

PROASSURANCE CORP
Form 10-Q
May 06, 2013
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q
(Mark One)

Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the quarterly period ended March 31, 2013 or

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

Commission file number 0-16533

ProAssurance Corporation
(Exact Name of Registrant as Specified in Its Charter)

Delaware 63-1261433
(State or Other Jurisdiction of
Incorporation or Organization) (IRS Employer Identification No.)

100 Brookwood Place, Birmingham, AL 35209
(Address of Principal Executive Offices) (Zip Code)

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

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter), during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

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

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

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

As of April 25, 2013, there were 61,816,938 shares of the registrant's common stock outstanding.

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Forward-Looking Statements

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

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

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

- changes in general economic conditions;
- our ability to maintain our dividend payments;
- regulatory, legislative and judicial actions or decisions that could affect our business plans or operations;
- the enactment or repeal of tort reforms;
- formation or dissolution of state-sponsored medical professional liability insurance entities that could remove or add sizable groups of physicians from or to the private insurance market;
- the impact of deflation or inflation;
- changes in the interest rate environment;
- changes in U.S. laws or government regulations regarding financial markets or market activity that may affect the U.S. economy and our business;
- changes in the ability of the U.S. government to meet its obligations that may affect the U.S. economy and our business;
- performance of financial markets affecting the fair value of our investments or making it difficult to determine the value of our investments;
- changes in accounting policies and practices that may be adopted by our regulatory agencies, the Financial Accounting Standards Board, the Securities and Exchange Commission, or the Public Company Accounting Oversight Board;
- changes in laws or government regulations affecting medical professional liability insurance or the financial community;
- the effects of changes in the healthcare delivery system, including but not limited to the Patient Protection and Affordable Care Act;
- consolidation of healthcare providers and entities that are more likely to self insure and not purchase medical professional liability insurance;
- uncertainties inherent in the estimate of loss and loss adjustment expense reserves and reinsurance;
- changes in the availability, cost, quality, or collectability of insurance/reinsurance;
- the results of litigation, including pre- or post-trial motions, trials and/or appeals we undertake;
- allegation of bad faith which may arise from our handling of any particular claim, including failure to settle;
- loss of independent agents;
- changes in our organization, compensation and benefit plans;
- our ability to retain and recruit senior management;

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assessments from guaranty funds;

our ability to achieve continued growth through expansion into other states or through acquisitions or business combinations;

- changes to the ratings assigned by rating agencies to our insurance subsidiaries, individually or as a group;

provisions in our charter documents, Delaware law and state insurance law may impede attempts to replace or remove management or may impede a takeover;

state insurance restrictions may prohibit assets held by our insurance subsidiaries, including cash and investment securities, from being used for general corporate purposes;

taxing authorities can take exception to our tax positions and cause us to incur significant amounts of legal and accounting costs and, if our defense is not successful, additional tax costs, including interest and penalties;

insurance market conditions may alter the effectiveness of our current business strategy and impact our revenues; and expected benefits from completed and proposed acquisitions may not be achieved or may be delayed longer than expected due to business disruption; loss of customers, employees and key agents; increased operating costs or inability to achieve cost savings; and assumption of greater than expected liabilities, among other reasons.

Additional risks that could adversely affect the merger of Independent Nevada Doctors Insurance Exchange, now Independent Nevada Doctors Insurance Company (IND), and Medmarc Mutual Insurance Company, now Medmarc Casualty Insurance Company (Medmarc), into ProAssurance, include but are not limited to the following:

- the outcome of any potential claims from policyholders of Medmarc and IND relating to payments or other issues arising from their respective conversions to stock insurance companies and subsequent mergers into ProAssurance;
- the businesses of ProAssurance and Medmarc or ProAssurance and IND may not be integrated successfully, or such integration may take longer to accomplish than expected;

cost savings from either transaction may not be fully realized or may take longer to realize than expected;

operating costs, customer loss and business disruption following either or both transactions, including adverse effects on relationships with employees, may be greater than expected.

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

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

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

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

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

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

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

See accompanying notes.

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

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

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Weighted average number of common shares outstanding:

Basic	61,708	61,177
Diluted	61,963	61,703

Cash dividends declared per common share	\$0.25	\$0.13
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See accompanying notes.

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

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

Significant non-cash transactions

Deposit transferred as consideration for acquisition	\$153,700	\$—
See accompanying notes.		

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ProAssurance Corporation and Subsidiaries

Notes to Condensed Consolidated Financial Statements (Unaudited)

March 31, 2013

1. Basis of Presentation

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

Stock Split

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

Accounting Changes Not Yet Adopted

Liabilities-Obligations Resulting from Joint and Several Liability Arrangements

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

Accounting Changes Adopted

Intangibles-Goodwill and Other

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

Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income

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

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

Disclosures About Offsetting Assets and Liabilities

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

2. Acquisitions

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

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

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

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

(In thousands)

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

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

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ProAssurance Corporation and Subsidiaries

Notes to Condensed Consolidated Financial Statements (Unaudited)

March 31, 2013

ProAssurance believes that all contractual cash flows related to acquired receivables will be collected. The fair value of reserves for losses and loss adjustment expenses and related reinsurance recoverables were estimated based on the present value of the expected underlying net cash flows, including a 5% profit margin and a 5% risk premium, and were determined to be materially the same as the recorded cost basis acquired.

The following table provides Pro Forma Consolidated Results for the three months ended March 31, 2013 and 2012 as if the Medmarc transaction had occurred on January 1, 2012. ProAssurance Actual Consolidated Results have been adjusted by the following, net of related tax effects, to reflect the Pro Forma Consolidated Results below.

For the three months ended March 31, 2012, the inclusion of Medmarc operating results as ProAssurance 2012 Actual Consolidated Results did not include Medmarc. ProAssurance Actual Consolidated Results for the three months ended March 31, 2013 included Medmarc operating results (Revenue of \$12.9 million and Earnings of \$3.2 million).

Certain costs included in ProAssurance actual results for the three months ended March 31, 2013 have been reported in the Pro Forma Consolidated Results as if the costs had been incurred for three months ended March 31, 2012. Such costs include direct transaction costs and certain compensation costs directly related to the integration of Medmarc operations.

Prior to the acquisition date, Medmarc reported on a statutory basis and expensed policy acquisition costs associated with successful contracts as incurred. After the acquisition date, in accordance with GAAP, Medmarc policy acquisition costs associated with successful contracts were capitalized and amortized to expense as the related premium revenues were earned, but no amortization was recognized for Medmarc policies written prior to the acquisition date. The Pro Forma Consolidated Results for both 2013 and 2012 have been adjusted to reflect policy acquisition costs as if Medmarc had followed GAAP guidance for these costs in pre-acquisition periods.

Earnings for the three months ended March 31, 2012, were reduced to reflect amortization of intangible assets and debt security premiums and discounts recorded as a part of the Medmarc purchase price allocation.

The gain on the acquisition of \$35.5 million that was included in ProAssurance Actual Consolidated Results for the three months ended March 31, 2013 has been reported in the Pro Forma Consolidated Results as being recognized during the three months ended March 31, 2012.

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

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ProAssurance Corporation and Subsidiaries

Notes to Condensed Consolidated Financial Statements (Unaudited)

March 31, 2013

3. Fair Value Measurement

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

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

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

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ProAssurance Corporation and Subsidiaries

Notes to Condensed Consolidated Financial Statements (Unaudited)

March 31, 2013

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

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ProAssurance Corporation and Subsidiaries

Notes to Condensed Consolidated Financial Statements (Unaudited)

March 31, 2013

(In thousands)	December 31, 2012			Total Fair Value
	Fair Value Measurements Level 1	Using Level 2	Level 3	
Assets:				
Fixed maturities, available for sale				
U.S. Treasury obligations	\$—	\$205,857	\$—	\$205,857
U.S. Government-sponsored enterprise obligations	—	56,947	—	56,947
State and municipal bonds	—	1,212,804	7,175	1,219,979
Corporate debt, multiple observable inputs	—	1,455,333	—	1,455,333
Corporate debt, limited observable inputs:				
Private placement senior notes	—	—	346	346
Other corporate debt, NRSRO ratings available	—	—	13,835	13,835
Other corporate debt, NRSRO ratings not available	—	—	1,010	1,010
Residential mortgage-backed securities	—	289,850	—	289,850
Agency commercial mortgage-backed securities	—	59,464	—	59,464
Other commercial mortgage-backed securities	—	74,106	—	74,106
Other asset-backed securities	—	67,237	4,035	71,272
Equity securities				
Financial	70,900	—	—	70,900
Utilities/Energy	31,383	—	—	31,383
Consumer oriented	51,100	—	—	51,100
Technology	11,495	—	—	11,495
Industrial	18,200	—	—	18,200
All other	19,540	—	—	19,540
Short-term investments	59,761	11,976	—	71,737
Financial instruments carried at fair value, classified as a part of:				
Investment in unconsolidated subsidiaries	—	—	33,739	33,739
Total assets	\$262,379	\$3,433,574	\$60,140	\$3,756,093

The fair values for securities included in the Level 2 category, with the few exceptions described below, have been developed by one of several third party, nationally recognized pricing services, including services that price only certain types of securities. Each service uses complex methodologies to determine values for securities and subject the values they develop to quality control reviews. Management has selected a primary source for each type of security in the portfolio, and reviews the values provided for reasonableness by comparing data to alternate pricing services and to available market and trade data. Values that appear inconsistent are further reviewed for appropriateness. If a value does not appear reasonable, the valuation is discussed with the service that provided the value and would be adjusted, if necessary. No such adjustments have been necessary in 2013 or 2012.

Level 2 Valuations

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

U.S. Treasury obligations 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-sponsored enterprise obligations 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.

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State and municipal bonds are valued using a series of matrices that consider 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 significant economic or geographic events or ratings changes that would affect the security's fair value.

Corporate debt with multiple observable inputs consists primarily of corporate bonds, but also includes a small number of bank loans. The methodology used to value Level 2 corporate bonds is the same as the methodology previously described for U.S. Government-sponsored enterprise obligations. Bank loans are valued by an outside vendor 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.

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

Other 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. Evaluations of subprime home equity loans use the same evaluation methodology as previously described for Alt-A mortgages.

Short-term investments included in the Level 2 category are commercial paper and certificates of deposit maturing within one year, carried at cost which approximates the fair value of the security due to the short term to maturity.

Level 3 Valuations

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

Level 3 Valuation Processes

Level 3 securities are priced by the Vice President of Investments for our subsidiaries, who reports to the Chief Financial Officer.

Level 3 valuations are computed quarterly. Prices are evaluated quarterly against prior period prices and the expected change in price.

Exclusive of Investments in unconsolidated subsidiaries, which are valued at NAV, the securities noted in the disclosure are primarily NRSRO rated corporate debt instruments for which comparable market inputs are commonly available for evaluating the securities in question. Valuation of these corporate debt instruments is not overly sensitive to changes in the unobservable inputs used.

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Level 3 Valuation Methodologies

State and municipal bonds consists of auction rate municipal bonds valued internally using either published quotes for similar securities or values produced by discounted cash flow models 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. At March 31, 2013 and December 31, 2012 all of these bonds were rated A- or better.

Corporate debt with limited observable inputs consists of private placement senior notes guaranteed by large regional banks and certain corporate bonds. Valuations are determined using dealer quotes for similar securities or discounted cash flow models using yields currently available for similar securities. Similar securities are defined as securities having like terms and payment features that are of comparable credit quality. Assessments of credit quality are based on NRSRO ratings, if available, or are subjectively determined by management if not available. At March 31, 2013, the average rating of rated securities was BBB+.

Other asset-backed securities consists of securitizations of receivables valued using dealer quotes for similar securities or discounted cash flow models using yields currently available for similar securities.

Investment in unconsolidated subsidiaries consist of limited partnership (LP) and limited liability company (LLC) interests valued using the net asset value (NAV) provided by the LP/LLC, which approximates the fair value of the interest.

Such interests include the following:

(In thousands)	Unfunded	Fair Value	
	Commitments	March 31,	December 31,
	March 31,	March 31,	2012
	2013	2013	
Investment in unconsolidated subsidiaries:			
LP invested in senior secured debt (1)	\$32,400	\$7,600	\$—
LP invested in long equities (2)	None	5,569	—
LP primarily invested in long/short equities (3)	None	16,985	17,115
LPs primarily invested in non-public equities (4)	\$44,107	17,386	16,624
		\$47,540	\$33,739

The LP is structured to provide income and capital appreciation primarily through investments in senior secured (1)debt. Redemptions are not allowed. Income and capital are to be periodically distributed at the discretion of the LP over an anticipated time frame that spans from 7 to 9 years.

