, the timing of expected cash flows, and the estimated value of collateral may not prove over time to be accurate, and we may experience losses on asset-backed securities that are greater or less than what we are currently projecting.

We hold three positions in financial institution fixed maturity securities for which the position held has a fair value that exceeds $20 million. The aggregate fair value of these three positions totals $87.0 million ($84.3 million recorded cost basis), of which $40.1 million is FDIC backed.

At June 30, 2010 we held fixed maturity securities with pretax net unrealized gains of approximately $159 million as compared to pretax net unrealized gains of $99 million as of December 31, 2009. The improvement is primarily due to lower market interest rates, as well as a reduction in credit spreads.

As discussed in Note 4 to the Condensed Financial Statements, at June 30, 2010 Other Investments includes a direct beneficial interest in certain high-yield asset backed securities (fair value of $11.6 million) held in a separate interest of a private investment fund. Investment in Unconsolidated Subsidiaries includes a joint interest in that same fund; the joint interest has a fair value at June 30, 2010 of $33.0 million. The fund was dissolved in July, 2010 and the securities held in the separate interest were returned to us. To date we have received cash of $28.8 million and securities having a fair value of $3.0 million as distributions from the joint interest.

We have requested redemption of approximately $16 million of our BOLI investment, which will be paid to us in November 2010. We previously had not intended to redeem the BOLI, and had treated increases in the cash surrender value as tax-exempt. Redemption will result in a tax liability of approximately $1.3 million, which we recognized during the second quarter of 2010.

Reinsurance

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

Our risk retention level is dependent upon numerous factors including our risk 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 within each state. We purchase reinsurance from a number of companies to mitigate concentrations of credit risk. We utilize a reinsurance broker to assist us in the analysis of the credit quality of our reinsurers. We base our reinsurance buying decisions on an evaluation of the then-current financial strength, rating and stability of prospective reinsurers. However, the financial strength of our reinsurers, and their corresponding ability to pay us, may change in the future due to circumstances or events we cannot control or anticipate.

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

Table of Contents

Debt

Our long-term debt as of June 30, 2010 is comprised of the following:

(In thousands, except %)	Contractual Rate	Outstanding Principal	Carrying Value June 30, 2010
2034 Trust Preferred Securities/Debentures	4.3% [1]	$22,992	$22,992
2034 Surplus Notes	4.3% [1]	12,000	12,000
2019 Note Payable[2]	6.6% [3]	17,589	15,107
2012 Surplus Note	3.3% [4]	517	487
			$50,586

(1) Adjusted quarterly based on LIBOR

(2) Both the 2019 Note Payable and the related interest rate swap are valued at fair value. See Note 9 of the Notes to the Condensed Consolidated Financial Statements

(3) The related interest rate swap fixes rate at 6.6%. Swap is settled monthly. See Note 9 of the Notes to the Condensed Consolidated Financial Statements

(4) Adjusted quarterly based on the U.S. prime rate

All of our long-term debt is currently repayable or redeemable, with proper notice, at a date no later than the next quarterly or semi-annual interest payment date. Insurance department approval is required for redemption of surplus notes. ProAssurance is currently in compliance with all covenants. Additional information regarding our debt is provided in Note 9 to the Condensed Consolidated Financial Statements and Note 10 of the Consolidated Financial Statements in our 2009 Form 10-K.

Treasury Stock

We repurchased approximately 674,000 common shares having a total cost of $39.2 million during the six-month period ended June 30, 2010, all in the second quarter. At June 30, 2010, prior authorizations from our Board of Directors for the repurchase of common shares or the retirement of outstanding debt of approximately $76.2 million remain available for use.

Litigation

We are involved in various legal actions related to our insurance activities which we consider in our evaluation of our reserve for losses. We also have other direct actions against the company which we evaluate and account for as a part of our other liabilities.

In accordance with GAAP for insurance entities, claim-related actions are considered as a part of our loss reserving process. We evaluate the likely outcomes from these actions giving consideration to the facts and laws applicable to each case, appellate issues, coverage issues, potential recoveries from our insurance and reinsurance programs, and settlement discussions as well as our historical claims resolution practices. This data is then considered in the overall evaluation of our reserve for losses.

There are risks, as outlined in our Risk Factors in Part 1 of our 2009 Form 10-K, that any of these actions could cost us more than our estimates. In particular, we or our insureds may receive adverse verdicts; post-trial motions may result in unfavorable rulings; any appeals that may be undertaken may be unsuccessful; we may be unsuccessful in our legal efforts to limit the scope of coverage available to insureds; and we may become a party to bad faith litigation over the resolution of a claim. To the extent that the cost of resolving these actions exceeds our estimates, the legal actions could have a material effect on our results of operations in the period in which any such action is resolved.

For non-claim related actions, we evaluate each case separately and establish what we believe is an appropriate reserve based on GAAP guidance related to contingent liabilities.

Table of Contents

The Patient Protection and Affordable Care Act of 2010; The Dodd-Frank Wall Street Reform and Consumer Protection Act

The Patient Protection and Affordable Care Act of 2010, otherwise known as the Healthcare Reform bill, was passed and signed into law in March 2010. While the general provisions of the Healthcare Reform bill are known, specific regulations to implement the reforms are just now being written, so we cannot predict with any certainty the effect that Healthcare Reform will have on our business. However, as changes in the healthcare system are phased in between now and 2013, we believe we could see a range of changes that affect our business.

Additionally, the Healthcare Reform bill is a complex document that contains numerous administrative provisions that deal with non-healthcare matters. Regulations to implement these provisions are being developed and may impose additional administrative burdens that will increase our operating costs.

