PROASSURANCE CORP
Form 10-K
February 25, 2009

United States
Securities and Exchange Commission
Washington, D.C. 20549
FORM 10-K

(Mark One)

þ **Annual report pursuant to section 13 or 15(d) of the Securities Exchange Act of 1934 [Fee Required]**
for the fiscal year ended December 31, 2008,

or

o **Transition report pursuant to section 13 or 15(d) of the Securities Exchange Act of 1934 [No Fee Required]**
for the transition period from _____ to _____.

Commission file number: 001-16533
ProAssurance Corporation
(Exact name of registrant as specified in its charter)

Delaware	63-1261433
(State of incorporation or organization)	(I.R.S. 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)

Securities registered pursuant to Section 12(b) of the Act:

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

Securities registered pursuant to Section 12(g) of the Act: None.

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes þ
No o

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes o No þ

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. þ

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting

company in Rule 12b-2 of the Exchange Act. (Check one):

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

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

The aggregate market value of voting stock held by non-affiliates of the registrant at June 30, 2008 was $1,383,630,033.

As of February 13, 2009, the registrant had outstanding approximately 33,345,880 shares of its common stock.

TABLE OF CONTENTS

Documents incorporated by reference in this Form 10-K

(i) The definitive proxy statement for the 2009 Annual Meeting of the Stockholders of ProAssurance Corporation (File No. 001-16533) is incorporated by reference into Part III of this report.

(ii) The MAIC Holdings, Inc. Registration Statement on Form S-4 (File No. 33-91508) is incorporated by reference into Part IV of this report.

(iii) The MAIC Holdings, Inc. Definitive Proxy Statement for the 1996 Annual Meeting (File No. 0-19439 is incorporated by reference into Part IV of this report.

(iv) The Professionals Group, Inc. Registration Statement on Form S-4 (File No. 333-3138) is incorporated by reference into Part IV of this report.

(v) The ProAssurance Corporation Registration Statement on Form S-4 (File No. 333-49378) is incorporated by reference into Party IV of this report.

(vi) The ProAssurance Corporation Annual Report on Form 10-K for the year ended December 31, 2001 (Commission File No. 001-16533) is incorporated by reference into Part IV of this report.

(vii) The ProAssurance Corporation Annual Report on the Form 10-K for the year ended December 31, 2002 (File No. 001-16533) is incorporated by reference in Part IV of this report.

(viii) The ProAssurance Corporation Definitive Proxy Statement filed on April 16, 2004 (File No. 001-16533) is incorporated by reference into Part IV of this report.

(ix) The ProAssurance Corporation Registration Statement on Form S-4 (File No. 333-124156) is incorporated by reference in Part IV of this report.

(x) The ProAssurance Corporation Current Report on Form 8-K for event occurring on November 4, 2005 (File No. 001-16533) is incorporated by reference into Part IV of this report.

(xi) The ProAssurance Corporation Registration Statement of Form S-4 (File No. 333-131874) is incorporated by reference in Part IV of this report.

(xii) The ProAssurance Corporation Current Report on Form 8-K for event occurring on September 13, 2006 (File No. 001-16533) is incorporated by reference into Part IV of this report.

(xiii) The ProAssurance Corporation Quarterly Report on Form 10-Q for the quarter ended September 30, 2006 (File No. 001-16533) is incorporated by reference into Part IV of this report.

(xiv) The ProAssurance Corporation Current Report on Form 8-K for event occurring on May 12, 2007 (File No. 001-16533) is incorporated by reference into Part IV of this report.

(xv) The ProAssurance Corporation Current Report on Form 8-K for event occurring November 5, 2007 (File No. 001-16533) is incorporated by reference into Part IV of this report.

(xvi) The ProAssurance Corporation Annual Report on Form 10-K for the year ended December 31, 2007 (File No. 001-16533) is incorporated by reference into Part IV of this report.

(xvii) The ProAssurance Corporation Registration Statement on Form S-8 (File No. 333-156645) is incorporated by reference into Part IV of this report.

(xviii) The ProAssurance Corporation Definitive Proxy Statement filed on April 11, 2008 (File No. 001-16533) is incorporated by reference into Part IV of this report.

(xix) The ProAssurance Corporation Current Report on Form 8-K for the event occurring May 21, 2008 (File No. 001-16533) is incorporated by reference into Part IV of this report.

(xx) The ProAssurance Corporation Current Report on Form 8-K for event occurring November 13, 2008 as filed on November 17, 2008 and amended on December 24, 2008 (File No. 001-16533) is incorporated by reference into Part IV of this report.

PART I

ITEM 1. BUSINESS.

General / Corporate Overview

ProAssurance Corporation is a holding company for property and casualty insurance companies focused on professional liability insurance. Throughout this report, references to ProAssurance, we , us and our refers to ProAssurance Corporation and its consolidated subsidiaries. Our executive offices are located at 100 Brookwood Place, Birmingham, Alabama 35209 and our telephone number is (205) 877-4400. Our stock trades on the New York Stock Exchange under the symbol PRA. Our website is www.ProAssurance.com. Because the insurance business uses certain terms and phrases that carry special and specific meanings, we encourage you to read the Glossary included in this section.

The Investor Home Page on our website provides many resources for investors seeking to learn more about us. Our annual report on Form 10K, our quarterly reports on Form 10Q, and our current reports on Form 8K are available on our website as soon as reasonably practical after filing with the Securities and Exchange Commission (the SEC) on its EDGAR system. We show details about stock trading by corporate insiders by providing access to SEC Forms 3, 4 and 5 when they are filed with the SEC. We maintain access to these reports for at least one year after their filing.

In addition to federal filings on our website, we make available the financial statements we file with state regulators (compiled under Statutory Accounting Principals as required by regulation), news releases that we issue, a listing of our investment holdings, and certain investor presentations. We believe these documents provide important additional information about our financial condition and operations.

The Governance section of our website provides copies of the Charters for our Audit Committee, Internal Audit department, Compensation Committee and Nominating/Corporate Governance Committee. In addition you will find our Code of Ethics and Conduct, Corporate Governance Principles, Policy Regarding Determination of Director Independence and Share Ownership Guidelines for Management and Directors. We also provide the Pre-Approval Policy and Procedures for our Audit Committee and our Policy Regarding Stockholder-Nominated Director Candidates. Printed copies of these documents may be obtained from Frank O Neil, Senior Vice President, ProAssurance Corporation, either by mail at P.O. Box 590009, Birmingham, Alabama 35259-0009, or by telephone at (205) 877-4400 or (800) 282-6242.

Caution Regarding Forward-Looking Statements

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

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

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

general economic conditions, either nationally or in our market areas, that are different than anticipated;

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

the enactment or repeal of tort reforms;

formation of state-sponsored malpractice insurance entities that could remove some physicians from the private insurance market.

the impact of deflation or inflation;

changes in the interest rate environment;

the effect that changes in laws or government regulations affecting the U.S. economy or financial institutions, including the Emergency Economic Stabilization Act of 2008 and the American Recovery and Reinvestment Act of 2009, may have on the U.S. economy and our business;

performance of financial markets affecting the fair value of our investments or making it difficult to determine the value of our investments;

changes in accounting policies and practices that may be adopted by our regulatory agencies and the Financial Accounting Standards Board, or the Securities and Exchange Commission;

changes in laws or government regulations affecting medical professional liability insurance or the financial community;

the effects of changes in the health care delivery system;

uncertainties inherent in the estimate of loss and loss adjustment expense reserves and reinsurance, and changes in the availability, cost, quality, or collectibility of insurance/reinsurance;

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

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

loss of independent agents;

changes in our organization, compensation and benefit plans;

our ability to retain and recruit senior management;

our ability to purchase reinsurance and collect payments from our reinsurers;

increases in guaranty fund assessments;

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

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

changes in competition among insurance providers and related pricing weaknesses in our markets; and

the expected benefits from completed and proposed acquisitions may not be achieved or may be delayed longer than expected due to business disruption, loss of customers and employees, increased operating costs or inability to achieve cost savings, and assumption of greater than expected liabilities, among other reasons.

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

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

any revisions that may be made to any forward-looking statements to reflect events or circumstances after the date of such statements or to reflect the occurrence of anticipated or unanticipated events.

GLOSSARY OF SELECTED INSURANCE AND RELATED FINANCIAL TERMS

In an effort to help our investors and other interested parties better understand our report, we are providing a Glossary of Selected Insurance Terms. Most of the definitions are taken from recognized industry sources such as A. M. Best and The Insurance Information Institute. This list is intended to be informative and explanatory, but we do not represent that it is a comprehensive glossary.

Accident year: The accounting period in which an insured event becomes a liability of the insurer.

Admitted company; admitted basis: An insurance company licensed and authorized to do business in a particular state. An admitted company doing business in a state is said to operate on an admitted basis and is subject to all state insurance laws and regulations pertaining to its operations. (See: Non-admitted company)

Adverse selection: The tendency of those exposed to a higher risk to seek more insurance coverage than those at a lower risk. Insurers react either by charging higher premiums or not insuring at all, as in the case of floods. Adverse selection can be seen as concentrating risk instead of spreading it.

Agent: An individual or firm that represents an insurer under a contractual or employment agreement for the purpose of selling insurance. There are two types of agents: independent agents, who represent one or more insurance companies but are not employed by those companies and are paid on commission, and exclusive or captive agents, who by contract are required to represent or favor only one insurance company and are either salaried or work on commission. Insurance companies that use employee or captive agents are called direct writers. Agents are compensated by the insurance company whose products they sell. By definition, with respect to a given insurer, an agent is not a broker (See: Broker)

Alternative markets: Mechanisms used to fund self-insurance. This includes captives, which are insurers owned by one or more insureds to provide owners with coverage. Risk-retention groups, formed by members of similar professions or businesses to obtain liability insurance, are also a form of self-insurance.

Assets; admitted; non-admitted: Property owned, in this case by an insurance company, including stocks, bonds, and real estate. Because insurance accounting is concerned with solvency and the ability to pay claims, insurance regulators require a conservative valuation of assets, prohibiting insurance companies from listing assets on their balance sheets whose values are uncertain, such as furniture, fixtures, debit balances, and accounts receivable that are more than 90 days past due (these are non-admitted assets). Admitted assets are those assets that can be easily sold in the event of liquidation or borrowed against, and receivables for which payment can be reasonably anticipated.

Bodily injury: Physical harm, sickness, disease or death resulting from any of these.

Broker: An intermediary between a customer and an insurance company. Brokers typically search the market for coverage appropriate to their clients and they usually sell commercial, not personal, insurance. Brokers are compensated by the insureds on whose behalf they are working. With respect to a given insurer, a broker is not an agent. (See: Agent)

Bulk reserves: Reserves for losses that have occurred but have not been reported as well as anticipated changes to losses on reported claims. Bulk reserves are the difference between (i) the sum of case reserves and paid losses and (ii) an actuarially determined estimate of the total losses necessary for the ultimate settlement of all reported and incurred but not reported claims, including amounts already paid. (See: Case Reserves)

Capacity: For an individual insurer, the maximum amount of premium or risk it can underwrite based on its financial condition. The adequacy of an insurer s capital relative to its exposure to loss is an important measure of solvency.

Capital: Stockholders equity (as defined in GAAP see definition on page 9) or policyholders surplus (as defined in SAP see definition on page 12). Capital adequacy is linked to the riskiness of an insurer s business. (See: Risk-Based Capital, Surplus, Solvency)

Case reserves: Reserves for future losses for reported claims as established by an insurer s claims department.

Casualty insurance: Insurance which is primarily concerned with the losses caused by injuries to third persons (in other words, persons other than the policyholder) and the legal liability imposed on the insured resulting therefrom. (See: Professional liability insurance, Medical professional liability insurance)

Cede, cedant; ceding company: When a party reinsures its liability with another, it cedes business and is referred to as the cedant or ceding company.

Claim: Written or oral demands, as well as civil and administrative proceedings.

Claims-made policy; coverage: A form of insurance that pays claims presented to the insurer during the term of the policy or within a specific term after its expiration. It limits a liability insurers exposure to unknown future liabilities. Under a claims-made policy, an insured event becomes a liability when the event is first reported to the insurer.

Combined ratio: The sum of the underwriting expense ratio and net loss ratio, determined in accordance with either SAP or GAAP.

Commission: Fee paid to an agent or insurance salesperson as a percentage of the policy premium. The percentage varies widely depending on coverage, the insurer, and the marketing methods.

Consent to settle: Clause provided in some professional liability insurance policies requiring the insurer to receive authority from an insured before settling a claim.

Damages; economic, non-economic and punitive: Monies awarded to a plaintiff or claimant. Economic damages are intended to compensate a plaintiff or claimant for quantifiable past and future losses, such as lost wages and/or medical costs. Non-economic damages are those awarded separately and apart from economic damages, that are intended to compensate the claimant or plaintiff for non-quantifiable losses such as pain and suffering or loss of consortium. Punitive damages are non-economic damages intended to punish the defendant for perceived outrageous conduct.

Direct premiums written: Premiums charged by an insurer for the policies that it underwrites, excluding any premiums that it receives as a reinsurer.

Direct writer(s): Insurance companies that sell directly to the public using exclusive agents or their own employees.

Domestic insurance company: Term used by a state to refer to any company incorporated there.

Excess & surplus lines; surplus lines: Property/casualty insurance coverage that isn t generally available from insurers licensed in the state (See: Admitted company) and must be purchased from a non-admitted company . Examples include risks of an unusual nature that require greater flexibility in policy terms and conditions than exist in standard forms or where the highest rates allowed by state regulators are considered inadequate by admitted companies. Laws governing surplus lines vary by state.

Excess coverage; excess limits: An insurance policy that provides coverage limits above another policy with similar coverage terms, or above a self-insured amount.

Extended reporting endorsement: Also known as a tail policy, or tail coverage. Provides protection for future claims filed after a claims-made policy has lapsed. Typically requires payment of an additional premium, the tail premium. Tail coverage may also be granted if the insured becomes disabled, dies or permanently retired from the covered occupation (i.e., the practice of medicine in medical liability policies.)

Facultative reinsurance: A generic term describing reinsurance where the reinsurer assumes all or a portion of a single risk. Each risk is separately evaluated and each contract is separately negotiated by the reinsurer.

Financial Accounting Standards Board (FASB): An independent board that establishes and communicates standards of financial accounting and reporting in the United States.

Frequency: Number of times a loss occurs per unit of risk or exposure. One of the criteria used in calculating premium rates.

Front, fronting: A procedure in which a primary insurer acts as the insurer of record by issuing a policy, but then passes all or virtually all of the risk to a reinsurer in exchange for a commission. Often, the fronting insurer is licensed to do business in a state or country where the risk is located, but the reinsurer is not. The reinsurer in this scenario is often a captive or an independent insurance company that cannot sell insurance directly in a particular location.
Generally Accepted Accounting Principles; GAAP: A set of widely accepted accounting standards, set primarily by the Financial Accounting Standards Board (FASB), and used to standardize financial accounting and reporting in the U.S.
Gross premiums written: Total premiums for direct insurance written and assumed reinsurance during a given period. The sum of direct and assumed premiums written.
Guaranty fund; assessment(s): The mechanism by which all 50 states, the District of Columbia and Puerto Rico ensure that solvent insurers fund the payment of claims against insurance companies that fail. The type and amount of claim covered by the fund varies from state to state.
Incurred but not reported (IBNR): Actuarially estimated reserves for estimated losses that have been incurred by insureds and reinsureds but not yet reported to the insurer or reinsurer including unknown future developments on losses which are known to the insurer or reinsurer. Insurance companies regularly adjust reserves for such losses as new information becomes available.
Incurred losses: Losses covered by the insurer within a fixed period, whether or not adjusted or paid during the same period, plus changes in the estimated value of losses from prior periods.
Insolvent; insolvency: Insurer s inability to pay debts. Typically the first sign of problems is inability to pass the financial tests regulators administer as a routine procedure. (See: Risk-based capital)
Investment income: Income generated by the investment of assets. Insurers have two sources of income, underwriting (premiums less claims and expenses) and investment income.
Liability insurance: A line of casualty insurance for amounts a policyholder is legally obligated to pay because of bodily injury or property damage caused to another person. (See: Bodily Injury, Casualty insurance, Professional liability insurance, Medical professional liability insurance)
Limits: The maximum amount payable under an insurance policy for a covered loss.
Long-tail: The long period of time between collecting the premium for insuring a risk and the ultimate payment of losses. This allows insurance companies to invest the premiums until losses are paid, thus producing a higher level of invested assets and investment income as compared to other lines of property and casualty business. Medical professional liability is considered a long tail line of insurance. (See: Medical professional liability, Professional liability)
Loss adjustment expenses (LAE): The expenses of settling claims, including legal and other fees and the portion of general expenses allocated to claim settlement costs.
Loss costs: The portion of an insurance rate used to cover claims and the costs of adjusting claims. Insurance companies typically determine their rates by estimating their future loss costs and adding a provision for expenses, profit, and contingencies.
Loss ratio: The ratio of incurred losses and loss-adjustment expenses to net premiums earned. This ratio helps measure the company s underlying profitability, or loss experience, on its total book of business.
Loss reserves: Liabilities established by insurers to reflect the estimated cost of claims payments and the related expenses that the insurer will ultimately be required to pay in respect of insurance or reinsurance it has written. Loss reserves are a liability on the insurer s balance sheet.
Medical malpractice: An act or omission by a health care provider that falls below a recognized standard of care. (See: Standard of Care)
Medical professional liability insurance: Insurance for the legal liability of an insured (and against loss, damage or expense incidental to a claim of such liability) arising out of death, injury or disablement of a person as the result of negligent deviation from the standard of care or other misconduct in rendering medical professional service.