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

The LP 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 (3)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 LP's annual audit.

Comprised of interests in two unrelated LP funds, each structured to provide capital appreciation through diversified investments in private equity, which can include investments in buyout, venture capital, mezzanine (4)debt, distressed debt and other private equity-oriented LPs. One LP allows redemption by special consent; the other does not permit redemption. Income and capital are to be periodically distributed at the discretion of the LP over an anticipated time frame that spans from 4 to 7 years.

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Quantitative Information Regarding Level 3 Valuations

Quantitative Information about Level 3 Fair Value Measurements

(In millions)	Fair Value at		Valuation Technique	Unobservable Input	Range (Weighted Average)
	March 31, 2013	December 31, 2012			
Assets:					
State and municipal bonds	\$7.2	\$7.2	Market Comparable Securities	Comparability Adjustment	0% - 10% (5%)
			Discounted Cash Flows	Comparability Adjustment	0% - 10% (5%)
Corporate debt with limited observable inputs	\$9.7	\$15.2	Market Comparable Securities	Comparability Adjustment	0% - 5% (2.5%)
			Discounted Cash Flows	Comparability Adjustment	0% - 5% (2.5%)
Other asset-backed securities	\$7.1	\$4.0	Market Comparable Securities	Comparability Adjustment	0% - 5% (2.5%)
			Discounted Cash Flows	Comparability Adjustment	0% - 5% (2.5%)

The significant unobservable inputs used in the fair value measurement of the entity's corporate bonds are the valuations of comparable securities with similar issuer, credit quality and maturity. Changes in the availability of comparable securities could result in changes in the fair value measurements.

Fair Value Measurements - Level 3 Assets

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

(In thousands)	March 31, 2013					
	Level 3 Fair Value Measurements – Assets					
	State and Municipal Bonds	Corporate Debt	Asset-backed Securities	Investment in Unconsolidated Subsidiaries	Other Investments	Total
Balance December 31, 2012	\$7,175	\$15,191	\$ 4,035	\$ 33,739	\$ —	\$60,140
Total gains (losses) realized and unrealized:						
Included in earnings, as a part of:						
Net Investment Income	—	(102)	(16)	—	—	(118)
Equity in earnings of unconsolidated subsidiaries	—	—	—	1,848	—	1,848
Net realized investment gains (losses)	—	(69)	—	—	—	(69)
Included in other comprehensive income	—	—	—	—	—	—
Purchases	—	3,875	1,356	13,078	—	18,309
Sales	—	(616)	—	(1,125)	—	(1,741)
Transfers in	—	—	1,701	—	—	1,701
Transfers out	—	(8,617)	—	—	—	(8,617)
Balance March 31, 2013	\$7,175	\$9,662	\$ 7,076	\$ 47,540	\$ —	\$71,453
Change in unrealized gains (losses) included in earnings for the above period	\$—	\$—	\$ —	\$ 1,848	\$ —	\$1,848

for Level 3 assets held at period-end

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ProAssurance Corporation and Subsidiaries

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March 31, 2013

(In thousands)	March 31, 2012					Total
	Level 3 Fair Value Measurements – Assets					
	State and Municipal Bonds	Corporate Debt	Asset-backed Securities	Investment in Unconsolidated Subsidiaries	Other Investments	
Balance December 31, 2011	\$7,200	\$8,082	\$ —	\$ 23,841	\$ 15,873	\$54,996
Total gains (losses) realized and unrealized:						
Included in earnings, as a part of:						
Equity in earnings of unconsolidated subsidiaries	—	—	—	589	—	589
Net realized investment gains (losses)	—	—	—	—	(131)	(131)
Included in other comprehensive income	—	607	—	—	—	607
Purchases	—	—	—	—	—	—
Sales	(25)	—	—	—	—	(25)
Transfers in	—	—	—	—	—	—
Transfers out	—	—	—	—	—	—
Balance March 31, 2012	\$7,175	\$8,689	\$ —	\$ 24,430	\$ 15,742	\$56,036
Change in unrealized gains (losses) included in earnings for the above period for Level 3 assets held at period-end	\$—	\$—	\$ —	\$ 589	\$ (131)	\$458

Transfers

There were no transfers between the Level 1 and Level 2 categories during the three months ended March 31, 2013 or 2012.

Transfers shown in the preceding Level 3 Tables are as of the end of the period and were to or from Level 2, unless otherwise noted.

All transfers during the three months ended March 31, 2013 related to securities held for which there was little market activity for identical or nearly identical securities during the period. The securities were valued using multiple observable inputs when those inputs were available; otherwise the securities were valued using limited observable inputs.

Fair Value Measurements - Level 3 Liabilities

The following table presents information for the three months ended March 31, 2012 regarding liabilities for which ProAssurance had elected fair value treatment.

(In thousands)	March 31, 2012		
	Level 3 Fair Value Measurements - Liabilities		
	2019 Note Payable	Interest rate swap agreement	Total
Balance December 31, 2011	\$14,180	\$4,659	\$18,839
Total (gains) losses realized and unrealized:			
Included in earnings as a part of:			
Net realized investment (gains) losses	868	(244)	624
Settlements	(86)	—	(86)
Balance March 31, 2012	\$14,962	\$4,415	\$19,377
	\$868	\$(244)	\$624

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

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The 2019 Note Payable (the Note) and a related interest rate swap agreement (the Swap) were measured at fair value on a recurring basis as of March 31, 2012 and December 31, 2011, with changes in the fair value of each liability recorded in net realized gains (losses). ProAssurance assumed both liabilities as part of a previous acquisition. The fair value option was elected for the Note and the Swap because valuation at fair value better reflected the economics of the related liabilities and eliminated the inconsistency that would have otherwise resulted from carrying the Note on an amortized cost basis and the Swap at fair value. Both the Note and the Swap were repaid in July 2012. The fair values of these liabilities were determined using the present value of the expected underlying cash flows of each instrument, discounted at rates available on the valuation date for similar instruments issued by entities with a similar credit standing to ProAssurance.

Financial Instruments - Methodologies Other Than Fair Value

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

(In thousands)	March 31, 2013		December 31, 2012	
	Carrying Value	Estimated Fair Value	Carrying Value	Estimated Fair Value
Financial assets:				
Other Investments	\$33,104	\$42,666	\$31,085	\$38,656
Investment in Unconsolidated Subsidiaries	150,649	151,593	87,310	91,528
BOLI	52,850	52,850	52,414	52,414
Other Assets	11,964	11,964	11,400	11,385
Financial liabilities:				
Revolving credit agreement	\$125,000	\$125,000	\$125,000	\$125,000
Other Liabilities	12,544	12,534	12,130	12,085

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

Investment in Unconsolidated Subsidiaries consisted of investments in tax credit partnerships and a non-controlling interest in a limited liability company. Fair values of investments in tax credit partnerships were based on the present value of the cash flows expected to be generated by the partnerships discounted at rates for investments with similar risk structures and repayment periods. The fair value of the LLC interest was estimated as the proceeds ProAssurance would receive upon liquidation of the LLC.

The fair value of the BOLI was equal to the cash surrender value associated with the policies on the valuation date. Other Assets and Other Liabilities primarily consisted of related investment assets and liabilities associated with funded deferred compensation agreements. Other Liabilities also included certain contractual liabilities related to prior business combinations. Fair values of the funded deferred compensation assets and liabilities were based on the NAVs of the underlying securities. The fair values of the business combination liabilities were based on the present value of the expected cash flows, discounted at ProAssurance's assumed incremental borrowing rate on the valuation date for unsecured liabilities with similar repayment structures.

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

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The recorded cost basis and estimated fair value of available-for-sale fixed maturities at March 31, 2013, by contractual maturity, are shown below. Actual maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

(In thousands)	Amortized Cost	Due in one year or less	Due after one year through five years	Due after five years through ten years	Due after ten years	Total Fair Value
Fixed maturities, available for sale						
U.S. Treasury obligations	\$216,932	\$33,718	\$149,918	\$44,190	\$3,178	\$231,004
U.S. Government-sponsored enterprise obligations	55,054	—	51,631	7,684	238	59,553
State and municipal bonds	1,212,808	60,391	414,146	492,665	325,326	1,292,528
Corporate debt	1,460,887	89,847	704,590	706,162	53,103	1,553,702
Residential mortgage-backed securities	281,426					295,347
Agency commercial mortgage-backed securities	45,700					47,436
Other commercial mortgage-backed securities	70,047					74,369
Other asset-backed securities	72,488					73,141
	\$3,415,342					\$3,627,080

Excluding investments in bonds and notes of the U.S. Government, U.S. Government-sponsored enterprise obligations or pre-refunded state and municipal bonds which are 100% backed by U.S. Treasury obligations, no investment in any entity or its affiliates exceeded 10% of shareholders' equity at March 31, 2013.

Securities with a carrying value of \$36.4 million at March 31, 2013 were on deposit with various state insurance departments to meet regulatory requirements. ProAssurance also held securities with a carrying value of \$197.3 million at March 31, 2013 and \$196.2 million at December 31, 2012 that are pledged as collateral security for advances under the Revolving Credit Agreement (see Note 9).

Business Owned Life Insurance (BOLI)

ProAssurance holds BOLI policies on management employees that are carried at the current cash surrender value of the policies (original cost \$33 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.

Other Investments

Other Investments at March 31, 2013 and December 31, 2012 was comprised as follows:

(In millions)	March 31, 2013	December 31, 2012
Investments in LPs/LLCs, at cost	\$28.2	\$25.1
FHLB capital stock, at cost	3.4	4.3
Other, principally an annuity, at amortized cost	1.5	1.7
	\$33.1	\$31.1

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.

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Unconsolidated Subsidiaries

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

(In millions)	March 31, 2013		Carrying Value	
	Unfunded Commitments	Percentage Ownership	March 31, 2013	December 31, 2012
Investment LPs/LLCs:				
Tax credit partnerships	\$55.8	See below	\$150.6	\$87.3
Secured debt fund	32.4	< 20%	7.6	—
Long equity fund	None	< 20%	5.6	—
Long/Short equity fund	None	< 20%	17.0	17.1
Non-public equity funds	44.1	< 20%	17.4	16.6
			\$198.2	\$121.0

Tax credit partnership interests held by ProAssurance generate investment returns by providing tax benefits to fund investors in the form of project operating losses and tax credits. The related properties are principally low income housing projects. ProAssurance's ownership percentage relative to two of the tax credit partnership interests was almost 100%; these interests had a carrying value of \$66.0 million at March 31, 2013. ProAssurance's ownership percentage relative to the remaining tax credit partnership interests was less than 20%; these interests had a carrying value of \$84.6 million at March 31, 2013. All are accounted for under the equity method as ProAssurance does not have the ability to exert control over the partnership.

The Secured debt fund is structured to provide interest distributions and capital appreciation primarily through investments in senior secured debt.

The Long equity fund targets long-term total returns through holdings in public international companies.

The Long/Short equity fund targets absolute returns using a strategy designed to take advantage of event-driven market opportunities.

The Non-public equity funds hold diversified private equities and are structured to provide capital appreciation.

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Investments Held in a Loss Position

The following tables provide summarized information with respect to investments held in an unrealized loss position at March 31, 2013 and December 31, 2012, including the length of time the investment had been held in a continuous unrealized loss position.