The Dodd-Frank Wall Street Reform and Consumer Protection Act was passed in July 2010. The provisions of the bill do not appear to directly affect our business. However, the bill establishes new regulatory oversight of financial institutions. 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 compliance, or both.

Overview of Results Three and Six Months Ended June 30, 2010 and 2009

Net income is $40.4 million and $78.5 million for the three and six months ended June 30, 2010, respectively, as compared to $53.9 million and $82.2 million for the same respective periods in 2009. Net income per diluted share is $1.23 and $2.40 for the three and six months ended June 30, 2010, respectively, (as compared to $1.62 and $2.46 for the same respective periods in 2009).

Results from the three and six months ended June 30, 2010 and 2009 compare as follows:

Premiums

Net premiums earned decreased during the three-month period of 2010 by approximately $2.3 million or 1.8% due to the effects of a competitive market place and rate reductions resulting from improved loss trends. The 2010 six-month period increased by $17.2 million or 7.4%, which reflects $23.5 million of additional premium from PICA, primarily attributable to three additional months of activity in 2010, partially offset by declines of $6.3 million at our other subsidiaries, attributable to competitive pressures and rate reductions.

Net Investment Income; Net Realized Investment Gains (Losses)

Our 2010 net investment results (which includes both net investment income and earnings from unconsolidated subsidiaries) decreased by $1.9 million, or 4.8%, for the three-month period, principally due to lower earnings from fixed income securities. Results for the 2010 six-month period increased by $5.6 million, or 7.6%, primarily due to an increase in earnings from unconsolidated subsidiaries. Average yields decreased during the 2010 six-month period, but the effect was offset by higher average invested balances.

Net realized investment losses decreased earnings in 2010 by $3.5 million for the three-month period and by $5.9 million for the six-month period. In 2009, net realized investment gains increased earnings by $5.1 million for the three-month period, but net realized investment losses decreased earnings by $2.5 million for the six-month period.

Expenses

Net losses increased by $1.5 million, or 2.2%, in the 2010 three-month period due to additional current accident year losses of $2.0 million offset by increased favorable loss development of $500,000. Net losses increased by $11.1 million, or 8.2%, in the 2010 six-month period due to additional current accident year losses of $18.1 million offset by increased favorable loss development of $7.0 million. The increase in current accident year losses in the six-month period is primarily attributable to an additional three months of PICA activity in 2010.

Underwriting, acquisition and insurance expenses increased in 2010 by $1.6 million or 5.4% for the three-month period and $8.9 million or 16.4% for the six-month period. Expenses were higher in 2010 because of higher policy acquisition costs and a cost reduction in 2009 related to payment of a judgment; the effect of the expense increases was partially offset by PICA transaction expenses incurred only in 2009. The 2010 six-month period also includes three additional months of PICA activity.

Ratios

Our net loss ratio increased in 2010 by 2.1 points for the three-month period and increased by 0.4 points for the six-month period. The increase is due to higher current accident year loss ratios in 2010, the effect of which, for the six-month period was largely offset by higher favorable development.

Our expense ratio increased in 2010 by 1.7 points for the three-month period and by 1.8 points for the six-month period. The increase primarily reflects higher average policy acquisition costs and the effect of lower net earned premiums at our subsidiaries other than PICA.

Table of Contents

Our operating ratio increased in 2010 by 5.3 points and 4.3 points for the three- and six-month period, respectively, reflecting the increases to the net loss and expense ratios and declines in the investment ratio of approximately 1.5 points and 2.1 points for the three- and six-month period, respectively.

Return on equity is 9.1% for the 2010 three-month period and 9.0% for the six-month period on an annualized basis.

Book Value per Share

Our book value per share at June 30, 2010 is $56.31 compared to $52.59 at December 31, 2009. The change reflects our 2010 income, the increase in accumulated other comprehensive income and a benefit from treasury share purchases. Due to the size of our Shareholders Equity (approximately $1.8 billion at June 30, 2010), 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 realized gains or losses, guaranty fund assessments. 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:

	Three Months Ended June 30		**Six Months Ended June 30**	
(In thousands, except per share data)	**2010**	2009	**2010**	2009
Net income	**$40,381**	$53,881	**$78,493**	$82,248
Items excluded in the calculation of operating income:				
Net realized investment (gains) losses	**3,501**	(5,084)	**5,905**	2,453
Guaranty fund (recoupments) assessments	**(616)**	(289)	**(750)**	(478)
Pre-tax effect of exclusions	**2,885**	(5,373)	**5,155**	1,975
Tax effect, at 35%	**(1,010)**	1,881	**(1,804)**	(691)
Operating income	**$42,256**	$50,389	**$81,844**	$83,532
Per diluted common share:				
Net income	**$ 1.23**	$ 1.62	**$ 2.40**	$ 2.46
Effect of exclusions	**0.06**	(0.10)	**0.10**	0.04
Operating income per diluted common share	**$ 1.29**	$ 1.52	**$ 2.50**	$ 2.50

Table of Contents

Results of Operations-Three and Six Months Ended June 30, 2010 Compared to Three and Six Months Ended June 30, 2009

