PROASSURANCE CORP
Form 10-Q
May 07, 2012
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

x **Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
For the quarterly period ended March 31, 2012 or

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

Commission file number 0-16533

ProAssurance Corporation

(Exact Name of Registrant as Specified in Its Charter)

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

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

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

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

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

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

As of April 30, 2012, there were 30,649,575 shares of the registrant s common stock outstanding.

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FORWARD-LOOKING STATEMENTS

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

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

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

- general economic conditions, either nationally or in our market areas, that are different than anticipated;
- our ability to maintain our dividend payments;
- regulatory, legislative and judicial actions or decisions that could affect our business plans or operations;
- the enactment or repeal of tort reforms;
- formation or dissolution of state-sponsored medical professional liability insurance entities that could remove or add sizable groups of physicians from or to the private insurance market;
- the impact of deflation or inflation;
- changes in the interest rate environment;
- changes in U.S. laws or government regulations regarding financial markets or market activity that may affect the U.S. economy and our business;
- changes in the ability of the U.S. government to meet its obligations that may affect the U.S. economy and our business;
- performance of financial markets affecting the fair value of our investments or making it difficult to determine the value of our investments;

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

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

the effects of changes in the healthcare delivery system, including but not limited to the Patient Protection and Affordable Care Act;

consolidation of healthcare providers and entities that are more likely to self insure and not purchase medical professional liability insurance;

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

- the results of litigation, including pre- or post-trial motions, trials and/or appeals we undertake;
- allegation of bad faith which may arise from our handling of any particular claim, including failure to settle;
- loss of independent agents;
- changes in our organization, compensation and benefit plans;
- our ability to retain and recruit senior management;
- our ability to purchase reinsurance and collect recoveries from our reinsurers;
- assessments from guaranty funds;
- our ability to achieve continued growth through expansion into other states or through acquisitions or business combinations;
- changes to the ratings assigned by rating agencies to our insurance subsidiaries, individually or as a group;
- provisions in our charter documents, Delaware law and state insurance law may impede attempts to replace or remove management or may impede a takeover;
- state insurance restrictions may prohibit assets held by our insurance subsidiaries, including cash and investment securities, from being used for general corporate purposes;
- taxing authorities can take exception to our tax positions and cause us to incur significant amounts of defense costs and, if our defense is not successful, additional tax costs, including interest and penalties;
- insurance market conditions may alter the effectiveness of our current business strategy and impact our revenues; and
- expected benefits from completed and proposed acquisitions may not be achieved or may be delayed longer than expected due to business disruption, loss of customers, employees and key agents, increased operating costs or inability to achieve cost savings, and assumption of greater than expected liabilities, among other reasons.

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

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

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ProAssurance Corporation and Subsidiaries

Condensed Consolidated Balance Sheets (Unaudited)

(In thousands, except share data)

	March 31 **2012**	December 31 2011
Assets		
Investments		
Fixed maturities, available for sale, at fair value; amortized cost, $3,458,213 and $3,465,720, respectively	**$ 3,662,886**	$ 3,665,763
Equity securities, available for sale, at fair value; cost, $5 and $6, respectively	**27**	25
Equity securities, trading, at fair value; cost, $112,493 and $101,078, respectively	**122,486**	103,133
Short-term investments	**132,739**	119,421
Business owned life insurance	**53,115**	52,651
Investment in unconsolidated subsidiaries	**116,020**	111,324
Other investments	**37,645**	38,224
Total Investments	**4,124,918**	4,090,541
Cash and cash equivalents	**120,430**	130,400
Premiums receivable	**130,310**	120,220
Receivable from reinsurers on paid losses and loss adjustment expenses	**10,071**	4,175
Receivable from reinsurers on unpaid losses and loss adjustment expenses	**245,984**	247,658
Prepaid reinsurance premiums	**14,075**	12,568
Deferred policy acquisition costs	**27,548**	26,626
Deferred taxes	**26,844**	30,989
Real estate, net	**40,381**	40,432
Intangible assets	**52,463**	53,703
Goodwill	**159,625**	159,625
Other assets	**80,679**	81,941
Total Assets	**$ 5,033,328**	$ 4,998,878
Liabilities and Shareholders Equity		
Liabilities		
Policy liabilities and accruals		
Reserve for losses and loss adjustment expenses	**$ 2,234,758**	$ 2,247,772
Unearned premiums	**273,844**	251,155
Reinsurance premiums payable	**90,599**	82,039
Total Policy Liabilities	**2,599,201**	2,580,966
Other liabilities	**167,382**	203,772
Long-term debt, $34,992 and $35,507, at amortized cost, respectively; $14,962 and $14,180 at fair value, respectively	**49,954**	49,687
Total Liabilities	**2,816,537**	2,834,425
Shareholders Equity		
Common shares, par value $0.01 per share, 100,000,000 shares authorized, 34,647,526 and 34,551,494 shares issued, respectively	**346**	346
Additional paid-in capital	**539,969**	538,625
	133,049	130,037

Accumulated other comprehensive income (loss), net of deferred tax expense (benefit) of $71,644 and $70,022, respectively		
Retained earnings	**1,747,835**	1,699,853
	2,421,199	2,368,861
Treasury shares, at cost, 3,997,951 shares	**(204,408)**	(204,408)
Total Shareholders Equity	**2,216,791**	2,164,453
Total Liabilities and Shareholders Equity	**$ 5,033,328**	$ 4,998,878

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ProAssurance Corporation and Subsidiaries

Condensed Consolidated Statements of Changes in Capital (Unaudited)

(In thousands)

	Total	Accumulated Other Comprehensive Income (Loss)	Retained Earnings	Other Capital Accounts
Balance at December 31, 2011	**$ 2,164,453**	**$ 130,037**	**$ 1,699,853**	**$ 334,563**
Net income	**55,645**		**55,645**	
Dividends to shareholders	**(7,663)**		**(7,663)**	
Change in net unrealized gains (losses) on investments, after tax, net of reclassification adjustments	**3,012**	**3,012**		
Common shares issued for compensation and net effect of restricted and performance shares issued and stock options exercised	**(786)**			**(786)**
Share-based compensation	**2,130**			**2,130**
Balance at March 31, 2012	**$ 2,216,791**	**$ 133,049**	**$ 1,747,835**	**$ 335,907**

	Total	Accumulated Other Comprehensive Income (Loss)	Retained Earnings	Other Capital Accounts
Balance at December 31, 2010	$ 1,855,863	$ 79,124	$ 1,428,026	$ 348,713
Net income	47,693		47,693	
Change in net unrealized gains (losses) on investments, after tax, net of reclassification adjustments	(4,291)	(4,291)		
Common shares reacquired	(14,993)			(14,993)
Common shares issued for compensation and net effect of performance shares issued and stock options exercised	(1,269)			(1,269)
Share-based compensation	1,737			1,737
Balance at March 31, 2011	$ 1,884,740	$ 74,833	$ 1,475,719	$ 334,188

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ProAssurance Corporation and Subsidiaries

Condensed Consolidated Statements of Income and Comprehensive Income (Unaudited)

(In thousands, except per share data)

	Three Months Ended March 31	
	2012	2011
Revenues		
Net premiums earned	**$ 136,659**	$ 132,077
Net investment income	**33,492**	36,161
Equity in earnings (loss) of unconsolidated subsidiaries	**(2,066)**	(1,364)
Net realized investment gains (losses):		
Other-than-temporary impairment (OTTI) losses	**(1,206)**	(1,837)
Portion of OTTI losses recognized in (reclassified from) other comprehensive income before taxes		(568)
Net impairment losses recognized in earnings	**(1,206)**	(2,405)
Other net realized investment gains (losses)	**11,883**	6,529
Total net realized investment gains (losses)	**10,677**	4,124
Other income	**1,809**	2,587
Total revenues	**180,571**	173,585
Expenses		
Losses and loss adjustment expenses	**78,305**	77,101
Reinsurance recoveries	**(8,106)**	(6,678)
Net losses and loss adjustment expenses	**70,199**	70,423
Underwriting, policy acquisition and operating expenses	**34,398**	35,709
Interest expense	**825**	795
Total expenses	**105,422**	106,927
Income before income taxes	**75,149**	66,658
Provision for income taxes		
Current expense (benefit)	**16,981**	5,059
Deferred expense (benefit)	**2,523**	13,906
Total income tax expense (benefit)	**19,504**	18,965
Net income	**$ 55,645**	$ 47,693
Other comprehensive income, after tax, net of reclassification adjustments (see Note 9)	**3,012**	(4,291)
Comprehensive income	**$ 58,657**	$ 43,402

Earnings per share:		
Basic	**$ 1.82**	$ 1.56
Diluted	**$ 1.80**	$ 1.55
Weighted average number of common shares outstanding:		
Basic	**30,589**	30,616
Diluted	**30,852**	30,853
Cash dividends declared per common share	**$ 0.25**	$

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ProAssurance Corporation and Subsidiaries

Condensed Consolidated Statements of Cash Flows (Unaudited)

(In thousands)

	Three Months Ended March 31	
	2012	2011
Operating Activities		
Net income	**$ 55,645**	$ 47,693
Depreciation and amortization	**10,382**	9,115
Net realized investment (gains) losses	**(10,677)**	(4,124)
Share-based compensation	**2,130**	1,737
Deferred income taxes	**2,523**	13,906
Other	**(2,588)**	(757)
Changes in assets and liabilities:		
Premiums receivable	**(10,090)**	(2,678)
Other assets	**(2,920)**	650
Reserve for losses and loss adjustment expenses	**(13,014)**	(2,742)
Unearned premiums	**22,689**	19,548
Reinsurance related assets and liabilities	**2,831**	(9,242)
Other liabilities	**(28,811)**	(48,245)
Net cash provided by operating activities	**28,100**	24,861
Investing Activities		
Purchases of:		
Fixed maturities, available for sale	**(247,622)**	(252,043)
Equity securities, trading	**(26,678)**	(15,750)
Other investments	**(158)**	
(Investments in) distributions from unconsolidated subsidiaries, net:		
Tax credit limited partnerships	**(12,236)**	(6,228)
Other partnership investments		
Proceeds from sale or maturities of:		
Fixed maturities, available for sale	**252,234**	211,573
Equity securities, available for sale		3,589
Equity securities, trading	**16,039**	18,621
Other investments	**486**	
Net sales or maturities (purchases) of short-term investments	**(13,143)**	22,948
Unsettled security transactions, net	**4,403**	30,320
Cash received (paid) for other assets	**(1,358)**	(12,227)
Net cash provided (used) by investing activities	**(28,033)**	803
Financing Activities		
Repurchase of common stock		(14,993)
Dividend to shareholders	**(7,622)**	
Other	**(2,415)**	(2,018)

Net cash provided (used) by financing activities	**(10,037)**	(17,011)
Increase (decrease) in cash and cash equivalents	**(9,970)**	8,653
Cash and cash equivalents at beginning of period	**130,400**	50,851
Cash and cash equivalents at end of period	**$ 120,430**	$ 59,504

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ProAssurance Corporation and Subsidiaries

Notes to Condensed Consolidated Financial Statements (Unaudited)

March 31, 2012

1. Basis of Presentation

The accompanying unaudited Condensed Consolidated Financial Statements include the accounts of ProAssurance Corporation and its consolidated subsidiaries (ProAssurance or PRA). The financial statements have been prepared in accordance with U.S. Generally Accepted Accounting Principles (GAAP) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and notes required by GAAP for complete financial statements. In the opinion of management, all adjustments considered necessary for a fair presentation, consisting of normal recurring adjustments, have been included. ProAssurance s results for the three-month period ended March 31, 2012 are not necessarily indicative of the results that may be expected for the year ending December 31, 2012. The accompanying Condensed Consolidated Financial Statements should be read in conjunction with the Consolidated Financial Statements and Notes contained in ProAssurance s December 31, 2011 report on Form 10-K. In connection with its preparation of the Condensed Consolidated Financial Statements, ProAssurance evaluated events that occurred subsequent to March 31, 2012 for recognition or disclosure in its financial statements and notes to financial statements.

Accounting Changes Not Yet Adopted

Disclosures About Offsetting Assets and Liabilities

Effective for fiscal years beginning on or after January 1, 2013, the Financial Accounting Standards Board (FASB) revised guidance related to disclosures about certain assets and liabilities in an entity s financial statements. The guidance requires disclosures related to the net and gross positions of certain financial instruments and transactions that are either eligible for offset in accordance with existing GAAP guidance or subject to an agreement that requires such offset. The guidance must be applied retrospectively for all prior periods presented. ProAssurance plans to adopt the guidance beginning January 1, 2013. Adoption of this guidance is not expected to have a material effect on ProAssurance s results of operations or financial position.

Accounting Changes

Accounting for Costs Associated with Acquiring or Renewing Insurance Contracts

Effective for fiscal years beginning after December 15, 2011, the FASB revised guidance regarding the interpretation of which costs relating to the acquisition of new or renewal insurance contracts qualify for deferral. The guidance permits deferral of qualifying costs only when associated with successful contract acquisitions. Internal selling agent and underwriter salary and benefit costs allocated to unsuccessful contracts, as well as advertising costs, are excluded. The guidance must be applied prospectively, but may be applied retrospectively for all prior periods. ProAssurance prospectively adopted the guidance on January 1, 2012. Adoption of this guidance had no material effect on ProAssurance s results of operations or financial position.