(In thousands)	March 31, 2013					
	Total		Less than 12 months		More than 12 months	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
Fixed maturities, available for sale						
U.S. Treasury obligations	\$9,578	\$(301)	\$9,578	\$(301)	\$—	\$—
U.S. Government-sponsored enterprise obligations	2,746	(18)	2,746	(18)	—	—
State and municipal bonds	110,237	(901)	107,956	(878)	2,281	(23)
Corporate debt	142,622	(1,849)	139,865	(1,645)	2,757	(204)
Residential mortgage-backed securities	44,170	(1,043)	43,860	(1,040)	310	(3)
Agency commercial mortgage-backed securities	667	(13)	445	(5)	222	(8)
Other commercial mortgage-backed securities	4,145	(21)	4,145	(21)	—	—
Other asset-backed securities	9,450	(423)	6,257	(21)	3,193	(402)
	\$323,615	\$(4,569)	\$314,852	\$(3,929)	\$8,763	\$(640)
Other investments						
Investments in LPs/LLCs carried at cost	\$4,730	\$(378)	\$3,690	\$(320)	\$1,040	\$(58)

(In thousands)	December 31, 2012					
	Total		Less than 12 months		More than 12 months	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
Fixed maturities, available for sale						
U.S. Treasury obligations	\$4,073	\$(51)	\$4,073	\$(51)	\$—	\$—
State and municipal bonds	11,234	(94)	9,232	(65)	2,002	(29)
Corporate debt	90,154	(1,543)	81,878	(1,377)	8,276	(166)
Residential mortgage-backed securities	10,721	(210)	10,029	(205)	692	(5)
Agency commercial mortgage-backed securities	1,643	(25)	498	(2)	1,145	(23)
Other commercial mortgage-backed securities	2,100	(5)	1,103	(1)	997	(4)
Other asset-backed securities	10,746	(601)	7,707	(20)	3,039	(581)
	\$130,671	\$(2,529)	\$114,520	\$(1,721)	\$16,151	\$(808)
Other investments						
Investments in LPs/LLCs carried at cost	\$9,474	\$(851)	\$8,697	\$(688)	\$777	\$(163)

As of March 31, 2013, there were 446 debt securities (15.4% of all available-for-sale fixed maturity securities held) in an unrealized loss position representing 242 issuers. The single greatest unrealized loss position was approximately \$0.4 million; the second greatest unrealized loss position was approximately \$0.3 million. The securities were evaluated for impairment as of March 31, 2013.

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As of December 31, 2012, there were 142 debt securities (5.7% of all available-for-sale fixed maturity securities held) in an unrealized loss position representing 131 issuers. The single greatest unrealized loss position approximated \$0.6 million; the second greatest unrealized loss position approximated \$0.2 million. The securities were evaluated for impairment as of December 31, 2012.

Each quarter, ProAssurance performs a detailed analysis for the purpose of assessing whether any of the securities it holds in an unrealized loss position have suffered an other-than-temporary impairment in value. A detailed discussion of the factors considered in the assessment is included in Note 1 of the Notes to Consolidated Financial Statements included in ProAssurance's December 31, 2012 Form 10-K.

Fixed maturity securities held in an unrealized loss position at March 31, 2013, excluding asset-backed securities, have paid all scheduled contractual payments and are expected to continue doing so. Expected future cash flows of asset-backed securities held in an unrealized loss position were estimated as part of the March 31, 2013 impairment evaluation using the most recently available six-month historical performance data for the collateral (loans) underlying the security or, if historical data was not available, sector based assumptions, and equaled or exceeded the current amortized cost basis of the security.

Net Investment Income

Net investment income by investment category was as follows:

(In thousands)	Three Months Ended March 31	
	2013	2012
Fixed maturities	\$30,854	\$33,270
Equities	2,183	1,041
Short-term investments and Other invested assets	448	421
Business owned life insurance	436	457
Investment fees and expenses	(1,795)	(1,697)
Net investment income	\$32,126	\$33,492

Net Realized Investment Gains (Losses)

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

(In thousands)	Three Months Ended March 31	
	2013	2012
Total other-than-temporary impairment losses:		
Residential mortgage-backed securities	\$—	\$(245)
Corporate debt	—	(830)
Other investments	—	(131)
Net impairment losses recognized in earnings	—	(1,206)
Gross realized gains, available-for-sale securities	3,114	3,887
Gross realized (losses), available-for-sale securities	(75)	(94)
Net realized gains (losses), trading securities	2,789	777
Change in unrealized holding gains (losses), trading securities	20,852	7,937
Decrease (increase) in the fair value of liabilities carried at fair value	—	(624)
Net realized investment gains (losses)	\$26,680	\$10,677

No impairment losses were recognized in the 2013 three-month period. Impairment losses recognized during the 2012 three-month period were as follows:

ProAssurance recognized impairment losses related to certain residential mortgage-backed securities during the 2012 three-month period because carrying values for those securities were greater than the future cash flows expected to be received from the securities.

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ProAssurance recognized impairments related to corporate debt securities during the 2012 three-month period because the credit standing of the issuers had deteriorated.

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ProAssurance recognized impairments during the 2012 three-month period related to an interest in an LLC, accounted for using the cost method, that was classified as a part of Other Investments. In 2011, the LLC announced a plan to convert to a publicly traded investment fund, and OTTI was recognized in subsequent periods in order to carry the interest at the NAV reported by the fund. The conversion occurred in the second quarter of 2012.

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

	Three Months Ended March 31	
(In thousands)	2013	2012
Balance beginning of period	\$3,301	\$5,870
Additional credit losses recognized during the period, related to securities for which OTTI has been previously recognized	—	67
Balance March 31	\$3,301	\$5,937

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

	Three Months Ended March 31	
(In millions)	2013	2012
Proceeds from sales (exclusive of maturities and paydowns)	\$128.4	\$206.1
Purchases	\$100.8	\$247.6

5. Income Taxes

ProAssurance estimates its annual effective tax rate at the end of each quarterly reporting period which is used to record the provision for income taxes in the interim financial statements. The provision for income taxes is different from that which would be obtained by applying the statutory Federal income tax rate to income before taxes primarily because a portion of ProAssurance's investment income is tax-exempt, because ProAssurance utilizes tax credit benefits transferred from tax credit partnership investments, and because, during the first three months of 2013, ProAssurance recognized a non-taxable gain related to an acquisition.

The IRS has concluded an examination of the 2009 and 2010 returns and has issued a Notice of Proposed Adjustment (NOPA) for these years which would increase our current tax liability by approximately \$130 million. ProAssurance has begun the IRS appeals process and is unable to reliably predict the timing of the final resolution or the ultimate outcome. The contested issues affect only the timing of when certain expense items are deductible for tax purposes and resolution of the NOPA would have no effect on our recorded tax expense, exclusive of interest found to be due on past-due taxes, if any.

At March 31, 2013, ProAssurance had a receivable for federal income taxes of \$29 million, which was carried as a part of Other Assets. ProAssurance had a payable for federal income taxes of \$19 million at December 31, 2012, which was carried as a part of Other Liabilities.

Except for the 2006 tax year, the statutes of limitation are closed for all years prior to 2009. The statute for the 2006 tax year, as well as the 2009 and 2010 tax year, was extended until September 30, 2014.

6. Deferred Policy Acquisition Costs

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

Amortization of deferred policy acquisition costs was \$13.4 million and \$15.1 million for the three months ended March 31, 2013 and 2012, respectively.

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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 \$53.1 million related to previously established reserves for the three months ended March 31, 2013. The favorable net loss development reflects reductions in the Company's estimates of claims severity, principally for the 2005 through 2010 accident years.

For the three months ended March 31, 2012, ProAssurance recognized favorable net loss development of \$47.5 million to reflect reductions in estimated claim severity principally for accident years 2004 through 2009.

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. These types of legal actions arise in the Company's ordinary course of business and, in accordance with GAAP for insurance entities, are considered as a part of the Company's loss reserving process, which is described in detail under "Accounting Policies – Losses and Loss Adjustment Expenses" in Note 1 of the Notes to Consolidated Financial Statements in ProAssurance's 2012 Form 10-K.

ProAssurance has commitments primarily related to non-public investment entities totaling approximately \$168.0 million, expected to be paid as follows: \$78.3 million in 2013, \$68.5 million in 2014 and 2015 combined, and \$21.2 million in 2016 and 2017 combined.

9. Long-term Debt

ProAssurance's outstanding long-term debt consisted of the following:

	(In thousands)	
	March 31, 2013	December 31, 2012
Revolving Credit Agreement, expires in 2016. Outstanding borrowings are not permitted to exceed \$150 million. The interest rate on a borrowing is set at the time the borrowing is initiated or renewed. The outstanding borrowing at March 31, 2013 was fully secured, see Note 4, and carried an interest rate of 0.78%. The current borrowing can be repaid or renewed on June 25, 2013. If renewed, the interest rate will reset.	\$125,000	\$125,000

Covenant Compliance

ProAssurance is currently in compliance with all covenants.

Additional Information

For additional information regarding ProAssurance's long-term debt, see Note 10 of the Notes to Consolidated Financial Statements included in ProAssurance's December 31, 2012 Form 10-K.

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ProAssurance Corporation and Subsidiaries

Notes to Condensed Consolidated Financial Statements (Unaudited)

March 31, 2013

10. Shareholders' Equity

At March 31, 2013 and December 31, 2012, ProAssurance had 100 million shares of authorized common stock and 50 million shares of authorized preferred stock. The Board has the authority to determine provisions for the issuance of preferred shares, including the number of shares to be issued, the designations, powers, preferences and rights, and the qualifications, limitations or restrictions of such shares. To date, the Board has not approved the issuance of preferred stock.

ProAssurance declared cash dividends of \$0.25 per common share for the first quarter of 2013, totaling \$15.4 million, that were paid in April 2013. ProAssurance declared cash dividends of \$0.125 per common share for the first quarter of 2012 which totaled \$7.7 million that were paid in April 2012. The liability for unpaid dividends was included in Other liabilities. No dividends were paid in first quarter 2013 because payment of the regular fourth quarter 2012 dividend was accelerated into December, 2012.

At March 31, 2013, prior Board authorizations of \$135.1 million for the repurchase of common shares or the retirement of outstanding debt remained available for use. ProAssurance did not repurchase any common shares during the three months ended March 31, 2013 and 2012.

Share-based compensation expense was \$2.3 million and \$2.1 million for the three months ended March 31, 2013 and 2012, respectively. Related tax benefits were \$0.8 million and \$0.7 million for the three months ended March 31, 2013 and 2012, respectively.

ProAssurance awarded approximately 39,000 restricted share units and 146,000 (target) performance share units to employees in February 2013. The fair value of each unit awarded was estimated at \$46.97, equal to the market value of a ProAssurance common share on the date of grant. All awards are charged to expense as an increase to equity over the service period (generally the vesting period) associated with the award. Restricted share units and performance share units vest in their entirety at the end of a three-year period following the grant date based on a continuous service requirement and, for performance share units, achievement of a performance objective. Partial vesting is permitted for retirees. A ProAssurance common share is issued for each unit once vesting requirements are met, except that units sufficient to satisfy required tax withholdings are paid in cash. The number of common shares issued for performance share units varies from 75% to 125% of base awards depending upon the degree to which stated performance objectives are achieved. ProAssurance issued approximately 32,000 and 120,000 common shares to employees in February 2013 related to restricted share units and performance share units granted in 2010, respectively. Shares issued for performance share units were awarded at the maximum level (125%).

ProAssurance issued approximately 41,000 and 19,000 common shares to employees in February 2013 and 2012, 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).

Other Comprehensive Income

For all periods presented, other comprehensive income was comprised of unrealized gains and losses, including non-credit impairment losses, arising during the period related to available-for-sale securities less reclassification adjustments for gains (losses) from available-for-sale securities recognized in current period net income (net of tax). At March 31, 2013 and December 31, 2012, accumulated other comprehensive income was comprised entirely of unrealized gains and losses from available-for-sale securities, including non-credit impairment losses, net of tax. Amounts reclassified from accumulated other comprehensive income to net income during the three months ended March 31, 2013 and 2012 included the following:

(In thousands)	Three Months Ended March 31	
	2013	2012
Reclassifications from accumulated other comprehensive income to net income:		
Realized investment gains (losses), available-for-sale securities	\$3,039	\$2,718
Non-credit impairment losses reclassified to earnings, available for sale securities	—	—

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Total amounts reclassified, before tax effect	3,039		2,718	
Tax effect (at 35%)	(1,064)	(951)
Net reclassification adjustments	\$1,975		\$1,767	

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ProAssurance Corporation and Subsidiaries

Notes to Condensed Consolidated Financial Statements (Unaudited)

March 31, 2013

11. Variable Interest Entities

ProAssurance holds passive interests in a number of entities that are considered to be Variable Interest Entities (VIEs) under GAAP guidance. ProAssurance's VIE interests include 1) interests in LPs/LLCs formed for the purpose of achieving diversified equity and debt returns and 2) a limited liability interest in a development stage business operation. ProAssurance VIE interests carried as a part of Other Investments totaled \$28.2 million at March 31, 2013 and \$25.1 million at December 31, 2012. ProAssurance VIE interests carried as a part of Investment in Unconsolidated Subsidiaries totaled \$34.4 million at March 31, 2013 and \$33.7 million at December 31, 2012. ProAssurance has not consolidated these VIE's because it has either very limited or no power to control the activities that most significantly affect the economic performance of these entities and is not the primary beneficiary of any of the entities. ProAssurance's involvement with each entity is limited to its direct ownership interest in the entity. ProAssurance has no arrangements or agreements of significance with any of the entities to provide other financial support to or on behalf of the entity. At March 31, 2013, ProAssurance's maximum loss exposure relative to these investments was limited to the carrying value of ProAssurance's investment in the VIE.