National Association of Insurance Commissioners: Generally referred to as the NAIC. The organization of insurance regulators from the 50 states, the District of Columbia and the four U.S. territories.
Net losses: Incurred losses and loss adjustment expenses for the period, net of anticipated reinsurance recoveries for the period.
Net loss ratio: The net loss ratio measures the ratio of net losses to net premiums earned determined in accordance with SAP or GAAP.
Net paid losses: Paid losses and loss adjustment expenses for the period, net of related reinsurance recoveries.
Net premium earned: The portion of net premium that is recognized for accounting purposes as income during a particular period. Net earned premium is equal to net premiums written plus the change in net unearned premiums during the period.
Net premiums written: Gross premiums written for a given period less premiums ceded to reinsurers during such period.
Non-admitted company; basis: Insurers licensed in some states, but not others. States where an insurer is not licensed call that insurer non-admitted. Non-admitted companies sell coverage that is unavailable from licensed insurers within a state and are generally exempt from most state laws and regulations related to rates and coverages. Policyholders of such companies generally do not have the same degree of consumer protection and financial recourse as policyholders of admitted companies. Non-admitted companies are said to operate on a non-admitted basis.
Nose coverage: See: Prior acts coverage.
Occurrence policy; coverage: Insurance that pays claims arising out of incidents that occur during the policy term, even if they are filed many years later. Under an occurrence policy the insured event becomes a liability when the event takes place.
Operating ratio: The operating ratio is the combined ratio, less the ratio of investment income (exclusive of realized gains and losses) to net earned premiums, if determined in accordance with GAAP. While the combined ratio strictly measures underwriting profitability, the operating ratio incorporates the effect of investment income.
Paid loss ratio: The ratio of paid losses, net of anticipated reinsurance recoveries related to those losses, to net premiums earned. (See Loss ratio)
Paid to incurred ratio: The ratio of net paid losses to net incurred losses.
Policy: A written contract for insurance between an insurance company and policyholder stating details of coverage.
Premium: The price of an insurance policy; typically charged annually or semiannually.
Premiums written: The total premiums on all policies written by an insurer during a specified period of time, regardless of what portions have been earned.
Premium tax: A state tax on premiums for policies issued in the state, paid by insurers.
Primary company: In a reinsurance transaction, the insurance company that is reinsured.
Prior acts coverage: An additional coverage for claims-made policies, optionally made available by an insurer, that covers an insured for claims that occurred, but were not reported prior to the inception date, or retroactive date, of the policy. Sometimes called Nose Coverage.
Professional liability insurance: Covers professionals for negligence and errors or omissions that cause injury or economic loss to their clients. (See: Casualty insurance, Liability insurance, Medical professional liability insurance)
Property casualty insurance: Covers damage to or loss of policyholders property and legal liability for damages caused to other people or their property.

Rate: The cost of insurance for a specific unit of exposure, such as for one physician. Rates are based primarily on historical loss experience for similar risks and are generally regulated by state insurance offices.

Rating agencies: These agencies assess insurers financial strength and viability to meet claims obligations. Some of the factors considered include company earnings, capital adequacy, operating leverage, liquidity, investment performance, reinsurance programs, and management ability, integrity and experience. A high financial rating is not the same as a high consumer satisfaction rating.

Recorded Cost Basis: The original cost basis of the security less impairments recognized to-date plus related accumulated accretion or minus related accumulated amortization.

Reinsurance: Insurance bought by insurance companies. In a reinsurance contract the reinsurer agrees to indemnify another insurance or reinsurance company, the ceding company, against all or a portion of the insurance or reinsurance risks underwritten by the ceding company under one or more policies. Reinsurers don t pay policyholder claims. Instead, they reimburse insurers for claims paid.

Reinsured layer; retained layer: The retained layer is the cumulative portion of each loss, on a per-claim basis, which is less than an insurer s reinsurance retention for a given coverage year. Likewise, the reinsured layer is the cumulative portion of each loss that exceeds the reinsurance retention. (See: Reinsurance, Retention)

Reserves: A company s best estimate of what it will pay at some point in the future, for claims for which it is currently responsible.

Retention: The amount or portion of risk that an insurer retains for its own account. Losses in excess of the retention level up to the outer limit, if any, are paid by the reinsurer. In proportional treaties, the retention may be a percentage of the original policy s limit. In excess of loss business, the retention is a dollar amount of loss, a loss ratio or a percentage.

Retroactive date: Applicable only to claims-made policies. Claims that have occurred and have not been reported prior to this date are excluded from coverage. The retroactive date is generally the date coverage was first afforded to an insured by a company under a claims-made policy form, unless extended into the past by Prior Acts Coverage. (See: Prior Acts Coverage)

Return on equity: Net Income (or if applicable, Income from Continuing Operations) divided by the average of beginning and ending stockholders equity. This ratio measures a company s overall after-tax profitability from underwriting and investment activity and shows how efficiently invested capital is being used.

Risk-Based Capital (RBC): A regulatory measure of the amount of capital required for an insurance company, based upon the volume and inherent riskiness of the insurance sold, the composition of its investment portfolio and other financial risk factors. Higher-risk types of insurance, liability as opposed to property business, generally necessitate higher levels of capital. The NAIC s RBC model law stipulates four levels of regulatory action with the degree of regulatory intervention increasing as the level of surplus falls below a minimum amount as determined under the model law. (See: National Association of Insurance Commissioners)

Risk management: Management of the varied risks to which a business firm or association might be subject. It includes analyzing all exposures to gauge the likelihood of loss and choosing options to better manage or minimize loss. These options typically include reducing and eliminating the risk with safety measures, buying insurance, and self-insurance.

Self-insurance: The concept of assuming a financial risk oneself, instead of paying an insurance company to take it on. Every policyholder is a self-insurer in terms of paying a deductible and co-payments. Larger policyholders often self-insure frequent or predictable losses to avoid insurance overhead expenses.

Severity: The average claim cost, statistically determined by dividing dollars of losses by the number of claims.

Solvent; solvency: Insurance companies ability to pay the claims of policyholders. Regulations to promote solvency include minimum capital and surplus requirements, statutory accounting conventions, limits to insurance company investment and corporate activities, financial ratio tests, and financial data disclosure.

Standard of care: The standard by which negligence is determined. The degree of skill associated with the activities and treatment from a reasonable, prudent, ordinary practitioner acting under the same or similar circumstances.
Statement of Financial Accounting Standards (SFAS): A formal document issued by the Financial Accounting Standards Board (FASB), which details accounting standards and guidance on selected accounting policies set out by the FASB.
Statutory Accounting Principles; SAP: Accounting rules imposed by state laws that emphasize the solvency of insurance companies. A primary objective of SAP is to allow financial statement users to evaluate whether an insurer has sufficient funds readily available to meet all anticipated insurance obligations. SAP generally recognizes liabilities earlier or at a higher value than GAAP and assets later or at a lower value. For example, SAP requires that selling expenses be recorded immediately rather than amortized over the life of the policy. (See: Generally Accepted Accounting Principles, Admitted assets)
Surplus; statutory surplus: The excess of assets over total liabilities (including loss reserves) that protects policyholders in case of unexpectedly high claims. Statutory Surplus is determined in accordance with Statutory Accounting Principles.
Tail: The period of time that elapses between the occurrence of the loss event and the payment in respect thereof.
Tail coverage: See: Extended Reporting Endorsement
Third-party coverage: Liability coverage purchased by the policyholder as a protection against possible lawsuits filed by a third party. The insured and the insurer are the first and second parties to the insurance contract.
Tort: A civil wrong which may result in damages.
Treaty reinsurance: The reinsurance of a specified type or category of risks defined in a reinsurance agreement (a treaty) between a primary insurer and a reinsurer. Typically, in treaty reinsurance, the primary insurer or reinsured is obligated to offer and the reinsurer is obligated to accept a specified portion of all such type or category of risks originally written by the primary insurer or reinsured.
Underwriting: The insurer s or reinsurer s process of reviewing applications submitted for insurance coverage, deciding whether to accept all or part of the coverage requested and determining the applicable premiums.
Underwriting expense ratio: Under GAAP, the ratio of underwriting, acquisition and other insurance expenses incurred to net premiums earned (for SAP, the ratio of underwriting expenses incurred to net premiums written.)
Underwriting expenses: The aggregate of policy acquisition costs, including commissions, and the portion of administrative, general and other expenses attributable to underwriting operations.
Underwriting income; loss: The insurer s profit on the insurance sales after all expenses and losses have been paid, before investment income or income taxes. When premiums aren t sufficient to cover claims and expenses, the result is an underwriting loss.
Underwriting profit: The amount by which net earned premiums exceed claims and expenses. (See: Underwriting Income)
Unearned premium: The portion of premium that represents the consideration for the assumption of risk for a future period. Such premium is not yet earned since the risk has not yet been assumed. May also be defined as the pro-rata portion of written premiums that would be returned to policyholders if all policies were terminated by the insurer on a given date.

Business Overview

We operate in a single business segment in the United States. We sell professional liability insurance primarily to physicians, dentists, other healthcare providers and healthcare facilities. We also have a small book of legal professional liability business.

Our top five states represented 56% of our gross premiums written for the year ended December 31, 2008. The following table shows our gross premiums written in these states for each of the periods indicated.

	Gross Written Premiums Years Ended December 31 *($ in thousands)*					
	2008		2007		2006[2]	
Alabama	**$ 91,116**	**19%**	$ 95,641	17%	$102,998	18%
Ohio	**75,859**	**16%**	89,607	16%	106,267	18%
Indiana[1]	**33,822**	**7%**	38,188	7%	40,335	7%
Wisconsin[2]	**32,640**	**7%**	40,680	7%	10,702	2%
Michigan	**31,946**	**7%**	41,092	7%	43,757	8%
All other states[3]	**206,099**	**44%**	243,866	46%	274,924	47%
Total	**$471,482**	**100%**	$549,074	100%	$578,983	100%

(1) Not a top five state in 2007

(2) Not a top five state in 2006

(3) Florida was included in the top five states in 2007 and 2006 (gross premiums written of $41,291 and $53,469, respectively)

We believe we differentiate ourselves from our competitors in several ways. Our financial strength, commitment to a local market presence and personal service, and commitment to our physician heritage have allowed us to establish what we believe to be a leading position in our markets, thus enabling us to effectively compete on a basis other than just price.

During 2008 we introduced Treated Fairly a new branding strategy that is being used along with our new logo to reinforce our public pledge that all of our actions will deliver fair treatment, informed by the core values that guide our organization: integrity, respect, doctor involvement, collaboration, communication, and enthusiasm. These values, along with our enduring commitment to financial strength, the defense of non-meritorious claims and the prompt, fair settlement of those claims with merit, have been at the heart of our existence since we were founded. Our new brand strategy is the result of almost a year of intense research into how our target markets perceive ProAssurance and our competitors, and how our customers expect to be treated.

We maintain local claims and/or underwriting offices to ensure that we have a local presence in the markets we serve. We believe this emphasis on local knowledge allows us to maintain active relationships with our customers and

be more responsive to their needs.

We believe our local knowledge also allows us to be more effective in evaluating claims because we have a detailed understanding of the medical and legal climates of each market. We also believe our insureds value our willingness and ability to defend non-meritorious claims.

Using our local knowledge and our experienced underwriting staff, we rigorously underwrite each application for coverage to ensure that we understand the risks we accept, and are able to develop an adequate price for that risk. By charging rates we believe to be adequate, we seek to maintain the strong financial position that allows us to protect our customers in the long-term.

Corporate Organization and History

We were incorporated in Delaware as the successor to our predecessor company, Medical Assurance, Inc. in connection with its merger with Professionals Group, Inc. (Professionals Group) in June 2001. The following table lists our core operating subsidiaries, most of which were renamed in 2008 in order to reinforce our corporate identity.

Core Operating Subsidiaries	Formerly Operating As:
ProAssurance Indemnity Company, Inc. (PRA Indemnity)	The Medical Assurance Company, Inc.*
ProAssurance Casualty Company (PRA Casualty)	ProNational Insurance Company
ProAssurance National Capital Insurance Company (PRA National)	NCRIC, Inc.
ProAssurance Wisconsin Insurance Company (PRA Wisconsin)	Physicians Insurance Company of Wisconsin, Inc.
ProAssurance Specialty Insurance Company, Inc. (PRA Specialty)	Red Mountain Casualty Insurance Company, Inc.

* We merged Woodbrook Casualty Insurance, Inc. into ProAssurance Indemnity Company, Inc. effective December 31, 2008. Woodbrook ceased operations when the merger was effective, as PRA Indemnity assumed its policies and obligations.

We are the successor to twelve insurance organizations and much of our growth has come through mergers and acquisitions. In each, we retained key personnel, allowing us to maintain a local presence and preserve important institutional knowledge in underwriting, claims, risk management and marketing. We believe that our ability to utilize this local knowledge is a critical factor in the operation of our companies. Our successful integration of each organization demonstrates our ability to grow effectively through acquisitions.

Recent Developments

In December 2008 we repurchased $23.0 million of our outstanding trust preferred securities for approximately $18.4 million. We recognized a gain of approximately $4.6 million on the extinguishment of debt which is discussed in more detail in Note 11 to the Consolidated Financial Statements. The repurchased securities had been issued in April and May, 2004 as a part of a larger transaction wherein we issued $45.0 million of trust preferred securities, having a 30-year maturity and callable at par beginning in May 2009. The proceeds from the sale of the trust preferred securities were used for general corporate purposes, including contributions to the capital of our insurance subsidiaries

to support growth in our insurance operations.

In December and November of 2008, ProAssurance announced the following acquisitions:

We completed our purchases of Georgia Lawyers Insurance Company (Georgia Lawyers) and Mid-Continent General Agency, Inc. (Mid-Continent) were completed in the first quarter of 2009. Georgia Lawyers provides professional liability insurance for lawyers in the state of Georgia and reported premiums written of approximately $5.7 million in 2008. Mid-Continent is a Managing General Agent, based in Houston, Texas producing approximately $26 million a year in premiums from ancillary healthcare providers and other professional liability coverages, including approximately $2.7 million of premium produced for ProAssurance.

We have executed an agreement to acquire The PICA Group (PICA) through a cash sponsored demutualization. We will purchase all of PICA s stock for $120 million in cash and provide a $15 million cash surplus contribution for premium credits to be given to eligible policyholders over a three year period beginning in 2010. PICA primarily provides professional liability insurance to podiatric physicians throughout the United States and had gross written premium of approximately $96 million in 2008. The PICA transaction remains subject to policyholder approval but is expected to close in the second quarter of 2009.

In August 2008 our Board of Directors authorized $100 million to be used for the repurchase of our common stock or debt securities. As of December 31, 2008 we have used $7.2 million of that authorization to repurchase approximately 165,000 shares of our common stock, and we used approximately $18.4 million of that authorization for the repurchase of trust preferred securities, as previously discussed in this section.

In July 2008, we converted all our outstanding Convertible Debentures (aggregate principal of $107.6 million) into approximately 2,572,000 shares of ProAssurance common stock. No gain or loss was recorded related to the conversion, which is discussed in more detail in Notes 11 and 12 to the Consolidated Financial Statements, included herein.

In December 2007 we redeemed, at face value, for cash, outstanding subordinated debentures of $15.5 million that became our obligation when we acquired NCRIC Corporation (NCRIC). In April 2007 our Board of Directors authorized $150 million to be used for the repurchase of our common stock and debt securities. All of the authorization has been utilized for the repurchase of 2.6 million shares of common stock in 2007 and 2008 and the redemption of the NCRIC debt, as previously discussed.

Effective July 1, 2007 A. Derrill Crowe, M.D. retired as Chief Executive Officer (CEO). The Board of Directors elected W. Stancil Starnes to succeed Dr. Crowe as CEO. Mr. Starnes formerly served as President, Corporate Planning and Administration, of Brasfield & Gorrie, LLC, a large commercial construction firm, and as the Senior and Managing Partner of Starnes & Atchison, LLP, Attorneys at Law, a firm extensively involved with ProAssurance and its predecessor companies in the defense of its medical liability claims. On September 22, 2008, Dr. Crowe resigned as non executive Chairman of the Board and from his position as a director, for personal reasons. On October 16, 2008, our Board of Directors elected our CEO, W. Stancil Starnes, to serve as the Chairman of the Board.

Effective August 1, 2006 we completed our acquisition of Physicians Insurance Company of Wisconsin, Inc., now PRA Wisconsin, in an all stock merger. PRA Wisconsin is a stock insurance company that sells professional liability insurance to physicians, groups of physicians, dentists, and hospitals principally in the state of Wisconsin as well as other Midwestern states.

Effective January 1, 2006 we sold the operating subsidiaries that comprised our personal lines operations, MEEMIC Insurance Company and MEEMIC Insurance Services (collectively, the MEEMIC companies), for $400 million before taxes and transaction expenses. We recognized a gain on the sale in the first quarter of 2006 of $109.4 million after consideration of sales expenses and estimated taxes. We used the sale proceeds to support the capital requirements of our professional liability insurance subsidiaries and other general corporate purposes. Additional information regarding the sale of the MEEMIC companies is provided in Note 4 to the Consolidated Financial Statements.