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

	Three Months Ended June 30			Six Months Ended June 30		
($ in thousands, except share data)	**2010**	2009	Change	**2010**	2009	Change
Revenues:						
Gross premiums written	**$ 98,522**	$111,612	$(13,090)	**$255,699**	$266,156	$(10,457)
Net premiums written	**$ 88,868**	$100,542	$(11,674)	**$234,089**	$242,929	$ (8,840)
Premiums earned	**$135,933**	$139,182	$ (3,249)	**$270,204**	$254,736	$ 15,468
Premiums ceded	**(10,535)**	(11,438)	903	**(21,379)**	(23,102)	1,723
Net premiums earned	**125,398**	127,744	(2,346)	**248,825**	231,634	17,191
Net investment income	**37,081**	39,697	(2,616)	**74,709**	74,266	443
Equity in earnings (loss) of unconsolidated subsidiaries	**839**	119	720	**3,825**	(1,309)	5,134
Net realized investment gains (losses)	**(3,501)**	5,084	(8,585)	**(5,905)**	(2,453)	(3,452)
Other income	**1,683**	2,597	(914)	**4,005**	4,071	(66)
Total revenues	**161,500**	175,241	(13,741)	**325,459**	306,209	19,250
Expenses:						
Losses and loss adjustment expenses	**77,170**	75,928	1,242	**165,078**	152,635	12,443
Reinsurance recoveries	**(8,646)**	(8,903)	257	**(17,853)**	(16,493)	(1,360)
Net losses and loss adjustment expenses	**68,524**	67,025	1,499	**147,225**	136,142	11,083
Underwriting, acquisition and insurance expenses	**31,642**	30,013	1,629	**62,846**	53,990	8,856
Interest expense	**827**	1,203	(376)	**1,640**	1,830	(190)
Total expenses	**100,993**	98,241	2,752	**211,711**	191,962	19,749
Income before income taxes	**60,507**	77,000	(16,493)	**113,748**	114,247	(499)
Income taxes	**20,126**	23,119	(2,993)	**35,255**	31,999	3,256
Net income	**$ 40,381**	$ 53,881	$(13,500)	**$ 78,493**	$ 82,248	$ (3,755)

Earnings per share:						
Basic	**$ 1.25**	$ 1.64	$ (0.39)	**$ 2.42**	$ 2.48	$ (0.06)
Diluted	**$ 1.23**	$ 1.62	$ (0.39)	**$ 2.40**	$ 2.46	$ (0.06)
Net loss ratio	**54.6%**	52.5%	2.1	**59.2%**	58.8%	0.4
Underwriting expense ratio	**24.5%**	22.8%	1.7	**24.6%**	22.8%	1.8
Combined ratio	**79.1%**	75.3%	3.8	**83.8%**	81.6%	2.2
Operating ratio	**49.5%**	44.2%	5.3	**53.8%**	49.5%	4.3
Return on equity*	**9.1%**	14.4%	(5.3)	**9.0%**	11.1%	(2.1)

* *Annualized*

In all the tables that follow, the abbreviation nm indicates that the percentage change is not meaningful, either because the amount is zero or because the percent change exceeds 100%.

Table of Contents

Premiums

	Three Months Ended June 30				Six Months Ended June 30			
($ in thousands)	**2010**	2009	*Change*		**2010**	2009	*Change*	
Gross premiums written	**$ 98,522**	$111,612	*$(13,090)*	*(11.7)%*	**$255,699**	$266,156	*$(10,457)*	*(3.9)%*
Net premiums written	**$ 88,868**	$100,542	*$(11,674)*	*(11.6)%*	**$234,089**	$242,929	*$ (8,840)*	*(3.6)%*
Premiums earned	**$135,933**	$139,182	*$ (3,249)*	*(2.3)%*	**$270,204**	$254,736	*$ 15,468*	*6.1%*
Premiums ceded	**10,535**	11,438	*(903)*	*(7.9)%*	**21,379**	23,102	*(1,723)*	*(7.5)%*
Net premiums earned	**$125,398**	$127,744	*$ (2,346)*	*(1.8)%*	**$248,825**	$231,634	*$ 17,191*	*7.4%*

Gross Premiums Written

Changes in our premium volume are driven by three primary factors: our retention of existing business, the amount of new business we are able to generate (including business that comes to PRA as a result of acquisitions), and the premium charged for business that is renewed, which is affected both by rates charged and by the amount and type of coverage an insured chooses to purchase. The professional liability market continues to remain competitive with some competitors choosing to compete primarily on price.

Gross premiums written by component are shown in the table that follows. The six-month period of 2009 includes only three months of PICA activity, whereas 2010 includes six months of PICA activity.

	Three Months Ended June 30				Six Months Ended June 30			
($ in thousands)	**2010**	2009	*Change*		**2010**	2009	*Change*	
Physician [1]	**$71,206**	$ 84,343	*$(13,137)*	*(15.6)%*	**$198,219**	$214,415	*$(16,196)* [2]	*(7.6)%*
Non-physician [1]:								
Healthcare providers	**8,276**	8,091	*185*	*2.3%*	**19,055**	16,141	*2,914* [3]	*18.1%*
Hospital and facility	**8,395**	8,783	*(388)*	*(4.4)%*	**14,869**	16,281	*(1,412)*	*(8.7)%*
Other	**3,798**	3,937	*(139)*	*(3.5)%*	**8,503**	6,564	*1,939*	*29.5%*
Non continuing	**2,424**	2,735	*(311)*	*(11.4)%*	**5,586**	3,743	*1,843*	*49.2%*
	22,893	23,546	*(653)*	*(2.8)%*	**48,013**	42,729	*5,284*	*12.4%*
Tail Premiums	**4,423**	3,723	*700*	*18.8%*	**9,467**	9,012	*455*	*5.0%*
	$98,522	$111,612	*$(13,090)*	*(11.7)%*	**$255,699**	$266,156	*$(10,457)*	*(3.9)%*

Total Gross Premiums Written

(1) Excludes tail premiums

(2) $14.8 million of the change is due to an additional three months of PICA activity in 2010

(3) $3.1 million of the change is due to an additional three months of PICA activity in 2010

Physician Premiums

Physician premiums continue to be our primary revenue source and comprise 72% and 78% of our gross premiums written for the quarter and year-to-date periods ended June 30, 2010, respectively, as compared to 76% and 81% for the same respective periods in 2009.