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 and restricted share 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 dilutive for the three-month periods ended March 31, 2013 and 2012.

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

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

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

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

The estimation of professional and products liability losses is inherently difficult and is the subject of significant judgment on the part of management. Loss costs, even for claims with similar characteristics, can vary significantly depending upon many factors, including but not limited to: the nature of the claim, including whether or not the claim is an individual or a mass tort claim, and the personal situation of the claimant or the claimant's family, the outcome of jury trials, the legislative and judicial climate where the insured event occurred, general economic conditions and, for claims involving bodily harm, the trend of healthcare costs. Products and 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 significant judgment, and such estimates require periodic revision.

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

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Acquired Reserves

The acquisition of Medmarc increased our loss reserves by \$201.1 million which represented the fair value of Medmarc's loss reserves at the time of the acquisition. The estimated fair value was calculated as the present value of the expected underlying net cash flows, including a 5% profit margin and a 5% risk premium. Expected net cash flows were derived from the expected loss payment patterns included in an actuarial analysis of Medmarc reserves performed as of December 31, 2012. Actuarial methods used to evaluate Medmarc reserves included the Bornhuetter-Ferguson (Paid and Reported) Method and the Development Method (Paid and Reported) described in Item 2 of ProAssurance 2012 Form 10K. The Adjusted Reported, Adjusted Paid, and the Expected Loss Methods, described below, were also used to evaluate Medmarc's reserves. We supplemented relevant industry data where sufficient Medmarc historical data was not available. Approximately 85% of the reserves assumed in the Medmarc acquisition are products liability reserves and 15% are professional liability reserves.

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

The Expected Loss Method estimates ultimate loss amounts based on an expected ratio of losses per exposure, with the exposure measure often being premium. The expected ratio is then applied to the exposure measure to project ultimate losses for each accident year under evaluation.

Initial Reserve Estimates-Current Accident Year

Considerable judgment is required in both the pricing of our business and in establishing our initial reserves for any current accident year period. The targeted loss ratio in our pricing varies to some extent by jurisdiction, type of coverage and policy limits. For our largest line of business, physician professional liability, we are on average targeting a 75% loss ratio. Due to the lack of available open or closed claims data for the current accident year period, we heavily rely on the loss assumptions used in pricing our business in making our initial estimate of physician professional losses for the current accident year period. For our physician business, we presently and have historically utilized loss ratios that are approximately 8 to 10 percentage points above the ratios we have targeted in our pricing for the current accident year. We believe this appropriately considers inherent risks associated with our physician professional rate development process and the historic volatility of MPL losses and produces a reasonable best estimate of the reserves required to cover actual ultimate losses. We follow the same practice in establishing initial loss reserves for our other professional liability lines. In the current environment this equates to an overall average initial loss ratio of approximately 85% for our professional liability business.

Severity is defined as the average cost of resolving claims and the severity trend is the increase, or decrease, in severity from period to period. Although we remain uncertain regarding the ultimate severity trend to project into the future for our medical professional liability (MPL) business, as discussed in following paragraphs, we have given consideration to observed lower loss costs for this business and reduced rates in recent years. For example, on average, excluding our podiatry business acquired in 2009, we have gradually reduced the premium rates we charge on our standard physician renewal business (our largest MPL line) by approximately 17% from the beginning of 2006 to March 31, 2013.

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Consideration of Severity

The severity trend assumption is a key assumption for both pricing models and the actuarial estimation of reserves. The severity trend is an explicit component of our pricing models, whereas in our reserving process the severity trend's impact is implicit. Our estimate of this trend and our expectations about changes in this trend impact a variety of factors, from the selection of expected loss ratios to the ultimate point estimates established by management. Because of the implicit and wide-ranging nature of severity trend assumptions on the loss reserving process it is not practical to specifically isolate the impact of changing severity trends. However, because severity is an explicit component of our pricing process we can better isolate the impact that changing severity can have on our loss costs and loss ratios as regards our pricing models. For our MPL business, which comprises 90% of our first quarter 2013 gross earned premium, our current pricing models assume a severity trend of 2% to 3% in most states and lines of business. If the severity trend were to be higher by 1 percentage point, the impact would be an increase in our expected loss ratio of this business of 3.2 percentage points, based on current claim disposition patterns. An increase in the severity trend of 3 percentage points would result in a 10.1 percentage point increase in our expected loss ratio. Due to the long tailed nature of MPL claims and the previously discussed historical volatility of loss costs, selection of a severity trend assumption is a subjective process that is inherently likely to prove inaccurate over time. Given the long-tail and volatility, we are generally cautious in making changes to the severity assumptions within our pricing model. Also of note is that all open claims and accident years are generally impacted by a change in the severity trend, which compounds the effect of such a change.

For the 2004 to 2009 accident years both our internal and consulting actuaries have observed an unprecedented reduction in the frequency of MPL claims (or number of claims per exposure unit) that cannot be attributed to any single factor, which has complicated the selection of an appropriate severity trend for our pricing models for this business. It has also made it more challenging to factor severity into the various actuarial methodologies we use to evaluate our reserves. We believe that much of the reduction in claim frequency is the result of a decline in the filing of frivolous lawsuits that have historically been dismissed or otherwise result in no payment of indemnity on the part of our insureds. With fewer frivolous claims being filed we expect that the claims that are filed have the potential for greater average losses, or greater severity. As a result, we cannot be certain as to the impact this decline will ultimately have on the average cost of claims. Based on a weighted average of payments, only 85% of our MPL claims are resolved after eight years for a given accident year. Due to this long tail, it can take several years before we are able to determine what impact, if any, has resulted from the decline in frequency and whether there is a related increase in severity.

Development of Prior Accident Year Reserves

We re-evaluate our previously established reserves each period based on our most recently available claims data and currently available industry trend information. Changes to previously established reserve estimates are recognized in the current period if management's best estimate of ultimate losses differs from the estimate previously established. While management considers a variety of variables in determining its best estimate, in general, as claims age, our methodologies for estimating reserves give more weight to actual loss costs which, as a whole, continue to indicate that ultimate loss costs will be lower than our previous estimates. The development recognized in the first three months of both 2013 and 2012 was primarily attributable to the favorable resolution of MPL claims during the period and an evaluation of established case reserves and paid claims data that indicated that the actual severity associated with the remaining MPL claims will be lower than we had previously estimated. The Critical Accounting Estimates discussion in our 2012 Form 10K and our discussion of acquired reserves, above, include additional information regarding the methodologies used to evaluate our reserves.

Any change in our estimate of net ultimate losses for prior years is reflected in net income in the period in which such changes are made. Over the past several years such changes have been to reduce our estimate of net ultimate losses, resulting in a reduction of reported losses for the period and a corresponding increase in pre-tax income.

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

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Reinsurance

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

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

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 March 31, 2013, all ceded contracts were accounted for as risk transferring contracts.

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

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

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

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

Investment Valuations

We record the majority of our investments at fair value as shown in the table below. At March 31, 2013 the distribution of our investments based on GAAP fair value hierarchies (levels) was as follows:

	Distribution by GAAP Fair Value Hierarchy			March 31, 2013 Total Investments
	Level 1	Level 2	Level 3	
Investments recorded at:				
Fair value	9%	84%	2%	95%
Other valuations				5%

Total Investments

100%

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. All of our fixed maturity and equity security investments are carried at fair value. Our short-term securities are carried at amortized cost, which approximates fair value.

Because of the number of securities we own and the complexity and cost of developing accurate fair values, we utilize multiple independent pricing services to assist us in establishing the fair value of individual securities. The pricing services provide fair values based on exchange traded prices, if available. If an exchange traded price is not available, the pricing

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services, if possible, provide a fair value that is based on multiple broker/dealer quotes or that has been developed using pricing models. Pricing models vary by asset class and utilize currently available market data for securities comparable to ours to estimate the fair value for our security. The pricing services scrutinize market data for consistency with other relevant market information before including the data in the pricing models. The pricing services disclose the types of pricing models used and the inputs used for each asset class. Determining fair values using these pricing models requires the use of judgment to identify appropriate comparable securities and to choose a valuation methodology that is appropriate for the asset class and available data.

The pricing services provide a single value per instrument quoted. We review the values provided for reasonableness each quarter by comparing market yields generated by the supplied value versus market yields observed in the market place. We also compare yields indicated by the provided values to appropriate benchmark yields and review for values that are unchanged or that reflect an unanticipated variation as compared to prior period values. In addition, we compare provided information for consistency with our other pricing services, known market data and information from our own trades, considering both values and valuation trends. We also review weekly trades versus the prices supplied by the services. If a supplied value appears unreasonable, we discuss the valuation in question with the pricing service and make adjustments if deemed necessary. To date, our review has not resulted in any changes to the values supplied by the pricing services.

The pricing services do not provide a fair value unless an exchange traded price or multiple observable inputs are available. As a result, the pricing services may provide a fair value for a security in some periods but not others, depending upon the level of recent market activity for the security or comparable securities.

Level 1 Investments

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

Level 2 Investments

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

Level 3 Investments

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

We also classify as Level 3 our investment interests that are carried at fair value based on a fund-provided net asset value (NAV) for our interest. All investments valued in this manner are LP or LLC interests that hold debt and equity securities. At March 31, 2013 interests valued using a fund-provided NAV totaled \$47.5 million, or 1% of total investments, and were classified as part of our Investment in Unconsolidated Subsidiaries.

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Investments - Other Valuation Methodologies

Certain of our investments, in accordance with GAAP for the type of investment, are measured using methodologies other than fair value. At March 31, 2013 these investments had a carrying value of approximately \$236.6 million, which represented 5% of total investments, as shown in the following table. Additional information about these investments is provided in Notes 3 and 4 of the Notes to Condensed Consolidated Financial Statements.

(In millions)	Carrying Value	GAAP Measurement Method
Other investments:		
Investments in LP/LLCs, at cost	\$28.2	Cost
Federal Home Loan Bank (FHLB) capital stock	3.4	Cost
Other	1.5	Amortized cost
Total other investments	33.1	
Investment in unconsolidated subsidiaries:		
Investments in tax credit partnerships	150.6	Equity
Business owned life insurance	52.9	Cash surrender value
Total investments - Other valuation methodologies	\$236.6	

Investment Impairments

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

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

- third party research and credit rating reports;
- the current credit standing of the issuer, including credit rating downgrades;
- the extent to which the decline in fair value is attributable to credit risk specifically associated with the security or its issuer;
- our internal assessments and those of our external portfolio managers regarding specific circumstances surrounding a security, which can cause us to believe the security is more or less likely to recover its value than other securities with a similar structure;
- for asset-backed securities, the origination date of the underlying loans, the remaining average life, the probability that credit performance of the underlying loans will deteriorate in the future, and our assessment of the quality of the collateral underlying the loan;
- failure of the issuer of the security to make scheduled interest or principal payments;
- any changes to the rating of the security by a rating agency;
- recoveries or additional declines in fair value subsequent to the balance sheet date; and
- our intent to sell and whether it is more likely than not we will be required to sell the security before the recovery of its amortized cost basis.

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

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

from the LP/LLC and audited financial statements of the entity, if available, in considering whether an OTTI exists.

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

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

Deferred Policy Acquisition Costs

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

Deferred Taxes

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

Unrecognized Tax Benefits

We evaluate tax positions taken on tax returns and recognize positions in our financial statements when it is more likely than not that we will sustain the position upon resolution with a taxing authority. If recognized, the benefit is measured as the largest amount of benefit that has a greater than fifty percent probability of being realized. We review uncertain tax positions each period, considering changes in facts and circumstances, such as changes in tax law, interactions with taxing authorities and developments in case law, and make adjustments as we consider necessary. Adjustments to our unrecognized tax benefits may affect our income tax expense, and settlement of uncertain tax positions may require the use of cash. At March 31, 2013, our liability for unrecognized tax benefits approximated \$4.8 million, and related accrued interest approximated \$1.3 million.