On August 3, 2005 we acquired all of the outstanding common stock of NCRIC Corporation and its subsidiaries in an all stock merger. NCRIC s primary business is a single insurance company that provides medical professional liability insurance principally in the vicinity of the District of Columbia.

Products and Services

We sell professional liability insurance primarily to physicians, dentists, other healthcare providers and healthcare facilities. We also have a small, but growing, book of legal professional liability business. We are licensed to do business in every state but Connecticut, Maine, New Hampshire, New York and Vermont.

We generate the majority of our medical professional liability premiums from individual and small group practices, but also insure large physician groups as well as hospitals. While most of our business is written in the standard market, we also offer medical professional liability insurance on an excess and surplus lines basis. We also offer professional office package and workers compensation insurance products in connection with our medical professional liability products.

Marketing

We utilize both direct marketing and independent agents to write our business. For the year ended December 31, 2008, we estimate that approximately 69% of our gross premiums written were produced through independent insurance agencies. These local agencies usually have producers who specialize in professional liability insurance and who we believe are able to convey the factors that differentiate our professional liability insurance products. No single agent or agency accounts for more than 10% of our total direct premiums written.

Our marketing of medical professional liability insurance is primarily directed to individual physicians, and those in smaller groups. We generally do not target large physician groups or facilities because of the difficulty in underwriting the individual risks within those groups and because their purchasing decisions are more focused on price. Through Treated Fairly we emphasize:

excellent claims service,

the sponsorship of risk management education seminars as an accredited provider of continuing medical education,

risk management consultation, loss prevention seminars and other educational programs,

legislative oversight and active support of proposed legislation we believe will have a positive effect on liability issues affecting the healthcare industry,

the dissemination of newsletters and other printed material with information of interest to the healthcare industry, and

endorsements by, and attendance at meetings of, medical societies and related organizations.

These communications and services demonstrate our understanding of the insurance needs of the healthcare industry and promote a commonality of interest among us and our insureds. We believe that a local presence in our markets enables us to effectively provide these communications and services, all of which have helped us gain exposure among potential insureds.

Underwriting

Our underwriting process is driven by individual risk selection rather than by the size or other attributes of an account. Our pricing decisions are focused on achieving rate adequacy. We assess the quality and pricing of the risk, emphasizing loss history, practice specialty and location in making our underwriting decision. In performing their assessment, our underwriters may also consult with internal actuaries regarding loss trends and pricing and utilize loss-rating models to assess the projected underwriting results of certain insured risks.

Our underwriting focuses on knowledge of local market conditions and legal environments through our six regional underwriting offices located in Alabama, Indiana, Missouri, Michigan, the District of Columbia, and Wisconsin. Our underwriters work closely with our local claims departments. This includes consulting with staff about claims histories and patterns of practice in a particular locale as well as monitoring claims activity.

Our underwriters are also assisted by our local medical advisory committees that operate in our key states. These committees are comprised of local physicians, dentists and representatives of hospitals and healthcare entities and help us maintain close ties to the medical communities in these states, provide information on the practice of medicine in each state and provide guidance on critical underwriting issues.

Claims Management

We have 15 claims offices located in Alabama (2), Delaware, Florida (2), Illinois, Indiana, Kentucky, Michigan, Missouri, Ohio (2), Virginia, the District of Columbia, and Wisconsin so that we can provide localized and timely attention to claims. We offer our insureds a strong defense of claims that we believe are non-meritorious or those we believe cannot be settled by reasonable, good faith negotiations. Many of these claims are resolved by jury verdict, and we engage experienced trial attorneys in each venue to handle the litigation in defense of our policyholders.

Our claims department promptly and thoroughly investigates the circumstances surrounding a reported claim against an insured. As this investigation progresses, our claims department develops an estimate of the case reserves for each claim. Thereafter, we monitor development of new information about the claim and adjust the case reserve as loss cost estimates are revised.

Through our investigation, and in consultation with the insured and appropriate experts, we evaluate the merit of the claim and either seek reasonable good faith settlement or aggressively defend the claim. If the claim is defended, our claims department carefully manages the case, including selecting defense attorneys who specialize in professional liability defense and obtaining medical, legal and/or other expert professionals to assist in the analysis and defense of the claim. As part of the evaluation and preparation process for medical professional liability claims, we meet regularly with medical advisory committees in our key states to examine claims, attempt to identify potentially troubling practice patterns and make recommendations to our staff.

We believe that our claims philosophy contributes to lower overall loss costs and results in greater customer loyalty. The success of this claims philosophy is based on our access to attorneys who have significant experience in the defense of professional liability claims and who are able to defend claims in an aggressive, cost-efficient manner.

Investments

The majority of our assets are held in the operating insurance companies. We oversee our investments to ensure that we apply a consistent management strategy to the entire portfolio.

Our overall investment strategy is to focus on maximizing current income from our investment portfolio while maintaining safety, liquidity, duration and portfolio diversification. The portfolio is generally managed by professional third party asset managers whose results we monitor and evaluate. The asset managers typically have the authority to make investment decisions within the asset class they are responsible for managing, subject to our investment policy and oversight, including a requirement that securities in a loss position cannot be sold without specific authorization from us. See Note 5 to the Consolidated Financial Statements for more information on our investments.

Rating Agencies

Our claims-paying ability and financial strength are regularly evaluated and rated by two major rating agencies, A. M. Best and Fitch. In developing their claims-paying ratings, these agencies evaluate an insurer s ability to meet its obligations to policyholders. While these ratings may be of interest to investors, these are not ratings of our securities nor a recommendation to buy, hold or sell any of our securities.

The following table presents the claims paying ratings of our group and our core subsidiaries as of February 10, 2009:

Rating Agency	ProAssurance Group	PRA Indemnity	PRA National	PRA Wisconsin	PRA Casualty	PRA Specialty
Fitch (www.fitchratings.com)	A (Strong)	A (Strong)	A (Strong)	A (Strong)	A (Strong)	A (Strong)
A. M. Best (www.ambest.com)	A- (Excellent)	A- (Excellent)	B++ (Good)	A- (Excellent)	A- (Excellent)	A- (Excellent)

The rating process is dynamic and ratings can change. If you are seeking updated information about our ratings, please visit the rating agency websites listed in the table.

Competition

Competition depends on a number of factors including pricing, size, name recognition, service quality, market commitment, market conditions, breadth and flexibility of coverage, method of sale, financial stability, ratings assigned by rating agencies and regulatory conditions. Many of these factors, such as market conditions and regulatory conditions are beyond our control.

We believe that we have a competitive advantage due to our financial stability, local market presence, service quality, size, geographic scope and name recognition, as well as our heritage as a policyholder-founded company with a long-term commitment to the professional liability insurance industry. We have achieved these advantages through our balance sheet strength, claims defense expertise, strong ratings and ability to deliver a high level of service to our insureds and agents.

We compete in a fragmented market with many insurance companies and alternative insurance mechanisms such as risk retention groups or self-insuring entities. Many of our competitors concentrate on a single state and have an extensive knowledge of the local markets. We also compete with several large national insurers whose financial strength and resources may be greater than ours. We believe that the largest competitors in our market area are The Medical Protective Company (Berkshire Hathaway) and The Doctors Company.

Improvements in loss cost trends have allowed us to reduce rates in many markets and offer targeted new business and renewal retention programs in selected markets. This improves policyholder retention but decreases our average premiums. While we reflect loss cost trends in our pricing, we have chosen not to aggressively compete on price alone, and we have not compromised our commitment to strict underwriting.

Thus, we have lost some insureds due to aggressive, price-based competition which we face in virtually all of our markets. This competition comes mostly from established insurers that are willing to write coverage at rates that we believe do not meet our long-term profitability goals. We believe many competitors are also employing less-stringent underwriting standards than they have in the past and they appear to be offering more liberal coverage options.

We have also lost insureds as some physicians and hospitals have entered into alternative risk transfer mechanisms. Historically, these alternatives have been less attractive when prices soften in the traditional insurance markets.

If competitors continue to be less disciplined in their pricing, or become more permissive in their coverage terms, we could lose business because our ongoing commitment to adequate rates and strong underwriting standards affects our willingness to write new business and to renew existing business in the face of this price-based competition.

Insurance Regulatory Matters

We are subject to regulation under the insurance and insurance holding company statutes of various jurisdictions including the domiciliary states of our insurance subsidiaries and other states in which our insurance subsidiaries do business. Our operating insurance subsidiaries are domiciled in Alabama, Michigan, the District of Columbia, and Wisconsin.

Insurance companies are also affected by a variety of state and federal legislative and regulatory measures and judicial decisions. These could include new or updated definitions of risk exposure and limitations on business practices. In addition, individual state insurance departments may prevent premium rates for some classes of insureds from reflecting the level of risk assumed by the insurer for those classes.

There is currently limited federal regulation of the insurance business, but each state has a comprehensive system for regulating insurers operating in that state. In addition, these insurance regulators periodically examine each insurer s financial condition, adherence to statutory accounting practices, and compliance with insurance department rules and regulations.

Our operating subsidiaries are required to file detailed annual reports with the state insurance regulators in each of the states in which they do business. The laws of the various states establish agencies with broad authority to regulate, among other things, licenses to transact business, premium rates for certain types of coverage, trade practices, agent licensing, policy forms, underwriting and claims practices, reserve adequacy, transactions with affiliates, and insurer solvency. Many states also regulate investment activities on the basis of quality, distribution and other quantitative criteria. States have also enacted legislation regulating insurance holding company systems, including acquisitions, the payment of dividends, the terms of affiliate transactions, and other related matters.

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

Insurance Regulation Concerning Change or Acquisition of Control

The insurance regulatory codes in our operating subsidiaries respective domiciliary states each contain provisions (subject to certain variations) to the effect that the acquisition of control of a domestic insurer or of any person that directly or indirectly controls a domestic insurer cannot be consummated without the prior approval of the domiciliary insurance regulator. In general, a presumption of control arises from the direct or indirect ownership, control or possession with the power to vote or possession of proxies with respect to 10% (5% in Alabama) or more of the voting securities of a domestic insurer or of a person that controls a domestic insurer. A person seeking to acquire control, directly or indirectly, of a domestic insurance company or of any person controlling a domestic insurance company must generally file an application for approval of the proposed change of control with the relevant insurance regulatory authority.

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

Statutory Accounting and Reporting

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

Regulation of Dividends and Other Payments from Our Operating Subsidiaries

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

State insurance holding company regulations generally require domestic insurers to obtain prior approval of extraordinary dividends. Insurance holding company regulations that govern our principal operating subsidiaries, except PRA National and PRA Wisconsin, deem a dividend as extraordinary if the combined dividends and distributions to the parent holding company in any 12 month period are more than the greater of either the insurer s net income for the prior fiscal year or 10% of its surplus at the end of the prior fiscal year.

The regulations governing District of Columbia insurers, which have jurisdiction over PRA National, deem a dividend to be extraordinary if the combined dividends and distributions made in any 12 month period exceeds the lesser of:

net income less capital gains; or

10% surplus at the prior calendar year end.

The regulations governing Wisconsin insurers, which have jurisdiction over PRA Wisconsin, deems a dividend to be extraordinary if the amount exceeds the lesser of:

10% of a company s capital and surplus as of December 31 of the preceding year; or

the greater of:

Statutory net income for the preceding calendar year, minus realized capital gains for that calendar year; or

The aggregate of statutory net income for the three previous calendar years minus realized capital gains for those calendar years, minus dividends paid or credited and distributions made within the first two of the preceding three calendar years.

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

Risk-Based Capital

In order to enhance the regulation of insurer solvency, the National Association of Insurance Commissioners specifies risk-based capital requirements for property and casualty insurance companies. At December 31, 2008, all of ProAssurance s insurance subsidiaries exceeded the minimum RBC levels.

Investment Regulation

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

Guaranty Funds

Admitted insurance companies are required to be members of guaranty associations which administer state Guaranty Funds. These associations levy assessments (up to prescribed limits) on all member insurers in a particular state on the basis of the proportionate share of the premiums written by member insurers in the covered lines of business in that state. Maximum assessments permitted by law in any one year generally vary between 1% and 2% of annual premiums written by a member in that state. Some states permit member insurers to recover assessments paid through surcharges on policyholders or through full or partial premium tax offsets, while other states permit recovery of assessments through the rate filing process.

Shared Markets

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

Changes in Legislation and Regulation

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

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

Appeals are underway in most states where tort reforms were enacted and past experience leads us to believe some of the reforms will be overturned, although we cannot predict with any certainty how appellate courts will rule. We continue to monitor developments on a state-by-state basis, and make business decisions accordingly.

Tort reform proposals are considered from time-to-time at the Federal level. This legislation has had the backing of the Bush administration and passed the House of Representatives in 2008, as in prior legislative sessions, but has never been approved in the Senate. We do not expect passage of Federal tort reform in the foreseeable future. As in the states, passage of a Federal tort reform package would likely be subject to judicial challenge and we cannot be certain that it would be upheld by the courts.

Healthcare reform could alter the healthcare delivery system or reimbursement plans, which could raise the cost sensitivity of our insureds, or change how health care providers insure their medical malpractice risks. We expect that a broad range of healthcare reform measures will be proposed in the newly-elected Congress, with the backing of the new administration. Prior proposals have included spending limits, price controls, limiting increases in health insurance premiums and/or health savings accounts, limiting the liability of doctors and hospitals for tort claims, imposing liability on institutions rather than physicians, and restructuring the healthcare insurance system. We expect some type of health care reform, but we cannot predict which reform proposals will be adopted, when proposals might take effect or what effect they may have on our business.

In addition to regulatory and legislative efforts, there have been significant market driven changes in the healthcare environment that have negatively affected or threatened to affect the practices and

economic independence of our insureds. Medical professionals have found it more difficult to conduct a traditional fee-for-service practice and many have joined or contractually affiliated with larger organizations.

These changes may result in the elimination of, or a significant decrease in, the role of the physician in the medical malpractice insurance purchasing decision. They could also result in greater emphasis on the role of professional managers, who may seek to purchase insurance on a price competitive basis, and who may favor insurance companies that are larger and more highly rated than we are. In addition, such change and consolidation could reduce our medical malpractice premiums as groups of insurance purchasers generally retain more risk or self insure.

Federal legislation could be passed that regulates the business of insurance directly**.** There have been prior attempts to involve the federal government in the regulation of the insurance industry at some level. We believe that federal regulation of the insurance industry will be considered by Congress and the new administration. Other federal initiatives, including additional pro-patient protection legislation that would ultimately affect our business, may also be undertaken.

Employees

At December 31, 2008, we had 551 employees, none of whom are represented by a labor union. We consider our employee relations to be good.

ITEM 1A. RISK FACTORS.

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

Our operating results may be affected if actual insured losses differ from our loss reserves.

Due to the size of our reserve for loss and loss adjustment expenses, even a small percentage adjustment to the assumptions we make in establishing our reserve can have a material effect on our results of operations for the period in which the change is made. Significant periods of time often elapse between the occurrence of an insured loss, the reporting of the loss by the insured and payment of that loss. To recognize liabilities for unpaid losses, we establish reserves as balance sheet liabilities representing estimates of amounts needed to pay reported and unreported losses and the related loss adjustment expense. The process of estimating loss reserves is a difficult and complex exercise involving many variables and subjective judgments. As part of the reserving process, we review historical data and consider the impact of various factors such as:

trends in claim frequency and severity;

changes in operations;

emerging economic and social trends;

inflation; and

changes in the regulatory and litigation environments.

This process assumes that past experience, adjusted for the effects of current developments and anticipated trends, is an appropriate, but not necessarily accurate, basis for predicting future events. There is no precise method for evaluating the impact of any specific factor on the adequacy of reserves, and actual results are likely to differ from original estimates.

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

To the extent loss reserves prove to be inadequate to meet future claim payments, we would incur a charge to earnings in the period the reserves are increased, which could have a material adverse impact on our financial condition and results of operations and the price of our common stock.

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

Independent rating agencies assess and rate the claims-paying ability of insurers based upon criteria established by the agencies. Periodically the rating agencies evaluate us to confirm that we continue to meet the criteria of previously assigned ratings. The financial strength ratings assigned by rating agencies to insurance companies represent independent opinions of financial strength and ability to meet policyholder obligations and are not directed toward the protection of investors. Ratings by rating agencies are not ratings of securities or recommendations to buy, hold or sell any security.

Our principal operating subsidiaries hold favorable financial strength ratings with A.M. Best and Fitch. Financial strength ratings are used by agents and customers as an important means of assessing the financial strength and quality of insurers. If our financial position deteriorates or the rating agencies significantly change the rating criteria that are used to determine ratings, we may not maintain our favorable financial strength ratings from the rating

agencies. A downgrade or involuntary withdrawal of any such rating could limit or prevent us from writing desirable business.

The following table presents the claims paying ratings of our group and our core subsidiaries as of February 10, 2009:

Rating Agency	ProAssurance Group	PRA Indemnity	PRA National	PRA Wisconsin	PRA Casualty	PRA Specialty
Fitch (www.fitchratings.com)	A (Strong)	A (Strong)	A (Strong)	A (Strong)	A (Strong)	A (Strong)
A. M. Best (www.ambest.com)	A- (Excellent)	A- (Excellent)	B++ (Good)	A- (Excellent)	A- (Excellent)	A- (Excellent)

The rating process is dynamic and ratings can change. If you are seeking updated information about our ratings, please visit the rating agency websites listed in the table.

We operate in a highly competitive environment.