We began offering policy renewals for a two-year term (as opposed to a one-year term) to our physician insureds in one selected jurisdiction during late 2008. The premium associated with both policy terms is included in written premium in the period the policy is renewed, which increases gross written premium in the year the policy is written but reduces gross written premium in the following year. Earned premiums are not affected because premiums are earned pro rata over the entire policy term, whatever that term may be. Gross written premium associated with two-year term policies is $1.6 million and $5.7

million for the three and six months ended June 30, 2010, respectively, as compared to $7.1 million and $12.5 million written for the 2009 respective periods. Approximately $6.3 million and $9.7 million of the gross written premium decline during the 2010 three- and six-month periods, respectively, is attributable to the policies converted to a two-year term.

We wrote approximately $2 million and $7 million of new physician business during the three and six months ended June 30, 2010, respectively. During 2009, in order to more evenly distribute renewals throughout the year, we offered early renewal to a number of insureds who otherwise would have had a first quarter 2010 renewal date. Approximately $6.5 million of the 2010 year-to-date decrease in physician premiums is attributable to the shift in renewal dates.

As discussed in our 8K filed July 22, 2010, our calculation methodology for physician premium retention is now calculated by comparing expiring premium on renewed risks against total expiring premium. Historically, we have determined retention by comparing the number of renewed risks against all expiring risks. The variation in premium between individual policies has increased as we have expanded our business (for example, the number of insured physicians who work part-time has grown) and we believe a retention rate based on premium is more meaningful. The 2010 retention rate for our physician business is 89% for both the three months and six months ended June 30, 2010. In 2009, the retention rate was 90% for both the three-month and six-month periods. Both 2010 and 2009 rates have been calculated based on premium retained. Retention rates are affected by a number of factors. Insureds may terminate coverage because they are leaving the practice of medicine through death, disability or retirement. We may choose not to renew an insured as a result of our underwriting evaluation. We may lose business to competitors or to self-insurance mechanisms (often when physicians join hospital based practice groups) due to pricing or other issues.

As favorable loss trends have emerged we have lowered our rates where indicated. Pricing for our physician business showed no change from expiring premiums in the second quarter of 2010, compared to an average 3% decrease for the same 2009 period. For the 2010 and 2009 six-month periods, our charged rates decreased an average of 1% and 3%, respectively. Our charged rates include the effects of filed rates, surcharges and discounts. Despite competitive pressures, we remain committed to a rate structure that will allow us to fulfill our obligations to our insureds, while generating competitive returns for our shareholders.

Non-physician Premiums

Our non-physician healthcare providers are primarily dentists, chiropractors and allied health professionals. The 2010 increase for the six-month period is primarily due to the additional PICA activity in 2010.

Hospital and facility premiums decreased for the three-month and six-month periods in 2010. The decline reflects the same competitive pressures in this area as we are seeing in our physician business.

Non-physician other premiums are primarily legal professional liability premiums, but also includes other types of general liability premiums. The increase in premium volume for the six-month period principally relates to our legal professional liability premiums.

Non-continuing in the above table separately identifies premium generated by certain types of miscellaneous liability coverages which we plan to exit. We will continue to write some business related to these books as exit strategies are finalized, but expect declining volumes for the remainder of 2010.

Tail Premiums

We separately report tail premiums because we offer extended reporting endorsement or tail policies to insureds that are discontinuing their claims-made coverage with us, but we do not market such coverages separately. The amount of tail premium written and earned can vary widely from period to period.

Premiums Earned

($ in thousands)	Three Months Ended June 30				Six Months Ended June 30			
	2010	2009	*Change*		**2010**	2009	*Change*	
Premiums earned	**$135,933**	$139,182	*$(3,249)*	*(2.3)%*	**$270,204**	$254,736	*$15,468*	*6.1%*

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 premiums are 100% earned in the period written because the policies insure only incidents that occurred in prior periods and are not cancellable.

Earned premiums for the 2010 six-month period includes six months of PICA activity as compared to only three months of PICA activity for the same period in 2009. The additional PICA premiums are partially offset by the reduction in premium in our existing book of business due to the effects of a competitive market place and rate reductions resulting from improved loss trends.

Premiums Ceded

($ in thousands)	Three Months Ended June 30				Six Months Ended June 30			
	2010	2009	*Change*		**2010**	2009	*Change*	
Premiums ceded	**$10,535**	$11,438	*$(903)*	*(7.9)%*	**$21,379**	$23,102	*$(1,723)*	*(7.5)%*
			(points)				*(points)*	
Reinsurance expense ratio:*	**7.8%**	8.2%	*(0.4)*		**7.9%**	9.1%	*(1.2)*	

* *Calculated as premiums ceded as a percentage of premiums earned*

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

The 2010 three-month period decrease in the reinsurance expense ratio is principally due to a change in the structure of the reinsurance arrangements at our PICA subsidiary. Prior to 2010, certain miscellaneous liability coverages offered by PICA were heavily reinsured. In 2010, we discontinued offering the coverages and canceled the related reinsurance arrangements, which has reduced reinsurance costs in 2010 as compared to 2009.