Fair Value Measurements

Effective for interim and annual reporting periods beginning after December 15, 2011, the FASB revised guidance related to fair value measurements and disclosures, all of which are to be applied prospectively. The new guidance increases disclosure requirements regarding valuation methods used to determine fair value measurements categorized as Level 3, as well as the sensitivity to change of those measurements, and requires additional disclosures regarding the consideration given to highest and best use in fair value measurements of nonfinancial assets. The guidance also requires that when fair value measurements of items not carried at fair value are disclosed, the fair value measurements are to be categorized by level of the fair value hierarchy. Additionally, the guidance also clarifies or revises certain

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ProAssurance Corporation and Subsidiaries

Notes to Condensed Consolidated Financial Statements (Unaudited)

March 31, 2012

1. Basis of Presentation (continued)

fair value measurement principles related to the valuation of financial instruments managed within a portfolio, the valuation of instruments classified as a part of shareholders equity, the appropriate application of the highest and best use valuation premise, and the consideration of premium and discounts in a fair value measurement. ProAssurance adopted the guidance on January 1, 2012. Adoption of this guidance had no material effect on ProAssurance s results of operations or financial position.

2. Fair Value Measurement

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

Level 1: quoted (unadjusted) market prices in active markets for identical assets and liabilities. For ProAssurance, Level 1 inputs are generally quotes for debt or equity securities actively traded in exchange or over-the-counter markets.

Level 2: market data obtained from sources independent of the reporting entity (observable inputs). For ProAssurance, Level 2 inputs generally include quoted prices in markets that are not active, quoted prices for similar assets/liabilities, and results from pricing models that use observable inputs such as interest rates and yield curves that are generally available at commonly quoted intervals.

Level 3: the reporting entity s own assumptions about market participant assumptions based on the best information available in the circumstances (non-observable inputs). For ProAssurance, Level 3 inputs are used in situations where little or no Level 1 or 2 inputs are available or are inappropriate given the particular circumstances. Level 3 inputs include results from pricing models for which some or all of the inputs are not observable, discounted cash flow methodologies, single non-binding broker quotes and adjustments to externally quoted prices that are based on management judgment or estimation.

The following tables present information about ProAssurance s assets and liabilities that are measured at fair value on a recurring basis as of March 31, 2012 and December 31, 2011 and indicate the fair value hierarchy of the valuation techniques utilized to determine such value. For some assets, the inputs used to measure fair value may fall into different levels of the fair value hierarchy. When this is the case, the asset is categorized based on the level of the most significant input to the fair value measurement. ProAssurance s assessment of the significance of a particular input to the fair value measurement requires judgment and considers factors specific to the assets being valued.

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ProAssurance Corporation and Subsidiaries

Notes to Condensed Consolidated Financial Statements (Unaudited)

March 31, 2012

2. Fair Value Measurement (continued)

Assets and liabilities measured at fair value on a recurring basis as of March 31, 2012 and December 31, 2011, including financial instruments for which ProAssurance has elected fair value accounting, are as follows:

	March 31, 2012			
	Fair Value Measurements Using			Total
(In thousands)	Level 1	Level 2	Level 3	Fair Value
Assets:				
Fixed maturities, available for sale				
U.S. Treasury obligations	**$**	**$ 249,281**	**$**	**$ 249,281**
U.S. Agency obligations		**69,883**		**69,883**
State and municipal bonds		**1,219,500**	**7,175**	**1,226,675**
Corporate debt, multiple observable inputs		**1,420,912**		**1,420,912**
Corporate debt, limited observable inputs:				
Private placement senior notes			**605**	**605**
Other corporate debt, NRSRO ratings available			**6,959**	**6,959**
Other corporate debt, NRSRO ratings not available			**1,125**	**1,125**
Residential mortgage-backed securities		**513,030**		**513,030**
Commercial mortgage-backed securities		**77,819**		**77,819**
Other asset-backed securities		**96,597**		**96,597**
Equity securities				
Financial	**33,423**			**33,423**
Energy	**15,492**			**15,492**
Consumer oriented	**33,448**			**33,448**
Technology	**8,825**			**8,825**
Industrial	**13,866**			**13,866**
All other	**17,459**			**17,459**
Short-term investments	**124,723**	**8,016**		**132,739**
Financial instruments carried at fair value, classified as a part of:				
Investment in unconsolidated subsidiaries			**24,430**	**24,430**
Other investments			**15,742**	**15,742**
Total assets	**$ 247,236**	**$ 3,655,038**	**$ 56,036**	**$ 3,958,310**
Liabilities:				
2019 Note payable			**14,962**	**14,962**
Interest rate swap agreement			**4,415**	**4,415**

Total liabilities	**$**	**$**	**$ 19,377**	**$ 19,377**

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ProAssurance Corporation and Subsidiaries

Notes to Condensed Consolidated Financial Statements (Unaudited)

March 31, 2012

2. Fair Value Measurement (continued)

	December 31, 2011			
	Fair Value Measurements Using			Total
(In thousands)	Level 1	Level 2	Level 3	Fair Value
Assets:				
Fixed maturities, available for sale				
U.S. Treasury obligations	$	$ 283,865	$	$ 283,865
U.S. Agency obligations		68,104		68,104
State and municipal bonds		1,221,187	7,200	1,228,387
Corporate debt, multiple observable inputs		1,359,866		1,359,866
Corporate debt, limited observable inputs:				
Private placement senior notes			612	612
Other corporate debt, NRSRO ratings available			6,310	6,310
Other corporate debt, NRSRO ratings not available			1,160	1,160
Residential mortgage-backed securities		542,551		542,551
Commercial mortgage-backed securities		81,188		81,188
Other asset-backed securities		93,720		93,720
Equity securities				
Financial	25,281			25,281
Energy	13,381			13,381
Consumer oriented	29,711			29,711
Technology	7,556			7,556
Industrial	9,185			9,185
All other	18,044			18,044
Short-term investments	111,359	8,062		119,421
Financial instruments carried at fair value, classified as a part of:				
Investment in unconsolidated subsidiaries			23,841	23,841
Other investments			15,873	15,873
Total assets	$ 214,517	$ 3,658,543	$ 54,996	$ 3,928,056
Liabilities:				
2019 Note payable			14,180	14,180
Interest rate swap agreement			4,659	4,659
Total liabilities	$	$	$ 18,839	$ 18,839

The fair values for securities included in the Level 2 category, with the few exceptions described below, have been developed by third party, nationally recognized pricing services. These services use complex methodologies to determine values for securities and subject the values they develop to quality control reviews. The services collect and utilize multiple inputs, although not all inputs are used for every security type or given the same priority in every evaluation. Inputs used include: benchmark yields, reported trades, broker/dealer quotes, issuer spreads, two-sided markets, benchmark securities, bids, and offers. The services also consider credit ratings, where appropriate, including ratings updates and information available in appropriate market research publications. Management reviews service-provided values for reasonableness by comparing data among pricing services and to available market and trade data. Values that appear inconsistent are further reviewed for appropriateness. If a value does not appear reasonable, the valuation is discussed with the service that provided the value and would be adjusted, if necessary. No such adjustments have been necessary in 2012 or 2011.

ProAssurance Corporation and Subsidiaries

Notes to Condensed Consolidated Financial Statements (Unaudited)

March 31, 2012

2. Fair Value Measurement (continued)

Level 2 Valuations

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

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

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

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

Corporate debt with multiple observable inputs consists primarily of corporate bonds, but also includes a small number of bank loans. The methodology used to value Level 2 corporate bonds is the same as the methodology previously described for U.S. agency obligations. Bank loans are valued by an outside vendor based upon a widely distributed, loan-specific listing of average bid and ask prices published daily by an investment industry group. The publisher of the listing derives the averages from data received from multiple market-makers for bank loans.

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

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

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

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ProAssurance Corporation and Subsidiaries

Notes to Condensed Consolidated Financial Statements (Unaudited)

March 31, 2012

2. Fair Value Measurement (continued)

Level 3 Valuations

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

Level 3 Valuation Processes

Level 3 securities are priced by the Company s Vice President of Investments, who reports to the Chief Financial Officer.

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

The Company s Level 3 valuations are not overly sensitive to changes in the unobservable inputs used. The securities noted in the disclosure are primarily investment grade debt where comparable market inputs are commonly available for evaluating the securities in question.

Level 3 Valuation Methodologies

State and municipal bonds consists of auction rate municipal bonds valued internally using published quotes for similar securities or by using a model based on discounted cash flows using yields currently available on fixed rate securities with a similar term and collateral, adjusted to consider the effect of a floating rate and a premium for illiquidity. All are rated A or better.

Corporate debt with limited observable inputs consists of private placement senior notes guaranteed by large regional banks and corporate bonds. Valuations are determined using dealer quotes for similar securities or discounted cash flow models using yields currently available for similar securities. Similar securities are defined as securities having like terms and payment features that are of comparable credit quality. Assessments of credit quality are based on NRSRO ratings, if available, or are subjectively determined by management if not available. At March 31, 2012, the average NRSRO rating of rated securities is BBB.

Investments in unconsolidated subsidiaries and Other investments consist of limited partnership (LP) and limited liability company (LLC) interests valued using net asset values (NAVs) provided by the LP/LLC, which approximates the fair value of the interest. Such interests include the following:

	December 31,	December 31,	December 31, Unfunded
	Fair Value		Commitments

(In thousands)		**March 31, 2012**		December 31, 2011	**March 31, 2012**
Investment in unconsolidated subsidiaries:					
LP primarily invested in long/short equities (1)	**$**	**17,505**	$	17,123	**None**
LP primarily invested in non-public equities (2)		**6,925**		6,718	**$3,500**
		24,430		23,841	
Other investments:					
LLC primarily invested in private equity and debt (3)		**15,742**		15,873	**None**
	$	**40,172**	$	39,714	

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

(2) The LP is structured to provide capital appreciation through diversified investments in private equity, including investments in buyout, venture capital, mezzanine debt, distressed debt and other private equity-oriented LPs. Redemptions are not allowed, except by special permission of the LP. Income and capital are to be periodically distributed at the discretion of the LP over an anticipated time frame that spans 3 to 5 years.

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ProAssurance Corporation and Subsidiaries

Notes to Condensed Consolidated Financial Statements (Unaudited)

March 31, 2012

2. Fair Value Measurement (continued)

(3) The LLC is structured to provide income through diversified investments in private equity, including mezzanine debt, distressed debt, syndicated bank loans and other private equity-oriented investments. The LLC converted into a publicly traded investment fund in April 2012. Due to conversion restrictions, ProAssurance cannot sell its interest in the fund before October 2012.

Liabilities (the 2019 Note payable and the Interest rate swap agreement) are valued using the present value of expected underlying cash flows of the instrument, discounted at rates available on the valuation date for similar instruments issued by entities with a similar credit standing to ProAssurance.

Quantitative Information Regarding Level 3 Valuations

Quantitative information about Level 3 Fair Value Measurements

($ in millions)	Fair Value at March 31, 2012	Valuation Technique	Unobservable Input	Range (Weighted Range)
Assets:				
State and municipal bonds	$ 7.2	Market Comparable Securities	Comparability Adjustment	0% - 10% (5%)
		Discounted Cash Flows	Comparability Adjustment	0% - 10% (5%)
Corporate debt with limited observable inputs	$ 8.7	Market Comparable Securities	Comparability Adjustment	0% - 5% (2.5%)
		Discounted Cash Flows	Comparability Adjustment	0% - 5% (2.5%)
Liabilities:				
2019 Note payable, Interest rate swap agreement	$ 19.4	Discounted Cash Flows	Comparability Adjustment	0% - 5% (2.5%)

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

ProAssurance Corporation and Subsidiaries

Notes to Condensed Consolidated Financial Statements (Unaudited)

March 31, 2012

2. Fair Value Measurement (continued)

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

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

	March 31, 2011 Level 3 Fair Value Measurements Assets					
(In thousands)	State and Municipal Bonds	Corporate Bonds	Asset-backed Securities	Investment in Unconsolidated Subsidiaries	Other Investments	Total

Assets						
Balance December 31, 2010	$ 7,550	$ 21,229	$ 2,220	$ 25,112	$	$ 56,111
Total gains (losses) realized and unrealized:						
Included in earnings, as a part of:						
Equity in earnings of unconsolidated subsidiaries				550		550
Net realized investment gains (losses)			314			314
Included in other comprehensive income		(180)	(15)			(195)
Purchases						
Sales	(100)	(5,195)	(1,921)			(7,216)
Transfers in		3,447				3,447
Transfers out		(2,421)	(598)			(3,019)
Balance March 31, 2011	$ 7,450	$ 16,880	$	$ 25,662	$	$ 49,992
Change in unrealized gains (losses) included in earnings for the above period for Level 3 assets held at period-end	$	$	$	$ 550	$	$ 550

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ProAssurance Corporation and Subsidiaries

Notes to Condensed Consolidated Financial Statements (Unaudited)

March 31, 2012

2. Fair Value Measurement (continued)

Transfers

There were no transfers between the Level 1 and Level 2 categories during the three months ended March 31, 2012 or 2011.

There were no transfers in or out of Level 3 during the three months ended March 31, 2012. The transfers shown during the three months ended March 31, 2011 relate to securities held for which there was little market activity for identical or nearly identical securities during the period and represent transfers to or from Level 2. Such securities are valued using multiple observable inputs when those inputs are available; otherwise the securities are valued using limited observable inputs.