The property and casualty insurance business is highly competitive. We compete with large national property and casualty insurance companies, locally-based specialty companies, strong mutuals, reciprocals, self-insured entities and alternative risk transfer mechanisms (such as captive insurers and risk retention groups) whose activities are directed to limited markets in which they have extensive knowledge. Competitors include companies that have substantially greater financial resources than we do, as well as mutual companies and similar companies not owned by shareholders whose return on equity objectives may be lower than ours.

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

Our revenues may fluctuate with insurance market conditions.

Our policy is to charge adequate premiums on risks that meet our underwriting standards. We have lowered our rates where warranted by loss cost improvements, however, some competitors may offer, or are currently offering, rates that are lower than we consider to be justified given the risk(s) involved. Increased competition in our markets makes it difficult for us to develop new business and may reduce our retention of current business, although our retention has not eroded significantly in the past year. Our competitors may become even less disciplined in their pricing, or more permissive in their terms. We cannot predict whether, when, or how market conditions will change, or the manner in which, or the extent to which, any such changes may have an adverse effect on the results of our operations.

Our investment results will fluctuate as interest rates change.

Our investment portfolio is primarily comprised of interest-earning assets. Thus, prevailing economic conditions, particularly changes in market interest rates, may significantly affect our operating results. Changes in market interest rate levels generally affect our net income to the extent that reinvestment yields are different than the yields on maturing securities. Changes in interest rates also can affect the value of our interest-earning assets, which are principally comprised of fixed and adjustable-rate investment securities. Generally, the values of fixed-rate investment securities fluctuate inversely with changes in interest rates. Interest rate fluctuations could adversely affect our stockholders equity, income and/or cash flows. Our total investments at December 31, 2008 were $3.6 billion, of which $3.0 billion was invested in fixed maturities. Unrealized pre-tax net investment losses on investments in available-for-sale fixed maturities were approximately $43.3 million at December 31, 2008.

At December 31, 2008, we held equity investments having a fair value of $7.0 million in an available-for-sale portfolio and held additional equity securities having a fair value of $11.9 million in a trading portfolio. The fair value of these securities fluctuates depending upon company specific and general market conditions.

Any decline in the fair value of available-for-sale securities that we determine to be other-than-temporary will reduce our current period net income. Any changes in the fair values of trading securities, whether unrealized/realized gains or losses, will be included in current period net income.

Our investments are subject to credit and prepayment risk.

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

Our portfolio holds asset-backed securities which consist of securitizations of underlying loans collateralized by homes, autos, credit card receivables, commercial properties, hotels, and multi-family housing. In addition to interest rate fluctuations, asset-backed security values are subject to the existence of US Government or Government-Sponsored Enterprise guarantees, the value and cash flows of the underlying collateral, and the security s seniority in the securitization s capital structure. Approximately 28% of our fixed maturities are asset-backed securities, which are investment grade, (96% AAA, 2% AA, 2% A) as determined by Nationally Recognized Statistical Rating Organizations (NRSROs) (Moody s, Standard & Poor s and Fitch). Ratings published by the NRSROs are one of the tools used to evaluate the credit worthiness of our securities. The ratings are subject to error by the agencies, therefore, we may be subject to additional credit exposure should the rating be misstated.

We have direct exposure to asset-backed securitizations that we classify as subprime (See Investment Exposures included in Item 7, page 47). We have no exposure to subprime loans through collateralized debt obligations (CDOs).

Changes in healthcare could have a material affect on our operations.

Proposals have included, among others, spending limits, price controls, limiting increases in health insurance premiums and/or health savings accounts, limiting the liability of doctors and hospitals for tort claims, imposing liability on institutions rather than physicians, limiting the premiums that can be charged for professional liability insurance, and restructuring the healthcare insurance system. We cannot predict which, when, or if any reform proposals will be adopted or what effect they may have on our business.

In addition to regulatory and legislative efforts, there have been significant market driven changes in the healthcare environment that have negatively affected or threatened to affect the practices and economic independence of our insureds. Medical professionals have found it more difficult to conduct a traditional fee-for-service practice and many have joined or contractually affiliated with larger organizations.

These changes may result in the elimination of, or a significant decrease in, the role of the physician in the medical malpractice insurance purchasing decision. They could also result in greater emphasis on the role of professional managers, who may seek to purchase insurance on a price competitive basis, and who may favor insurance companies that are larger and more highly rated than we are. In addition, such change and consolidation could reduce our medical malpractice premiums as groups of insurance purchasers generally retain more risk or self insure.

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

We are a holding company whose principal source of funds is cash dividends and other permitted payments from operating subsidiaries. If our subsidiaries are unable to make payments to us, or are able to pay only limited amounts, we may be unable to make payments on our indebtedness. The payment of dividends by these operating subsidiaries is subject to restrictions set forth in the insurance laws and regulations of their respective states of domicile, as discussed under Item 1, Insurance Regulatory Matters on page 20.

Regulatory requirements could have a material effect on our operations.

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

licensing requirements;

trade practices;

capital and surplus requirements;

investment practices; and

rates charged to insurance customers.

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

Future legislative or regulatory changes may also adversely affect our business operations.

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

We could be sued for allegedly acting in bad faith during our handling of a claim. The damages in actions for bad faith may include amounts owed by the insured in excess of the policy limits as well as consequential and punitive damages. Awards above policy limits are possible whenever a case is taken to trial, and they have been more common in recent years. These actions have the potential to have a material adverse effect on our financial condition and results of operations. Historically, we have been successful in resolving actions alleging bad faith on terms that have no material adverse effect on our financial condition and results of operations.

The unpredictability of court decisions could have a material affect on our operations.

The financial position of our insurance subsidiaries may also be affected by court decisions that expand insurance coverage beyond the intention of the insurer at the time it originally issued an insurance policy. In addition, a significant jury award, or series of awards, against one or more of our insureds could require us to pay large sums of money in excess of our reserve amounts.

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

Tort reforms generally restrict the ability of a plaintiff to recover damages by, among other limitations, eliminating certain claims that may be heard in a court, limiting the amount or types of damages, changing statutes of limitation or the period of time to make a claim, and limiting venue or court selection. A number of states in which we do business, notably Georgia, Florida, Illinois, Missouri, Ohio, Texas, and West Virginia, enacted tort reform legislation in the early part of this decade as a response to a rapid deterioration in loss trends. We cannot predict with any certainty how appellate courts will rule on these laws. While the effects of tort reform have been generally beneficial to our business in states where these laws have been enacted, there can be no assurance that such reforms will be ultimately upheld by the courts. Further, if tort reforms are effective, the business of providing professional liability insurance

27

may become more attractive, thereby causing an increase in competition. In addition, the enactment of tort reforms could be accompanied by legislation or regulatory actions that may be detrimental to our business because of expected benefits which may or may not be realized. These expectations could result in regulatory or legislative action limiting the ability of professional liability insurers to maintain rates at adequate levels. Coverage mandates or other expanded insurance requirements could also be imposed. States may also consider state sponsored malpractice insurance entities that could remove some physicians from the private insurance market.

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

Our business could be adversely affected by the loss of independent agents.

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

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

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

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

We transfer some of our risks to reinsurance companies in exchange for part of the premium we receive in connection with the risk. Although reinsurance makes the reinsurer liable to us to the extent the risk is transferred, it does not relieve us of our liability to our policyholders. If reinsurers fail to pay us or fail to pay on a timely basis, our financial results would be adversely affected. At December 31, 2008 our Receivable from Reinsurers on Unpaid Losses is $268 million and our Receivable from Reinsurers on Paid Losses is $18 million.

The guaranty fund assessments that we are required to pay to state guaranty associations may increase and results of operations and financial condition could suffer as a result.

Each state in which we operate has separate insurance guaranty fund laws requiring admitted property and casualty insurance companies doing business within their respective jurisdictions to be members of their guaranty associations. These associations are organized to pay covered claims (as defined and limited by the various guaranty association statutes) under insurance policies issued by insolvent insurance companies. Most guaranty association laws enable the associations to make assessments against member insurers to obtain funds to pay covered claims after a member insurer becomes insolvent. These associations levy assessments (up to prescribed limits) on all member insurers in a particular state on the basis of the proportionate share of the premiums written by member insurers in the covered lines of business in that state. Maximum assessments permitted by law in any one year generally vary between 1% and 2% of annual premiums written by a member in that state, although one notable exception occurred in Florida in 2006, when the state assessed all property casualty insurers a total of 4% of their non-property premiums to offset bankruptcies caused by hurricane claims. Some states permit member insurers to recover assessments paid through surcharges on policyholders or through full or partial premium tax offsets, while other states permit recovery of assessments through the rate filing process.

In 2008, guaranty fund refunds/recoupments exceeded current year assessments by $1.3 million which reduced total acquisition expenses. In 2007, guaranty fund assessments exceeded refunds/recoupments by approximately $550,000, which increased our total acquisition expenses. Our policy is to accrue for the insurance insolvencies when notified of assessments. We are not able to reasonably estimate the liabilities of an insolvent insurer or develop a meaningful range of the insolvent insurer s liabilities because the guaranty funds do not provide sufficient information for development of such ranges.

Our business could be adversely affected by the loss of one or more key employees.

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

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

The current economic environment may have a significant adverse effect on our financial condition and results of operations.

Economic conditions and the stability of financial markets have significantly deteriorated in 2008, both in the U.S. and globally. A significant portion of our assets ($3.6 billion or 84%) at December 31, 2008 are financial instruments whose value can be significantly affected by economic and market factors beyond our control including, among others, the unemployment rate, the strength of the domestic housing market, the price of oil, changes in interest rates and spreads, consumer confidence, investor confidence regarding the economic prospects of the entities in which we invest, corrective or remedial actions taken by the entities in which we invest, including mergers, spin-offs and bankruptcy filings, the actions of the U.S. government, and global perceptions regarding the stability of the U.S. economy. The U.S. government has undertaken measures to stabilize the U.S. economy and financial markets, including the Emergency Economic Stabilization Act of 2008 and the American Recovery and Reinvestment Act of 2009, and measures are also being undertaken by the governments of other leading nations, but there is no assurance that the measures will be effective. In such an uncertain economy there is increased risk that the fair value of our investments may decline in the future. Additionally, the financial situation of our insureds may also decline significantly which could result in an increase in non-renewals or reductions in the level of coverage purchased. A worsening economy could cause shifts in the frequency and severity of the claims filed against our insureds. Although we have not experienced such shifts to-date, a worsening economy could result in actual claims experience that is worse than that estimated by us in establishing our reserves and premium rates, making our operations less profitable or unprofitable. Our reinsurers are subject to the same uncertainties and risks. If the downturn is prolonged or if losses significantly increase, reinsurers may become less willing or unable to meet their obligations to us.

Also, actions of the U.S. government undertaken to improve the overall economy may have a specific detrimental effect on the value of certain types of investments we own. While future actions cannot be predicted, it is widely assumed that actions will be undertaken to reduce home mortgage foreclosures, and it is possible that the actions taken may benefit homeowners more than holders of mortgages. The fair value of our investments in non-agency mortgage-backed securities that might likely be affected by mortgage modification efforts approximates $67.4 million ($75.1 million recorded cost basis). We also hold agency mortgage-backed securities which are guaranteed by Ginnie Mae, Fannie Mae, or Freddie Mac, having a combined fair value of $522.0 million ($506.3 million recorded cost basis). Agency mortgage-backed securities may also be affected, although the guarantees provided are intended to protect bond holders from credit loss.

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

In accordance with applicable GAAP, we value 96% of our investments at fair value and the remaining 4% at cost or equity (primarily holdings in private investment funds) or the current cash surrender value (BOLI). See Notes 1 and 5 to the Consolidated Financial Statements for additional information. Approximately 9% of our investments are traded in active markets and we use quoted market prices to value those investments. We estimate fair values for the remaining 91% of our investments, based on broker dealer quotes and various other valuation methodologies, which may require us to choose among various input assumptions and which requires us to utilize judgment. When markets exhibit much volatility, there is more risk that we may utilize a quoted market price, broker dealer quote, valuation technique or input assumption that results in a fair value estimate that is either over or understated as compared to actual amounts received upon disposition or maturity of the security. Also, from time to time, changes to GAAP guidance may cause us to revise our methodology for valuing a particular investments or type of investment, which may result in a fair value that differs significantly from amounts previously determined.

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

Our certificate of incorporation, bylaws and Delaware law contain provisions that may have the effect of inhibiting a non-negotiated merger or other business combination. Additionally, the board of directors may issue preferred stock, which could be used as an anti-takeover device, without a further vote of our stockholders. We currently have no preferred stock outstanding, and no present intention to issue any shares of preferred stock. However, because the rights and preferences of any series of preferred stock may be set by the board of directors in its sole discretion, the rights and preferences of any such preferred stock may be superior to those of our common stock and thus may adversely affect the rights of the holders of common stock.

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

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

These provisions apply even if the offer may be considered beneficial by stockholders.

If a change in management or a change of control is delayed or prevented, the market price of our common stock could decline.

ITEM 1B. UNRESOLVED STAFF COMMENTS.

None.

ITEM 2. PROPERTIES.

We own three office buildings, all of which are unencumbered. In Birmingham, Alabama we own a 165,000 square foot building in which we currently occupy approximately 82,000 square feet with the remaining office space leased to unaffiliated persons or available to be leased. In Okemos, Michigan we own, and fully occupy a 53,000 square foot building and in Madison, Wisconsin we own and fully occupy a 38,000 square foot building.

ITEM 3. LEGAL PROCEEDINGS.

Our insurance subsidiaries are involved in various legal actions, a substantial number of which arise from claims made under insurance policies. While the outcome of all legal actions is not presently determinable, management and its legal counsel are of the opinion that these actions will not have a material adverse effect on our financial position or results of operations. See Note 10 to the Consolidated Financial Statements included herein.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS.

Not applicable.

EXECUTIVE OFFICERS OF PROASSURANCE CORPORATION

The executive officers of ProAssurance Corporation (ProAssurance) serve at the pleasure of the Board of Directors. We have a knowledgeable and experienced management team with established track records in building and managing successful insurance operations. In total, our senior management team has average experience in the insurance industry of 19 years. Following is a brief description of each executive officer of ProAssurance, including their principal occupation, and relevant background with ProAssurance and former employers.

W. Stancil Starnes	Mr. Starnes was appointed as Chief Executive Officer of ProAssurance effective July 2, 2007 and has served as the Chairman of the Board since October 2008. Mr. Starnes served as President, Corporate Planning and Administration, of Brasfield & Gorrie, LLC, a large commercial construction firm from October, 2006 to May, 2007. Prior to October 2006, Mr. Starnes served as the Senior and Managing Partner of Starnes & Atchison, LLP, Attorneys at Law, and was extensively involved with ProAssurance and its predecessor companies in the defense of its medical liability claims. (Age 60)
Victor T. Adamo	Mr. Adamo has been the President of ProAssurance since its inception. Mr. Adamo joined the predecessor to Professionals Group in 1985 as general counsel and was elected as Professionals Group CEO in 1987. From 1975 to 1985, Mr. Adamo was in private legal practice and represented the predecessor to Professionals Group. Mr. Adamo is a Chartered Property Casualty Underwriter. (Age 60)
Howard H. Friedman	Mr. Friedman is a Co-President of our Professional Liability Group, a position he has held since October 2005, and is also our Chief Underwriting Officer. Mr. Friedman has served in a number of positions for ProAssurance, most recently as Chief Financial Officer and Corporate Secretary. He was also the Senior Vice President, Corporate Development of Medical Assurance. Mr. Friedman is an Associate of the Casualty Actuarial Society. (Age 50)
Jeffrey P. Lisenby	Mr. Lisenby was appointed as a Senior Vice President in December 2007 and has served as our Corporate Secretary since January 1, 2006. Mr. Lisenby has served as Vice President and head of the corporate Legal Department since 2001. Mr. Lisenby also previously practiced law privately in Birmingham, Alabama and served as a judicial clerk for the United States District Court for the Northern District of Alabama. Mr. Lisenby is a member of the Alabama State Bar and the United States Supreme Court Bar and is a Chartered Property Casualty Underwriter. (Age 40)
Frank B. O Neil	Mr. O Neil was appointed as our Senior Vice President of Corporate Communications and Investor Relations in September 2001. Mr. O Neil first joined our predecessor in 1987 and has been our Senior Vice President of Corporate Communications since 1997. (Age 55)
Edward L. Rand, Jr.	Mr. Rand was appointed Chief Financial Officer on April 1, 2005, having joined ProAssurance as our Senior Vice President of Finance in November 2004. Prior to joining ProAssurance Mr. Rand was the Chief Accounting Officer and Head of Corporate Finance for PartnerRe Ltd. Prior to that time Mr. Rand served as the Chief Financial Officer of Atlantic American Corporation. Mr. Rand is a Certified Public Accountant. (Age 42)

Darryl K. Thomas	Mr. Thomas has been with ProAssurance since its inception and currently serves as a Co-President of our Professional Liability Group, a position he has held since October 2005, and as our Chief Claims Officer. Previously, Mr. Thomas was Senior Vice President of Claims for Professionals Group. Prior to joining the predecessor to Professionals Group in 1995, Mr. Thomas was Executive Vice President of a national third-party administrator of professional liability claims. Mr. Thomas was also Vice President and Litigation Counsel for the Kentucky Hospital Association. (Age 51)

We have adopted a code of ethics that applies to our directors and executive officers, including our principal executive officers, principal financial officer, and principal accounting officer. We also have share ownership guidelines in place to ensure that management maintains a significant portion of their personal investments in the stock of ProAssurance. See Item 1 for information regarding the availability of the Code of Ethics and the Share ownership Guidelines.