Goodwill

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

Accounting Changes

We are not aware of any accounting changes not yet adopted as of March 31, 2013 that would have a material effect on our results of operations or financial position. Note 1 of the Notes to Condensed Consolidated Financial Statements provides additional detail regarding accounting changes.

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Liquidity and Capital Resources and Financial Condition

Overview

ProAssurance Corporation is a holding company and is a legal entity separate and distinct from its subsidiaries. Because the holding company has no other business operations, dividends from its operating subsidiaries represent a significant source of funds for its obligations, including debt service and shareholder dividends. At March 31, 2013, we held cash and liquid investments of approximately \$320.4 million outside our insurance subsidiaries that were available for use without regulatory approval, \$197.3 million of which was pledged as collateral for advances under our credit facility. Our insurance subsidiaries, in aggregate, are permitted to pay dividends of approximately \$311 million over the course of 2013 without the prior approval of state insurance regulators. 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. Our insurance subsidiaries paid no dividends during the first three months of 2013.

Operating Activities and Related Cash Flows

The principal components of our operating cash flows are the excess of premiums collected and net investment income over losses paid and operating costs, including income taxes. Timing delays exist between the collection of premiums and the payment of losses associated with the premiums. Premiums are generally collected within the twelve-month period after the policy is written, while claim payments for those policies 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 used cash flows of approximately \$13.1 million and provided cash flows of approximately \$28.1 million for the three months ended March 31, 2013 and 2012, respectively.

Operating cash flows for the three months ended March 31, 2013 and 2012 compare as follows:

(In millions)	Operating Cash Flow
Cash provided (used) by operating activities for the three months ended March 31, 2012	\$28
Increase (decrease) in operating cash flows:	
Decrease in premium receipts (1)	(20)
Increase in payments to reinsurers (2)	(7)
Decrease in losses paid, net of reinsurance recoveries (3)	18
Decrease in deposit contracts (4)	(7)
Increase in cash paid for other expenses (5)	(3)
Increase in Federal and state income tax payments (6)	(14)
Net cash flow provided (used) by acquisitions (7)	(9)
Other amounts not individually significant, net	1
Cash provided (used) by operating activities for the three months ended March 31, 2013	\$(13)

(1) The reduction in premium receipts reflected lower premium volume written during the preceding twelve months.

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

The timing of our net loss payments varies from period to period because the process for resolving claims is complex and occurs at an uneven pace depending upon the circumstances of the individual claim. The decrease in loss payments for the first three months of 2013 primarily reflected a smaller number of claims resolved with large indemnity payments. Loss payments were not isolated to any one state or to any specific risk groups. We have not seen evidence in our loss data that suggests the decrease in loss payments for the three-month period represents a change in loss trends and as such have not changed our loss assumptions for the current period.

(4) We are party to certain contracts that involve claims handling but do not transfer insurance risk. As required by GAAP, receipts and disbursements for these contracts are not considered as receipts of premium or payments of losses, but rather are considered as deposits received or returned. These contracts do not constitute a significant

business activity for us.

- (5) The increase in cash paid for other expenses was principally attributable to timing differences related to the settlement of certain operating liabilities and various operating expense payments.

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(6) The net increase in tax payments during 2013 primarily reflects a \$20.6 million protective tax payment made related to a dispute with the Internal Revenue Service (IRS), partially offset by a \$6.5 million decrease in the final tax payments for the prior fiscal year. The protective tax payment is discussed in further detail in this section under the heading "Taxes."

(7) The net cash payments made by our acquired entities during 2013 primarily reflect tax payments made for the prior fiscal year, payments made for acquisition related expenses, and a concentration of operating expenses normally paid in the first quarter.

Operating cash flows for the three months ended March 31, 2012 and 2011 compare as follows:

(In millions)	Operating Cash Flow
Cash provided by operating activities three months ended March 31, 2011	\$25
Increase (decrease) in operating cash flows for the three months ended March 31, 2012:	
Increase in premium receipts (1)	5
Decrease in payments to reinsurers (2)	11
Increase in losses paid, net of reinsurance recoveries (3)	(11))
Increase in Federal and state income tax payments (4)	(6))
Other amounts not individually significant, net	4
Cash provided by operating activities three months ended March 31, 2012	\$28

(1) The increase in premium receipts was primarily attributable to increased premium volume during the first three months of 2012.

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

(3) The timing of our net loss payments varies from period to period because the process for resolving claims is complex and occurs at an uneven pace depending upon the circumstances of the individual claim. The increase in paid losses for the first three months of 2012 reflected an increase in claims closed during 2012.

(4) The net increase in tax payments primarily reflected the following:

Estimated tax payments in 2012 were higher as compared to 2011 by \$4.8 million.

Federal tax refunds received in 2011 of \$7.1 million

Payments of \$5.9 million made in 2011 for the 2008 and 2007 tax years as a result of federal tax return audits conducted by the IRS. The payments reduced tax liabilities recognized in prior fiscal years and did not increase or decrease 2011 tax expense.

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. We purchase reinsurance from a number of companies to mitigate concentrations of credit risk. We utilize reinsurance brokers to assist us in the placement of our reinsurance coverage and 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 forces or events we cannot control or anticipate.

Taxes

In December 2012 we received a Notice of Proposed Adjustment (NOPA) from the IRS which disallows a substantial portion of the loss and loss adjustment expense deductions taken for the 2009 and 2010 fiscal years and would thereby increase our current tax liability by approximately \$130 million. We believe that our loss and loss adjustment expense deduction was computed in a manner consistent with tax law, our past practices, and the practices of other liability insurers, and we have

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begun the IRS appeals process. The proposed adjustment represents a temporary timing difference and impacts the timing of deductions, rather than their allowance, and would shift tax from deferred to current tax expense but would not increase total tax expense. Additional tax payments that might be made as a result of the NOPA would come out of our cash and investments and could impact future investment earnings, but, except for interest on past-due taxes, if any, will not change recorded tax expense. We have considered this matter in establishing our liability for uncertain tax matters. We do not know when a final resolution will be reached with the IRS, or the extent, if any, to which we might be required to accelerate our tax payments or the amount of interest, if any, we might be required to pay. In January 2013 we made a \$20.6 million protective tax payment to the IRS in order to reduce interest assessments should the IRS position be fully or partially sustained.

Litigation

We are involved in various legal actions related to insurance policies and claims handling including, but not limited to, claims asserted against us by policyholders. These types of legal actions arise in the ordinary course of business and, in accordance with GAAP for insurance entities, are generally considered as a part of our loss reserving process, which is described in detail under “Critical Accounting Estimates – Reserve for Losses and Loss Adjustment Expenses (reserve for losses or reserve).” We also have other direct actions against the company which we evaluate and account for as a part of our other liabilities. For these corporate legal actions, we evaluate each case separately and establish what we believe is an appropriate reserve based on GAAP guidance related to contingent liabilities.

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Investing Activities and Related Cash Flows

Investment Exposures

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

(\$ in thousands)	Carrying Value	Included in Carrying Value:			(1)	% Total Investments
		Unrealized Gains	Unrealized Losses	Average Rating		
Fixed Maturities						
Government						
U.S. Treasury	\$231,004	\$14,373	\$(301)	AA+	(2) 5	%
U.S. Government-sponsored enterprise	59,553	4,517	(18)	AA+	(2) 1	%
Total government	290,557	18,890	(319)	AA+	(2) 7	%
State and Municipal Bonds						
Pre-refunded						
General obligation	188,944	10,637	—	AA	4	%
Special revenue	349,502	24,288	(203)	AA+	8	%
Total state and municipal bonds	754,082	45,696	(698)	AA	17	%
Corporate Debt	1,292,528	80,621	(901)	AA	30	%
Corporate Debt						
Financial institutions	449,930	24,724	(183)	A	10	%
Communications	117,979	5,725	(140)	BBB	3	%
Utilities/Energy	295,761	21,024	(348)	BBB+	7	%
Industrial	678,789	42,848	(1,174)	BBB+	16	%
Other	11,243	343	(4)	A	<1%	
Total corporate debt	1,553,702	94,664	(1,849)	A-	36	%
Securities backed by:						
Agency mortgages	282,241	14,363	(600)	AA+	(2) 7	%
Non-agency mortgages	6,271	201	(1)	A	<1%	
Subprime home equity loans	7,174	95	(402)	BBB+	<1%	
Alt -A mortgages	6,835	400	(442)	CCC+	<1%	
Agency commercial mortgages	47,436	1,749	(13)	AA+	(2) 1	%
Other commercial mortgages	74,369	4,343	(21)	AAA	2	%
Credit card loans	17,273	513	(10)	AAA	<1%	
Automobile loans	36,142	242	(4)	AAA	1	%
Other asset loans	12,552	226	(7)	AA	<1%	
Total asset-backed securities	490,293	22,132	(1,500)	AA+	11	%
Total fixed maturities	3,627,080	216,307	(4,569)	A+	84	%
Equities						
Financial	80,312	—	—		2	%
Utilities/Energy	39,315	—	—		1	%
Consumer oriented	64,467	—	—		1	%
Technology	14,611	—	—		<1%	
Industrial	39,558	—	—		1	%
All Other	19,482	—	—		<1%	
Total equities	257,745	—	—		6	%
Short-Term	149,384	—	—		3	%
Business-owned life insurance (BOLI)	52,850	—	—		1	%
Investment in Unconsolidated Subsidiaries						
Investment in tax credit partnerships	150,649	—	—		3	%
Investment in LPs, carried at NAV	47,540	—	—		1	%
	198,189	—	—		5	%

Total investment in unconsolidated subsidiaries

Other Investments					
FHLB capital stock	3,449	—	—	<1%	
Investments in LP/LLCs, carried at cost	28,173	—	—	1	%
Other	1,482	—	—	<1%	
Total other investments	33,104	—	—	1	%
Total Investments	\$4,318,352	\$216,307	\$(4,569)	100	%

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

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

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

We manage our investments to ensure that we will have sufficient liquidity to meet our obligations, taking into consideration the timing of cash flows from our investments, including interest payments, dividends and principal payments, as well as the expected cash flows to be generated by our operations. In addition to the interest and dividends we will receive, we anticipate that between \$50 million and \$70 million of our investments will mature (or be paid down) each quarter of the next year and become available, if needed, to meet our cash flow requirements. The primary outflow of cash at our insurance subsidiaries is related to paid losses and operating costs, including income taxes. The payment of individual claims cannot be predicted with certainty; therefore, we rely upon the history of paid claims in estimating the timing of future claims payments. To the extent that we may have an unanticipated shortfall in cash we may either liquidate securities or borrow funds under existing borrowing arrangements through our credit facility and the FHLB system. In December 2012 we elected to partially fund our acquisition of Medmarc by borrowing \$125 million from our existing credit facility on a fully secured basis as this allowed us to continue to hold rather than liquidate certain higher yielding securities. At March 31, 2013, \$25 million of the credit facility remains available for use. Given the duration of our investments, we do not foresee a shortfall that would require us to meet operating cash needs through additional borrowings. Additional information regarding the credit facility is detailed in Note 9 of the Notes to Condensed Consolidated Financial Statements.

Our investment portfolio continues to be primarily composed of high quality fixed income securities with approximately 93% of our fixed maturities being investment grade securities as determined by national rating agencies. The weighted average effective duration of our fixed maturity securities at March 31, 2013 was 3.9 years; the weighted average effective duration of our fixed maturity securities combined with our short-term securities and cash was 3.7 years.

The carrying value of our equities portfolio increased \$55.1 million during the three months ended March 31, 2013. The increase is primarily attributable to the equity portfolio obtained from the acquisition of Medmarc and market appreciation.

The carrying value of our tax credit partnerships was approximately \$150.6 million at March 31, 2013 and \$87.3 million at December 31, 2012. The carrying value reflected our total commitments (both funded and unfunded) to the partnerships, less amortization, since our initial investment. These investments are comprised of separate limited partner interests designed to generate investment returns by providing tax benefits to investors in the form of project operating losses and tax credits. The related properties are principally low income housing properties. We fund these investments based on funding schedules maintained by the partnerships. We funded approximately \$30.2 million during the three months ended March 31, 2013, and \$12.2 million during the three months ended March 31, 2012. Approximately \$55.8 million and \$20.5 million of our total commitments to the tax credit partnerships had not yet been funded as of March 31, 2013 and December 31, 2012, respectively.