	March 31, 2012 Level 3 Fair Value Measurements - Liabilities		
(In thousands)	2019 Note Payable	Interest rate swap agreement	Total
Balance December 31, 2011	**$ 14,180**	**$ 4,659**	**$ 18,839**
Total (gains) losses realized and unrealized:			
Included in earnings as a part of net realized investment (gains) losses	**868**	**(244)**	**624**
Settlements	**(86)**		**(86)**
Balance March 31, 2012	**$ 14,962**	**$ 4,415**	**$ 19,377**
Change in unrealized (gains) losses included in earnings for the above period for Level 3 liabilities outstanding at period-end	**$ 868**	**$ (244)**	**$ 624**

	March 31, 2011 Level 3 Fair Value Measurements - Liabilities		
(In thousands)	2019 Note Payable	Interest rate swap agreement	Total
Liabilities			
Balance December 31, 2010	$ 15,616	$ 3,658	$ 19,274

Total (gains) losses realized and unrealized:			
Included in earnings as a part of net realized investment (gains) losses	19	(243)	(224)
Settlements	(80)		(80)
Balance March 31, 2011	$ 15,555	$ 3,415	$ 18,970
Change in unrealized (gains) losses included in earnings for the above period for Level 3 liabilities outstanding at period-end	$ 19	$ (243)	$ (224)

Fair Value Option Elections

The 2019 Note Payable and a related interest rate swap agreement (the Swap) are measured at fair value on a recurring basis, with changes in the fair value of each liability recorded in net realized gains (losses). ProAssurance assumed both liabilities as part of a previous acquisition. The fair value option was elected for the 2019 Note Payable and the Swap because valuation at fair value better reflects the economics of the related liabilities and eliminates the inconsistency that would otherwise result from carrying the 2019 Note Payable on an amortized cost basis and the Swap at fair value.

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ProAssurance Corporation and Subsidiaries

Notes to Condensed Consolidated Financial Statements (Unaudited)

March 31, 2012

2. Fair Value Measurement (continued)

Financial Instruments Not Measured At Fair Value

The following table provides the estimated fair value of our financial instruments that are not carried at fair value. All fair values provided fall within the Level 3 fair value category.

	March 31, 2012		December 31, 2011	
(In thousands)	**Carrying Value**	**Estimated Fair Value**	Carrying Value	Estimated Fair Value
Financial assets:				
Other investments	**$ 21,903**	**$ 29,608**	$ 22,351	$ 28,226
Investment in unconsolidated subsidiaries	**91,590**	**101,144**	87,483	96,443
BOLI	**53,115**	**53,115**	52,651	52,651
Other assets	**10,491**	**10,491**	9,636	9,636
Financial liabilities:				
Trust Preferred Securities	**$ 22,992**	**$ 22,992**	$ 22,992	$ 22,992
Surplus Notes due May 2034	**12,000**	**12,000**	12,000	12,000
Note Payable due February 2012			515	519
Other liabilities	**14,500**	**14,410**	15,076	14,946

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

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

The fair value of the BOLI is the cash surrender value associated with the policies on the valuation date.

Other Assets and Other Liabilities primarily consist of related investment assets and liabilities associated with funded deferred compensation agreements. Other Liabilities also includes certain contractual liabilities assumed as a part of a business combination. Fair values of the funded deferred compensation assets/liabilities are based on the NAVs of the underlying securities. The fair values of the business combination liabilities are based on the present value of the expected cash flows, discounted at ProAssurance s assumed incremental borrowing rate on the valuation date for unsecured liabilities with similar repayment structures.

The fair value of the long-term debt is the present value of expected underlying cash flows of the debt, discounted at rates available on the valuation date for similar debt issued by entities with a similar credit standing to ProAssurance or, if issued by an insurance subsidiary, the subsidiary issuing the debt.

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ProAssurance Corporation and Subsidiaries

Notes to Condensed Consolidated Financial Statements (Unaudited)

March 31, 2012

3. Investments

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

	March 31, 2012			
(In thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Fixed maturities				
U.S. Treasury obligations	**$ 234,249**	**$ 15,094**	**$ (62)**	**$ 249,281**
U.S. Agency obligations	**64,454**	**5,429**		**69,883**
State and municipal bonds	**1,146,835**	**80,459**	**(619)**	**1,226,675**
Corporate debt	**1,358,665**	**74,747**	**(3,811)**	**1,429,601**
Residential mortgage-backed securities	**486,279**	**28,701**	**(1,950)***	**513,030**
Commercial mortgage-backed securities	**72,322**	**5,554**	**(57)**	**77,819**
Other asset-backed securities	**95,409**	**1,197**	**(9)**	**96,597**
	3,458,213	**211,181**	**(6,508)**	**3,662,886**
Equity securities	**5**	**22**		**27**
	$ 3,458,218	**$ 211,203**	**$ (6,508)**	**$ 3,662,913**

	December 31, 2011			
(In thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Fixed maturities				
U.S. Treasury obligations	$ 267,120	$ 16,748	$ (3)	$ 283,865
U.S. Agency obligations	62,520	5,584		68,104
State and municipal bonds	1,145,025	83,568	(206)	1,228,387
Corporate debt	1,307,504	68,105	(7,661)	1,367,948
Residential mortgage-backed securities	514,412	30,270	(2,131)*	542,551

Commercial mortgage-backed securities	76,366	4,881	(59)	81,188
Other asset-backed securities	92,773	978	(31)	93,720
	3,465,720	210,134	(10,091)	3,665,763
Equity securities	6	19		25
	$ 3,465,726	$ 210,153	$ (10,091)	$ 3,665,788

* Includes other-than-temporary impairments recognized in accumulated other comprehensive income of $3.3 million at both March 31, 2012 and December 31, 2011.

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ProAssurance Corporation and Subsidiaries

Notes to Condensed Consolidated Financial Statements (Unaudited)

March 31, 2012

3. Investments (continued)

The recorded cost basis and estimated fair value of available-for-sale fixed maturities at March 31, 2012, by contractual maturity, are shown below. Actual maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties. ProAssurance uses the call date as the contractual maturity for pre-refunded state and municipal bonds which are 100% backed by U.S. Treasury obligations.

(In thousands)	Amortized Cost	Due in one year or less	Due after one year through five years	Due after five years through ten years	Due after ten years	Total Fair Value
Fixed maturities, available for sale						
U.S. Treasury obligations	$ 234,249	$ 16,799	$ 150,674	$ 78,005	$ 3,803	$ 249,281
U.S. Agency obligations	64,454	6,767	38,621	24,233	262	69,883
State and municipal bonds	1,146,835	38,292	358,818	548,871	280,694	1,226,675
Corporate debt	1,358,665	97,969	691,217	605,732	34,683	1,429,601
Residential mortgage-backed securities	486,279					513,030
Commercial mortgage-backed securities	72,322					77,819
Other asset-backed securities	95,409					96,597
	$ 3,458,213					$ 3,662,886

Excluding investments in bonds and notes of the U.S. Government, a U.S. Government agency, or pre-refunded state and municipal bonds which are 100% backed by U.S. Treasury obligations, no investment in any entity or its affiliates exceeds 10% of shareholders equity at March 31, 2012.

At March 31, 2012, ProAssurance has available-for-sale securities with a fair value of $21.9 million on deposit with various state insurance departments to meet regulatory requirements. ProAssurance also has available-for-sale securities with a fair value of $29.8 million that are pledged as collateral security for the 2019 Note Payable (see Note 8).

Business Owned Life Insurance (BOLI)

ProAssurance holds BOLI policies on management employees that are carried at the current cash surrender value of the policies (original cost $35 million). The primary purpose of the program is to offset future employee benefit expenses through earnings on the cash value of the policies. ProAssurance is the owner and principal beneficiary of these policies.

Other Investments

ProAssurance has Other Investments comprised of the following:

(In millions)	**March 31, 2012**	December 31, 2011
Investment in LLC, at NAV	**$ 15.7**	$ 15.9
Investments in LPs/LLCs, at cost	**15.9**	16.2
FHLB capital stock, at cost	**4.4**	4.4
Other, principally an annuity, at amortized cost	**1.6**	1.7
	$ 37.6	$ 38.2

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

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ProAssurance Corporation and Subsidiaries

Notes to Condensed Consolidated Financial Statements (Unaudited)

March 31, 2012

3. Investments (continued)

Unconsolidated Subsidiaries

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

	Carrying Value		Unfunded Commitments	Percentage Ownership
(In millions)	**March 31, 2012**	December 31, 2011	**March 31, 2012**	**March 31, 2012**
Investment LPs/LLCs:				
Tax Credit Partnerships	**$ 91.4**	$ 86.8	**$ 43.8**	**<20%**
Long/Short Equity Fund	**17.5**	17.1		**<20%**
Non-public Equity Fund	**6.9**	6.7	**3.5**	**<20%**
Business LLC	**0.2**	0.7		**See below**
	$ 116.0	$ 111.3	**$ 47.3**	

Investments in Tax Credit Partnerships are comprised of multiple separate LP/LLC interests designed to generate investment returns by providing tax benefits to fund investors in the form of project operating losses and tax credits. The related properties are principally low income housing projects.

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

The Non-public Equity Fund LP holds diversified private equities and is structured to provide capital appreciation.

The Business LLC interest is a convertible preferred interest in a service-related business that began business operations in 2011. The preferred interest can be converted into a non-controlling common interest in May 2015, but conversion is not required.

Investments Held in a Loss Position

The following tables provide summarized information with respect to investments held in an unrealized loss position at March 31, 2012 and December 31, 2011, including the length of time the investment has been held in a continuous unrealized loss position.

	March 31, 2012					
	Total		Less than 12 months		More than 12 months	
(In thousands)	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
Fixed maturities, available for sale						
U.S. Treasury obligations	$ 16,404	$ (62)	$ 16,404	$ (62)	$	$
State and municipal bonds	37,781	(619)	35,599	(523)	2,182	(96)
Corporate debt	188,772	(3,811)	171,595	(2,910)	17,177	(901)
Residential mortgage-backed securities	32,597	(1,950)	20,327	(651)	12,270	(1,299)
Commercial mortgage-backed securities	3,234	(57)	1,892	(1)	1,342	(56)
Other asset-backed securities	12,026	(9)	12,026	(9)		
	$ 290,814	$ (6,508)	$ 257,843	$ (4,156)	$ 32,971	$ (2,352)
Other investments						
Investments in LPs/LLCs carried at cost	$ 6,223	$ (290)	$ 5,824	$ (178)	$ 399	$ (112)

ProAssurance Corporation and Subsidiaries

Notes to Condensed Consolidated Financial Statements (Unaudited)

March 31, 2012

3. Investments (continued)

	December 31, 2011					
	Total		Less than 12 months		More than 12 months	
(In thousands)	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
Fixed maturities, available for sale						
U.S. Treasury obligations	$ 8,379	$ (3)	$ 8,379	$ (3)	$	$
State and municipal bonds	9,743	(206)	7,143	(10)	2,600	(196)
Corporate debt	205,605	(7,661)	194,057	(6,691)	11,548	(970)
Residential mortgage-backed securities	49,525	(2,131)	38,146	(488)	11,379	(1,643)
Commercial mortgage-backed securities	4,086	(59)	3,143	(2)	943	(57)
Other asset-backed securities	19,031	(31)	19,031	(31)		
	$ 296,369	$ (10,091)	$ 269,899	$ (7,225)	$ 26,470	$ (2,866)
Other investments						
Investments in LPs/LLCs carried at cost	$ 4,198	$ (984)	$ 3,815	$ (856)	$ 383	$ (128)

As of March 31, 2012, there are 192 debt securities (7.3% of all available-for-sale fixed maturity securities held) in an unrealized loss position representing 177 issuers. The single greatest unrealized loss position is approximately $0.9 million; the second greatest unrealized loss position is approximately $0.4 million. The securities were evaluated for impairment as of March 31, 2012.

As of December 31, 2011, there were 251 debt securities (9.6% of all available-for-sale fixed maturity securities held) in an unrealized loss position representing 224 issuers. The single greatest unrealized loss position approximated $1.2 million; the second greatest unrealized loss position approximated $1.0 million. The securities were evaluated for impairment as of December 31, 2011.

Each quarter, ProAssurance performs a detailed analysis for the purpose of assessing whether any of the securities it holds in an unrealized loss position have suffered an other-than-temporary impairment in value. A detailed discussion of the factors considered in the assessment is included in Note 1 of the Notes to Consolidated Financial Statements included in ProAssurance s December 31, 2011 Form 10-K.

At March 31, 2012, fixed maturity securities held in an unrealized loss position, excluding asset-backed securities, have paid all scheduled contractual payments and are expected to continue doing so. Expected future cash flows of asset-backed securities held in an unrealized loss position equaled or exceeded the current amortized cost basis of the security; such future cash flows were estimated using the most recently available six-month historical performance data for the collateral (loans) underlying the security or, if historical data was not available, sector based assumptions.