PART II

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

At February 13, 2009, ProAssurance Corporation (PRA) had 3,853 stockholders of record and 33,345,880 shares of common stock outstanding. ProAssurance s common stock currently trades on The New York Stock Exchange (NYSE) under the symbol PRA .

	2008		2007	
Quarter	**High**	**Low**	High	Low
First	**$58.65**	**$49.90**	$52.83	$48.67
Second	**55.19**	**48.11**	57.30	51.00
Third	**64.85**	**45.61**	56.17	48.69
Fourth	**55.07**	**41.78**	57.19	50.46

ProAssurance has not paid any cash dividends on its common stock and does not currently have a policy to pay regular dividends.

ProAssurance s insurance subsidiaries are subject to restrictions on the payment of dividends to the parent. Information regarding restrictions on the ability of the insurance subsidiaries to pay dividends is incorporated by reference from the paragraphs under the caption Insurance Regulatory Matters Regulation of Dividends and Other Payments from Our Operating Subsidiaries in Item 1 on page 20 of this 10-K.

Securities Authorized for Issuance Under Equity Compensation Plans

The following table provides information regarding ProAssurance s equity compensation plans as of December 31, 2008.

Plan Category	**Number of securities to be issued upon exercise of outstanding options, warrants and rights (a)**	**Weighted-average exercise price of outstanding options, warrants and rights (b)**	**Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a)) (c)**
Equity compensation plans approved by security holders	1,179,061	$ 42.48*	2,000,000
Equity compensation plans not approved by security holders			

** Exclusive of 165,403 performance shares which have no exercise price*

Issuer Purchases of Equity Securities

The following table provides information regarding ProAssurance s shares purchased as part of publicly announced plans or programs.

	Total Number of Shares	**Average Price Paid**	**Total Number of Shares Purchased as Part of Publicly Announced Plans or**	**Approximate Dollar Value of Shares that May Yet Be Purchased Under**

Period	Purchased	per Share	Programs	the Plans or Programs[1]
January 1-31, 2008	239,966	$53.95	239,966	$ 67,389,790
February 1-29, 2008				$ 67,389,790
March 1-31, 2008	205,247	$51.11	205,247	$ 56,899,430
April 1-30, 2008	3,000	$52.02	3,000	$ 56,743,370
May 1-31, 2008	241,162	$50.23	241,162	$ 44,628,753
June 1-30, 2008	544,527	$50.11	544,527	$ 17,343,229
July 1-31,2008	359,617	$48.23	359,617	$ 100,000,088
August 1-31, 2008				$ 100,000,088
September 1-30, 2008				$ 100,000,088
October 1-31, 2008				$ 100,000,088
November 1-30, 2008	118,400	$43.54	118,400	$ 94,844,686
December 1-31, 2008	46,144	$44.86	46,144	$ 74,409,144
Total	1,758,063	$49.81	1,758,063	

(1) Shown net of authorizations used for repurchase of debt.

ITEM 6. SELECTED FINANCIAL DATA

	Year Ended December 31				
	2008	2007	2006	2005	2004
	(In thousands except per share data)				
Selected Financial Data [1]					
Gross premiums written [2]	**$ 471,482**	$ 549,074	$ 578,983	$ 572,960	$ 573,592
Net premiums written [2]	**429,007**	506,397	543,376	521,343	535,028
Premiums earned [2]	**503,579**	585,310	627,166	596,557	555,524
Premiums ceded [2]	**(44,301)**	(51,797)	(44,099)	(53,316)	(35,627)
Net premiums earned [2]	**459,278**	533,513	583,067	543,241	519,897
Net investment income [2]	**158,384**	171,308	147,450	98,293	76,627
Equity in earnings (loss) of unconsolidated subsidiaries [2]	**(7,997)**	1,630	2,339	900	1,042
Net realized investment gains (losses) [2]	**(50,913)**	(5,939)	(1,199)	912	7,572
Other revenues [3]	**8,410**	5,556	5,941	4,604	2,419
Total revenues [2]	**567,162**	706,068	737,598	647,950	607,557
Net losses and loss adjustment expenses [2]	**211,499**	350,997	443,329	438,201	460,437
Income (loss) from continuing operations	**177,725**	168,186	126,984	80,026	43,043
Net income	**$ 177,725**	$ 168,186	$ 236,425	$ 113,457	$ 72,811
Income (loss) from continuing operations per share:					
Basic	**$ 5.43**	$ 5.10	$ 3.96	$ 2.66	$ 1.48
Diluted	**$ 5.22**	$ 4.78	$ 3.72	$ 2.52	$ 1.44
Net income per share:					
Basic	**$ 5.43**	$ 5.10	$ 7.38	$ 3.77	$ 2.50
Diluted	**$ 5.22**	$ 4.78	$ 6.85	$ 3.54	$ 2.37
Weighted average shares outstanding:					
Basic	**32,750**	32,960	32,044	30,049	29,164
Diluted	**34,362**	35,823	34,925	32,908	31,984
Balance Sheet Data (as of December 31)					
Total investments [2]	**$3,575,942**	$3,639,395	$3,492,098	$2,614,319	$2,145,609
Total assets from continuing operations	**4,280,938**	4,440,808	4,342,853	3,341,600	2,743,295
Total assets	**4,280,938**	4,440,808	4,342,853	3,909,379	3,239,198
Reserve for losses and loss adjustment expenses [2]	**2,379,468**	2,559,707	2,607,148	2,224,436	1,818,636
Long-term debt [2]	**34,930**	164,158	179,177	167,240	151,480
Total liabilities from continuing operations	**2,857,353**	3,185,738	3,224,306	2,806,820	2,333,405

Total capital	**$1,423,585**	$1,255,070	$1,118,547	$ 765,046	$ 611,019
Total capital per share of common stock outstanding	**$ 42.69**	$ 38.69	$ 33.61	$ 24.59	$ 20.92
Common stock outstanding at end of year	**33,346**	32,443	33,276	31,109	29,204

(1) Includes acquired entities since date of acquisition, only. PRA Wisconsin was acquired on August 1, 2006. NCRIC Corporation was acquired on August 3, 2005.

(2) Excludes discontinued operations.

(3) Includes a gain on extinguishment of debt of $4.6 million for the period ended December 31, 2008.

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

The following discussion should be read in conjunction with the Consolidated Financial Statements and Notes to those statements which accompany this report. Throughout the discussion, references to ProAssurance, we, us and our refers 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 Consolidated Financial Statements are prepared in conformity with U.S. generally accepted accounting principles (GAAP). Preparation of these financial statements requires us to make estimates and assumptions that affect the amounts we report on those statements. We evaluate these estimates and assumptions on an ongoing basis based on current and historical developments, market conditions, industry trends and other information that we believe to be reasonable under the circumstances. There can be no assurance that actual results will conform to our estimates and assumptions; reported results of operations may be materially affected by changes in these estimates and assumptions.

Management considers the following accounting estimates to be critical because they involve significant judgment by management and the effect of those judgments could result in a material effect on our financial statements.

Reserve for Losses and Loss Adjustment Expenses (reserve for losses or reserve)

The largest component of our liabilities is our reserve for losses and the largest component of expense for our operations is incurred losses. Net losses in any period reflect our estimate of net losses incurred related to the premiums earned in that period as well as any changes to our estimates of the reserve established for net losses of prior periods.

The estimation of professional liability losses is inherently difficult. Ultimate loss costs, even for claims with similar characteristics, vary significantly depending upon many factors, including but not limited to, the nature of the claim and the personal situation of the claimant or the claimant s family, the outcome of jury trials, the legislative and judicial climate where the insured event occurred, general economic conditions and, for medical professional liability, the trend of health care costs. Professional liability claims are typically resolved over an extended period of time, often five years or more. The combination of changing conditions and the extended time required for claim resolution results in a loss cost estimation process that requires actuarial skill and the application of judgment, and such estimates require periodic revision.

In establishing our reserve for losses, management considers a variety of factors including claims frequency, historical paid and incurred loss development trends, the effect of inflation, general economic trends and the legal and political environment. We perform an in-depth review of our reserve for losses on a semi-annual basis. Additionally, during each reporting period we update and review the data underlying the estimation of our reserve for losses and make adjustments that we believe best reflect emerging data.

External actuaries review our reserve for losses at least semiannually in order to provide management with an independent viewpoint and broader perspective regarding our loss experience and industry loss trends. We compile loss and exposure data from our own company experience which is analyzed by both the external actuaries and our internal actuarial staff. In establishing reserves, management considers the estimates and inputs of our internal actuarial staff as well as those of our external actuaries. Factors considered by management and the actuaries in establishing reserves include known or estimated changes in the frequency and severity of claims, loss retention levels and premium rates.

As a result of the variety of factors that must be considered by management there is a significant risk that actual incurred losses will develop differently from these estimates. In establishing our initial reserves for a given accident year we rely significantly on the loss assumptions embedded within our pricing. Because of the historically volatile nature of professional liability losses, we establish the initial loss estimates at a level which is approximately 8 to 10% above our pricing assumptions. This difference recognizes the volatility of the professional liability loss environment and the risk in determining pricing parameters. As each accident year matures we analyze reserves in a variety of ways and use multiple actuarial methodologies in performing these analyses, including:

Bornhuetter-Ferguson Method

Paid Development Method

Reported Development Method

Average Paid Value Method

Average Reported Value Method

Backward Recursive Method

A brief description of each method follows. The descriptions require some explanation as to how we and actuaries view our reserves. We segment our reserves by accident year, which is the year in which the claim becomes our liability. As claim payments are made, they are aggregated by accident year for analysis purposes. We also segment our reserves by reserve type: case reserves and IBNR (incurred but not reported) reserves. Case reserves are established by our claims department based upon the particular circumstances of each reported claim and represent our estimate of the future loss costs (often referred to as expected losses) that will be paid on reported claims. Case reserves are decremented as claim payments are made and are periodically adjusted upward or downward as claim department estimates regarding the amount of future losses are revised; reported loss is the case reserve at any point in time plus the claim payments that have been made to date. IBNR reserves represent our estimate of the loss costs that will eventually be paid on all claims, less the case reserves we have established.

Bornhuetter-Ferguson Method. We use both the *Paid* and the *Reported Bornhuetter-Ferguson methods*. The *Paid* method assigns partial weight to initial expected losses for each accident year (initial expected losses being the first established case and IBNR reserves for a specific accident year) and partial weight to paid to-date losses. The *Reported* method assigns partial weight to the initial expected losses and partial weight to current reported losses. The weights assigned to the initial expected losses decrease as the accident year matures.

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

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

Backward Recursive Development Method. This method is an extrapolation on the movements in case reserve adequacy in order to estimate unpaid loss costs. Historical data showing incremental changes to case reserves over progressive time periods is used to derive factors that represent the ratio of case reserve values at successive

maturities. Historical claim payments data showing the additional payments in progressive time periods is used to derive factors that represent the portion of a case reserve paid in the following period. Starting from the most mature period, after which all the case reserve is paid and the case reserve is exhausted, the next prior ultimate development factor for the prior case reserve can be calculated as the case factor times the established ultimate development factor plus the

paid factor. For each successive prior maturity, the ultimate development factor is calculated similarly. The result of multiplying the ultimate development factor times the case reserve is the total indicated unpaid.

Generally, methods such as the Bornhuetter-Ferguson method are used on more recent accident years where we have less data on which to base our analysis. As time progresses and we have an increased amount of data for a given accident year we begin to give more confidence to the development and average methods as these methods typically rely more heavily on our own historical data. Each of these methods treats our assumptions differently, and thus provides a different perspective for our reserve review.

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

In performing these analyses we partition our business by coverage type, geography, layer of coverage and accident year. This procedure is intended to balance the use of the most representative data for each partition, capturing its unique patterns of development and trends. For each partition, the results of the various methods, along with the supplementary statistical data regarding such factors as the current economic environment, are used to develop a point estimate based upon management s judgment and past experience. The process of selecting the point estimate from the set of possible outcomes produced by the various actuarial methods is based upon the judgment of management and is not driven by formulaic determination. For each partition of our business we select a point estimate with due regard for the age, characteristics and volatility of the partition of the business, the volume of data available for review and past experience with respect to the accuracy of estimates. This series of selected point estimates is then combined to produce an overall point estimate for ultimate losses.

We have modeled implied reserve ranges around our single point reserve estimates for our professional liability business assuming different confidence levels. The ranges have been developed by aggregating the expected volatility of losses across partitions of our business to obtain a consolidated distribution of potential reserve outcomes. The aggregation of this data takes into consideration the correlation among our geographic and specialty mix of business. The result of the correlation approach to aggregation is that the ranges are narrower than the sum of the ranges determined for each partition.

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

	Low End Point	**Carried Reserve**	**High End Point**
80% Confidence Level	$1.611 billion	$2.111 billion	$2.685 billion
60% Confidence Level	$1.752 billion	$2.111 billion	$2.440 billion

The claims environment in which we and others in our industry operate is inherently uncertain. The development of a statistical distribution models the uncertainty as well as the limited predictive power of past loss data. The distributions represent an estimate of the range of possible outcomes and should not be confused with a range of best estimates. Given the number of factors considered it is neither practical nor meaningful to isolate a particular assumption or parameter of the process and calculate the impact of changing that single item.

Any change in our estimate of the reserve is reflected in then-current operations. Due to the size of our reserve for losses, even a small percentage adjustment to these estimates could have a material effect on our results of operations for the period in which the adjustment is made as has been the case in 2008, 2007 and 2006.

Reinsurance

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

We evaluate each of our ceded reinsurance contracts at inception to determine if there is sufficient risk transfer to allow the contract to be accounted for as reinsurance under current accounting guidance. At December 31, 2008 all ceded contracts are accounted for as risk transferring contracts.

Our receivable from reinsurers on unpaid losses and loss adjustment expenses represents our estimate of the amount of our reserve for losses that will be recoverable under our reinsurance programs. We base our estimate of funds recoverable upon our expectation of ultimate losses and the portion of those losses that we estimate to be allocable to reinsurers based upon the terms of our reinsurance agreements. Our assessment of the collectibility of the recorded amounts receivable from reinsurers considers the payment history of the reinsurer, publicly available financial and rating agency data, our interpretation of the underlying contracts and policies, and responses by reinsurers. Appropriate reserves are established for any balances we believe may not be collected.

Given the uncertainty of the ultimate amounts of our losses, our estimates of losses and related amounts recoverable may vary significantly from the eventual outcome. Also, we estimate premiums ceded under reinsurance agreements wherein the premium due to the reinsurer, subject to certain maximums and minimums, is based in part on losses reimbursed or to be reimbursed under the agreement. Any adjustments are reflected in then-current operations. Due to the size of our reinsurance balances, an adjustment to these estimates could have a material effect on our results of operations for the period in which the adjustment is made.

Investment Valuations

We adopted a new accounting pronouncement, Statement of Financial Accounting Standards 157, *Fair Value Measurements,* effective January 1, 2008. The new pronouncement revises the definition of fair value and establishes a framework for measuring fair value. The pronouncement defines fair value 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. The framework establishes a three level hierarchy for valuing assets and liabilities based on how transparent (observable) the inputs are that are used to determine fair value. For example, a quoted market price for an actively traded security on an established trading exchange is considered the most transparent (observable) input used to establish a fair value for that security and is classified as a Level 1 in the fair value hierarchy. An investment valued using multiple broker dealer quotes is considered to be valued using observable input that is not as transparent as a quoted market price on an exchange and is classified as a Level 2. An investment valued using either a single broker dealer quote or based on a cash flow valuation model is considered to be valued based on limited observable input and a significant amount of judgment and is classified as Level 3. For further information on the adoption of the pronouncement and the fair value of our investments, see Note 2 to the Consolidated Financial Statements.

Virtually all of our financial assets are comprised of investments recorded at fair value. Of the Company s investments recorded at fair value totaling $3.4 billion, approximately 98% of our investments are based on observable market prices or observable market parameters (i.e. broker quotes, benchmark yield curves, issuer spreads, bids, etc.). The availability of observable market prices and pricing parameters (referred to as observable inputs) can vary from investment to investment. We utilize observable inputs, where available, to value our investments. In many cases, we obtain multiple observable inputs for an investment to derive the fair value without requiring significant judgments.

We use a pricing service, Interactive Data Corporation (IDC), to value our investments that have an exchange traded price or multiple observable inputs. We do not utilize IDC to price investments that do not have multiple observable inputs (Level 3). IDC discloses the inputs used for each asset class that it prices. We review the inputs for the asset classes we own in order to make the appropriate level designation.

All securities priced by IDC using an exchange traded price are designated by us as Level 1. Level 1 investments are currently limited to exchange traded common and preferred equity securities, and money market funds with quoted Net Asset Values (NAVs).

We designate as Level 2 those securities not actively traded on an exchange for which IDC uses multiple verifiable observable inputs including last reported trade, non-binding broker quotes, benchmark yield curves, issuer spreads, two sided markets, benchmark securities, bids, offers, and assumed prepayment speeds.

IDC provides a single price per instrument quoted. We review the pricing for reasonableness each quarter by comparing market yields generated by the supplied price versus market yields observed in the market place. If a supplied price is deemed unreasonable, we will challenge the price with IDC and make adjustments if deemed necessary. To date, we have not adjusted any prices supplied by IDC.