The reinsurance expense ratio for the 2010 six-month period reflects an additional reduction that is due to the effect of an additional three months of PICA earned premium during 2010. Only a small percentage of PICA earned premiums are reinsured, which lowered the average ratio for the consolidated group. The ratio for the six month period of 2010 also reflects a decrease due to a favorable result from restructuring our primary reinsurance arrangements effective October 1, 2009. The October 1, 2009 reinsurance arrangement reduced minimum payments

but also excluded certain indirect loss costs from our reinsurance coverage.

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, 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 is as follows:

	Three Months Ended June 30				Six Months Ended June 30			
(In thousands)	**2010**	2009	*Change*		**2010**	2009	*Change*	
Fixed maturities	**$36,700**	$39,250	$(2,550)	(6.5)%	**$74,396**	$73,228	$1,168	1.6%
Equities	**238**	394	(156)	(39.6)%	**456**	556	(100)	(18.0)%
Short-term investments	**61**	268	(207)	(77.2)%	**164**	931	(767)	(82.4)%
Other invested assets	**1,054**	877	177	20.2%	**1,606**	1,465	141	9.6%
Business owned life insurance	**413**	399	14	3.5%	**821**	820	1	0.1%
Investment expenses	**(1,385)**	(1,491)	106	(7.1)%	**(2,734)**	(2,734)		
Net investment income	**$37,081**	$39,697	$(2,616)	(6.6)%	**$74,709**	$74,266	$ 443	0.6%

Fixed Maturities. Both the three- and the six-month periods reflect lower yields and higher average investment balances in 2010, with the decline in yields having the greater effect for the comparative three-month periods and the increase in investment balances having the greater effect for the comparative six-month periods.

Yields have decreased because market rates are lower in 2010 than in 2009 and as securities have matured, or in some instances, been sold, proceeds have been reinvested at lower rates. Average yields for our available-for-sale fixed maturity securities during 2010 and 2009 are as follows:

	Three Months Ended June 30		Six Months Ended June 30	
	2010	2009	**2010**	2009
Average income yield	**4.3%**	4.7%	**4.4%**	4.6%
Average tax equivalent income yield	**5.0%**	5.5%	**5.1%**	5.3%

The increase in average balances is related to the timing of the PICA transaction and market conditions in 2009. In the first quarter of 2009, because of the upcoming PICA transaction and the instability in the market, we allowed our short term and cash balances to increase. The PICA transaction closed on April 1, 2009 and we gradually invested more funds in the fixed securities as market conditions improved, particularly during the last half of 2009. Thus our average investment in fixed maturities increased in 2010 as compared to 2009 (by approximately 2% for the three-month period and 7% for the six-month period).

Short-term Investments. The decrease in earnings for both the three-month period and the six-month period reflects a decline in rates and also lower average invested balances.

Equity in Earnings (Loss) of Unconsolidated Subsidiaries

(In thousands)	**Three Months Ended June 30**			**Six Months Ended June 30**		
	2010	2009	*Change*	**2010**	2009	*Change*
Equity in earnings (loss) of unconsolidated subsidiaries	**$839**	$119	*$720*	**$3,825**	$(1,309)	*$5,134*

Equity in earnings (loss) of unconsolidated subsidiaries is derived from our investment interests accounted for under the equity method. Three funds, held in 2010 and in 2009, primarily hold trading

portfolios, and changes in the fair value of securities held by the fund are included in current earnings of the fund. The performance of those three funds is affected by the volatility of equity and credit markets. Five of the funds are tax credit funds acquired in 2010. As discussed under Capital and Liquidity Investment Exposures, the tax credit funds are designed to generate investment returns by providing tax benefits to fund investors in the form of net operating losses and tax credits. The three- and six-month periods of 2010 include operating losses from the fund of approximately $150,000.

Net Realized Investment Gains (Losses)

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

	Three Months Ended June 30		**Six Months Ended June 30**	
(In thousands)	**2010**	2009	**2010**	2009
Total other-than-temporary impairment losses[1]:				
Residential mortgage-backed securities	**$**	$ (247)	**$ (23)**	$(2,703)
Corporate bonds		(2,189)		(3,733)
Equities				(422)
Equity interest in a private investment fund			**(3,373)**	
High yield asset-backed securities, beneficially owned	**(4,912)**		**(8,983)**	(536)
Portion recognized in Other Comprehensive Income:				
Residential mortgage-backed securities		172	**6**	172
High yield asset-backed securities, beneficially owned	**(2,128)**			
Net impairment losses recognized in earnings	**(7,040)**	(2,264)	**(12,373)**	(7,222)
Net gains (losses) from sales	**7,840**	2,961	**9,896**	5,125
Reserve for loss on investment receivable[2]				(3,090)
Trading portfolio gains (losses)	**(3,305)**	4,296	**(1,562)**	2,643
Fair value adjustments, net	**(996)**	91	**(1,866)**	91
Net realized investment gains (losses)	**$(3,501)**	$ 5,084	**$ (5,905)**	$(2,453)

(1) In accordance with GAAP, all OTTI losses prior to April 1, 2009 were recognized in earnings

(2) Relates to amounts due from Reserve Primary Fund. Subsequent recoveries from

the Reserve Primary Fund exceeded estimated amounts, and the loss was reversed in the fourth quarter of 2009.

We recognized impairment losses in earnings of $7.0 million for the three-month period, including a reclassification of non-credit losses of $2.1 million previously recognized in OCI, and $9.0 million for the six-month period related to high-yield asset backed securities held in a private investment fund (see discussion under investment exposures) which we intend to sell. Management received notice during the second quarter of 2010 the fund would be dissolved as of July 1, 2010 and the securities therein distributed back to us. Management subsequently concluded that the securities would be sold in the near term.