Net Investment Income

Net investment income by investment category is as follows:

	Three Months Ended March 31	
(In thousands)	**2012**	2011
Fixed maturities	**$ 33,270**	$ 35,951
Equities	**1,041**	230
Short-term investments	**19**	55
Other invested assets	**402**	992
Business owned life insurance	**457**	464
	35,189	37,692
Investment expenses	**(1,697)**	(1,531)
Net investment income	**$ 33,492**	$ 36,161

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Notes to Condensed Consolidated Financial Statements (Unaudited)

March 31, 2012

3. Investments (continued)

Net Realized Investment Gains (Losses)

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

(In thousands)	Three Months Ended March 31 2012	2011
Total other-than-temporary impairment losses:		
Residential mortgage-backed securities	**$ (245)**	$ (450)
Corporate debt	**(830)**	
Other investments	**(131)**	(1,387)
Portion recognized in (reclassified from) Other Comprehensive Income:		
Residential mortgage-backed securities		(568)
Net impairment losses recognized in earnings	**(1,206)**	(2,405)
Gross realized gains, available-for-sale securities	**3,887**	4,628
Gross realized (losses), available-for-sale securities	**(94)**	(244)
Net realized gains (losses), trading securities	**777**	2,692
Change in unrealized holding gains (losses), trading securities	**7,937**	(771)
Decrease (increase) in the fair value of liabilities carried at fair value	**(624)**	224
Net realized investment gains (losses)	**$ 10,677**	$ 4,124

ProAssurance recognized credit-related impairments of $0.8 million during the first three months of 2012 related to a corporate debt security due to deterioration of the credit standing of the issuer during the first quarter of 2012.

ProAssurance recognized impairments of $0.1 million and $1.4 million during the three months ended March 31, 2012 and 2011, respectively, related to an interest in an LLC which is accounted for using the cost method. The LLC announced plans to convert into a publicly traded investment fund during the first quarter of 2011 and completed the conversion in April 2012. In both 2012 and 2011, ProAssurance recognized impairments in order to reduce the carrying value of its interest in the LLC to fair value, based upon the NAV most recently reported by the fund.

ProAssurance recognized credit-related impairments in earnings of $0.2 million and $1.0 million during the first three months of 2012 and 2011, respectively, related to certain residential mortgage-backed securities because the expected discounted future cash flows from the securities were less than the carrying value for the securities.

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

(In thousands)	**Three Months Ended March 31 2012**	**Three Months Ended March 31 2011**
Balance January 1	**$ 5,870**	$ 4,446
Additional credit losses recognized during the period, related to securities for which:		
No OTTI has been previously recognized		
OTTI has been previously recognized	**67**	888
Reductions due to:		
Securities sold during the period (realized)		
Securities which will be sold in coming periods		
Securities for which it is more likely than not that the security will be required to be sold prior to anticipated recovery of amortized cost basis		
Accretion recognized during the period related to cash flows that are expected to exceed the amortized cost basis of the security		
Balance March 31	**$ 5,937**	$ 5,334

ProAssurance Corporation and Subsidiaries

Notes to Condensed Consolidated Financial Statements (Unaudited)

March 31, 2012

3. Investments (continued)

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

(In millions)	Three Months Ended March 31 **2012**	2011
Proceeds from sales (exclusive of maturities and paydowns)	**$ 206.1**	$ 169.5
Purchases of other available-for-sale securities	**$ 247.6**	$ 252.0

4. Income Taxes

ProAssurance estimates its annual effective tax rate at the end of each quarterly reporting period which is used to record the provision for income taxes in the interim financial statements. The provision for income taxes is different from that which would be obtained by applying the statutory Federal income tax rate to income before taxes primarily because a portion of ProAssurance s investment income is tax-exempt.

The Internal Revenue Service has begun but has not completed an examination of the 2009 and 2010 returns. Except for the 2006 tax year, the statutes of limitation are closed for all years prior to 2008. The statute for the 2006 tax year has been extended from May 31, 2012 to September 15, 2013.

ProAssurance s liability for unrecognized tax benefits, exclusive of accrued interest, is $23.7 million at March 31, 2012 and $18.6 million at December 31, 2011 with the increase in the provision being entirely attributable to unrecognized benefits associated with tax positions taken in a prior year. Unrecognized tax benefits at March 31, 2012 and December 31, 2011, if recognized, would not affect the effective tax rate but would accelerate the payment of tax. As with any uncertain tax position, there is a possibility that the ultimate deduction recognized could differ from the provision ProAssurance has established.

5. Deferred Policy Acquisition Costs

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

As of January 1, 2012, policy acquisition costs related to unsuccessful contracts are expensed immediately as a result of the revised FASB guidance as discussed in Note 1. ProAssurance adopted the revised guidance on a prospective basis. Under prior guidance, policy acquisition costs capitalized during the three months ended March 31, 2012 would have been $17.1 million as compared to $16.0 million capitalized under the revised guidance.

Amortization of deferred policy acquisition costs is $15.1 million and $14.4 million for the three months ended March 31, 2012 and 2011, respectively.

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March 31, 2012

6. Reserve for Losses and Loss Adjustment Expenses

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

ProAssurance recognized favorable net loss development of $47.5 million related to previously established reserves for the three months ended March 31, 2012. The favorable net loss development reflects reductions in the Company s estimates of claims severity, principally for the 2004 through 2009 accident years.

For the three months ended March 31, 2011, ProAssurance recognized favorable net loss development of $40.0 million, to reflect reductions in estimated claim severity principally for accident years 2004 through 2008.

7. Commitments and Contingencies

ProAssurance is involved in various legal actions related to insurance policies and claims handling including, but not limited to, claims asserted by policyholders. These types of legal actions arise in the Company s ordinary course of business and, in accordance with GAAP for insurance entities, are considered as a part of the Company s loss reserving process, which is described in detail under Accounting Policies Losses and Loss Adjustment Expenses in Note 1 of the Notes to the Consolidated Financial Statements in ProAssurance s 2011 Form 10-K.

ProAssurance has commitments to fund approximately $44 million in capital contributions to tax credit partnerships as of March 31, 2012. Funding of the commitments is primarily expected to occur in 2012 and 2013; additional information regarding tax credit partnership investments is provided in Note 3. ProAssurance has also entered into agreements with several LPs/LLCs, totaling approximately $51 million at March 31, 2012, to be funded within the next five years as requested by the partnership.

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ProAssurance Corporation and Subsidiaries

Notes to Condensed Consolidated Financial Statements (Unaudited)

March 31, 2012

8. Long-term Debt

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

	December 31, (In thousands) March 31 2012		December 31, December 31 2011	
Trust Preferred Securities due 2034, unsecured. Bears interest at a variable rate of LIBOR plus 3.85%, adjusted quarterly, set at 4.4% at March 31, 2012.	**$**	**22,992**	$	22,992
Surplus Notes due May 2034, unsecured. Bears interest at a variable rate of LIBOR plus 3.85%, adjusted quarterly, set at 4.3% at March 31, 2012.		**12,000**		12,000
Note Payable due February 2019, carried at fair value, principal of $17.0 million at March 31, 2012 and $17.1 million at December 31, 2011. Secured by available-for-sale securities having a fair value at March 31, 2012 of approximately $29.8 million. Bears interest at a variable rate of LIBOR plus 0.7%. See information below regarding the associated interest rate swap.		**14,962**		14,180
Note Payable due February 2012. Note was repaid on due date.				515
Revolving Credit Agreement, expires in 2014, maximum outstanding borrowing of $150 million, interest rate set at the time funds are borrowed. No borrowings have occurred during the periods shown.				
	$	**49,954**	$	49,687

Interest Rate Swap

ProAssurance is party to an interest rate swap agreement (the Swap) with the issuing bank of the Note Payable due February 2019 (the 2019 Note Payable). The purpose of the Swap is to reduce the market risk from changes in future interest rates relative to the 2019 Note Payable. The Swap, which terminates February 1, 2019, effectively fixes the interest rate related to the 2019 Note Payable at 6.6%. The notional amount of the Swap corresponds directly to the unamortized portion of the debt being hedged each month. Under the Swap agreement, ProAssurance agrees to exchange, at monthly intervals, the difference between the fixed-rate and LIBOR variable rate by reference to the notional principal amount. The liability associated with the Swap is measured at fair value on a recurring basis which approximates $4.4 million at March 31, 2012 and $4.7 million at December 31, 2011. The Swap liability is classified as a part of other liabilities.

Covenant Compliance

ProAssurance is currently in compliance with all covenants.

Additional Information

For additional information regarding the terms of ProAssurance s outstanding long-term debt, see Note 10 of the Notes to the Consolidated Financial Statements included in ProAssurance s December 31, 2011 Form 10-K.

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ProAssurance Corporation and Subsidiaries

Notes to Condensed Consolidated Financial Statements (Unaudited)

March 31, 2012

9. Shareholders Equity

At March 31, 2012 and December 31, 2011, ProAssurance had 100 million shares of authorized common stock and 50 million shares of authorized preferred stock. The Board of Directors of ProAssurance Corporation (the Board) has the authority to determine provisions for the issuance of preferred shares, including the number of shares to be issued, the designations, powers, preferences and rights, and the qualifications, limitations or restrictions of such shares. To date, the Board has not approved the issuance of preferred stock.

During 2011 the Board of Directors of ProAssurance instituted a cash dividend policy. ProAssurance declared a quarterly dividend of $0.25 per common share for the first quarter of 2012, totaling $7.7 million, to be paid in April 2012. Any decision to pay future cash dividends is subject to the Board s final determination after a comprehensive review of financial performance, future expectations and other factors deemed relevant by the Board. The liability for unpaid dividends is included in Other Liabilities.

At March 31, 2012 approximately $188.4 million in prior authorizations from the Board for the repurchase of common shares or the retirement of outstanding debt remains available for use. The timing and quantity of purchases depends upon market conditions and changes in ProAssurance s capital requirements and is subject to limitations that may be imposed on such purchases by applicable securities laws and regulations, and the rules of the New York Stock Exchange.

ProAssurance did not repurchase any common shares during the three months ended March 31, 2012. ProAssurance repurchased approximately 252,000 common shares, having a total cost of $15.0 million, during the three months ended March 31, 2011, including approximately 6,900 forfeited employer match shares (cost basis of $0.4 million) reacquired due to the termination of the ProAssurance Corporation Stock Ownership Plan.

Share-based compensation expense is $2.1 million and $1.7 million for the three months ended March 31, 2012 and 2011, respectively. Related tax benefits are $0.7 million and $0.6 million for the three months ended March 31, 2012 and 2011, respectively.

ProAssurance awarded approximately 25,000 restricted share units and 100,000 (target) performance share units to employees in February 2012. The fair value of each unit awarded was estimated at $89.28, equal to the market value of a ProAssurance common share on the date of grant. All awards are charged to expense as an increase to equity over the service period (generally the vesting period) associated with the award. Restricted share units and performance share units vest in their entirety at the end of a three-year period following the grant date based on a continuous service requirement and, for performance share units, achievement of a performance objective. Partial vesting is permitted for retirees. A ProAssurance common share is issued for each unit once vesting requirements are met, except that units sufficient to satisfy required tax withholdings are paid in cash. The number of common shares issued for performance share units varies from 75% to 125% of base awards depending upon the degree to which stated performance objectives are achieved. ProAssurance issued approximately 17,000 and 50,000 common shares, respectively, to employees in February 2012 related to restricted share units and performance share units granted in 2009. Shares issued for performance share units were awarded at the maximum level (125%).

ProAssurance issued approximately 19,000 and 20,000 common shares to employees in February 2012 and February 2011, respectively, as bonus compensation, as approved by the Compensation Committee of the Board. The shares issued were valued at fair value (the market price of a ProAssurance common share on the date of award).

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ProAssurance Corporation and Subsidiaries

Notes to Condensed Consolidated Financial Statements (Unaudited)

March 31, 2012

9. Shareholders Equity (continued)

Other Comprehensive Income

For all periods presented, other comprehensive income is comprised of unrealized gains and losses, including non-credit impairment losses, arising during the period related to available-for-sale securities less reclassification adjustments for gains (losses) from available-for-sale securities recognized in current period net income (net of tax). Accumulated other comprehensive income is comprised entirely of unrealized gains and losses from available for sale securities, net of tax.

Reclassification adjustments related to available-for-sale securities for the three months ended March 31, 2012 and 2011 are as follows:

(In thousands)	Three Months Ended March 31 2012	2011
Net realized investment gains (losses) included in the calculation of net income	**$ 2,094**	$ 2,179
Tax effect (at 35%)	**(733)**	(763)
Net realized investment gains (losses) reclassified from other comprehensive income	**$ 1,361**	$ 1,416

10. Variable Interest Entities

ProAssurance holds passive interests in a number of LPs/LLCs that are considered to be Variable Interest Entities (VIEs) under GAAP guidance. ProAssurance has not consolidated these entities because it has either very limited or no power to control the activities that most significantly affect the economic performance of these entities and is thus not the primary beneficiary of any of the entities. ProAssurance s involvement with each entity is limited to its direct ownership interest in the entity. ProAssurance has no arrangements or agreements of significance with any of the entities to provide other financial support to or on behalf of the entity. At March 31, 2012 ProAssurance s maximum loss exposure relative to these investments is limited to the carrying value of ProAssurance s investment in the entity.

The entities consist of 1) investments in LPs/LLCs formed for the purpose of achieving diversified equity and debt returns, and 2) a limited liability interest in a development stage business operation classified as Other Investments (carrying value of $31.6 million and $32.1 million at March 31, 2012 and December 31, 2011, respectively) and Investment in Unconsolidated Subsidiaries (carrying value of $24.6 million and $24.5 million at March 31, 2012 and December 31, 2011, respectively).