During the three months ended March 31, 2013, we increased our investments in investment fund LPs/LLCs by approximately \$15.0 million. As of March 31, 2013, we had unfunded commitments to investment fund LPs/LLCs of \$112.2 million. The remaining commitments will be paid over a period of approximately 5 years as requested by the fund managers.

European Debt Exposure

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

Our debt securities at March 31, 2013 included \$197.9 million (5% of our total investments) where the issuer is domiciled in Europe or the underlying revenue stream supporting the security is European.

Our investments outside of Europe, and particularly our financial sector investments, could also be negatively affected by a significant European economic crisis. At March 31, 2013 we held non-European financial sector debt securities of approximately \$375.3 million.

Our reinsurers typically operate globally and have large investment portfolios which may be linked directly or indirectly to the European economy. As of December 31, 2012, two of our largest reinsurers were domiciled in Europe; our net receivables with these reinsurers totaled approximately \$53 million. Net amounts due from reinsurers approximated \$233.2 million at March 31, 2013.

We do not currently write insurance policies in Europe and do not have any notes or accounts receivable from European issuers, exclusive of our reinsurance receivables.

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Acquisitions

We acquired a Nevada reciprocal exchange (IND) on November 30, 2012 through a conversion from a reciprocal to a stock insurance company. IND, which had net earned premium for the 2012 calendar year of approximately \$9.4 million, primarily provides medical professional liability insurance to physicians. We acquired Medmarc Mutual Insurance Company, now Medmarc Casualty Insurance Company, and its subsidiaries (Medmarc) effective January 1, 2013 through a sponsored demutualization, as discussed in more detail in Note 2 of the Notes to Condensed Consolidated Financial Statements. Medmarc is an underwriter of products liability insurance for medical technology and life sciences companies and also underwrites a book of legal professional liability insurance. Medmarc had net earned premium for the 2012 calendar year of \$30.0 million, of which \$20.9 million related to medical and life sciences corporate liability coverages, and \$9.1 million related to legal professional liability coverages. A gain was recognized on the acquisition of Medmarc of \$35.5 million as the estimated fair value of net assets acquired exceeded the purchase consideration given. Note 2 of the Notes to Condensed Consolidated Financial Statements provides additional information regarding acquisitions.

Financing Activities and Related Cash Flows

Treasury Shares

We did not repurchase any common shares during the three months ended March 31, 2013 or 2012. At March 31, 2013, approximately \$135.1 million of Board authorizations for the repayment of debt or repurchase of common shares remained available for use.

Shareholder Dividends

The Board of Directors of ProAssurance declared regular quarterly cash dividends totaling \$15.4 million and \$7.7 million during the first quarters of 2013 and 2012, respectively. The dividends were paid in April 2013 and 2012, respectively. No dividends were paid during the first quarter of 2013, because we accelerated the payment of dividends declared during the fourth quarter of 2012 that would normally have been paid in January 2013. Dividends of \$7.6 million declared in the fourth quarter of 2011 were paid during the first quarter of 2012. Any decision to pay future cash dividends is subject to the Board's final determination after a comprehensive review of financial performance, future expectations and other factors deemed relevant by the Board. The liability for unpaid dividends is included in Other Liabilities.

Debt

We have a revolving credit agreement that allows us to borrow up to \$150 million for general corporate purposes, including, but not limited to, short-term working capital, share repurchases as authorized by the Board, and support for other activities we enter into in the normal course of business. The agreement expires April 15, 2016. At March 31, 2013 and December 31, 2012 we had borrowed \$125 million under the agreement, on a fully secured basis. The borrowing at March 31, 2013 is repayable in June 2013, but repayment can be deferred until expiration of the credit agreement.

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

ProAssurance is currently in compliance with all covenants associated with the revolving credit agreement. Additional information regarding our debt is provided in Note 9 of the Notes to Condensed Consolidated Financial Statements.

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Overview of Results—Three Months Ended March 31, 2013 and 2012

Net income and Operating income (a non-GAAP financial measure, see reconciliation on the following page) are presented in the table below. The \$57 million improvement in net income in 2013 as compared to 2012 is primarily attributable to a \$35.5 million gain on an acquisition and a \$16.0 million increase in net realized investment gains.

(In millions, except per share data)	Three Months Ended	
	March 31	
	2013	2012
Net income	\$112.9	\$55.6
Operating income	\$60.0	\$48.2
Net income per diluted share	\$1.82	\$0.90
Operating income per diluted share	\$0.97	\$0.78

Results for the three months ended March 31, 2013 and 2012 compare as follows:

Revenues

Net premiums earned decreased during the 2013 three-month period by approximately \$2.1 million or 1.5%. Our acquisitions of Medmarc and IND contributed an additional \$10.2 million of net premiums earned during the 2013 three-month period. In addition, the favorable emergence of losses ceded to our reinsurers resulted in a \$4.8 million reduction to ceded premium under the variable component of our reinsurance arrangements. These positive factors were offset by a competitive marketplace and a \$6.9 million reduction in tail premium.

Our net investment result (which includes both net investment income and earnings from unconsolidated subsidiaries) increased \$0.5 million or 1.5% for the 2013 three-month period. Net investment income decreased during the 2013 three-month period primarily due to lower yields on our fixed income portfolio, while earnings from unconsolidated subsidiaries increased due to stronger earnings from investment LPs.

Net realized investment gains in the 2013 three-month period were approximately \$16.0 million higher than in 2012. The change was principally attributable to an increase in our average equity trading portfolio investment and improved stock market yields.

Expenses

Current accident year net losses decreased by \$7.0 million or 5.9% in the 2013 three-month period. The decline was principally attributable to lower risk exposures and changes to our mix of risks. Favorable development of prior accident year reserves reduced calendar year net losses by \$53.1 million and \$47.5 million for the 2013 and 2012 three-month periods, respectively.

Underwriting, policy acquisition and operating expenses increased by \$2.9 million or 8.4% in the 2013 three-month period, which primarily reflected the inclusion of the operating costs of newly acquired entities, Medmarc and IND, a portion of which were non-recurring. Additionally, the amortization of deferred policy acquisition costs decreased in 2013, partially offsetting the expense increases associated with the new entities.

Ratios

Our current accident year net loss ratio decreased 3.8 percentage points in the 2013 three-month period, primarily reflecting a favorable effect from changes to our estimate of ceded premium and a reduced number of tail risks insured. Our calendar year net loss ratio was 42.8% for the 2013 three-month period as compared to 51.4% for the 2012 three-month period, with the decrease reflecting the improved current accident year net loss ratio and the emergence of a higher amount of favorable development in 2013.

Our underwriting expense ratio increased 2.5 percentage points in the 2013 three-month period, principally reflecting the effect of lower net premiums earned in 2013 and the effect of larger non-recurring expenses in 2013 as compared to 2012.

Our operating ratio (calculated as our combined ratio, less our investment income ratio) decreased by 5.4 percentage points in the 2013 three-month period, reflecting an improved net loss ratio, partially offset by a higher expense ratio and a lower investment ratio in 2013.

Return on equity was 13.4% in the 2013 three-month period and 10.2% in the 2012 three-month period. The calculation of return on equity for the 2013 three-month period excluded the effect of the \$35.5 million gain on acquisition.

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Book Value per Share

Our book value per share at March 31, 2013 as compared to December 31, 2012 is shown in the following table. Due to the size of our Shareholders' Equity (approximately \$2.4 billion at March 31, 2013), 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.

	Book Value Per Share
Book Value Per Share at December 31, 2012	\$36.85
Increase (decrease) to book value per share during the three months ended March 31, 2013 attributable to:	
Dividends declared	(0.25)
Net income	1.83
Decline in accumulated other comprehensive income	(0.13)
Other	(0.11)
Book Value Per Share at March 31, 2013	\$38.19

Non-GAAP Financial Measures

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

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

(In thousands, except per share data)	Three Months Ended March 31	
	2013	2012
Net income	\$112,850	\$55,645
Items excluded in the calculation of operating income:		
Net realized investment (gains) losses	(26,680)	(10,677)
Guaranty fund assessments (recoupments)	(1)	(23)
Gain on Acquisition	(35,492)	—
Effect of confidential settlements, net	—	(714)
Pre-tax effect of exclusions	(62,173)	(11,414)
Tax effect, at 35%, exclusive of non-taxable gain on acquisition	9,338	3,995
Operating income	\$60,015	\$48,226
Per diluted common share:		
Net income	\$1.82	\$0.90
Effect of exclusions	(0.85)	(0.12)
Operating income per diluted common share	\$0.97	\$0.78

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Results of Operations—Three Months Ended March 31, 2013 Compared to Three Months Ended March 31, 2012
Selected consolidated financial data for each period is summarized in the table below.

(\$ in thousands, except per share data)	Three Months Ended March 31		Change
	2013	2012	
Revenues:			
Net premiums earned	\$134,578	\$136,659	\$(2,081)
Net investment income	32,126	33,492	(1,366)
Equity in earnings (loss) of unconsolidated subsidiaries	(223)	(2,066)	1,843
Net investment result	31,903	31,426	477
Net realized investment gains (losses)	26,680	10,677	16,003
Other income	1,813	1,809	4
Total revenues	194,974	180,571	14,403
Expenses:			
Losses and loss adjustment expenses	60,887	78,305	(17,418)
Reinsurance recoveries	(3,261)	(8,106)	4,845
Net losses and loss adjustment expenses	57,626	70,199	(12,573)
Underwriting, policy acquisition and operating expenses	37,285	34,398	2,887
Interest expense	371	825	(454)
Total expenses	95,282	105,422	(10,140)
Gain on acquisition	35,492	—	35,492
Income before income taxes	135,184	75,149	60,035
Income taxes	22,334	19,504	2,830
Net income	\$112,850	\$55,645	\$57,205
Earnings per share:			
Basic	\$1.83	\$0.91	\$0.92
Diluted	\$1.82	\$0.90	\$0.92
Net loss ratio	42.8	% 51.4	% (8.6)
Underwriting expense ratio	27.7	% 25.2	% 2.5
Combined ratio	70.5	% 76.6	% (6.1)
Operating ratio	46.6	% 52.0	% (5.4)
Tax ratio	16.5	% 26.0	% (9.5)
Return on equity*	13.4	% 10.2	% 3.2

* Annualized. Gain on acquisition is excluded from this calculation.

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

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Premiums Written

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

Gross, ceded and net premiums written were as follows:

(\$ in thousands)	Three Months Ended March 31					
	2013	2012	Change			
Gross premiums written	\$163,210	\$170,448	\$(7,238)	)	(4.2	%)
Ceded premiums written	(13,157)	(12,450)	(707)	)	5.7	%)
Net premiums written	\$150,053	\$157,998	\$(7,945)	)	(5.0	%)

Gross Premiums Written

Gross premiums written by component were as follows:

(In thousands)	Three Months Ended March 31					
	2013	2012	Change			
Gross premiums written:						
Professional liability						
Physicians, twelve month term	\$116,915	\$125,973	\$(9,058)	)	(7.2	%)
Physicians, twenty-four month term	6,433	6,050	383	)	6.3	%)
Total Physicians	123,348	132,023	(8,675)	)	(6.6	%)
Other healthcare providers	11,483	12,007	(524)	)	(4.4	%)
Facilities, including hospitals	7,585	7,076	509	)	7.2	%)
Legal professionals	8,072	5,699	2,373	)	41.6	%)
Tail coverages, all policy types	6,319	13,197	(6,878)	)	(52.1	%)
Total professional liability	156,807	170,002	(13,195)	)	(7.8	%)
Medical and life science products liability	5,885	—	5,885	)	nm	
Other	518	446	72	)	16.1	%)
Total	\$163,210	\$170,448	\$(7,238)	)	(4.2	%)

Our gross written premium in the above table for the three months ended March 31, 2013 includes premium contributed by entities acquired subsequent to March 31, 2012 as follows:

(In thousands)	Three Months Ended March 31 2013
Gross premiums written:	
Professional liability	
Physicians, twelve month term	\$3,476
Legal professionals	2,737
Total professional liability	6,213
Medical and life science products liability	5,885
Total	\$12,098

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Physician policies were our greatest source of premium revenues in both 2013 and in 2012. Exclusive of the \$3.5 million increase attributable to acquisitions, gross written premiums for physician policies with a twelve month term decreased by approximately \$12.5 million as compared to the first quarter of 2012, reflecting the impact of an 87% retention rate and largely flat pricing on renewal business, partially offset by approximately \$5 million of new physician business.