We recognized an impairment of $3.4 million in the first six months of 2010 related to an interest in a private investment fund which we account for on a cost basis. The fund has reported realized losses on the sale of securities, and we have reduced the carrying value of our interest in the fund in recognition of our pro rata share of those losses.

Trading portfolio gains (losses) are primarily attributable to the equity securities acquired in the PICA transaction, which were sold in the second quarter of 2010. Fair value adjustments are attributable to our election of fair value treatment for both the 2019 Note Payable and related interest rate swap, as discussed in Note 9 to the Condensed Consolidated Financial Statements.

Losses and Loss Adjustment Expenses

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

Accident year refers to the accounting period in which the insured event becomes a liability of the insurer. For occurrence policies the insured event becomes a liability when the event takes place; for

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

The following tables summarize calendar year net losses and net loss ratios for the three and six months ended June 30, 2010 and 2009 by separating losses between the current accident year and all prior accident years.

	Net Losses					
	Three Months Ended June 30			**Six Months Ended June 30**		
(In millions)	**2010**	2009	*Change*	**2010**	2009	*Change*
Current accident year	**$106.0**	$104.0	*$ 2.0*	**$209.7**	$191.6	*$18.1*
Prior accident years	**(37.5)**	(37.0)	*(0.5)*	**(62.5)**	(55.5)	*(7.0)*
Calendar year	**$ 68.5**	$ 67.0	*$ 1.5*	**$147.2**	$136.1	*$11.1*

	Net Loss Ratios*					
	Three Months Ended June 30			**Six Months Ended June 30**		
	2010	2009	*Change*	**2010**	2009	*Change*
Current accident year	**84.5%**	81.4%	*3.1*	**84.3%**	82.7%	*1.6*
Prior accident years	**(29.9)%**	(28.9)%	*(1.0)*	**(25.1)%**	(23.9)%	*(1.2)*
Calendar year	**54.6%**	52.5%	*2.1*	**59.2%**	58.8%	*0.4*

* Net losses as specified divided by net premiums earned.

Approximately half of the increase in the ratio for both the three and the six month periods is attributable to higher expected losses, as compared to 2009, for our PICA subsidiary. The remainder of the increase is primarily attributable to our physician business and principally reflects shifts in the geographic mix of premiums earned, as we expect higher losses in some jurisdictions. We consider the results of our 2009 year-end actuarial review and our 2010 semi-annual review of claims data in establishing our loss estimates, and have increased our loss estimates where indicated.

During the three and six months ended June 30, 2010, we recognized favorable loss development of $37.5 million and $62.5 million, respectively, on a net basis, related to reserves established in prior years. Principally this is due to favorable net loss development within our retained layers of coverages ($1 million and below) for accident years 2004-2008.

During the three and six months ended June 30, 2009, we recognized favorable loss development of $37.0 million and $55.5 million, respectively, on a net basis, related to our previously established (prior accident year) reserves, principally for the 2004 to 2007 accident years within our retained layers of coverage ($1 million and below).

Substantially all of the development recognized during 2010 relates to medical professional liability claims-made reserves. The favorable development for medical professional claims-made policies in both 2010 and 2009 is based upon observation of actual claims data that indicates that claims severity (i.e., the expected average cost of claims) is trending below our initial expectations. Given both the long tailed nature of our business and the past volatility of final

claim settlement values, we are generally cautious in giving credence to the trends that lead to the recognition of favorable net loss development. As we conclude that sufficient credible data with respect to these trends exists we take appropriate actions. In the case of the claims severity trends, we believe it is appropriate to recognize the impact of these trends in our actuarial evaluation of prior period loss estimates while also remaining attentive to the past volatility of claims severity.

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

Table of Contents

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 has been the case in 2010 and 2009.

Underwriting, Acquisition and Insurance Expenses

	Three Months Ended June 30				**Six Months Ended June 30**			
($ in thousands)	**2010**	2009	*Change*		**2010**	2009	*Change*	
Insurance related expenses, excluding items below	**$30,730**	$28,509	*$2,221*	*7.8%*	**$61,127**	$52,197	*$8,930*	*17.1%*
Transaction expenses; CHW reduction		677	*(677)*	*nm*		677	*(677)*	*nm*
	$30,730	$29,186	*$1,544*	*5.3%*	**$61,127**	$52,874	*$8,253*	*15.6%*
Non-insurance related expenses	**912**	827	*85*	*10.3%*	**1,719**	1,116	*603*	*54.0%*
	$31,642	$30,013	*$1,629*	*5.4%*	**$62,846**	$53,990	*$8,856*	*16.4%*
Underwriting expense ratio [1]	**24.5%**	22.8%	*1.7*		**24.6%**	22.8%	1.8	

[1] Our expense ratio computations exclude non-insurance related expenses.

Insurance Related Expenses

The $2.2 million increase in expenses for the 2010 three-month period primarily reflects an increase in amortization of deferred policy acquisition costs of approximately $2.5 million, the effect of which was somewhat offset by other cost reductions. Approximately $1.3 million of the increase in amortization is attributable to our PICA subsidiary. Under GAAP purchase accounting rules there is no recognition of policy acquisition costs for policies written prior to the acquisition date but earned after the acquisition date; consequently, PICA amortization expense was below normal levels in the second quarter of 2009. Amortization expense also increased at our other subsidiaries, primarily because more premium was earned from allied healthcare, legal and miscellaneous professional coverages. Commission and underwriting expenses associated with these premiums are higher than those associated with physician premiums.