11. Earnings Per Share

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

Stock options are not dilutive when the option exercise price exceeds the average price of a common share during the period or when the result from assuming an option is exercised is a net decrease to outstanding shares. All outstanding options were dilutive for the three-month periods ended March 31, 2012 and 2011.

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

The following discussion should be read in conjunction with the unaudited Condensed Consolidated Financial Statements and Notes to those statements which accompany this report as well as our 2011 Form 10-K. A glossary of insurance terms and phrases is available on the investor section of our website. Throughout the discussion, references to ProAssurance, PRA , Company , we , us and our refer to ProAssurance Corporation and its consolidated subsidiaries. The discussion contains certain forward-looking information that involves risks and uncertainties. As discussed under Forward-Looking Statements , our actual financial condition and operating results could differ significantly from these forward-looking statements.

Critical Accounting Estimates

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

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

Reserve for Losses and Loss Adjustment Expenses

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

The estimation of professional liability losses is inherently difficult and is the subject of significant judgment on the part of management. Loss costs, even for claims with similar characteristics, can vary significantly depending upon many factors, including but not limited to: the nature of the claim 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 (MPL) claims, the trend of healthcare 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 significant judgment, and such estimates require periodic revision.

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

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Initial Reserve Estimates

In establishing our initial reserves for a given accident year, due to the lack of available data for both open and closed claims for that accident year, we rely heavily on the loss assumptions that are used in our pricing models. Loss assumptions used in our pricing models are based on our analysis of our actual and projected claims data, adjusted for perceived differences between the current legal and economic environment and that of the periods associated with the claims data. In recent years, our analysis of claims has indicated reductions in average loss costs, and we have reflected those reductions in our pricing loss assumptions. Our average pricing for 2012 is approximately 16 percentage points below our average pricing in 2006 (exclusive of our podiatry and chiropractic lines acquired in 2009), principally reflecting expected reductions in loss costs.

Historically, and at present, in establishing our initial reserves we utilize loss ratios that are approximately 8 to 10 percentage points above the loss ratios incorporated within the pricing targets for that accident year. We believe this reflects expected loss costs but also considers the inherent risks associated with our rate development process and the historic volatility of professional liability losses (the industry has experienced accident year loss ratios as high as 163% and as low as 57% over the past 30 years) and produces a reasonable best estimate of the reserves required to cover actual ultimate unpaid losses. In the current environment this equates to an initial loss ratio of approximately 85% on our physician business as compared to an average loss ratio of approximately 75% assumed in our pricing.

The Effect of Changing Severity

Severity is defined as the average cost of resolving claims. The severity trend assumption (the expected annual percentage change in severity) is a key assumption for our pricing models. Our current pricing model assumes an average severity trend of 4%. If the severity trend were to be higher by 1 percentage point, the impact would be an increase in our expected loss ratio of 3.2 percentage points. An increase in the severity trend of 3 percentage points would result in a 10.1 percentage point increase in our expected loss ratio. Due to the long tailed nature of MPL claims and the previously discussed historical volatility of loss costs, selection of a severity trend assumption is a subjective process that is inherently likely to prove inaccurate over time. Given this long-tail and the previously discussed historical volatility of loss costs, we are generally judicious in making changes to our severity assumptions and actuarial estimations.

Recent changes in frequency have also complicated the selection of an appropriate severity trend. Both our internal and consulting actuaries have observed fluctuating but generally lower claims frequency that cannot be attributed to any single factor. We believe that much of the reduction in the number of claims is the result of a decline in the filing of frivolous lawsuits that have historically been dismissed or otherwise result in no payment of indemnity on the part of our insureds. With fewer frivolous claims being filed we expect that the claims that are filed have the potential for greater average losses, or greater severity. As a result, we cannot be certain as to the impact this decline will ultimately have on the average cost of claims. Based on a weighted average of payments, resolution of 85% of claims for a given accident year requires more than eight years (based on a weighted average of payments). Due to this long tail, it will be several years before we are able to determine if the decline in frequency has indeed resulted in a related increase in severity.

Additionally, given the length of time required for resolution of our claims, we are cautious in giving full credibility to claims data indicating emerging trends. Numerical data both within our own information and in the broader MPL marketplace may in the short term indicate development of a trend, whether positive or negative, that mitigates or reverses over the longer term as claims mature and additional data becomes available. Our current severity trend assumption gives recognition to both the indications from our recent claims data and the known volatility associated with the long tail claims environment in which we operate.

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Loss Development

We re-evaluate our previously established reserves each period based on our most recently available claims data and available industry trend information. Changes to previously established reserve estimates are recognized in the current period if management s best estimate of ultimate losses differs from the estimate previously established. While management considers a variety of variables in determining its best estimate, in general, as claims age, our methodologies for estimating reserves give more weight to actual loss costs which, as a whole, continue to indicate that ultimate loss costs will be lower than our previous estimates. The development recognized in both the first quarter of 2012 and in the first quarter of 2011 is primarily attributable to the favorable resolution of claims during the period and an evaluation of established case reserves and paid claims data that indicates that the actual severity associated with the remaining claims will be lower than we had previously estimated. The Critical Accounting Estimates discussion in our 2011 Form 10K includes a more detailed discussion of the methodologies used to evaluate our reserves, beginning on page 30.

Reinsurance

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

We evaluate each of our ceded reinsurance contracts at inception to confirm that there is sufficient risk transfer to allow the contract to be accounted for as reinsurance under current accounting guidance. At March 31, 2012, all ceded contracts are accounted for as risk transferring contracts.

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

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

Under the terms of certain of our reinsurance agreements, the amount of premium that we cede to our reinsurers is based in part on the losses we recover under the agreements. Therefore we make an estimate of premiums ceded under these reinsurance agreements subject to certain maximums and minimums.

Any adjustments to our estimates of either balances recoverable under our reinsurance agreements or premiums owed under our agreements are reflected in then-current operations. Due to the size of our reinsurance balances, an adjustment to these estimates could have a material effect on our results of operations for the period in which the adjustment is made.

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

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We have not experienced significant collection difficulties due to the financial condition of any reinsurer as of March 31, 2012; however, periodically, reinsurers may dispute our claim for reimbursement from them based upon their interpretation of the terms of our agreements. We have established appropriate reserves for any balances that we believe may not be ultimately collected. Should future events lead us to believe that any reinsurer will not meet its obligations to us, adjustments to the amounts recoverable would be reflected in the results of current operations. Such an adjustment has the potential to be material to the results of operations in the period in which it is recorded; however, we would not expect such an adjustment to have a material effect on our capital position or our liquidity.

Investment Valuations

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

	Distribution by GAAP Fair Value Hierarchy			March 31, 2012
	Level 1	Level 2	Level 3	Total Investments
Fair Value	6%	89%	1%	96%
Investments not at fair value				4%
Total Investments				100%

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

Because of the number of securities we own and the complexity and cost of developing accurate fair values, we utilize multiple independent pricing services to assist us in establishing the fair value of individual securities. The pricing services provide fair values based on exchange traded prices, if available. If an exchange traded price is not available, the pricing services, if possible, provide a fair value that is based on multiple broker/dealer quotes or that has been developed using pricing models. Pricing models vary by asset class and utilize currently available market data for securities comparable to ours to estimate the fair value for our security. The pricing services scrutinize market data for consistency with other relevant market information before including the data in the pricing models. The pricing services disclose the types of pricing models used and the inputs used for each asset class. Determining fair values using these pricing models requires the use of judgment to identify appropriate comparable securities and to choose a valuation methodology that is appropriate for the asset class and available data.

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

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

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Level 1 Investments

As of March 31, 2012, fair values for our equity and a portion of our short-term securities have been determined using an exchange traded price. There is little judgment involved when fair value is determined using an exchange traded price. In accordance with GAAP, for disclosure purposes we classify securities valued using an exchange traded price as Level 1 securities.

Level 2 Investments

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

Level 3 Investments

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

We also classify as Level 3 our investment interests carried at fair value, based on NAVs provided to us. All investments valued in this manner are limited partnership (LP) and limited liability company (LLC) interests that hold debt and equity securities. Interests valued using a fund-provided NAV are as follows:

(In Millions)	Carrying Value
Interests classified as a part of:	
Other investments	$ 15.7
Investment in unconsolidated subsidiaries	24.4
Total interests valued using fund-provided NAV	$ 40.1

Investments Not at Fair Value

Investments having a carrying value of approximately $166.6 million, or 4% of total investments, are not carried at fair value, as required by GAAP for the type of investment. Refer to the following table and Note 2 of the Notes to Condensed Consolidated Financial Statements for further details:

(In Millions)	Carrying Value	GAAP Measurement Method
Other investments:		
Interests in LPs	$ 15.9	Cost
Federal Home Loan Bank (FHLB) capital stock	4.4	Cost
Other	1.6	Cost
Total other investments	$ 21.9	
Investment in unconsolidated subsidiaries:		
Interests in tax credit partnerships	$ 91.4	Equity

Interest in a business LLC		0.2	Equity
Total investment in unconsolidated subsidiaries	$	91.6	
Business owned life insurance	$	53.1	Cash surrender value
Total investments not at fair value	$	166.6	

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Investment Impairments

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

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

- third party research and credit rating reports;
- the current credit standing of the issuer, including credit rating downgrades;
- the extent to which the decline in fair value is attributable to credit risk specifically associated with an investment or its issuer;
- our internal assessments and those of our external portfolio managers regarding specific circumstances surrounding an investment, which can cause us to believe the investment is more or less likely to recover its value than other investments with a similar structure;
- for asset-backed securities, the origination date of the underlying loans, the remaining average life, the probability that credit performance of the underlying loans will deteriorate in the future, and our assessment of the quality of the collateral underlying the loan;
- failure of the issuer of the security to make scheduled interest or principal payments;
- any changes to the rating of the security by a rating agency;
- recoveries or additional declines in fair value subsequent to the balance sheet date; and
- our ability and intent to hold the investment for a period of time sufficient to allow for any anticipated recovery in fair value.

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

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

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

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

Deferred Policy Acquisition Costs

Policy acquisition costs (primarily commissions, premium taxes and underwriting salaries) which are directly related to the successful acquisition of new and renewal premiums are capitalized as deferred policy acquisition costs and charged to expense as the related premium revenue is recognized. We evaluate the recoverability of our deferred policy acquisition costs each reporting period, and any amounts estimated to be unrecoverable are charged to expense in the current period. Beginning January 1, 2012, in order to comply with adopted Financial Accounting Standards Board (FASB) guidance, we no longer capitalize internal selling agent and underwriter salary and benefit costs that are allocated to unsuccessful insurance contracts. Adoption of this guidance had no material effect on our results of operations or financial position.

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Deferred Taxes

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

Unrecognized Tax Benefits

We evaluate tax positions taken on tax returns and recognize positions in our financial statements when it is more likely than not that we will sustain the position upon resolution with a taxing authority. If recognized, the benefit is measured as the largest amount of benefit that has a greater than fifty percent probability of being realized. We review uncertain tax positions each period, considering changes in facts and circumstances, such as changes in tax law, interactions with taxing authorities and developments in case law, and make adjustments as we consider necessary. Adjustments to our unrecognized tax benefits may affect our income tax expense and settlement of uncertain tax positions may require the use of cash. At March 31, 2012, our current tax liability includes $23.7 million for unrecognized tax benefits, and $1.0 million for accrued interest related to unpaid taxes.

Goodwill

Management evaluates the carrying value of goodwill annually during the fourth quarter. If, at any time during the year, events occur or circumstances change that would more likely than not reduce the fair value below the carrying value, we also evaluate goodwill at that time. We evaluate goodwill as one reporting unit because we operate in a single operating segment and our segment components are economically similar. We estimate the fair value of our reporting unit on the evaluation date based on market capitalization and an expected premium that would be paid to acquire control of our Company (a control premium). We then perform a sensitivity analysis using a range of historical stock prices and control premiums. We concluded as of our last evaluation date, October 3, 2011, that the fair value of our reporting unit exceeded the carrying value and no adjustment to impair goodwill was necessary.

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Accounting Changes

We are not aware of any accounting changes that we have not yet adopted as of March 31, 2012 that would have a material impact on our results of operations or financial position. Note 1 of the Notes to Condensed Consolidated Financial Statements provides additional detail regarding accounting changes.

Liquidity and Capital Resources and Financial Condition

Overview

ProAssurance Corporation is a holding company and is a legal entity separate and distinct from its subsidiaries. Because the holding company has no other business operations, dividends from its operating subsidiaries represent a significant source of funds for its obligations, including debt service and dividends. At March 31, 2012, we held cash and liquid investments of approximately $329.2 million outside of our insurance subsidiaries that are available for use without regulatory approval. Our insurance subsidiaries, in aggregate, are permitted to pay dividends of approximately $275 million over the course of 2012 without the prior approval of state insurance regulators. However, the payment of any dividend requires prior notice to the insurance regulator in the state of domicile and the regulator may prevent the dividend if, in its judgment, payment of the dividend would have an adverse effect on the surplus of the insurance subsidiary. As of March 31, 2012, none of the permitted dividends have been paid.