For securities that do not have multiple observable inputs (Level 3), we do not rely on a price from IDC. Our Level 3 assets, which primarily are private placements and limited partnerships, are valued by management either using non-binding broker quotes or pricing models that utilize market based assumptions which have limited observable inputs including treasury yield levels, issuer spreads and non-binding broker quotes. The valuation techniques involve some degree of judgment. Approximately $53 million (2% of investments recorded at fair value) are valued in this manner.

Most of our investments recorded at fair value are considered available-for-sale with a small portion classified as trading. For investments considered available-for-sale, changes in the fair value are recognized as unrealized gains and losses and are included, net of related tax effects, in stockholders equity as a component of other comprehensive income (loss). Gains or losses on these investments are recognized in earnings in the period the investment is sold or an other-than-temporary impairment is deemed to have occurred. Changes in the fair value of investments considered as trading are recorded in realized investment gains and losses in the current period.

We also have other investments, primarily comprised of equity interests in private investment funds (non-public investment partnerships and limited liability companies), $44.5 million of which are accounted for using the equity method and $31.0 million of which are carried at cost. We evaluate these investments for other-than-temporary impairment by considering any declines in fair value below the recorded value. Determining whether there has been a decline in fair value involves assumptions and estimates as there are typically no observable inputs to determine the fair value of these investments.

We evaluate all our investments on at least a quarterly basis for declines in fair value that represent other-than-temporary impairments. Some of the factors we consider in the evaluation of our investments are:

the extent to which the fair value of an investment is less than its recorded basis,

the length of time for which the fair value of the investment has been less than its recorded basis,

the financial condition and near-term prospects of the issuer underlying the investment, taking into consideration the economic prospects of the issuer s industry and geographical region, to the extent that information is publicly available,

third party research and credit rating reports,

the extent to which the decline in fair value is attributable to credit risk specifically associated with an investment or its issuer,

the extent to which we believe market assessments of credit risk for a specific investment or category of investments are either well founded or are speculative,

our internal assessments and those of our external portfolio managers regarding specific circumstances surrounding an investment, which can cause us to believe the investment is more or less likely to recover its value than other investments with a similar structure,

for asset-backed securities: the origination date of the underlying loans, the remaining average life, the probability that credit performance of the underlying loans will deteriorate in the future, and our assessment of

the quality of the collateral underlying the loan, and

our ability and intent to hold the investment for a period of time sufficient to allow for any anticipated recovery in fair value.

Determining whether a decline in the fair value of investments is an other-than-temporary impairment may also involve a variety of assumptions and estimates, particularly for investments that are not actively traded in established markets or during periods of market dislocation. For example, assessing the value of certain investments requires us to perform an analysis of expected future cash flows or prepayments. For investments in tranches of structured transactions, we are required to assess the credit worthiness of the underlying investments of the structured transaction.

When we judge a decline in fair value to be other-than-temporary, we reduce the basis of the investment to fair value and recognize a loss in the current period income statement for the amount of the reduction. In subsequent periods, we base any measurement of gain or loss or decline in value upon the recorded cost basis of the investment.

Deferred Policy Acquisition Costs

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

Deferred Taxes

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

Goodwill

We make at least an annual assessment as to whether the value of our goodwill assets is impaired. Management evaluates the carrying value of goodwill annually during the fourth quarter and before the annual evaluation if events occur or circumstances change that would more likely than not reduce the fair value below the carrying value. In assessing goodwill, management estimates the fair value of the reporting unit and compares that estimate to external indictors such as market capitalization. We concluded in 2008, 2007 and 2006 that the fair value of our reporting unit exceeded the carrying value and no adjustment to impair goodwill was necessary.

ProAssurance Overview

We are an insurance holding company and our operating results are primarily derived from the operations of our insurance subsidiaries, all of which principally write medical and other professional liability insurance.

Corporate Strategy

Our mission is to be the preferred source of professional liability protection by providing unparalleled claims defense, highly responsive customer service and innovative risk management while maintaining our commitment to long-term financial strength. According to A.M. Best s analysis of 2007 data, we are the fifth largest medical professional liability insurance writer in the nation, and we believe we are the largest medical professional liability writer in our collective states of operation. We believe that our strong reputation in our regional markets, combined with our financial strength, strong customer service and proven ability to manage claims, should enable us, over the long-term, to profitably expand our position in select states. We have successfully acquired and integrated companies and books of business in the past and believe our financial size and strength make us an attractive acquirer. We emphasize disciplined underwriting and do not manage our business to achieve a certain level of premium growth or market share. We apply our local knowledge to individual risk selection and determine the appropriate price based on our assessment of the specific characteristics of each risk. In addition to prudent risk selection, we seek to control our underwriting results through effective claims management. We investigate each claim and have fostered a strong culture of defending claims that we believe have no merit. We manage claims at the local level, tailoring claims handling to the legal climate of each state, which we believe differentiates us from national writers.

Through our regional underwriting and claims office structure, we are able to gain a strong understanding of local market conditions and efficiently adapt our underwriting and claims strategies to regional conditions. Our regional presence also allows us to maintain active relationships with our customers and be more responsive to their needs. We understand the importance of the professional identity and reputation of our insureds. An important part of our strategy is to emphasize the needs of our insureds throughout our operations. We attempt to further our understanding of those needs through the use of advisory boards and operational committees that ensure we understand the challenges facing our insureds and ways we may best assist them. We also believe that it is important to employ medical and legal professionals throughout our organization, especially on our senior management team. We emphasize our pledge that each insured professional will be treated fairly in all of our conduct with them and that all of our business actions will be informed by the core values that guide our organization: integrity, respect, doctor involvement, collaboration, communication and enthusiasm. We believe our strategy allows us to compete on a basis other than just price. We also believe that our presence in local markets allows us to monitor and understand changes in the liability climate and thus develop better business strategies in a timely manner.

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

We measure performance in a number of ways, but particularly focus on our combined ratio and investment returns, both of which directly affect our return on equity (ROE). We target a long-term average ROE of 12% to 14%.

We believe that a focus on rate adequacy, selective underwriting and effective claims management is required if we are to achieve our ROE targets. We closely monitor premium revenues, losses and loss adjustment costs, and acquisition, underwriting and insurance expenses. Our overall investment strategy is to focus on maximizing current income from our investment portfolio while maintaining safety, liquidity, duration and portfolio diversification. We engage in activities that generate other income; however, such activities, principally fee and agency services, do not constitute a significant use of our resources or a significant source of revenues or profits.

Growth Opportunities and Outlook

We expect our long-term growth to come through controlled expansion in states where we are already writing business and into additional states within, or adjacent to, our existing business footprint. We also look to expand through the acquisition of other companies or books of business; however, such expansion is opportunistic and cannot be predicted.

We face price-based competition in virtually all of our markets, with some competitors offering coverage at rates that we believe do not meet our long-term profitability goals. Additionally, a number of physicians and hospitals are seeking to lower their costs through the use of alternative risk transfer approaches such as self insurance and risk sharing pools, although these alternatives become less attractive as prices soften in the traditional insurance markets.

Our on-going commitment to adequate rates and strong underwriting standards affects our willingness to write new business and to renew existing business in the face of this price-based competition. Improvements in loss cost trends have allowed us to reduce rates in certain markets during 2008 and to offer targeted new business and renewal retention programs in selected markets. In 2008 we launched a new branding campaign, Treated Fairly , which we believe will help us emphasize our fair treatment of our insureds and other important stakeholders. We are emphasizing Treated Fairly in all of our activities, and we believe that as we reach more customers with this message we will both improve retention and add new insureds, both of which will help offset the effects of lower rates.

We also believe our recent acquisition of Georgia Lawyers (which will be merged into PRA Casualty) and Mid-Continent, along with our pending acquisition of PICA will add at least $100 million of premium during 2009. In addition to providing an avenue for premium growth, we believe these transactions will also broaden our business footprint and diversify our book of business.

PICA will become part of ProAssurance in the second quarter of 2009 if its eligible policyholders approve the planned sponsored demutualization. PICA is the nation s leading provider of professional liability insurance to doctors of podiatric medicine, with a market share of approximately 70%. PICA insures approximately 9,800 podiatric physicians in 47 states and the District of Columbia, and its PACO subsidiary provides professional liability insurance for approximately 7,000 chiropractors and writes Errors & Omissions insurance for a small, but growing, number of independent insurance agents. PICA wrote approximately $96 million in premium in 2008, has $336 million in total assets and has maintained an A.M. Best rating of A- (Excellent) for the past 13 years.

PICA s near-universal licensure will help us become a national writer of medical professional liability insurance, and its experience in markets in which we do not write could make it easier for us to expand our existing medical professional liability lines. Further, its experience in writing high volume, lower cost professional liability policies, such as those for chiropractors, will be advantageous as we expand our allied health care professional liability business.

We expect our acquisition of Mid-Continent, which closed in January of 2009, to also broaden our market presence in the rapidly expanding professional liability market for allied health care providers such as nurse practitioners, home health care nurses, medical technicians and other similar professionals. Under almost every likely healthcare reform scenario these professionals are likely to have a greater role in the delivery of health care and we believe their need for professional liability coverages will expand as their responsibilities expand.

Mid-Continent, which underwrote approximately $26 million in premium in 2008, also underwrites other lines of professional and general liability coverage. In 2008, Mid-Continent generated approximately $2.7 million of premium for ProAssurance. Business they underwrite, but do not place with ProAssurance, will generate commission income for us.

Our acquisition of Georgia Lawyers was completed in February of 2009, and we believe we can use that business as a springboard for expansion in the legal professional liability market throughout the southeast. We have written legal professional liability

insurance for attorneys in Indiana, Michigan and Ohio since 1995. We have publicly stated our intention to double our premiums from this line of business to $20 million, and we expect Georgia Lawyers to help us achieve that goal. Georgia Lawyers wrote approximately $5.7 million of direct written premium in 2008, and insured about 2,700 attorneys, most in small-to-medium sized practices. This increases the size of our legal professional liability book, in terms of both premium and insureds, by approximately 50%.

We have also taken steps to broaden the distribution of our legal professional liability policies by adding business through Grayhawk General Agency, Inc. (Grayhawk) and ProLawyer Insurance, LLC (ProLawyer).

Grayhawk, which is based in the Phoenix area, solicits business in Arizona, California, Colorado, Nevada, and Washington, and seeks to expand its business throughout the west. ProLawyer, based in Philadelphia, writes business in Delaware, the District of Columbia, Maryland, New Jersey, Pennsylvania, and Virginia, and seeks to expand in the mid-Atlantic states.

Recent Accounting Pronouncements and Guidance

In May 2008, the FASB issued FASB Staff Position (FSP) APB 14-1, *Accounting for Convertible Debt Instruments That May Be Settled in Cash upon Conversion (Including Partial Cash Settlement),* which will alter the accounting for our Convertible Debentures. FSP APB 14-1 requires issuers to account for convertible debt securities that allow for either mandatory or optional cash settlement (including partial cash settlement) by separating the liability and equity components in a manner that reflects the issuer s nonconvertible debt borrowing rate at the time of issuance and requires recognition of additional (non-cash) interest expense in subsequent periods based on the nonconvertible rate. Additionally, FSP APB 14-1 requires that when such debt instruments are repaid or converted any consideration transferred at settlement is to be allocated between the extinguishment of the liability component and the reacquisition of the equity component. FSP APB 14-1 will become effective for ProAssurance on January 1, 2009 and must be applied retrospectively with a cumulative effect adjustment being made as of the earliest period presented. Early adoption is not permitted. In July of 2008 we converted all of our outstanding Convertible Debentures and are currently assessing the impact that the adoption will have on our financial condition and results of operations but expect no impact on total Stockholders Equity.

In December 2007 the FASB issued SFAS 160, *Noncontrolling Interests in Consolidated Financial Statements.* SFAS 160 amends Accounting Research Bulletin (ARB) 51 to establish accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. The Statement is effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2008. Earlier adoption is prohibited. We will adopt the Statement on its effective date. The adoption is not expected to have an effect on our results of operations or financial position.

In December 2007 the FASB issued SFAS 141 (Revised December 2007), *Business Combinations.* SFAS 141R replaces FASB Statement No. 141, *Business Combinations,* but retains the fundamental requirement in SFAS 141 that the acquisition method (referred to as the purchase method in SFAS 141) of accounting be used for all business combinations. SFAS 141R provides new or additional guidance with respect to business combinations including: defining the acquirer in a transaction, the valuation of assets and liabilities when noncontrolling interests exist, the treatment of contingent consideration, the treatment of costs incurred to effect the acquisition, the treatment of reorganization costs, and the valuation of assets and liabilities when the purchase price is below the net fair value of assets acquired. SFAS 141R applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. Earlier adoption is prohibited. We will adopt the Statement on its effective date.

Accounting Changes

FSP EITF 99-20-1, *Amendments to the Impairment Guidance of EITF Issue No 99-20,* was issued in January 2009 to amend the impairment guidance in EITF Issue No. 99-20, *Recognition of Interest Income and Impairment on Purchased Beneficial Interests and Beneficial Interests That Continue to Be Held by a Transferor in Securitized Financial Assets*. EITF 99-20 specifies that an impairment is considered other-than-temporary if, based on an estimate of cash flows that a market participant would use in determining the current fair value, there has been an adverse change in those estimated cash flows. FSP EITF 99-20-1 alters this guidance by specifying that an impairment be considered other-than- temporary if it is probable there has been an adverse change in the holder s estimated cash flows from those previously projected. We adopted FSP EITF 99-20-1 as of December 31, 2008 and considered the guidance provided therein in our impairment evaluations performed as of December 31, 2008. There was no material effect from adoption.

In September 2006, the FASB issued SFAS 157, *Fair Value Measurements.* The standard revises the definition of fair value, establishes a framework for measuring fair value under GAAP, and expands disclosures about fair value measurements. SFAS 157 is applicable to other accounting pronouncements that require or permit fair value measurements but does not establish new guidance regarding the assets and liabilities required or allowed to be measured at fair value. The statement is effective for fiscal years beginning after November 15, 2007, with early adoption permitted. We adopted SFAS 157 on January 1, 2008. We did not recognize any cumulative effect related to the adoption of SFAS 157 and the adoption did not have a significant effect on our 2008 results of operations or financial condition.

In February 2007, the FASB issued SFAS 159, *The Fair Value Option for Financial Assets and Financial Liabilities Including an Amendment of FASB Statement No. 115.* SFAS 159 permits many financial assets and liabilities to be reported at fair value that are not otherwise required under GAAP to be measured at fair value. Under SFAS 159 guidance, the election of fair value treatment is specific to individual assets and liabilities, with changes in fair value recognized in earnings as they occur. The election of fair value measurement is generally irrevocable. SFAS 159 is effective for fiscal years beginning after November 15, 2007, with early adoption permitted. We adopted SFAS 159 on January 1, 2008 but did not elect fair value measurement for any financial assets or liabilities that were not otherwise required to be measured at fair value.

Liquidity and Capital Resources and Financial Condition

Overview

ProAssurance Corporation is a holding company and is a legal entity separate and distinct from its subsidiaries. Because it has no other business operations, dividends from its operating subsidiaries represent a significant source of funds for its obligations, including debt service. The ability of our insurance subsidiaries to pay dividends is subject to limitation by state insurance regulations. See our discussions under Regulation of Dividends and Other Payments from Our Operating Subsidiaries in Part I, and in Note 16 of our Notes to the Consolidated Financial Statements for additional information regarding the ordinary dividends that can be paid by our insurance subsidiaries in 2009. At December 31, 2008 we held cash and investments of approximately $204 million outside of our insurance subsidiaries that are available for use without regulatory approval. Cash of approximately $135 million will be used in the ProAssurance-sponsored demutualization of PICA, $15 million of which will be a surplus contribution to PICA. The transaction is expected to close in the second quarter of 2009 (see Note 10 to the Consolidated Financial Statements).

Cash Flows

The principal components of our operating cash flows are the excess of net investment income and premiums collected over net losses paid and operating costs, including income taxes. Timing delays exist between the collection of premiums and the ultimate payment of losses. Premiums are generally collected within the twelve-month period after the policy is written while our claim payments are generally paid over a more extended period of time. Likewise, timing delays exist between the payment of claims and the collection of any associated reinsurance recoveries. Our operating activities provided positive cash flows of approximately $164.8 million and $244.1 million for the years ended December 31, 2008 and 2007, respectively.

The decline in operating cash flows during 2008 as compared to 2007 is primarily attributable to:

	(*In millions*) **Cash Flow Increase (Decrease)**
Lower premium receipts due to the decline in premiums written	**$ (96)**
Increase in net premium payments to reinsurers, including the effect of refunds received related to prior years; greater refunds were received in 2007	**(19)**
Net trading securities purchases in 2008 versus net trading securities sales in 2007	**(46)**
Decrease in gross losses paid	**38**
Increase in reinsurance recoveries, including commutation receipts of $27 million	**37**
Other amounts not individually significant, net	**7**
Net decrease in operating cash flows	**$ (79)**

Two metrics commonly used to analyze the operating cash flows of insurance companies are the net paid-to-incurred ratio and the net paid loss ratio.

	Year Ended December 31	
	2008	2007
Net paid-to-incurred ratio	**157.4%**	101.1%
Net paid loss ratio	**72.5%**	66.5%

The net paid-to-incurred ratio is calculated as net paid losses divided by net incurred losses. The net paid loss ratio is calculated as net paid losses divided by net premiums earned. In calculating both of these ratios, net paid losses is defined as losses and loss adjustment expenses paid during the period, net of the anticipated reinsurance recoveries related to those losses.

