

HANOVER INSURANCE GROUP, INC.

Form 10-Q

August 07, 2009

[Table of Contents](#)

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended June 30, 2009

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 1-13754

THE HANOVER INSURANCE GROUP, INC.

(Exact name of registrant as specified in its charter)

Edgar Filing: HANOVER INSURANCE GROUP, INC. - Form 10-Q

Delaware
(State or other jurisdiction of
incorporation or organization)

04-3263626
(I.R.S. Employer
Identification No.)

440 Lincoln Street, Worcester, Massachusetts 01653
(Address of principal executive offices) (Zip Code)

(508) 855-1000
(Registrant's telephone number, including area code)

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

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

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

Large accelerated filer Accelerated filer
Non-accelerated filer (Do not check if a smaller reporting company) Smaller reporting company
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

The number of shares outstanding of the registrant's common stock was 50,860,359 as of August 1, 2009.

Table of Contents

TABLE OF CONTENTS

PART I. FINANCIAL INFORMATION

Item 1.	Financial Statements	
	<u>Consolidated Statements of Income</u>	3
	<u>Consolidated Balance Sheets</u>	5
	<u>Consolidated Statements of Shareholders' Equity</u>	6
	<u>Consolidated Statements of Comprehensive Income</u>	7
	<u>Consolidated Statements of Cash Flows</u>	8
	<u>Notes to Interim Consolidated Financial Statements</u>	9-35
Item 2.	<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	36
Item 3.	<u>Quantitative and Qualitative Disclosures About Market Risk</u>	84
Item 4.	<u>Controls and Procedures</u>	85

PART II. OTHER INFORMATION

Item 1.	<u>Legal Proceedings</u>	86
Item 1A.	<u>Risk Factors</u>	87
Item 2.	<u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	92
Item 4.	<u>Submission of Matters to a Vote of Security Holders</u>	92
Item 6.	<u>Exhibits</u>	93
	<u>SIGNATURES</u>	94

Table of Contents**PART I - FINANCIAL INFORMATION****ITEM 1 - FINANCIAL STATEMENTS****THE HANOVER INSURANCE GROUP, INC.****CONSOLIDATED STATEMENTS OF INCOME**

(In millions)	(Unaudited) Quarter Ended June 30,		(Unaudited) Six Months Ended June 30,	
	2009	2008	2009	2008
REVENUES				
Premiums	\$ 630.0	\$ 619.3	\$ 1,262.0	\$ 1,237.0
Net investment income	61.3	63.8	126.2	128.4
Net realized investment losses:				
Total other-than temporary impairment losses on securities	(18.1)	(8.3)	(34.6)	(13.6)
Portion of loss recognized in other comprehensive income	11.4		11.4	
Net other than temporary impairment losses on securities recognized in earnings	(6.7)	(8.3)	(23.2)	(13.6)
Realized gains from sales and other	3.1	0.7	13.5	5.7
Total net realized investment losses	(3.6)	(7.6)	(9.7)	(7.9)
Fees and other income	8.7	9.5	16.8	17.4
Total revenues	696.4	685.0	1,395.3	1,374.9
LOSSES AND EXPENSES				
Losses and loss adjustment expenses	393.8	385.4	822.1	765.5
Policy acquisition expenses	144.8	139.0	287.9	276.4
Gain on tender offer	(34.3)		(34.3)	
Other operating expenses	95.5	83.9	189.7	169.9
Total losses and expenses	599.8	608.3	1,265.4	1,211.8
Income before federal income taxes	96.6	76.7	129.9	163.1
Federal income tax expense:				
Current	12.4	19.4	25.0	41.7
Deferred	21.1	9.4	21.6	16.2
Total federal income tax expense	33.5	28.8	46.6	57.9
Income from continuing operations	63.1	47.9	83.3	105.2
Discontinued operations (See Notes 3 and 4):				
Gain (loss) from discontinued FAFLIC business (net of income tax (expense) benefit of \$(1.7) for the quarter ended June 30, 2008 and \$0.4 for the six months ended June 30, 2008), including loss on assets held-for-sale of \$66.1 in 2008	0.9	(67.7)	5.9	(71.2)
Gain (loss) from operations of discontinued accident and health business (net of income tax expense of \$0.1 for the quarter ended June 30, 2009)	0.2		(3.1)	
Income from operations of AMGRO (net of income tax benefit of \$1.3 for the quarter and six months ended June 30, 2008), including gain on disposal of \$11.1 in 2008		10.4		10.1

Edgar Filing: HANOVER INSURANCE GROUP, INC. - Form 10-Q

Gain (loss) on disposal of variable life and annuity business (net of income tax benefit of \$0.5 for the quarter ended June 30, 2008 and \$0.4 for the six months ended June 30, 2008)	0.2	(0.8)	4.1	5.4
Other discontinued operations				(1.2)
Net income (loss)	\$ 64.4	\$ (10.2)	\$ 90.2	\$ 48.3

Table of Contents

THE HANOVER INSURANCE GROUP, INC.