Shareholder Dividends

During 2011 the Board of Directors of ProAssurance instituted a cash dividend policy. ProAssurance declared a quarterly dividend of $0.25 per common share for the first quarter of 2012, totaling $7.7 million, to be paid in April 2012. Any decision to pay future cash dividends is subject to the Board s final determination after a comprehensive review of financial performance, future expectations and other factors deemed relevant by the Board. The liability for unpaid dividends is included in Other Liabilities.

Acquisitions

On November 30, 2010, we acquired 100% of the outstanding shares of American Physicians Service Group, Inc. (APS), a MPL provider principally insuring physicians in the state of Texas, in a transaction valued at $237 million including cash paid of $233 million and liabilities assumed of $4 million.

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Cash Flows

The principal components of our operating cash flows are the excess of premiums collected and net investment income over losses paid and operating costs, including income taxes. Timing delays exist between the collection of premiums and the payment of losses associated with the premiums. Premiums are generally collected within the twelve-month period after the policy is written while our claim payments are generally paid over a more extended period of time. Likewise, timing delays exist between the payment of claims and the collection of any associated reinsurance recoveries.

Our operating activities provided positive cash flows of approximately $28.1 million and $24.9 million for the three months ended March 31, 2012 and 2011, respectively. Operating cash flows for 2012 and 2011 compare as follows:

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

(1) The increase in premium receipts is primarily attributable to increased premium volume during the first three months of 2012.
(2) Reinsurance contracts are generally for premiums written in a specific annual period, but can remain in effect until all claims under the contract have been resolved. Some contracts require annual settlements while others require settlement only after a number of years have elapsed, thus the amounts paid can vary widely from period to period.
(3) The increase in paid losses reflects an increase in claims closed during 2012.
(4) The net increase in tax payments primarily reflects (in millions):

Estimated tax payments in 2012 were higher as compared to 2011 by $4.8 million.
Federal tax refunds received in 2011 of $7.1 million
Payments of $5.9 million made in 2011 for the 2008 and 2007 tax years as a result of federal tax return audits conducted by the Internal Revenue Service. The payments reduced tax liabilities recognized prior to January 1, 2011 and did not increase or decrease 2011 tax expense.

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Investment Exposures

The following table provides summarized information regarding our investments as of March 31, 2012:

(In thousands)	Carrying Value	Unrealized Gains (Losses) Included in Carrying Value Gains	Losses	Average Rating	(1)	% Total Investments
Fixed Maturities						
Government						
U.S. Treasury	$ 249,281	$ 15,094	$ (62)	AA+	(2)	6%
U.S. Agency	69,883	5,429		AA+	(2)	2%
Total government	319,164	20,523	(62)	AA+	(2)	8%
State and Municipal Bonds	1,226,675	80,459	(619)	AA		30%
Corporate Debt						
Financial institutions	406,529	13,997	(1,847)	A+		10%
FDIC insured	38,195	132		AA+	(2)	1%
Communications	39,853	1,903	(124)	BBB+		1%
Utilities/Energy	168,613	10,283	(587)	A-		4%
Industrial	726,969	45,253	(1,209)	A-		18%
Transportation	32,241	2,234	(44)	A		1%
Other	17,201	945		A+		<1%
Total corporate debt	1,429,601	74,747	(3,811)	A-		35%
Asset-backed Securities						
Agency mortgage-backed securities	486,241	28,016	(119)	AA+	(2)	12%
Non-agency mortgage-backed securities	13,565	306	(535)	BB		<1%
Subprime	8,088	331	(1,255)	BBB		<1%
Alt A	5,136	48	(41)	B-		<1%
Commercial mortgage-backed securities	77,819	5,554	(57)	AAA		2%
Credit card	22,621	487		AAA		1%
Automobile	56,800	414	(6)	AAA		1%
Other	17,176	296	(3)	AAA		<1%
Total asset-backed securities	687,446	35,452	(2,016)	AA+		17%
Total fixed maturities	3,662,886	211,181	(6,508)	AA-		89%
Equities						
Equity						
Financial	33,423	22				1%
Energy	15,492					<1%
Consumer oriented	33,448					1%
Technology	8,825					<1%
Industrial	13,866					<1%
All Other	17,459					<1%
Total equities	122,513	22				3%

Short-Term	132,739			3%
Business-owned life insurance (BOLI)	53,115			1%
Investment in Unconsolidated Subsidiaries				
Investment in tax credit partnerships	91,408			2%
Business LLC interest	182			<1%
Investment in LPs primarily invested in:				
Long/short equities	17,505			<1%
Non-public equities	6,925			<1%
Total investment in unconsolidated subsidiaries	116,020			3%
Other Investments				
FHLB capital stock	4,380			<1%
Investments in LP/LLCs primarily invested in:				
Private equity and debt	15,742			<1%
Long/short equities	11,010			<1%
Non-public portfolio	4,854			<1%
Other	1,659			<1%
Total other investments	37,645			1%
Total Investments	**$ 4,124,918**	**$ 211,203**	**$ (6,508)**	**100%**

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

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

A detailed listing of our investment holdings as of March 31, 2012 is presented in an Investor Supplement we make available in the Investor Relations section of our website, www.proassurance.com or directly at www.proassurance.com/investorrelations/supplemental.aspx.

We manage our investments to ensure that we will have sufficient liquidity to meet our obligations, taking into consideration the timing of cash flows from our investments, including interest payments, dividends and principal payments, as well as the expected cash flows to be generated by our operations. In addition to the interest and dividends we will receive, we anticipate that between $50 million and $90 million of our investments will mature (or be paid down) each quarter of the next year and become available, if needed, to meet our cash flow requirements. The primary outflow of cash at our insurance subsidiaries is related to paid losses and operating costs, including income taxes. The payment of individual claims cannot be predicted with certainty; therefore, we rely upon the history of paid claims in estimating the timing of future claims payments. To the extent that we may have an unanticipated shortfall in cash we may either liquidate securities or borrow funds under existing borrowing arrangements through our $150 million credit facility and the FHLB system. However, given the relatively short duration of our investments, we do not foresee any such shortfall. Additional information regarding the credit facility is detailed in Note 8 of the Notes to Condensed Consolidated Financial Statements.

Our investment portfolio continues to be primarily composed of high quality fixed income securities with approximately 96% of our fixed maturities being investment grade securities as determined by national rating agencies. The weighted average effective duration of our fixed maturity securities at March 31, 2012 is 4.1 years; the weighted average effective duration of our fixed maturity securities combined with our short-term securities is 3.9 years.

We increased our investment in tax credit limited partnerships by an additional $7 million during the first three months of 2012. These investments are comprised of multiple separate limited partner interests designed to generate investment returns by providing tax benefits to investors in the form of project operating losses and tax credits. The related properties are principally low income housing properties. The $91.4 million carrying value of the partnerships reflects the commitments to the partnerships (less amortization) of which approximately $43.8 million is not yet funded as of March 31, 2012.

European Debt Exposure

We have no direct European sovereign debt exposure. We have indirect exposure through our investments in debt securities and through our reinsurance receivables. Issuers of our debt securities and our reinsurers may hold European sovereign debt or have counterparty exposure to European banks or European corporations. Entities that have significant European exposure may suffer credit downgrades due to European sovereign debt exposure or due to European creditor exposure, if they have significant business in the Euro-zone or Eurocurrency denominated business should either or both fail, or should a severe European recession arise.

At March 31, 2012 we hold debt securities totaling $118.8 million (3% of our total investments) where the issuer is domiciled in Europe or the underlying revenue stream supporting the security is European. Of our European issuers, we believe those in the financial sector are most likely to suffer loss in the event of a European economic crisis.

Our investments outside of Europe, and particularly our financial sector investments, could also be negatively affected by a significant European economic crisis. Our financial sector investments outside of Europe approximate $393.3 million at March 31, 2012. Also, our reinsurers typically operate globally and have large investment portfolios which may be linked directly or indirectly to the European economy. As of December 31, 2011, two of our largest reinsurers were domiciled in Europe, with net receivables totaling approximately $61 million. Our reinsurance receivables total $256.1 million at March 31, 2012.

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

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Reinsurance

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

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

Taxes

During the fourth quarter of 2011 we received a Notice of Proposed Adjustment from the IRS related to its audit of our 2009 federal income tax return stating that the IRS intends to disallow a substantial portion of the loss and loss adjustment expense deduction taken on our 2009 return. The proposed adjustment represents a temporary timing difference and impacts the timing of deductions, rather than their allowance, and would shift tax from deferred to current tax expense but would not increase total tax expense. As now written, the Notice of Proposed Adjustment would require that we reduce our current deduction for loss and loss adjustment expenses, thereby increasing our current tax liability by approximately $100 million including interest associated with the timing of the payment. For financial reporting purposes, the tax liability asserted in the Notice of Proposed Adjustment would be offset, excluding the interest component, by the establishment of a deferred tax asset in recognition that these losses and loss adjustment expenses will be deductible in future periods. We believe that our loss and loss adjustment expense deduction was computed in a manner consistent with tax law, our past practices, and the practices of other MPL insurers. We remain in discussions with the IRS, challenging the position asserted in the Notice of Proposed Adjustment. There are other taxpayers with legal actions pending against the IRS in the United States Tax Court challenging IRS audit findings with regard to loss and loss adjustment expense deductions, and any rulings on these cases may influence the timing and amount of any asserted additional tax liability in any final report we receive from the IRS, and in our response to the final report. Any payments made would come out of our cash and investments and could impact future investment earnings, but, except for interest on past-due taxes if any, recorded tax expense will not change. We do not know when a final resolution will be reached with the IRS, or the amount of additional tax payments or interest that might be asserted.

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Debt

Our long-term debt as of March 31, 2012 is comprised of the following:

($ in thousands)	Contractual Rate	Outstanding Principal	Carrying Value March 31, 2012
Trust Preferred Securities due 2034	4.4% (1)	$ 22,992	$ 22,992
Surplus Notes due May 2034	4.3% (1)	12,000	12,000
Note Payable due February 2019 (2)	6.6% (3)	17,027	14,962
Revolving Credit Agreement (4)	N/A		
			$ 49,954

(1) Adjusted quarterly based on LIBOR.
(2) The 2019 Note Payable is valued at fair value. See Note 8 of the Notes to Condensed Consolidated Financial Statements.
(3) A related interest rate swap fixes rate at 6.6%. Swap is settled monthly. See Note 8 of the Notes to Condensed Consolidated Financial Statements.
(4) No balance outstanding during 2012.

All of our long-term debt is currently repayable or redeemable, with proper notice, at a date no later than the next quarterly interest payment date. Insurance department approval is required for redemption of surplus notes.

During 2011, we entered into a revolving credit agreement that expires April 15, 2014. The agreement allows us to borrow up to $150 million that would be used for general corporate purposes, including, but not limited to, short-term working capital, share repurchases as authorized by the Board, and support for other activities we enter into in the normal course of business. To date, we have not borrowed any funds under the agreement. We are also a member of the FHLB. Through membership, we have access to cash advances which can be used for liquidity purposes or other operational needs. To date, we have not established a FHLB line of credit or materially utilized our membership.

ProAssurance is currently in compliance with all covenants associated with its borrowing arrangements. Additional information regarding our debt is provided in Note 8 of the Notes to Condensed Consolidated Financial Statements.

Treasury Shares

We did not repurchase any common shares during the three months ended March 31, 2012. At March 31, 2012, we have approximately $188.4 million in authorizations from our Board available for use for the repurchase of common shares or the retirement of outstanding debt.

Litigation

We are involved in various legal actions related to insurance policies and claims handling including, but not limited to, claims asserted by policyholders. These types of legal actions arise in the ordinary course of business and, in accordance with GAAP for insurance entities, are considered as a part of our loss reserving process, which is described in detail under Critical Accounting Estimates Reserve for Losses and Loss Adjustment Expenses (reserve for losses or reserve).

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Overview of Results Three Months Ended March 31, 2012 and 2011

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

	Three Months Ended March 31	
(In millions, except per share data)	**2012**	2011
Net income	**$ 55.6**	$ 47.7
Operating income	**$ 48.2**	$ 45.0
Net income per diluted share	**$ 1.80**	$ 1.55
Operating income per diluted share	**$ 1.56**	$ 1.46

Results from the three months ended March 31, 2012 and 2011 compare as follows:

Revenues

Net premiums earned increased for the 2012 three-month period by approximately $4.6 million or 3.5% primarily due to increased tail premiums written.

Our net investment result (which includes both net investment income and earnings from unconsolidated subsidiaries) decreased by $3.4 million or 9.7% for the 2012 three-month period. Net investment income decreased $2.7 million primarily due to lower yields on our fixed income securities. Our equity in earnings of unconsolidated subsidiaries decreased $0.7 million for the 2012 three-month period due to the amortization of a larger investment in tax credit partnerships.

Net realized investment gains are $10.7 million and $4.1 million for the 2012 and 2011 three-month periods, respectively. Results principally reflect an increase in trading portfolio gains of approximately $6.8 million for the 2012 three-month period due to an overall improvement in stock market yields.

Expenses

Current accident year net losses increased by $7.3 million or 6.6% for the 2012 three-month period, reflecting both changes in the mix of risks and higher loss expectations relative to certain risk exposures. We reduced net losses by $47.5 million for the 2012 three-month period and by $40.0 million for the same period in 2011 as a result of our review of our estimate of net losses incurred for prior accident years.