The $8.9 million increase in expenses for the 2010 six-month period reflects the second quarter increase in amortization of policy acquisition costs of $2.5 million discussed above, an additional $1.6 million of expenses in the first quarter due to higher expenses associated with non-physician premiums, and an increase of approximately $5.7 million due to six months of PICA activity in 2010 as compared to three months in 2009, offset by a net reduction to operating expenses of $900,000.

Non-recurring expenses. Our second quarter 2009 expenses included PICA transaction costs of approximately $2.5 million, partially offset by a $1.8 million benefit related to the final settlement of the Columbia Hospital for Women Judgment (the CHW Judgment). For additional information regarding the CHW Judgment, see Note 10 of the Notes to the Consolidated Financial Statements in our 2009 Form 10-K.

Other Expense Information

Non-insurance related expenses. We operate several insurance agencies and provide benefit management services on a limited basis through a separate PICA subsidiary. These activities generate commission and service fee revenues, which are reported as a part of other income. We have excluded the direct expenses of these activities from our underwriting expense ratio computations because the activities are not associated with the generation of premium revenues. The 2010 six-month period increase primarily reflects three additional months of PICA activity.

Guaranty fund assessments. Insurance related expenses in the table above are reduced by net recoupments from guaranty fund assessments of approximately $616,000 and $750,000 during the three

Table of Contents

and six months ended June 30, 2010, respectively, and by approximately $289,000 and $478,000 during the same respective periods in 2009.

Underwriting Expense Ratio

The 2010 increase in our underwriting expense ratio for both the three- and the six-month periods is primarily attributable to higher policy acquisition costs, as previously discussed; however, lower net earned premiums at our subsidiaries other than PICA also increased the 2010 ratio. The previously discussed non-recurring items increased the 2009 ratio by 30 basis points; there were no similar items in 2010.

Interest Expense

Several factors reduced interest expense in 2010 as compared to 2009. Rates on our variable rate debt decreased almost 100 basis points in 2010 and in May 2009 our Surplus Notes due May 2034 converted from a fixed rate to a lower variable rate. Also, we repaid our 2033 Surplus Notes in the third quarter of 2009. For the six-month period these reductions are offset, to an extent, by higher expense in 2010 related to the Note Payable due February 2019, assumed in April 2009 as a part of the PICA transaction.

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

	Three Months Ended June 30			**Six Months Ended June 30**		
(In thousands)	**2010**	2009	*Change*	**2010**	2009	*Change*
Trust Preferred Securities/Debentures due 2034	**$244**	$ 300	*$ (56)*	**$ 482**	$ 640	*$(158)*
Surplus Notes due May 2034	**126**	226	*(100)*	**249**	511	*(262)*
Surplus Note due February 2012	**16**	8	*8*	**24**	12	*12*
Note Payable due February 2019	**294**	299	*(5)*	**588**	299	*289*
Surplus Notes due May 2033		92	*(92)*		92	*(92)*
Other	**147**	278	*(131)*	**297**	276	*21*
	$827	$1,203	*$(376)*	**$1,640**	$1,830	*$(190)*

Taxes

Our effective tax rate for each period is lower than the 35% statutory rate because a considerable portion of our net investment income is tax-exempt. Our effective tax rate is inversely affected by the ratio of tax-exempt income to pre-tax income; an increase in the ratio lowers our effective tax rate and vice versa. The ratio of tax exempt income to pre-tax income increased during the 2010 three-month period but decreased during the 2010 six-month period. The effective tax rate also increased in 2010 due to taxes expected to be paid on the planned BOLI redemption, as discussed in Capital and Liquidity -Investment Exposures. Below is a reconciliation of our effective tax rate to the statutory rate:

	Three Months Ended June 30		**Six Months Ended June 30**	
	2010	2009	**2010**	2009
Statutory rate	**35.0%**	35.0%	**35.0%**	35.0%
Tax-exempt income	**(6.3)%**	(5.6)%	**(7.0)%**	(7.3)%
BOLI Redemption	**2.1%**		**1.1%**	
Other	**2.5%**	0.6%	**1.9%**	0.3%

Effective tax rate	**33.3%**	30.0%	**31.0%**	28.0%

Table of Contents

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 June 30, 2010. 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				
June 30, 2010	**(200)**	**(100)**	**Current**	**100**	**200**
Fair Value (in millions):					
U.S. Treasury obligations	**$ 217**	**$ 213**	**$ 209**	**$ 205**	**$ 201**
U.S. Agency obligations	**70**	**69**	**65**	**61**	**58**
State and municipal bonds	**1,462**	**1,399**	**1,327**	**1,258**	**1,192**
Corporate bonds	**1,210**	**1,177**	**1,137**	**1,093**	**1,054**
Asset-backed securities	**759**	**735**	**719**	**697**	**670**
All fixed maturity securities	**$ 3,718**	**$ 3,593**	**$ 3,457**	**$ 3,314**	**$ 3,175**
Duration:					
U.S. Treasury obligations	***2.82***	***2.88***	***3.04***	***2.97***	***2.90***
U.S. Agency obligations	***3.04***	***4.22***	***4.42***	***4.36***	***4.30***
State and municipal bonds	***4.13***	***5.05***	***5.24***	***5.29***	***5.29***
Corporate bonds	***2.91***	***3.60***	***3.81***	***3.73***	***3.65***
Asset-backed securities	***2.08***	***2.31***	***2.64***	***3.54***	***3.96***
All fixed maturity securities	***3.22***	***3.87***	***4.08***	***4.25***	***4.30***
December 31, 2009					
Fair Value (in millions):					
U.S. Treasury obligations	$ 160	$ 156	$ 154	$ 150	$ 147
U.S. Agency obligations	70	69	67	66	64
State and municipal bonds	1,601	1,528	1,449	1,373	1,301
Corporate bonds	1,152	1,114	1,074	1,035	999
Asset-backed securities	725	717	699	673	645
All fixed maturity securities	$ 3,708	$ 3,584	$ 3,443	$ 3,297	$ 3,156
Duration:					
U.S. Treasury obligations	*3.22*	*3.27*	*3.29*	*3.23*	*3.14*
U.S. Agency obligations	*2.70*	*3.10*	*3.10*	*3.04*	*3.04*
State and municipal bonds	*4.38*	*5.20*	*5.29*	*5.31*	*5.27*
Corporate bonds	*3.45*	*3.69*	*3.71*	*3.62*	*3.54*