For a long-tailed business such as ProAssurance, fluctuations in the ratios over short periods of time are not unexpected and are not necessarily indicative of either positive or negative changes in loss experience. The timing of our indemnity payments is affected by many factors, including the nature and number of the claims in process during any one period and the speed at which cases work through the trial and appellate process. The ratios are affected not only by variations in net paid losses, but also by variations in premium volume and the recognition of reserve development.

While net paid losses decreased in 2008 as compared to 2007 both the net paid loss ratio and net paid-to-incurred ratio increased. The increase in the net paid-to-incurred ratio is caused by the decline in incurred losses, the denominator of the ratio. Likewise, the increase in the net paid loss ratio is caused by the decline in earned premiums, the denominator of the ratio.

Investment Exposures

The following table provides summarized information regarding our investments as of December 31, 2008:

		(In thousands)			
	Carrying Value	**Gross Gain**	**Gross Loss**	**Average Rating**	**% Total Investments**
Fixed Maturities:					
Government					
U.S. Treasury	$ 98,540	$ 2,376	$ (2,477)	AAA	3%
U.S. Agency	78,628	4,616		AAA	2%
Total government	177,168	6,992	(2,477)	AAA	5%
State and Municipal Bonds	1,356,206	26,268	(19,492)	AA	38%
Corporate Bonds					
Financial institutions	290,421	2,904	(20,013)	A	8%
Communications	55,665	710	(2,967)	BBB+	2%
Utilities	42,265	990	(862)	A	1%
Consumer cyclical	22,786	143	(2,967)	A-	1%
Consumer non-cyclical	47,276	754	(4,078)	BBB+	1%
Energy	30,448	133	(1,669)	BBB+	1%
Basic materials	26,082	132	(3,417)	BBB	1%
Industrial	45,805	354	(3,312)	A-	1%
Technology	10,696	264	(493)	A	
Other	22,338	439	(1,074)	BBB+	1%
Total corporate bonds	593,782	6,823	(40,852)	A-	17%
Asset-backed Securities					
Agency mortgage-backed securities	522,036	15,758	(36)	AAA	15%
Non-agency mortgage-backed securities	44,262	1,395	(5,231)	AA+	1%
Subprime	11,700	40	(2,528)	AA+	
Alt A	11,397	859	(2,286)	A	
Commercial mortgage-backed securities	170,859		(22,878)	AAA	5%
Credit card	40,697		(1,766)	AAA	1%
Automobile	24,903		(3,225)	AA+	1%
Other	8,558		(617)	AA-	
Total asset-backed securities	834,412	18,052	(38,567)	AAA	23%
Total fixed maturities	2,961,568	58,135	(101,388)	AA	83%
Equities					

Equity common					
Financial	2,365	119	(8)		
Energy	3,634	14			
Consumer non-cyclical	3,304	208	(34)		
Technology	1,487	7	(168)		
Industrial	1,479	198	(10)		
All other	3,971	12	(229)		
Total equities common	16,240	558	(449)		
Equity preferreds	2,593		(1,077)		
Total equities	18,833	558	(1,526)		1%
Other Investments					
High yield asset-backed securities	9,487		(11,001)		
Federal Home Loan Bank capital stock	5,088				
Private fund primarily invested in distressed stock	23,073				1%
Private fund primarily invested in long/short equities	6,010				
Other	1,925				
Total other investments	45,583		(11,001)		1%
BOLI	63,440			AA	2%
Investment in Unconsolidated Subsidiaries					
Private fund primarily invested in high yield asset-backed securities	28,498				1%
Private fund primarily invested in long/short equities	11,781				
Private fund primarily invested in equities	4,243				
Total investment in unconsolidated subsidiaries	44,522				1%
Short Term	441,996				12%
Total Investments	**$3,575,942**	**$58,693**	**$(113,915)**		**100%**

A complete listing of our investment holdings as of December 31, 2008, may be obtained from the Investor Home Page Supplemental Investor Information section of our website.

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. Approximately $50 million of our investments mature or are paid down in a given quarter and are available, if needed, to meet our cash flow requirements. At our insurance subsidiaries level, the primary outflow of cash is related to net paid losses and operating costs, including income taxes. The payment of individual claims cannot be predicted with certainty; therefore, we rely upon the history of paid claims in estimating the timing of future claims payments. To the extent that we have an unanticipated shortfall in cash we may either liquidate securities or borrow funds under previously established borrowing arrangements. However, given the relatively short duration of our investments, we do not foresee any such shortfall.

We held cash and short-term securities of $445.5 million at December 31, 2008 as compared to $260.1 million at December 31, 2007. The increased balance as of December 31, 2008 reflected our intent to hold additional highly liquid assets in response to the instability of credit markets as well as to meet the funding requirements for our planned acquisitions with PICA, Mid-Continent and Georgia Lawyers.

The weighted average effective duration of our fixed maturity securities at December 31, 2008 is 4.0 years; the weighted average effective duration of our fixed maturity securities and our short-term securities combined is 3.5 years. The duration of our fixed maturity securities has shortened due to expected prepayments on mortgage-backed securities increasing.

In September 2008, unprecedented events occurred in the financial markets which affected our investment results. Our investment portfolio was directly affected by the U.S. Treasury conservatorship of Federal National Mortgage Association (Fannie Mae) and Federal Home Loan Mortgage Corporation (Freddie Mac), the declaration of bankruptcy by Lehman Brothers Holding, Inc. (Lehman), the Federal Reserve s lending facility to American International Group, Inc. (AIG), and the ratings downgrades and subsequent FDIC facilitated sale of Washington Mutual Bank (Washington Mutual). In connection with these events, the net asset value of our investment in the Reserve Primary Fund (the Reserve Fund), a money market fund, fell below $1 per share on a market value basis due to a combination of holdings of short-term securities issued by Lehman Brothers and major shareholder redemptions. During 2008, our portfolio of asset-backed securities, particularly mortgage-backed securities, has been impacted by the dramatic deterioration of the real estate market due to a significant increase in home foreclosures and commercial delinquencies.

We realized the following losses on our investments in 2008:

	(*In thousands*) **2008**
Net gains from sales	**$ 1,533**
Other-than-temporary impairment losses:	
Corporate[1]	**(25,347)**
Equity[2]	**(10,564)**
Asset-backed securities	**(9,140)**
Other	**(1,969)**
	(47,020)
Trading portfolio losses	**(5,426)**
Net realized investment losses	**$ (50,913)**

(1)

Includes $19.5 million related to Lehman.

(2) Includes $9.5 million related to Fannie Mae and Freddie Mac preferred stock.

Due to our financial strength and capital position, these realized losses have not had and are not expected to have an impact on our ability to fund capital requirements. Furthermore, we have accumulated sufficient liquidity in the form of highly liquid assets to meet our capital needs until order is restored to the market. Our investment portfolio continues to be comprised of high quality fixed income securities with approximately 98% of our fixed maturities being either United States government agency or investment grade securities as determined by national rating agencies.

As a result of the turmoil in the U.S. credit markets, the overall value of fixed maturity securities declined in 2008. At December 31, 2008 we continue to hold fixed maturity securities in an unrealized loss position with pretax net unrealized losses of approximately $43 million as compared to pretax net unrealized gains of $20 million as of December 31, 2007. The declines reflect the effect of increased market rates for securities not considered risk-free as well as widespread concern regarding the credit quality of mortgages and financial institutions, the future of the U.S. credit markets in general and fears that the U.S. will experience a severe economic recession. It is our belief that we will recover the recorded cost basis of the fixed maturity securities that we hold in an unrealized loss position. We consider the declines in value to be temporary because we have the intent, and, due to the duration of our overall portfolio and positive cash flows, we have the ability to hold the securities to recovery of book value or maturity.

At December 31, 2008 we held asset-backed securities with a fair value of $834.4 million (recorded cost basis of $854.9 million). In 2008, we realized $9.1 million of losses on asset-backed securities (as reflected in the table above) primarily relating to mortgage-backed securities impacted by the deterioration of the housing market. In performing our other-than-temporary impairment assessment of mortgage-backed securities, management projects expected cash flows, making assumptions regarding expected foreclosure rates and the value of collateral available to recover losses. If estimated cash flows project a loss, an other-than-temporary impairment is realized for the difference between the book value and fair value of the security in accordance with generally accepted accounting principles. In some cases, the impairment loss is greater than the projected loss because market values are depressed as a result of market uncertainty and an aversion to risk by market participants. If we continue to hold these securities, and our estimates of projected loss prove over time to be accurate, the economic loss that we ultimately realize will be less than the impairment loss that has been recorded. Conversely, because our judgments about future foreclosure rates, the timing of expected cash flows and the estimated value of collateral may not prove over time to be accurate, we may experience losses on asset-backed securities that we are not currently projecting.

Mortgage-backed securities are generally categorized according to the expected credit quality of underlying mortgage loans. Generally, subprime loans are issued to borrowers with lower credit ratings while Alt-A borrowers have better credit ratings but the mortgage loan is of a type regarded as having a higher risk profile. As of December 31, 2008, we directly hold securities with a fair value of approximately $11.7 million (recorded cost basis of approximately $14.2 million and rated: 55% AAA, 32% AA, 10% A, 3% BBB or BB) and a beneficial interest in securities with a fair value of approximately $635,000 (recorded cost basis of approximately $5.3 million and average rating of B) that are supported by collateral we classify as subprime. We also have subprime exposure of approximately $4.4 million through our interests in private investments funds. We also hold securities with a fair value of approximately $11.4 million (recorded cost basis of approximately $12.8 million) that are supported by privately issued residential mortgage-backed securities we classify as Alt-A, of which approximately 23% are AAA rated, 27% are AA, 50% are A. Ratings given are as of December 31, 2008. During 2008 we evaluated our securities with subprime and Alt-A exposures and recognized other-than-temporary impairments of $5.2 million for the year ended December 31, 2008.

Some of our investments have become less liquid than they have historically been due to the extreme market volatility and disruption experienced in 2008. While the markets for these securities have temporarily become more intermittent and less active, trades are occurring. We determine the fair value of these securities by obtaining information from IDC which includes trade data. We confirmed the reasonableness of the fair value of these securities as of December 31, 2008 by reviewing market yields of the securities. Current yields are substantially elevated and reflect those seen on similar securities of similar credit quality and collateral. In addition to those securities which have become illiquid as a result of current market disruptions, we have historically purchased certain other investments that do not have a readily available market, including private placements, limited partnerships, inverse coupon mortgage-backed securities, municipal auction rate securities and Federal Home Loan Bank (FHLB) capital stock. The net unrealized gains (losses) as of December 31, 2008 associated with securities currently considered to be illiquid are detailed in the following table.

	(In thousands) Values at December 31, 2008	
	Fair Value	**Net Unrealized Gains (Losses)**
Fixed maturities, available for sale		
Mortgage-backed securities classified as:		
Inverse coupon	$ 24,157	$ 3,532
Alt-A	10,160	(2,268)
Subprime	11,700	(2,488)
Prime, privately issued	20,949	(4,232)
Prime, agency issued	536	46
Other asset-backed securities:		
Timber land	791	(209)
Hotel	985	(16)
Manufactured housing	228	(65)
Other	7,342	(534)
Corporate bonds:		
Privately placed	36,472	259
Municipal auction rated bonds	10,025	
Equity, available for sale:		
Privately placed	357	
	$ 123,702	$ (5,975)

We believe the fair values of these securities reflect declines due to the market disruptions and are below the true economic value. The unrealized losses should reverse over the remaining lives of the securities should no further deterioration of collateral relative to our position in the securities capital structures be experienced.

Financial institutions and asset-backed securities, as a whole, have been particularly affected by the market events noted above. The overall U.S. economy has also experienced a downturn which is expected to continue in 2009. The U.S. Government recently enacted legislation and created several programs to help stabilize credit markets and financial institutions and restore liquidity, including the Emergency Economic Stabilization Act of 2008 (EESA), the Federal Reserve s Commercial Paper Funding Facility (CPFF) and Money Market Investor Funding Facility and the Federal Deposit Insurance Corporations (FDIC) Temporary Liquidity Guarantee Program. The EESA authorizes the Secretary of the U.S. Treasury to establish the Troubled Asset Relief Program (TARP) for the repurchase of up to $700 billion of mortgage-backed securities and other troubled financial instruments from financial institutions. Among other EESA provisions are tax code revisions, budget measures, guidance related to the administration of TARP, and measures intended to mitigate mortgage foreclosures. Additional government actions are expected in 2009 to stimulate the economy. It is difficult to predict how recently enacted legislation and future government actions will impact the economy, certain industry sectors and specifically the value of certain investments we hold.

We continue to monitor our exposure to financial institutions. Our largest exposures, including both fixed maturity and equity securities, are to Bank of America ($27.3 million), Morgan Stanley ($24.3 million), and Wells Fargo ($20.9 million). Our concentration of exposure to these institutions has increased as a result of the acquisition of Merrill Lynch by Bank of America and the acquisition of Wachovia by Wells Fargo.

Losses

The following table, known as the Reserve Development Table, presents information over the preceding ten years regarding the payment of our losses as well as changes to (the development of) our estimates of losses during that time period. Years prior to 2001 relate only to the reserves of ProAssurance s predecessor, Medical Assurance. In years 2001 and thereafter the table reflects the reserves of ProAssurance, formed in 2001 in order to merge Medical Assurance and Professionals Group. PRA National reserves are included only in the year 2005 and thereafter. PRA Wisconsin reserves are included only in the year 2006 and thereafter. The table does not include the reserves of our personal lines operations, which are reflected in our financial statements as discontinued operations.

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

The following may be helpful in understanding the Reserve Development Table:

The line entitled Reserve for losses, undiscounted and net of reinsurance recoverables reflects our reserve for losses and loss adjustment expense, less the receivables from reinsurers, each as reported in our consolidated financial statements at the end of each year (the Balance Sheet Reserves).

The section entitled Cumulative net paid, as of reflects the cumulative amounts paid as of the end of each succeeding year with respect to the previously recorded Balance Sheet Reserves.

The section entitled Re-estimated net liability as of reflects the re-estimated amount of the liability previously recorded as Balance Sheet Reserves that includes the cumulative amounts paid and an estimate of additional liability based upon claims experience as of the end of each succeeding year (the Net Re-estimated Liability).

The line entitled Net cumulative redundancy (deficiency) reflects the difference between the previously recorded Balance Sheet Reserve for each applicable year and the Net Re-estimated Liability relating thereto as of the end of the most recent fiscal year.

Analysis of Reserve Development
(In thousands)

	December 31,								
1998	**1999**	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**	**2007**
$ 480,741	$ 486,279	$ 493,457	$1,009,354	$1,098,941	$1,298,458	$1,544,981	$1,896,743	$2,236,385	$2,232,596
89,864	133,832	143,892	245,743	224,318	200,314	199,617	242,608	331,294	312,348
192,716	239,872	251,855	436,729	393,378	378,036	384,050	503,271	600,500	
257,913	313,993	321,957	563,557	528,774	526,867	578,455	697,349		
308,531	358,677	367,810	656,670	635,724	680,470	728,582			
331,796	387,040	402,035	726,661	749,300	794,870				
346,623	408,079	422,005	794,786	824,761					
357,148	417,362	440,676	836,485						
362,978	430,779	457,761							
370,260	443,854								
376,569									
480,741	486,279	493,457	1,009,354	1,098,941	1,298,458	1,544,981	1,896,743	2,236,385	2,232,596
427,095	463,779	507,275	1,026,354	1,098,891	1,289,744	1,522,000	1,860,451	2,131,400	2,047,345
398,308	469,934	529,698	1,023,582	1,099,292	1,282,920	1,479,773	1,764,076	1,955,903	
400,333	488,416	527,085	1,032,571	1,109,692	1,259,802	1,418,802	1,615,125		
414,008	487,366	534,382	1,035,832	1,108,539	1,250,110	1,340,061			

415,381	485,719	536,875	1,045,063	1,133,343	1,230,105	
412,130	489,187	535,120	1,052,050	1,121,440		
409,501	490,200	531,995	1,040,376			
412,148	490,575	524,837				
411,107	487,380					
407,993						

$ 72,748	$ (1,101)	$ (31,380)	$ (31,022)	$ (22,499)	$ 68,353	$ 204,920	$ 281,618	$ 280,482	$ 185,251
$ 660,631	$ 665,786	$ 659,659	$1,322,871	$1,494,875	$1,634,749	$1,818,635	$2,224,436	$2,607,148	$2,559,707
(179,890)	(179,507)	(166,202)	(313,517)	(395,934)	(336,291)	(273,654)	(327,693)	(370,763)	(327,111)
$ 480,741	$ 486,279	$ 493,457	$1,009,354	$1,098,941	$1,298,458	$1,544,981	$1,896,743	$2,236,385	$2,232,596
$ 510,376	$ 588,879	$ 610,956	$1,273,667	$1,424,731	$1,544,793	$1,645,448	$1,985,749	$2,392,212	$2,393,444
(102,383)	(101,499)	(86,119)	(233,291)	(303,291)	(314,688)	(305,387)	(370,624)	(436,309)	(346,099)
$ 407,993	$ 487,380	$ 524,837	$1,040,376	$1,121,440	$1,230,105	$1,340,061	$1,615,125	$1,955,903	$2,047,345
$ 150,255	$ 76,907	$ 48,703	$ 49,204	$ 70,144	$ 89,956	$ 173,187	$ 238,687	$ 214,936	$ 166,263

52

In each year reflected in the table, we have estimated our reserve for losses utilizing the actuarial methodologies discussed in critical accounting estimates. These techniques are applied to the data in a consistent manner and the resulting projections are evaluated by management to establish the estimate of the reserve.