Underwriting, policy acquisition and operating expenses decreased by $1.3 million or 3.7% for the 2012 three-month period, primarily reflecting non-recurring costs incurred in 2011 related to the acquisition of APS and the termination of certain agency operations.

Ratios

Our net loss ratio decreased by 1.9 percentage points for the 2012 three-month period reflecting a 4.4 percentage point reduction attributable to prior year favorable development which was partially offset by an increase in the current accident year loss ratio of 2.5 percentage points reflecting both changes in the mix of risks and higher loss expectations relative to certain risk exposure.

Our underwriting expense ratio decreased 1.2 percentage points for the 2012 three-month period, reflecting lower expenses and a benefit from the growth in net earned premium.

Our operating ratio declined by 0.2 percentage points for the 2012 three-month period reflecting the improved net loss and expense ratios, offset by lower net investment income.

Return on equity is 10.2% for the 2012 three-month period on an annualized basis.

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Book Value per Share

Our book value per share at March 31, 2012 is $72.33 compared to $70.84 at December 31, 2011. The increase primarily reflects the effect of our 2012 income and an increase in accumulated other comprehensive income, partially offset by dividends declared during the period which reduced our book value per share by $0.25. Due to the size of our Shareholders Equity (approximately $2.2 billion at March 31, 2012), the growth rate of our book value per share may slow. The past growth rates of our book value per share do not necessarily predict similar future results.

Non-GAAP Financial Measures

Operating income is a non-GAAP financial measure that is widely used to evaluate the performance of insurance entities. Operating income excludes the after-tax effects of realized investment gains or losses, guaranty fund assessments and, in 2012, the effect of confidential settlements that do not reflect normal operating results. We believe operating income presents a useful view of the performance of our insurance operations, but should be considered in conjunction with net income computed in accordance with GAAP.

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

	Three Months Ended March 31	
(In thousands, except per share data)	**2012**	2011
Net income	**$ 55,645**	$ 47,693
Items excluded in the calculation of operating income:		
Net realized investment (gains) losses	**(10,677)**	(4,124)
Guaranty fund assessments (recoupments)	**(23)**	(43)
Effect of confidential settlements, net	**(714)**	
Pre-tax effect of exclusions	**(11,414)**	(4,167)
Tax effect, at 35%	**3,995**	1,458
Operating income	**$ 48,226**	$ 44,984
Per diluted common share:		
Net income	**$ 1.80**	$ 1.55
Effect of exclusions	**(0.24)**	(0.09)
Operating income per diluted common share	**$ 1.56**	$ 1.46

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Results of Operations Three Months Ended March 31, 2012 Compared to Three Months Ended March 31, 2011

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

($ in thousands, except share data)	**Three Months Ended March 31**		
	2012	2011	Change
Revenues:			
Net premiums earned	**$ 136,659**	$ 132,077	*$ 4,582*
Net investment income	**33,492**	36,161	*(2,669)*
Equity in earnings (loss) of unconsolidated subsidiaries	**(2,066)**	(1,364)	*(702)*
Net realized investment gains (losses)	**10,677**	4,124	*6,553*
Other income	**1,809**	2,587	*(778)*
Total revenues	**180,571**	173,585	*6,986*
Expenses:			
Losses and loss adjustment expenses	**78,305**	77,101	*1,204*
Reinsurance recoveries	**(8,106)**	(6,678)	*(1,428)*
Net losses and loss adjustment expenses	**70,199**	70,423	*(224)*
Underwriting, policy acquisition and operating expenses	**34,398**	35,709	*(1,311)*
Interest expense	**825**	795	*30*
Total expenses	**105,422**	106,927	*(1,505)*
Income before income taxes	**75,149**	66,658	*8,491*
Income taxes	**19,504**	18,965	*539*
Net income	**$ 55,645**	$ 47,693	*$ 7,952*
Earnings per share:			
Basic	**$ 1.82**	$ 1.56	*$ 0.26*
Diluted	**$ 1.80**	$ 1.55	*$ 0.25*
Net loss ratio	**51.4%**	53.3%	*(1.9)*
Underwriting expense ratio	**24.7%**	25.9%	*(1.2)*
Combined ratio	**76.1%**	79.2%	*(3.1)*
Operating ratio	**51.6%**	51.8%	*(0.2)*
Tax ratio	**26.0%**	28.5%	*(2.5)*
Return on equity*	**10.2%**	10.2%	*0.0*

*Annualized

Premiums Written

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

Gross, ceded and net premiums written are as follows:

	Three Months Ended March 31			
($ in thousands)	**2012**	2011	*Change*	
Gross premiums written	**$ 170,448**	$ 160,813	*$ 9,635*	*6.0%*
Ceded premiums written	**(12,450)**	(10,930)	*(1,520)*	*13.9%*
Net premiums written	**$ 157,998**	$ 149,883	*$ 8,115*	*5.4%*

Gross Premiums Written

Gross premiums written by component are as follows:

	Three Months Ended March 31			
($ in thousands)	**2012**	2011	*Change*	
Gross premiums written:				
Physician	**$ 132,023**	$ 132,086	*$ (63)*	*0.0%*
Non-physician healthcare providers	**11,675**	11,912	*(237)*	*(2.0%)*
Hospital and facility	**7,076**	6,249	*827*	*13.2%*
Other	**6,100**	5,307	*793*	*14.9%*
Non-continuing	**377**	465	*(88)*	*(18.9%)*
Tail coverage premium, all policy types	**13,197**	4,794	*8,403*	*175.3%*
Total	$ 170,448	$ 160,813	*$ 9,635*	*6.0%*

Physician Premiums

Physician premiums for the three months ended March 31, 2012 remained relatively flat as compared to the same period of 2011 as the loss of business during the quarter was offset by endorsements made to existing policies and new business written in both the standard and excess and surplus lines markets.

Two-year term policies also contributed to the increase in gross premiums written. Gross premiums written associated with two-year term policies is $6.0 million and $5.5 million for the three months ended March 31, 2012 and 2011, respectively. We offer two-year term policies (as opposed to a one-year term) to our physician insureds in one selected jurisdiction. The premium associated with both years is included in written premium in the period the policy is written.

Our retention rate for our standard physician business is 92% and 90% for the three months ended March 31, 2012 and 2011, respectively. We calculate our retention rate as retained premium divided by all premium subject to renewal. Retention rates are affected by a number of factors. We may lose insureds to competitors or to self-insurance mechanisms (often when physicians join hospital-based practice groups) or due to pricing or other issues. We may choose not to renew an insured as a result of our underwriting evaluation. Insureds may also terminate coverage because they have left the practice of medicine for various reasons, principally for retirement but also due to disability or other personal reasons.

Charged rates for our renewed physician business remained flat as compared to the expiring premiums during 2011. Our charged rates include the effects of filed rates, surcharges and discounts. Despite competitive pressures, we continue to base our rates on expected losses, as indicated by our historical loss data and available industry loss data. We are committed to a rate structure that will allow us to fulfill our obligations to our insureds, while generating competitive returns for our shareholders.

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Non-physician Premiums

Our healthcare providers premiums remained relatively flat and are primarily comprised of dentists, chiropractors and allied health professionals.

Hospital and facility premiums increased for the first quarter of 2012 primarily due to new business.

Non-physician other premiums are primarily legal professional liability premiums. The increase in premium volume in 2012 principally relates to legal professional liability premiums.

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

Tail Coverage Premiums

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

Ceded Premiums Written and Ceded Premiums Ratio

Ceded premiums written compare as follows:

	Three Months Ended March 31			
($ in thousands)	**2012**	2011	*Change*	
Primary reinsurance arrangements	**$ 7,562**	$ 6,697	*$ 865*	*12.9%*
Other reinsurance	**4,888**	4,233	*655*	*15.5%*
Total ceded premiums written	**$ 12,450**	$ 10,930	*$ 1,520*	*13.9%*
Ceded premiums ratio*	**7.3%**	6.8%	*0.5*	

* Ceded premiums written as a percentage of gross premiums written

We reinsure most of our MPL coverages under a single reinsurance agreement that is typically renewed annually in October. There was no significant change in treaty terms between 2012 and 2011. The 2012 increase associated with this reinsurance is largely due to higher premium volume relative to reinsured coverages.

The 2012 increase in Other reinsurance is largely attributable to policies written through our affiliation with Ascension Health (Ascension). Our arrangements with Ascension provide that a substantial portion of the initial policies written under the program are heavily reinsured by an Ascension affiliate. There was a nominal amount of Ascension premium written in the first quarter of 2011.

Net Premiums Earned

Net premiums earned are as follows:

($ in thousands)	Three Months Ended March 31			
	2012	2011	*Change*	
Premiums earned	**$ 147,602**	$ 141,373	*$ 6,229*	*4.4%*
Premiums ceded	**10,943**	9,296	*1,647*	*17.7%*
Net premiums earned	**$ 136,659**	$ 132,077	*$ 4,582*	*3.5%*

Net premiums earned consist of premiums earned less the portion of earned premiums that we cede to our reinsurers for their assumption of a portion of our losses. Because premiums are generally earned pro rata over the entire policy period, fluctuations in premiums earned tend to lag those of premiums written. Generally, our policies carry a term of one year, but as discussed above, we renew

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certain policies with a two-year term. Tail coverage premiums are generally 100% earned in the period written because the policies insure only incidents that occurred in prior periods and are not cancellable.

The 2012 increase in premiums earned is primarily attributable to tail premiums written in the first quarter of 2012. The 2012 increase in premiums ceded is primarily attributable to the previously discussed arrangements with Ascension.

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

Net Investment Income

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

Net investment income by investment category is as follows:

	Three Months Ended March 31			
($ in thousands)	**2012**	2011	*Change*	
Fixed maturities	**$ 33,270**	$ 35,951	*$ (2,681)*	*(7.5%)*
Equities	**1,041**	230	*811*	*352.6%*
Short-term investments	**19**	55	*(36)*	*(65.5%)*
Other invested assets	**402**	992	*(590)*	*(59.5%)*
Business owned life insurance	**457**	464	*(7)*	*(1.5%)*
Investment expenses	**(1,697)**	(1,531)	*(166)*	*10.8%*
Net investment income	**$ 33,492**	$ 36,161	*$ (2,669)*	*(7.4%)*

Fixed Maturities

The decrease in income for the 2012 three-month period primarily reflects lower yields on our portfolio, partially offset by higher average investment balances. A $0.4 million decline in the income produced by our Treasury Inflation-Protected Securities (TIPS) in 2012 contributed to the lower yield. In the first three months of 2011, our TIPS outperformed our other fixed maturities.

The overall yield on our portfolio declined for the 2012 three-month period because we were not able to reinvest proceeds from maturities, pay-downs and sales at rates comparable to expiring rates while maintaining our asset quality and the duration of our portfolio. Average yields for our available-for-sale fixed maturity securities during the three months ended March 31, 2012 and 2011 are as follows:

	Three Months Ended March 31	
	2012	2011
Average income yield	**3.8%**	4.1%
Average tax equivalent income yield	**4.4%**	4.7%

The level of our investment in fixed maturity securities varies depending upon a number of factors, including, among others, our operating cash needs, anticipated shifts in credit markets, the attractiveness of other investment alternatives and cash needed for acquisitions or other capital purposes. In the first three months of 2012, as compared to 2011, our average investment in fixed maturities increased by approximately 1%.

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Equity in Earnings (Loss) of Unconsolidated Subsidiaries

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

	Three Months Ended March 31		
(In thousands)	**2012**	2011	*Change*
Investment LPs	**$ 590**	$ 551	*$ 39*
Business LLC interest	**(546)**	(818)	*272*
Tax credit partnerships	**(2,110)**	(1,097)	*(1,013)*
Equity in earnings (loss) of unconsolidated subsidiaries	**$ (2,066)**	$ (1,364)	*$ (702)*

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

Our business LLC interest is a non-controlling interest in an entity that began active business in 2011. The entity is still in a start-up phase, and we recognized our portion of the LLC s operating losses in 2012 and 2011. The carrying amount of our investment is currently $0.2 million.

Our tax credit investments are designed to generate investment returns by providing tax benefits to fund investors in the form of project operating losses and tax credits. Our tax credit partnerships reduced our tax expenses by approximately $2.6 million during the three months ended March 31, 2012, while we recognized $2.1 million of pre-tax amortization ($1.4 million after tax) on these investments noted in the table above.