We offer twenty-four month term policies to our physician insureds in one selected jurisdiction. The premium associated with both years is included in written premium in the period the policy is written; comparison of gross written premium between successive years reflects volume differences that have no effect on earned premium. Our retention rate for our standard physician business was approximately 87% and 92% for the three months ended March 31, 2013 and 2012, respectively. We calculate our retention rate as retained premium divided by all premium subject to renewal. Retention rates are affected by a number of factors. We may lose insureds to competitors or to alternative insurance mechanisms such as risk retention groups or self-insurance entities (often when physicians join hospitals or large group practices) or due to pricing or other issues. We may choose not to renew an insured as a result of our underwriting evaluation. Insureds may also terminate coverage because they have left the practice of medicine for various reasons, principally for retirement but also for personal reasons or due to disability or death. The decline in 2013 as compared to 2012 was primarily attributable to business lost to competitors, principally over pricing that did not meet our profit objectives.

The pricing of our renewed physician business averaged 1% lower than the expiring premiums during 2013. The pricing of our business includes the effects of filed rates, surcharges and discounts. We continue to base our pricing on expected losses, as indicated by our historical loss data and available industry loss data. We are committed to a rate structure that will allow us to fulfill our obligations to our insureds, while generating competitive returns for our shareholders.

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

Our facilities premium which includes hospitals, surgery centers and other facilities remained relatively flat in 2013. The increase in legal professionals premium for 2013 is principally attributable to our acquisition of Medmarc. Our legal professionals premiums are sold throughout the United States, principally through agent and brokerage arrangements.

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

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

Ceded Premiums Written

Ceded premiums written compared as follows:

(\$ in thousands)	Three Months Ended March 31				
	2013	2012	Change		
Ceded premiums written, exclusive of separately listed items below (1)	\$10,320	\$12,076	\$(1,756)	(14.5) %
Ascension Health Certitude program (2)	2,817	374	2,443	>100%	
Fully reinsured clinic program begun in 2013 (3)	2,404	—	2,404	nm	
Premiums ceded associated with acquired entities (4)	2,446	—	2,446	nm	
Reduction in premiums owed under reinsurance agreements, prior accident years (5)	(4,830)	—	(4,830)	nm	
Total ceded premiums written	\$13,157	\$12,450	\$707	5.7	%

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

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Ceded premiums for the three months ended March 31, 2013 and 2012 compare as follows:

As discussed previously the premium that we cede under our reinsurance arrangements is determined, in part, by (1) the losses ceded under these arrangements. In the first quarter of 2013 we are projecting (estimating) fewer losses ceded under our reinsurance arrangements and thus lower ceded premiums.

We share the risk of loss for policies written or renewed under the Ascension Health (Ascension) Certitude (2) program with an Ascension affiliate under a quota share agreement. Growth in the program increased ceded premium in 2013 as compared to 2012.

During 2013, we began a program with a large clinic to provide coverage for the clinic and its related physicians through policies that are fully reinsured outside of our primary reinsurance agreements. This program does not (3) produce any net written premium but generates ceding commissions over the term of the policies, which reduces our expenses.

The business written by Medmarc and IND is currently reinsured under separate reinsurance arrangements that (4) existed at the time of those acquisitions.

Given the length of time that it takes to resolve our claims, many years may elapse before all losses recoverable under a reinsurance agreement are known. As a part of the process of estimating our loss reserves we also make estimates regarding the amounts recoverable under our reinsurance agreements. As previously discussed, the (5) amounts ultimately owed under our reinsurance agreements are subject to the losses ceded under the agreements. In the current period we have decreased the expected losses and associated recoveries for prior year ceded losses, and this has in turn resulted in a decrease to our estimate of premiums ceded under these treaties. Decreases to estimates of premiums ceded related to prior accident years are fully earned in the period the change in estimates occur.

Ceded Premiums Ratio

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

	Three Months Ended March 31		
	2013	2012	Change
Ceded premiums ratio, excluding other listed factors	7.2	% 7.1	% 0.1
Effect on ceded premiums ratio from:			
Ascension Certitude program	1.6	% 0.2	% 1.4
Clinic fully reinsured outside primary reinsurance agreements	1.4	% —	% 1.4
Premiums ceded associated with acquired entities	1.0	% —	% 1.0
Reduction in premiums owed under reinsurance agreements, prior accident years	(3.1	%) —	%) (3.1)
Ceded premiums ratio, as reported	8.1	% 7.3	% 0.8

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Net Premiums Earned

Net premiums earned were as follows:

(\$ in thousands)	Three Months Ended March 31					
	2013	2012	Change			
Premiums earned	\$143,532	\$147,602	\$ (4,070)	)	(2.8	%)
Premiums ceded	(8,954	) (10,943	) 1,989	)	(18.2	%)
Net premiums earned	\$134,578	\$136,659	\$ (2,081)	)	(1.5	%)

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

Gross premiums earned were lower in 2013 as compared to 2012 reflecting the pro-rata effect of lower physician premiums written during the preceding twelve months, including a \$6.9 million decline in tail premium for the 2013 three-month period, offset by additional earned premium of \$13.2 million contributed by Medmarc and IND. Our 2013 gross earned premium includes approximately \$11.2 million of earned premium associated with Medmarc and IND policies written prior to our acquisition of these operations. We expect Medmarc and IND policies written pre-acquisition to contribute gross earned premium of approximately \$8.8 million, \$4.0 million and \$1.2 million in the second, third and fourth quarters of 2013, respectively.

The decline in premiums ceded during 2013 reflected the previously discussed \$4.8 million reduction related to prior accident years, partially offset by increases attributable to our Ascension business and the acquisitions of Medmarc and IND.

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

Net Investment Income

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

Net investment income by investment category was as follows:

(\$ in thousands)	Three Months Ended March 31					
	2013	2012	Change			
Fixed maturities	\$30,854	\$33,270	\$(2,416)	)	(7.3	%)
Equities	2,183	1,041	1,142		>100%	
Short-term investments and other invested assets	448	421	27		6.4	%
Business owned life insurance	436	457	(21)	)	(4.6	%)
Investment fees and expenses	(1,795)	(1,697)	(98)	)	5.8	%
Net investment income	\$32,126	\$33,492	\$(1,366)	)	(4.1	%)

Fixed Maturities

Our average investment in fixed maturities was flat for the three months ended March 31, 2013 as compared to the same period in 2012. In 2012 we repaid debt, paid a special dividend, and increased our allocations to other asset classes, all of which reduced the funds available for investment in our fixed portfolio. Yields for our fixed maturity portfolio were generally lower in 2013. In order to maintain the quality and duration of our portfolio, we must reinvest maturities, paydowns and proceeds from sales in our fixed income portfolio at yields that are lower than the average yield on our portfolio. The result is that while the size of our fixed income portfolio remains largely the same, it is, in the aggregate, generating lower income. Additionally, the yields on fixed maturity securities acquired in the Medmarc and IND transactions, after adjustment as required by GAAP purchase accounting rules, approximated market yields on the acquisition dates which lowered our 2013 average consolidated tax equivalent yield by approximately 21 basis points. Yields for 2013 also reflected lower income from Treasury Inflation-Protected Securities of \$0.5 million. Average yields for our fixed maturity securities during the three months ended March 31, 2013 and 2012 were as follows:

	Three Months Ended March 31	
	2013	2012
Average income yield	3.6%	3.8%
Average tax equivalent income yield	4.2%	4.4%
Equities		

Income from our equity portfolio increased in the 2013 three-month period as compared to the 2012 three-month period primarily reflecting an increase in average investment balances of approximately 104% in 2013. Given the challenge in finding compelling returns in the fixed income portfolio and the sensitivity of the value of the fixed income portfolio to rising interest rates, we have increased our allocation to dividend yielding equities and other non-fixed income investments.

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Equity in Earnings (Loss) of Unconsolidated Subsidiaries

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

(In thousands)	Three Months Ended March 31		
	2013	2012	Change
Investment LPs	\$1,848	\$590	\$1,258
Business LLC interest	—	(546)	) 546
Tax credit partnerships	(2,071	) (2,110	) 39
Equity in earnings (loss) of unconsolidated subsidiaries	\$(223	) \$(2,066	) \$1,843

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

Our business LLC interest is a non-controlling interest in an entity that began active business in 2011. We recognize quarterly our allocable portion of the operating results reported by the LLC. During 2012, operating losses reduced the carrying amount of our interest to zero and we no longer believe that the entity will be able to produce operating profits.

Our tax credit investments are designed to generate returns by providing tax benefits in the form of project operating losses and tax credits. Our tax credit partnerships reduced our tax expenses by approximately \$4.5 million and \$2.6 million during the three months ended March 31, 2013 and 2012, respectively, while we recognized \$2.1 million of pre-tax amortization for both periods (approximately \$1.3 million after tax) on these investments as noted in the table above.

Non-GAAP Financial Measure – Tax Equivalent Investment Result

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

(In thousands)	Three Months Ended March 31		
	2013	2012	
Net investment income, as reported for GAAP	\$32,126	\$33,492	
Taxable equivalent adjustments, calculated using the 35% federal statutory tax rate:			
State and municipal bonds	4,922	4,684	
BOLI	235	246	
Dividends received	243	267	
Pro forma tax-equivalent net investment income	37,526	38,689	
Equity in earnings (loss) of unconsolidated subsidiaries, as reported for GAAP	(223) (2,066)
Taxable equivalent adjustment, calculated using the 35% federal statutory tax rate:			
Tax credit partnerships	6,874	4,043	
Pro forma tax-equivalent equity in earnings (loss) of unconsolidated subsidiaries	6,651	1,977	
Pro forma tax-equivalent investment results	\$44,177	\$40,666	

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Net Realized Investment Gains (Losses)

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

(In thousands)	Three Months Ended	
	March 31	
	2013	2012
Other-than-temporary impairment losses, total:		
Residential mortgage-backed securities	\$—	\$(245)
Corporate debt	—	(830)
Other investments	—	(131)
Net impairment losses recognized in earnings	—	(1,206)
Gross realized gains, available-for-sale securities	3,114	3,887
Gross realized (losses), available-for-sale securities	(75)	(94)
Net realized gains (losses), trading securities	2,789	777
Change in unrealized holding gains (losses), trading securities	20,852	7,937
Decrease (increase) in the fair value of liabilities carried at fair value	—	(624)
Net realized investment gains (losses)	\$26,680	\$10,677

No impairments were recognized in the three months ended March 31, 2013. All impairments of debt securities recognized during 2012 were credit-related.

The impairment recognized as part of Other investments during the three months ended March 31, 2012 related to an interest in an LLC which we accounted for using the cost method. The LLC announced in 2011 that it planned to convert to a publicly traded investment fund and we impaired the investment to the NAV reported by the fund during the first quarter of 2012. The conversion occurred during the second quarter of 2012.

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

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

Losses and Loss Adjustment Expenses

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

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

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The following table summarizes calendar year net losses and net loss ratios for the three months ended March 31, 2013 and 2012 by separating losses between the current accident year and all prior accident years.

(\$ In millions)	Net Losses		
	Three Months Ended March 31		
	2013	2012	Change
Current accident year:			
PRA all other	\$102.6	\$117.7	\$(15.1)
Acquisitions	8.1	—	8.1
Consolidated	\$110.7	\$117.7	\$(7.0)
Prior accident years:			
PRA all other	\$(53.1)	\$(47.5)	\$(5.6)
Acquisitions	—	—	—
Consolidated	\$(53.1)	\$(47.5)	\$(5.6)
Calendar year:			
PRA all other	\$49.5	\$70.2	\$(20.7)
Acquisitions	8.1	—	8.1
Consolidated	\$57.6	\$70.2	\$(12.6)

Our current accident year net loss ratios for the three months ended March 31, 2013 and 2012 compare as follows:

	Net Loss Ratios*				
	Three Months Ended March 31				
	2013	2012	Change		
Current accident year net loss ratio, excluding other listed factors	84.4	%	84.0	%	0.4
Effect attributable to:					
Reduction in premiums owed under reinsurance agreements, prior accident years	(3.4	%)	—	%	(3.4)
Tail coverages	1.8	%	2.1	%	(0.3)
Net losses, acquisitions	(0.5	%)	—	%	(0.5)
Current accident year net loss ratio, as reported	82.3	%	86.1	%	(3.8)
Prior accident year net loss ratio	(39.5	%)	(34.7	%)	(4.8)
Calendar year net loss ratio	42.8	%	51.4	%	(8.6)

* Net losses as specified divided by net premiums earned.