Factors that have contributed to the variation in loss development are primarily related to the extended period of time required to resolve medical professional liability claims and include the following:

Prior to the mid to late 1990 s our business was largely based in Alabama. When we began to expand geographically, we utilized industry based data as well as our own data to support our actuarial projection process. Our own claims experience proved to be better than the projected experience, but again, this was not known for some time after the reserves were established. Ultimately, as actual results proved better than that suggested by historical trends and industry claims data, redundancies developed and were recognized.

The medical professional liability legal environment deteriorated in the late 1990 s. Beginning in 2000, we recognized adverse trends in claim severity causing increased estimates of certain loss liabilities. As a result, favorable development of prior year reserves slowed in 2000 and reversed in 2001 and 2002. We addressed these trends through increased rates, stricter underwriting and modifications to claims handling procedures.

During 2006, 2007 and 2008 we have recognized favorable development related to our previously established reserves primarily for accident years 2002 through 2006 because we have reduced our estimates of claims severity related to those years. Based on recent internal and industry claims data, we believe claims severity (i.e., the average size of a claim) is increasing at a rate slower than we estimated when our reserves for those years were established.

Activity in our net reserve for losses during 2008, 2007 and 2006 is summarized below:

	In thousands		
	Year Ended December 31		
	2008	2007	2006
Balance, beginning of year	**$2,559,707**	$2,607,148	$2,224,436
Less receivable from reinsurers	**327,111**	370,763	327,693
Net balance, beginning of year	**2,232,596**	2,236,385	1,896,743
Reserves acquired from acquisitions, net of receivable from reinsurers of $57.2 million in 2006			171,246
Incurred related to:			
Current year	**396,750**	455,982	479,621
Prior years	**(185,251)**	(104,985)	(36,292)
Total incurred	**211,499**	350,997	443,329
Paid related to:			
Current year	**(20,635)**	(23,492)	(32,325)
Prior years	**(312,348)**	(331,294)	(242,608)
Total paid	**(332,983)**	(354,786)	(274,933)
Net balance, end of year	**2,111,112**	2,232,596	2,236,385

Plus receivable from reinsurers	**268,356**	327,111	370,763
Balance, end of year	**$2,379,468**	$2,559,707	$2,607,148

At December 31, 2008 our gross reserve for losses included case reserves of approximately $1.078 billion and IBNR reserves of approximately $1.301 billion. Our consolidated reserve for losses on a GAAP basis exceeds the combined reserves of our insurance subsidiaries on a statutory basis by approximately $43.4 million, which is principally due to the portion of the GAAP reserve for losses that is reflected for statutory accounting purposes as unearned premiums. These unearned premiums are applicable to extended reporting endorsements (tail coverage) issued without a premium charge upon death, disability, or retirement of an insured.

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.

We generally reinsure professional liability risks under annual treaties pursuant to which the reinsurer agrees to assume all or a portion of all risks that we insure above our individual risk retention of $1 million per claim, up to the maximum individual limit offered (currently $16 million). Historically, per claim retention levels have varied between the first $200,000 and the first $2 million depending on the coverage year and the state in which business was written. Periodically, we provide insurance to policyholders above the maximum limits of our primary reinsurance treaties. In those situations, we reinsure the excess risk above the limits of our reinsurance treaties on a facultative basis, whereby the reinsurer agrees to insure a particular risk up to a designated limit.

Our reinsurance treaties are renegotiated annually. There was no significant change in the cost or structure of the treaties renewed on October 1, 2008.

Our risk retention level is dependent upon numerous factors including our risk appetite and the capital we have to support it, the price and availability of reinsurance, volume of business, level of experience and our analysis of the potential underwriting results within each state. We purchase reinsurance from a number of companies to mitigate concentrations of credit risk. Our reinsurance broker assists us in the analysis of the credit quality of our reinsurers. We base our reinsurance buying decisions on an evaluation of the then-current financial strength, rating and stability of prospective reinsurers. However, the financial strength of our reinsurers, and their corresponding ability to pay us, may change in the future due to forces or events we cannot control or anticipate.

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

At December 31, 2008 our receivable from reinsurers on unpaid losses is $268.4 million and our receivable from reinsurers on paid losses is $17.8 million. The following table identifies our reinsurers from which our recoverables (net of amounts due to the reinsurer) are $10 million or more as of December 31, 2008:

		In thousands
Reinsurer	**A.M. Best Company Rating**	**Net Amounts Due From Reinsurer**
General Reinsurance Corporation	A++	$ 24,557
Hannover Rueckversicherung AG	A	$ 21,433
Transatlantic Reinsurance Company	A	$ 18,744
AXA Reassurances SA	NR-4	$ 11,846
Lloyd s Syndicate No. 2791	A	$ 10,409

Debt

Our long-term debt as of December 31, 2008 is comprised of the following:

	(In thousands, except %)		
	Rate	**December 31 2008**	**First Redemption Date**
Trust Preferred Securities/Debentures Due 2034	6.0% (LIBOR plus 3.85%, adjusted quarterly)	**$ 22,992**	May 2009
Surplus Notes due 2034	7.7%, until May 2009, adjusted quarterly to LIBOR plus 3.85% afterwards	**11,938**	May 2009*
		$ 34,930	

** Subject to approval by the Wisconsin Commissioner of Insurance*

A detailed description of our debt is provided in Note 11 to the Consolidated Financial Statements.

As discussed in Note 11, we completed the conversion of all our outstanding Convertible Debentures (aggregate principal of $107.6 million) in July 2008. Approximately 2,572,000 shares of our common stock were issued in the transaction (conversion rate was 23.9037 shares per $1,000 debenture). Of the common shares issued, approximately 2,120,000 were reissued Treasury Shares and 450,000 were newly issued shares. The transaction resulted in a $112.5 million net increase to Stockholders Equity in the third quarter of 2008. No gain or loss was recorded related to the conversion. Book value increased approximately $0.28 per share from the conversion.

As discussed in Note 11, in mid-December 2008 we extinguished approximately $23 million of our Trust Preferred Securities/Debentures due in 2034 (the TPS/TPS Debentures) for approximately $18.4 million, and recognized a gain on the extinguishment of $4.6 million.

Off Balance Sheet Arrangements/Guarantees

As discussed in Note 11 to the Consolidated Financial Statements, our TPS Debentures are held by, and are the sole assets of two related business trusts (the Trusts). The Trusts purchased the TPS Debentures with proceeds from related trust preferred stock issued and sold by each trust. The terms and maturities of the TPS Debentures mirror those of the related TPS. The Trusts will use the debenture interest and principal payments we pay into each trust to meet their TPS obligations. In December 2008, ProAssurance reacquired TPS having a face value of $23 million. When the TPS were reacquired, ProAssurance became the primary beneficiary of one of the trusts (Trust-1) and consequently, following the guidance of FASB Interpretation No. 46R Variable Interest Entities (FIN 46R), we have

consolidated Trust-1 as of December 31, 2008. The remaining trust (Trust-2) was not consolidated because we are not the primary beneficiary of Trust-2.

ProAssurance has issued guarantees that amounts paid to the Trusts related to the TPS Subordinated Debentures will subsequently be remitted to the holders of the related TPS.

Contractual Obligations

A schedule of our non-cancelable contractual obligations at December 31, 2008 follows:

	Payments due by period *In thousands*				
	Total	Less than 1 year	1-3 years	3-5 years	More than 5 years
Loss and loss adjustment expenses	$2,379,468	$519,943	$811,964	$535,700	$511,861
Interest on long-term debt	52,978	2,160	4,225	4,225	42,368
Long-term debt obligations	34,930				34,930
Operating lease obligations	8,269	1,980	2,729	1,284	2,276
Total	$2,475,645	$524,083	$818,918	$541,209	$591,435

For the purposes of this table, all long-term debt is assumed to be settled at its contractual maturity and interest on variable rate long-term debt is calculated using interest rates in effect at December 31, 2008. The anticipated payout of loss and loss adjustment expenses is based upon our historical payout patterns. Both the timing and amount of these payments may vary from the payments indicated. Our operating lease obligations are primarily for the rental of office space and office equipment.

Each of our debt instruments allows for repayment before maturity, at our option, on or after certain dates. For more information on our debt see Note 11 to the Consolidated Financial Statements.

Treasury Stock

The Board of Directors of ProAssurance authorized $150 million in April 2007, of which $80.3 million was available for use at January 1, 2008, and $100 million in August 2008 for the repurchase of common shares or the retirement of outstanding debt. During the year ended December 31, 2008, we repurchased approximately 1.8 million of our common shares having a total cost of $87.6 million and reacquired debt for $18.4 million. As of December 31, 2008, the repurchase authorization remaining available for use is approximately $74.4 million.

Litigation

We are involved in various legal actions arising primarily from claims against us related to insurance policies and claims handling, including, but not limited to, claims asserted by our policyholders. Legal actions are generally divided into two categories: (1) those dealing with claims and claim-related activities which we consider in our evaluation of our reserve for losses, and (2) those falling outside of these areas which we evaluate and account for as a part of our other liabilities.

Claim-related actions are considered as a part of our reserving process under the guidance provided by SFAS 60 *Accounting and Reporting by Insurance Enterprises.* We evaluate the likely outcomes from these actions giving consideration to the facts and laws applicable to each case, appellate issues, coverage issues, potential recoveries from our insurance and reinsurance programs, and settlement discussions as well as our historical claims resolution practices. This data is then given consideration in the overall evaluation of our reserve for losses.

For non-claim-related actions we evaluate each case separately and establish what we believe is an appropriate reserve under the guidance provided by SFAS 5 *Accounting for Contingencies.* As a result of the acquisition of NCRIC in 2005, we assumed the risk of loss for a judgment entered against PRA National on February 20, 2004 by a District of Columbia Superior Court in favor of Columbia Hospital for Women Medical Center, Inc. (CHW) in the amount of $18.2 million (the judgment). The judgment was appealed to the District of Columbia Court of Appeals, which affirmed the judgment in October 2008 and denied PRA National s petition for rehearing in January 2009. We included a liability of $19.5 million related to the judgment and post-trial interest as a component of the fair value of assets acquired and liabilities assumed in the allocation of the PRA National purchase price in 2005, and have continued to accrue additional post-trial interest. The judgment plus post-trial interest is expected to be paid in the second quarter of 2009.

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

Overview of Results Years Ended December 31, 2008 and 2007

Net income totals $177.7 million for the year ended December 31, 2008 as compared to $168.2 million for the year ended December 31, 2007. Net income per diluted share is $5.22 and $4.78 for the years ended December 31, 2008 and 2007, respectively. The increase in diluted earnings per share is attributable both to the increase in net income and a decrease in diluted weighted average shares outstanding.

Results from the years ended December 31, 2008 and 2007, respectively, compare as follows:

Revenues

Net premiums earned have declined in 2008 by approximately $74.2 million (14%). The decline reflects rate reductions implemented to reflect favorable loss trends and the effects of a highly competitive market place.

Our net investment result, which includes both net investment income and earnings from unconsolidated subsidiaries, has declined in 2008 by $22.6 million (13%). The decline primarily reflects lower interest rates on short-term funds during 2008 and unfavorable conditions in the credit markets.

Net realized investment losses during 2008 are almost $51 million as compared to net realized investment losses of $5.9 million in 2007, primarily due to other-than-temporary impairments of $47.0 million in 2008. The 2008 impairments are primarily related to our investments in the preferred stock of Fannie Mae and Freddie Mac, and debt securities issued by Lehman Brothers.

Revenues for 2008 include a $4.6 million gain related to the extinguishment of $23 million of our Trust Preferred Debentures.

Expenses

Net losses have decreased in 2008 as compared to 2007 by $139.5 million due to a decline in insured risks and favorable prior year loss development in 2008 of $185.3 million versus $105.0 million in 2007.

Underwriting, acquisition and insurance expenses have declined by approximately $6.4 million, principally due to the decline in policy acquisition costs.

Interest expense has declined by $5.1 million primarily because of lower average outstanding debt during 2008.

Ratios

Our net loss ratio has decreased in 2008 by 19.7 points due to the increased amount of favorable net loss development as discussed above. Our expense ratio has increased by 1.9 points primarily due to the decline in premium. Our operating ratio is lower by 20.2 points. Return on equity is 13.3% for 2008 as compared to 14.2% for 2007.

Results of Operations Year Ended December 31, 2008 Compared to Year Ended December 31, 2007

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

	($ in thousands, except share data) Year Ended December 31		
	2008	2007	*Change*
Revenues:			
Gross premiums written	**$471,482**	$549,074	*$ (77,592)*
Net premiums written	**$429,007**	$506,397	*$ (77,390)*
Premiums earned	**$503,579**	$585,310	*$ (81,731)*
Premiums ceded	**(44,301)**	(51,797)	*7,496*
Net premiums earned	**459,278**	533,513	*(74,235)*
Net investment income	**158,384**	171,308	*(12,924)*
Equity in earnings (loss) of unconsolidated subsidiaries	**(7,997)**	1,630	*(9,627)*
Net realized investment gains (losses)	**(50,913)**	(5,939)	*(44,974)*
Gain on extinguishment of debt	**4,571**		*4,571*
Other income	**3,839**	5,556	*(1,717)*
Total revenues	**567,162**	706,068	*(138,906)*
Expenses:			
Losses and loss adjustment expenses	**267,412**	438,527	*(171,115)*
Reinsurance recoveries	**(55,913)**	(87,530)	*31,617*
Net losses and loss adjustment expenses	**211,499**	350,997	*(139,498)*
Underwriting, acquisition and insurance expenses	**100,385**	106,751	*(6,366)*
Interest expense	**6,892**	11,981	*(5,089)*
Total expenses	**318,776**	469,729	*(150,953)*
Income before income taxes[1]	**248,386**	236,339	*12,047*
Income taxes	**70,661**	68,153	*2,508*
Net income[1]	**$177,725**	$168,186	*$ 9,539*

Earnings per share:[1]				
Basic	**$ 5.43**	$ 5.10	*$*	*0.33*
Diluted	**$ 5.22**	$ 4.78	*$*	*0.44*
Net loss ratio	**46.1%**	65.8%		*(19.7)*
Underwriting expense ratio	**21.9%**	20.0%		*1.9*
Combined ratio	**68.0%**	85.8%		*(17.8)*
Operating ratio	**33.5%**	53.7%		*(20.2)*
Return on equity	**13.3%**	14.2%		*(0.9)*

(1) No discontinued operations during 2008 or 2007

Premiums

	($ in thousands) Year Ended December 31			
	2008	2007	*Change*	
Gross premiums written	**$471,482**	$549,074	*$(77,592)*	*(14.1%)*
Premiums earned	**$503,579**	$585,310	*$(81,731)*	*(14.0%)*
Premiums ceded	**(44,301)**	(51,797)	*7,496*	*(14.5%)*
Net premiums earned	**$459,278**	$533,513	*$(74,235)*	*(13.9%)*

Gross Premiums Written

Gross premiums written declined 14.1% during 2008 as compared to 2007, reflecting the effects of lower premium rates and a very competitive insurance market. The change in premiums is driven by three primary factors, our ability and desire to retain expiring business, the change in premium rates we charge on the business we do renew, which can also be affected by the coverage an insured chooses to purchase, and the production of new business.

During 2008 our retention rate remained above 85% which is consistent with prior years. The professional liability market place remains extremely competitive and many of our competitors have been aggressive, particularly in pricing their products to retain their existing business as well as in seeking new business.

The decline in premiums during 2008 also reflects the fact that overall, we are charging our insureds less given the favorable trends that have been emerging in losses. During 2007 and 2008 we have recognized improving loss trends in our rate making analysis, and have lowered the rates we charge our insureds where indicated. As policies take effect at these lower rates our premiums written have declined. For our physician business, which is discussed in more detail below, our charged rates on renewed business reflect an average decrease of 6% for 2008. Charged rates include the effects of filed rates, surcharges and discounts.

Finally, the acquisition of new business continues to be challenging. Despite competitive pressures, we remain committed to a rate structure that will allow us to fulfill our obligations to our insureds, while still generating fair returns for our stockholders.

Physician premiums represent 83% and 84% of gross premiums written during 2008 and 2007, respectively. Amounts written in 2008 have declined as compared to 2007, as shown below.

	($ in thousands) Year Ended December 31			
	2008	2007	*Change*	
Physician Premiums*	**$389,492**	$459,609	*$(70,117)*	*(15.3%)*

* *Exclusive of tail premiums as discussed below*

Our overall retention rate is approximately 88% for the year ended December 31, 2008, as compared to 86% for the year ended December 31, 2007. The retention rate is driven by several factors. Our underwriting evaluation may cause us to non-renew an insured. An insured may leave the practice of medicine through death, disability or retirement and, finally, we may lose business due to pricing or other issues, to our competitors or to self-insurance mechanisms.

Premiums written for non-physician coverages represent 12% and 11% of our total gross premiums written for years ended December 31, 2008 and 2007, respectively.

	($ in thousands)			
	Year Ended December 31			
	2008	2007	*Change*	
Non-physician Premiums*				
Hospital and facility	**$31,229**	$34,237	*$(3,008)*	*(8.8%)*
Other non-physician	**27,241**	28,791	*(1,550)*	*(5.4%)*