Non-GAAP Financial Measure Tax Equivalent Investment Result

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

	Three Months Ended March 31	
(In thousands)	**2012**	2011
Net investment income, as reported for GAAP	**$ 33,492**	$ 36,161
Taxable equivalent adjustments, calculated using the 35% federal statutory tax rate		
State and municipal bonds	**4,684**	5,006
BOLI	**246**	250
Dividends received deduction	**267**	74
Pro forma tax-equivalent net investment income	**38,689**	41,491
Equity in earnings (loss) of unconsolidated subsidiaries, as reported for GAAP	**(2,066)**	(1,364)
Taxable equivalent adjustment, calculated using the 35% federal statutory tax rate		
Tax credit partnerships	**4,043**	2,029

Pro forma tax-equivalent equity in earnings (loss) of unconsolidated subsidiaries	**1,977**	665
Pro forma tax-equivalent investment results	**$ 40,666**	$ 42,156

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Net Realized Investment Gains (Losses)

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

	Three Months Ended March 31	
(In thousands)	**2012**	2011
Total other-than-temporary impairment losses:		
Residential mortgage-backed securities	**$ (245)**	$ (450)
Corporate debt	**(830)**	
Other investments	**(131)**	(1,387)
Portion recognized in (reclassified from) Other comprehensive income:		
Residential mortgage-backed securities		(568)
Net impairment losses recognized in earnings	**(1,206)**	(2,405)
Gross realized gains, available-for-sale securities	**3,887**	4,628
Gross realized (losses), available-for-sale securities	**(94)**	(244)
Net realized gains (losses), trading securities	**777**	2,692
Change in unrealized holding gains (losses), trading securities	**7,937**	(771)
Decrease (increase) in the fair value of liabilities carried at fair value	**(624)**	224
Net realized investment gains (losses)	**$ 10,677**	$ 4,124

We recognized credit-related impairments of $0.8 million during the first three months of 2012 related to a corporate debt security due to deterioration of the credit standing of the issuer during the first quarter of 2012.

We recognized impairments of $0.1 million and $1.4 million during the three months ended March 31, 2012 and 2011, respectively, related to an interest in an LLC which we account for using the cost method. The LLC announced plans to convert into a publicly traded investment fund during the first quarter of 2011 and completed the conversion in April 2012. In both 2012 and 2011, we recognized impairments as required to reduce the carrying value of our interest in the LLC to reflect the most recently reported fund NAV.

We recognized credit-related impairments in earnings of $0.2 million and $1.0 million during the first three months of 2012 and 2011, respectively, related to certain residential mortgage-backed securities, because the expected future cash flows from the securities were less than our carrying value.

Trading portfolio gains during 2012 primarily reflect higher average balances in our portfolio.

Fair value adjustments are attributable to our election of fair value treatment for both the 2019 Note Payable and related interest rate swap, as discussed in Notes 2 and 8 of the Notes to Condensed Consolidated Financial Statements.

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Losses and Loss Adjustment Expenses

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

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

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

	Net Losses Three Months Ended March 31			**Net Loss Ratios* Three Months Ended March 31**		
($ In millions)	**2012**	2011	*Change*	**2012**	2011	*Change*
Current accident year	**$ 117.7**	$ 110.4	$ 7.3	**86.1%**	83.6%	2.5
Prior accident years	**(47.5)**	(40.0)	(7.5)	**(34.7%)**	(30.3%)	(4.4)
Calendar year	**$ 70.2**	$ 70.4	$ (0.2)	**51.4%**	53.3%	(1.9)

* Net losses as specified divided by net premiums earned.

The 2012 increase in our current accident year ratio is partially attributable to an increase in tail coverages as we expect higher losses for tail coverages than for our other professional liability coverages. Also, during the first quarter of 2012, based on the results of our most recent actuarial review, we increased our loss estimates relative to earned premium with respect to physician coverages in certain jurisdictions.

During the three months ended March 31, 2012, we recognized favorable loss development of $47.5 million, on a net basis, related to reserves previously established for prior accident years. Principally this is due to favorable net loss development within our retained layers of coverage ($1 million and below) for accident years 2004 to 2009.

During the three months ended March 31, 2011, we recognized favorable loss development of $40.0 million, on a net basis, related to our previously established (prior accident year) reserves, principally for the 2004 to 2008 accident years within our retained layers of coverage ($1 million and below).

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

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Underwriting, Policy Acquisition and Operating Expenses

The table below provides a comparison of 2012 and 2011 underwriting, policy acquisition and operating expenses for the three months ended March 31:

	Three months ended March 31			
($ in thousands)	**2012**	2011	*Change*	
Insurance operation expenses	**$ 33,771**	$ 34,227	*$ (456)*	*(1.3%)*
Agency expenses	**627**	1,482	*(855)*	*(57.7%)*
	$ 34,398	$ 35,709	*$ (1,311)*	*(3.7%)*

Insurance Operation Expenses

The decline in insurance operation expenses primarily reflects the following:

Cost reductions

Costs associated with the operations acquired from APS, primarily personnel costs and professional fees, were approximately $1.5 million lower in 2012 than in 2011.

Cost recoveries of approximately $0.7 million were recognized in 2012 related to the settlement of litigation that is unrelated to our normal insurance activities.

Various other operating costs were collectively lower by approximately $1.4 million.

Cost increases

Amortization of deferred policy acquisition costs increased by approximately $0.7 million in 2012, reflecting an increase in both premium volume and expenses associated with the business we acquired from APS. Due to the application of GAAP purchase accounting rules, no asset for deferred policy acquisition costs was recognized as a part of the purchase price allocation of APS; consequently, amortization of deferred policy acquisition costs in 2011 was below what would be considered normal. These increases were partially offset by lower average commissions in 2012, primarily reflecting an increase in non-commissionable premiums as a percentage of total premiums earned for the first quarter of 2012.

Additional expense of approximately $1.3 million was recognized in 2012 related to our plan to enhance customer service capabilities by creating two claims and underwriting processing centers. The plan relocates but does not eliminate jobs and provides relocation benefits to affected employees.

As discussed in Notes 1 and 5 of the Notes to Condensed Consolidated Financial Statements, we adopted, on a prospective basis, new FASB guidance related to the deferral of policy acquisition costs. The new guidance affects the timing, but not the amount of acquisition costs ultimately expensed. Our 2012 insurance operation expenses include approximately $1.1 million of policy acquisition expenses that would have been deferred to later periods under previous accounting guidance.

Underwriting Expense Ratio

Our underwriting expense ratio for 2012 declined as compared to the 2011 ratio, reflecting a reduction in expenses and an increase in net premiums earned of 3.5%.

	Underwriting Expense Ratio *		
	Three months ended March 31		
	2012	2011	*Change*
Underwriting expense ratio	**24.7%**	25.9%	*(1.2)*

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

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Agency expenses

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

Interest Expense

Interest expense remained relatively flat for the three months ended March 31, 2012 as compared to the three months ended March 31, 2011.

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

	Three Months Ended March 31		
(In thousands)	**2012**	2011	*Change*
Trust Preferred Securities due 2034	**$ 254**	$ 238	*$ 16*
Surplus Notes due May 2034	**133**	127	*6*
Note Payable due February 2019	**285**	287	*(2)*
Revolving credit agreement fees and amortization	**150**		*150*
Other	**3**	143	*(140)*
	$ 825	$ 795	*$ 30*

Taxes

Factors affecting our effective tax rate include the following:

	Three Months Ended March 31	
	2012	2011
Statutory rate	**35.0%**	35.0%
Tax-exempt income	**(5.8%)**	(4.8%)
Tax credits	**(4.3%)**	(1.8%)
Other	**1.1%**	0.1%
Effective tax rate	**26.0%**	28.5%

Our effective tax rate decreased in 2012 as compared to 2011, primarily due to an increase in the expected tax benefit from tax credits transferred to us by our tax credit partnership investments and an increase in tax-exempt dividend income. We recognized expected tax benefits of approximately $2.6 million for the three months ended March 31, 2012 related to the credits, compared to expected tax benefits of $1.3 million for the 2011 three-month period.

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ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.

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

Interest Rate Risk

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

The following table summarizes estimated changes in the fair value of our available-for-sale fixed maturity securities for specific hypothetical changes in interest rates by asset class at March 31, 2012 and December 31, 2011. There are principally two factors that determine interest rates on a given security: market interest rates and credit spreads. As different asset classes can be affected in different ways by movements in those two factors, we have broken out our portfolio by asset class in the following table.

	March 31, 2012 Interest Rate Shift in Basis Points				
	(200)	(100)	Current	100	200
Fair Value (in millions):					
U.S. Treasury obligations	**$ 285**	**$ 266**	**$ 249**	**$ 243**	**$ 237**
U.S. Agency obligations	**72**	**72**	**70**	**67**	**65**
State and municipal bonds	**1,303**	**1,278**	**1,227**	**1,171**	**1,116**
Corporate debt	**1,517**	**1,485**	**1,430**	**1,369**	**1,312**
Asset-backed securities	**708**	**702**	**687**	**664**	**638**
All fixed maturity securities	**$ 3,885**	**$ 3,803**	**$ 3,663**	**$ 3,514**	**$ 3,368**
Duration:					
U.S. Treasury obligations	***3.33***	***3.30***	***3.23***	***3.16***	***3.10***
U.S. Agency obligations	***3.03***	***3.03***	***3.19***	***3.44***	***3.49***
State and municipal bonds	***4.16***	***4.38***	***4.53***	***4.64***	***4.72***
Corporate debt	***4.35***	***4.32***	***4.30***	***4.20***	***4.12***
Asset-backed securities	***1.40***	***1.51***	***3.15***	***3.80***	***4.13***
All fixed maturity securities	***3.60***	***3.70***	***4.07***	***4.20***	***4.20***
			December 31, 2011		
Fair Value (in millions):					
U.S. Treasury obligations	$ 303	$ 301	$ 284	$ 277	$ 270
U.S. Agency obligations	70	70	68	65	63
State and municipal bonds	1,301	1,279	1,228	1,172	1,117
Corporate debt	1,429	1,413	1,368	1,314	1,263
Asset-backed securities	735	733	718	695	669
All fixed maturity securities	$ 3,838	$ 3,796	$ 3,666	$ 3,523	$ 3,382
Duration:					
U.S. Treasury obligations	*3.42*	*3.39*	*3.33*	*4.00*	*3.95*
U.S. Agency obligations	*3.25*	*3.26*	*3.43*	*3.62*	*3.69*
State and municipal bonds	*4.22*	*4.44*	*4.58*	*4.69*	*4.76*

Corporate debt	*4.07*	*4.05*	*4.00*	*3.91*	*3.83*
Asset-backed securities	*1.01*	*1.54*	*2.87*	*3.48*	*3.83*
All fixed maturity securities	*3.47*	*3.63*	*3.91*	*4.09*	*4.14*

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

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

ProAssurance s cash and short-term investment portfolio at March 31, 2012 is on a cost basis which approximates its fair value. This portfolio lacks significant interest rate sensitivity due to its short duration.

Credit Risk

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

As of March 31, 2012, 96% of our fixed maturity securities are rated investment grade as determined by Nationally Recognized Statistical Rating Organizations (NRSROs), such as A.M. Best, Fitch, Moody s and Standard & Poor s. We believe that this concentration in investment grade securities reduces our exposure to credit risk on our fixed income investments to an acceptable level. However, investment grade securities, in spite of their rating, can rapidly deteriorate and result in significant losses. Ratings published by the NRSROs are one of the tools used to evaluate the credit worthiness of our securities. The ratings reflect the subjective opinion of the rating agencies as to the credit worthiness of the securities, and therefore, we may be subject to additional credit exposure should the rating prove to be unreliable.

We hold $1.2 billion of municipal bonds at March 31, 2012. We require the bonds that we purchase to meet our credit criteria on a stand-alone basis. As of March 31, 2012, on a stand-alone basis, our municipal bonds have a weighted average rating of AA.

We also have exposure to credit risk related to our receivables from reinsurers. Our receivables from reinsurers (on both paid and unpaid losses) approximate $256 million at March 31, 2012 and $252 million at December 31, 2011. We monitor the credit risk associated with our reinsurers using publicly available financial and rating agency data.

Equity Price Risk

At March 31, 2012 the fair value of our investment in common stocks is $123 million. These securities are subject to equity price risk, which is defined as the potential for loss in fair value due to a decline in equity prices. The weighted average beta of this group of securities is 0.97. Beta measures the price sensitivity of an equity security or group of equity securities to a change in the broader equity market, in this case the S&P 500 Index. If the value of the S&P 500 Index increased by 10%, the fair value of these securities would be expected to increase by 10% to $134 million. Conversely, a 10% decrease in the S&P 500 Index would imply a decrease of 10% in the fair value of these securities to $111 million. The selected hypothetical changes of plus or minus 10% do not reflect what could be considered the best or worst case scenarios and are used for illustrative purposes only.

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ITEM 4. CONTROLS AND PROCEDURES.

The Chief Executive Officer and Chief Financial Officer of the Company participated in management s evaluation of our disclosure controls and procedures (as defined in SEC Rule 13a-15(e)) as of March 31, 2012. ProAssurance s disclosure controls and procedures are designed to reasonably assure that information required to be disclosed by us in reports we file or submit under the Exchange Act is accumulated and communicated to our management as appropriate to allow timely decisions regarding disclosure and is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission s rules and forms. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures are effective.

Changes in Internal Control over Financial Reporting

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

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS.

See Note 7 of the Notes to Condensed Consolidated Financial Statements.

ITEM 1A. RISK FACTORS.

There are no changes to the Risk Factors in Part 1, Item 1A of the 2011 Form 10-K.

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

(a) Not applicable.

(b) Not applicable.

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

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Approximate Dollar Value of Shares that May Yet Be Purchased Under the Plans or Programs
January 1 31, 2012		$		$ 188,449,201
February 1 29, 2012		$		$ 188,449,201
March 1 31, 2012		$		$ 188,449,201
Total		$		

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ITEM 6. EXHIBITS

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

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SIGNATURE

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

PROASSURANCE CORPORATION

May 7, 2012

/s/ Edward L. Rand, Jr.
Edward L. Rand, Jr.
Chief Financial and Accounting Officer
(Duly authorized officer and principal financial and accounting officer)