Asset-backed securities	*1.65*	*1.64*	*3.03*	*3.91*	*4.21*
All fixed maturity securities	*3.44*	*3.84*	*4.15*	*4.30*	*4.31*

Table of Contents

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

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

ProAssurance s cash and short-term investment portfolio at June 30, 2010 is on a cost basis which approximates its fair value. This portfolio lacks significant interest rate sensitivity due to its short duration.

Credit Risk

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

As of June 30, 2010, 97% of our fixed maturity securities are rated investment grade as determined by Nationally Recognized Statistical Rating Organizations (NRSROs), such as Moody s, Standard & Poor s and Fitch. We believe that this concentration in investment grade securities reduces our exposure to credit risk on our fixed income investments to an acceptable level. However, investment grade securities, in spite of their rating, can rapidly deteriorate and result in significant losses. Ratings published by the NRSROs are one of the tools used to evaluate the credit worthiness of our securities. The ratings reflect the subjective opinion of the rating agencies as to the credit worthiness of the securities, and therefore, we may be subject to additional credit exposure should the rating prove to be unreliable.

We hold $1.3 billion of municipal bonds. These bonds may have enhanced credit ratings as a result of guarantees by an insurer, but we require the bonds that we purchase to meet our credit criteria on a stand-alone basis. As of June 30, 2010, on a stand-alone basis, our municipal bonds have a weighted average rating of AA.

Equity Price Risk

At June 30, 2010 the fair value of our investment in common stocks was $27.2 million. These securities are subject to equity price risk, which is defined as the potential for loss in fair value due to a decline in equity prices. The weighted average beta of this group of securities is 0.96. 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 $29.8 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 $24.5 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.

Table of Contents

ITEM 4. CONTROLS AND PROCEDURES

The Chief Executive Officer and Chief Financial Officer of the Company participated in management s evaluation of our disclosure controls and procedures (as defined in SEC Rule 13a-15(e)) as of June 30, 2010. ProAssurance s disclosure controls and procedures are designed to reasonably assure that information required to be disclosed by us in reports we file or submit under the Exchange Act is accumulated and communicated to our management as appropriate to allow timely decisions regarding disclosure and is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission s rules and forms. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures are effective.

Changes in Internal Control over Financial Reporting

On April 1, 2009 we completed the acquisition of Podiatry Insurance Company of America (PICA). We have excluded PICA s systems and processes from Management s report on Internal Control over Financial Reporting as of December 31, 2009 and will include PICA in Management s Report on Internal Control over Financial Reporting as of December 31, 2010.

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

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

See Note 9 of the Notes to the Condensed Consolidated Financial Statements.

ITEM 1A. RISK FACTORS

With the exception of the risk factors listed below, there are no changes to the Risk Factors in Part 1, Item 1A of the 2009 Form 10-K.

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

The Patient Protection and Affordable Care Act of 2010, otherwise known as the Healthcare Reform bill, was passed and signed into law in March 2010. While the general provisions of the Healthcare Reform bill are known, specific regulations to implement the reforms are just now being written, so we cannot predict with any certainty the effect that Healthcare Reform will have on our business. However, as changes in the healthcare system are phased in between now and 2013, we believe we could see a range of changes that affect our business.

Additionally, the Healthcare Reform bill is a complex document that contains numerous administrative provisions that deal with non-healthcare matters. Regulations to implement these provisions are being developed and may impose additional administrative burdens that will increase our operating costs.

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

The Dodd-Frank Wall Street Reform and Consumer Protection Act was passed and signed into law in July 2010. The provisions of the bill do not appear to directly affect our operations. However, the bill establishes new regulatory oversight of financial institutions. 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.

Table of Contents

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

(a) Not applicable.

(b) Not applicable.

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

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
April 1 30, 2010	1,454	$58.52	1,454	$ 115,279,087
May 1 31, 2010	195,940	$58.04	195,940	$ 103,905,857
June 1 30, 2010	476,164	$58.19	476,164	$ 76,196,194
Total	673,558	$58.15	673,558	

Table of Contents

ITEM 6. EXHIBITS

31.1	Certification of Principal Executive Officer of ProAssurance as required under SEC rule 13a-14(a).
31.2	Certification of Principal Financial Officer of ProAssurance as required under SEC rule 13a-14(a).
32.1	Certification of Principal Executive Officer of ProAssurance as required under SEC Rule 13a-14(b) and Section 1350 of Chapter 63 of Title 18 of the United States Code, as amended (18 U.S.C. 1350).
32.2	Certification of Principal Financial Officer of ProAssurance as required under SEC Rule 13a-14(b) and Section 1350 of Chapter 63 of Title 18 of the United States Code, as amended (18 U.S.C. 1350).
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema Document
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB	XBRL Taxonomy Extension Labels Linkbase Document
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document

Table of Contents

SIGNATURE

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

PROASSURANCE CORPORATION

60