The decrease in our current accident year net loss ratio during the first three months of 2013 principally reflected the net effect of the following:

Net earned premium in 2013 was increased by approximately \$4.8 million due to a reduction to premiums owed under reinsurance agreements for prior accident years. This increase to net earned premium reduced the 2013 current accident year ratio. There was no such reduction in 2012.

Our average net loss ratio was increased in both 2013 and 2012 due to tail coverages because we expected higher losses for these coverages than for our other professional liability coverages; however, the effect was less in 2013 due to a smaller amount of earned premium from tail coverages as compared to 2012.

Loss ratios associated with the business we acquired from Medmarc and IND, particularly the products liability business, were lower than the average for our other business, which decreased our average current accident year net loss ratio for 2013 as compared to 2012.

We recognized favorable loss development related to previously established reserves during the three months ended March 31, 2013 of \$53.1 million within our retained layers of coverage (generally, \$1 million and below) and \$6.9 million related to our ceded coverage layers (generally, above \$1 million). The reduction to gross losses in the ceded coverage layers

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was entirely offset by a corresponding reduction to loss recoveries. The net favorable development recognized of \$53.1 million principally related to accident years 2005 through 2010; none related to the reserves acquired from Medmarc and IND. We recognized net favorable loss development of \$47.5 million related to our retained layers of coverage during the three months ended March 31, 2012, primarily related to accident years 2004 through 2009. A detailed discussion of factors influencing our recognition of loss development recognized is included in the Critical Accounting Estimates section of Item 2, under the caption "Reserve for Losses and Loss Adjustment Expenses." Assumptions used in establishing our reserve are regularly reviewed and updated by management as new data becomes available. Any adjustments necessary are reflected in the current operations. Due to the size of our reserve, even a small percentage adjustment to the assumptions can have a material effect on our results of operations for the period in which the change is made, as was the case in both 2013 and 2012.

Underwriting, Policy Acquisition and Operating Expenses

The table below provides a comparison of the three months ended March 31, 2013 and 2012 underwriting, policy acquisition and operating expenses:

(\$ in thousands)	Three Months Ended March 31			8.4	%
	2013	2012	Change		
Underwriting, policy acquisition and operating expenses	\$37,285	\$34,398	\$2,887		

Our expenses reflect an increase in 2013 as compared to 2012 because of both the additional operations acquired from Medmarc and IND and the effect of non-recurring costs incurred in both 2013 and 2012.

Exclusive of the non-recurring expenses discussed below, expenses increased in 2013 as compared to 2012 by \$2.0 million. The increase primarily consisted of additional expenses of \$2.8 million associated with the operations acquired from Medmarc and IND, partially offset by lower amortization of deferred policy acquisition costs of \$0.9 million due to the decline in premium volume exclusive of our acquisitions. Medmarc and IND policy acquisition expenses were approximately \$1.8 million lower than would be considered normal due to the application of GAAP purchase accounting rules whereby the capitalized policy acquisition costs for policies written prior to the acquisition date were written off rather than being expensed ratably over the term of the associated insurance policy.

Our 2012 expenses included, on a net basis, approximately \$2.0 million of expenses that were non-recurring in nature, as follows: \$1.3 million related to the enhancement of our customer service capabilities, \$0.8 million of higher amortization of deferred policy acquisition costs (as compared to 2013) that was attributable to the prospective adoption of new accounting guidance as of January 1, 2012, and \$0.4 million related to the discontinuation of certain agency operations. Offsetting these higher costs was a \$0.7 million reduction in expenses resulting from recoveries related to the settlement of litigation.

Our 2013 expenses included, on a net basis, approximately \$2.9 million of expenses that were non-recurring in nature, as follows: \$1.8 million of Medmarc and IND transaction related costs comprised of principally professional fees and one time compensation costs, and \$1.1 million of other costs specific to the first quarter of 2013.

Underwriting Expense Ratio (the Expense Ratio)

	Underwriting Expense Ratio			Change	
	Three Months Ended March 31				
	2013	2012			
Underwriting expense ratio, excluding listed factors	23.8	% 23.7	% 0.1		
Reduction in premiums owed under reinsurance agreements, prior accident years	(0.8	%) —	% (0.8)	
Reduction in net premiums earned from prior year (see below)	2.5	% —	% 2.5		
Non-recurring expenses	2.2	% 1.5	% 0.7		
Underwriting expense ratio, as reported	27.7	% 25.2	% 2.5		

The increase in our consolidated underwriting expense ratio for 2013 was attributable to both the decline in net premiums earned, exclusive of premium earned from acquisitions and reductions to our estimate of ceded premiums (see discussion under "Premiums"), and to the effect of non-recurring expenses in 2013 as compared to 2012, as previously discussed. The normal operating expenses of our acquired business had a nominal effect on the ratio as it

was offset, almost in its entirety, by the effect on the ratio of the net premium earned contributed by our acquired business.

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Interest Expense

Interest expense declined during the three months ended March 31, 2013 as compared to the same period in 2012. Average outstanding debt for the 2012 three-month period was approximately \$50 million and consisted of long-term debt repaid during the third quarter of 2012. Average outstanding debt for the 2013 three-month period was \$125 million, all of which was under our revolving credit agreement and bore a more favorable rate of interest than the debt held during 2012. See Note 9 of the Notes to Condensed Consolidated Financial Statements for discussion of the Revolving credit agreement.

Interest expense for the three months ended March 31, 2013 and 2012 is provided in the following table:

(In thousands)	Three Months Ended		
	March 31		
	2013	2012	Change
Revolving credit agreement (including fees and amortization)	\$363	\$150	\$213
Long-term debt repaid in 2012	—	672	(672)
Other	8	3	5
	\$371	\$825	\$(454)

Taxes

Factors affecting our effective tax rate include the following:

	Three Months Ended		
	March 31		
	2013	2012	
Statutory rate	35.0	% 35.0	%
Tax-exempt income	(5.8	%) (5.8	%)
Tax credits	(7.3	%) (4.3	%)
Gain on acquisition	(5.9	%) —	%
Other	0.5	% 1.1	%
Effective tax rate	16.5	% 26.0	%

We estimate our annual effective tax rate at the end of each quarterly reporting period, which is used to record the provision for income taxes in our interim financial statements. Our effective tax rate in both the first quarter of 2013 and 2012 is different from the statutory Federal income tax rate primarily because a portion of our investment income is tax-exempt and because we utilize tax credit benefits transferred from our tax credit partnership investments. During the first quarter of 2013, net income included a non-taxable gain of \$35.5 million, the effect of which further reduced our 2013 effective tax rate.

Tax benefits recognized, related to the tax credits, approximated \$4.5 million for the three months ended March 31, 2013, as compared to \$2.6 million for the 2012 three-month period.

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ITEM 3. 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 March 31, 2013 and December 31, 2012. There are principally two factors that determine interest rates on a given security: market interest rates and credit spreads. As different asset classes can be affected in different ways by movements in those two factors, we have broken out our portfolio by asset class in the following table.

	Interest Rate Shift in Basis Points				
	March 31, 2013				
	(200)	(100)	Current	100	200
Fair Value (in millions):					
U.S. Treasury obligations	\$235	\$234	\$231	\$226	\$222
U.S. Government-sponsored enterprise obligations	61	61	60	58	57
State and municipal bonds	1,348	1,334	1,293	1,238	1,185
Corporate debt	1,623	1,607	1,554	1,489	1,428
Asset-backed securities	495	497	489	476	458
All fixed maturity securities	\$3,762	\$3,733	\$3,627	\$3,487	\$3,350
Duration:					
U.S. Treasury obligations	2.77	2.77	2.72	2.65	2.58
U.S. Government-sponsored enterprise obligations	2.75	2.75	2.80	2.92	2.91
State and municipal bonds	3.75	3.95	4.15	4.33	4.43
Corporate debt	4.21	4.22	4.23	4.18	4.11
Asset-backed securities	1.63	1.97	2.66	3.36	3.83
All fixed maturity securities	3.59	3.71	3.87	4.00	4.06
Fair Value (in millions):					
U.S. Treasury obligations	\$210	\$209	\$206	\$202	\$197
U.S. Government-sponsored enterprise obligations	58	58	57	55	53
State and municipal bonds	1,269	1,258	1,220	1,170	1,122
Corporate debt	1,533	1,521	1,471	1,409	1,350
Asset-backed securities	498	499	494	481	466
All fixed maturity securities	\$3,568	\$3,545	\$3,448	\$3,317	\$3,188
Duration:					
U.S. Treasury obligations	2.92	2.89	2.84	2.77	2.70
U.S. Government-sponsored enterprise obligations	2.89	2.90	2.98	3.08	3.08
State and municipal bonds	3.78	3.91	4.06	4.17	4.26

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

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

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

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

We also have exposure to credit risk related to our receivables from reinsurers. Our receivables from reinsurers (with regard to both paid and unpaid losses) approximated \$254 million at March 31, 2013 and \$196 million at December 31, 2012, with the 2013 increase primarily attributable to acquisitions. We monitor the credit risk associated with our reinsurers using publicly available financial and rating agency data.

Equity Price Risk

At March 31, 2013 the fair value of our investment in common stocks was \$258 million. These securities are subject to equity price risk, which is defined as the potential for loss in fair value due to a decline in equity prices. The weighted average beta of this group of securities was 0.95. 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 9.5% to \$282 million. Conversely, a 10% decrease in the S&P 500 Index would imply a decrease of 9.5% in the fair value of these securities to \$233 million. The selected hypothetical changes of plus or minus 10% do not reflect what could be considered the best or worst case scenarios and are used for illustrative purposes only.

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ITEM 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 March 31, 2013. 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

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. On January 1, 2013 we completed the acquisition of Medmarc Mutual Insurance Company, now Medmarc Casualty Insurance Company (Medmarc). Our management has concluded that it will exclude Medmarc's systems and processes from the scope of ProAssurance's assessment of internal control over financial reporting as of December 31, 2013 in reliance on the guidance set forth in Question 3 of a "Frequently Asked Questions" interpretive release issued by the staff of the Securities and Exchange Commission's Office of the Chief Accountant and the Division of Corporation Finance in September 2004 (and revised on October 6, 2004). We are excluding Medmarc from that scope because we will not have completed our assessment of Medmarc's systems and processes by that date.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS.

See Note 8 of the Notes to Condensed Consolidated Financial Statements.

ITEM 1A. RISK FACTORS.

There are no changes to the "Risk Factors" in Part 1, Item 1A of the 2012 Form 10-K.

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 *
January 1 - 31, 2013	—	\$—	—	\$135,083,102
February 1 - 28, 2013	—	\$—	—	\$135,083,102
March 1 - 31, 2013	—	\$—	—	\$135,083,102
Total	—	\$—	—	

* In November 2010, the ProAssurance Board of Directors authorized \$200 million for the repurchase of common shares or the retirement of outstanding debt. This is ProAssurance's only plan for the repurchase of common shares, and the plan has no expiration date.

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ITEM 6. EXHIBITS

Exhibit Number	Description
2.1	Stock Purchase Agreement dated as of June 26, 2012, by and among ProAssurance Corporation, PRA Professional Liability Group, Inc. and Medmarc Mutual Insurance Company. Exhibits and schedules are listed but not included in the filing. Copies of the omitted exhibits and schedules will be provided to the SEC supplementally upon request.
31.1	Certification of Principal Executive Officer of ProAssurance as required under SEC rule 13a-14(a).
31.2	Certification of Principal Financial and Accounting 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 and Accounting 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

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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

May 6, 2013

/s/ Edward L. Rand, Jr.

Edward L. Rand, Jr.

Chief Financial and Accounting Officer

(Duly authorized officer and principal financial and accounting officer)

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