CONSOLIDATED STATEMENTS OF INCOME (CONTINUED)

	(Unaudited) Quarter Ended June 30, 2009		(Unaudited) Six Months Ended June 30, 2008	
PER SHARE DATA				
<u>Basic</u>				
Income from continuing operations	\$ 1.23	\$ 0.93	\$ 1.63	\$ 2.04
Discontinued operations:				
Gain (loss) from discontinued FAFLIC business (net of income tax (expense) benefit of \$(0.03) for the quarter ended June 30, 2008 and \$0.01 for the six months ended June 30, 2008), including loss on assets held-for-sale of \$1.27 in 2008	0.02	(1.31)	0.12	(1.38)
Gain (loss) from operations of discontinued accident and health business	0.01		(0.06)	
Income from operations of AMGRO (net of income tax benefit of \$0.03 for the quarter and six months ended June 30, 2008), including gain on disposal of \$0.21 in 2008		0.20		0.20
(Loss) gain on disposal of variable life insurance and annuity business (net of income tax benefit of \$0.01 for the quarter and six months ended June 30, 2008)		(0.02)	0.08	0.10
Other discontinued operations				(0.02)
Net income (loss) per share	\$ 1.26	\$ (0.20)	\$ 1.77	\$ 0.94
Weighted average shares outstanding	51.1	51.3	51.1	51.5
<u>Diluted</u>				
Income from continuing operations	\$ 1.23	\$ 0.92	\$ 1.62	\$ 2.02
Discontinued operations:				
Gain (loss) from discontinued FAFLIC business (net of income tax (expense) benefit of \$(0.03) for the quarter ended June 30, 2008 and \$0.01 for the six months ended June 30, 2008), including loss on assets held-for-sale of \$1.27 in 2008	0.02	(1.30)	0.11	(1.37)
Loss from operations of discontinued accident and health business			(0.06)	
Income from operations of AMGRO (net of income tax benefit of \$0.03 for the quarter and six months ended June 30, 2008), including gain on disposal of \$0.21 in 2008		0.20		0.20
(Loss) gain on disposal of variable life insurance and annuity business (net of income tax benefit of \$0.01 for the quarter and six months ended June 30, 2008)		(0.02)	0.08	0.10
Other discontinued operations				(0.02)
Net income (loss) per share	\$ 1.25	\$ (0.20)	\$ 1.75	\$ 0.93
Weighted average shares outstanding	51.4	51.8	51.4	52.0

The accompanying notes are an integral part of these consolidated financial statements.

Table of Contents**THE HANOVER INSURANCE GROUP, INC.****CONSOLIDATED BALANCE SHEETS**

(In millions, except per share data)	(Unaudited) June 30, 2009	December 31, 2008
ASSETS		
Investments:		
Fixed maturities, at fair value (amortized cost of \$4,463.7 and \$4,382.0)	\$ 4,403.6	\$ 4,140.9
Equity securities, at fair value (cost of \$94.6 and \$97.6)	92.1	76.2
Mortgage loans	26.2	31.1
Other long-term investments	16.9	18.4
Total investments	4,538.8	4,266.6
Cash and cash equivalents	281.0	397.7
Accrued investment income	50.9	52.3
Premiums, accounts and notes receivable, net	605.7	578.5
Reinsurance receivable on paid and unpaid losses, benefits and unearned premiums	1,126.6	1,129.6
Deferred policy acquisition costs	272.3	264.8
Deferred federal income taxes	247.7	285.6
Goodwill	170.0	169.9
Other assets	323.4	315.7
Assets of discontinued operations	131.3	1,769.5
Total assets	\$ 7,747.7	\$ 9,230.2
LIABILITIES		
Policy liabilities and accruals:		
Losses and loss adjustment expenses	\$ 3,127.7	\$ 3,201.3
Unearned premiums	1,267.1	1,246.3
Contractholder deposit funds and other policy liabilities	1.6	1.8
Total policy liabilities and accruals	4,396.4	4,449.4
Expenses and taxes payable	623.2	622.3
Reinsurance premiums payable	65.1	61.3
Long-term debt	309.9	531.4
Liabilities of discontinued operations	132.0	1,678.6
Total liabilities	5,526.6	7,343.0
Commitments and contingencies (Note 13)		
SHAREHOLDERS EQUITY		
Preferred stock, \$0.01 par value, 20.0 million shares authorized, none issued		
Common stock, \$0.01 par value, 300.0 million shares authorized, 60.5 million shares issued	0.6	0.6
Additional paid-in capital	1,805.1	1,803.8
Accumulated other comprehensive loss	(173.0)	(384.8)
Retained earnings	1,073.3	949.8
Treasury stock at cost (9.7 and 9.6 million shares)	(484.9)	(482.2)
Total shareholders equity	2,221.1	1,887.2

Edgar Filing: HANOVER INSURANCE GROUP, INC. - Form 10-Q

Total liabilities and shareholders' equity	\$ 7,747.7	\$ 9,230.2
--	------------	------------

The accompanying notes are an integral part of these consolidated financial statements.

Table of Contents**THE HANOVER INSURANCE GROUP, INC.****CONSOLIDATED STATEMENTS OF SHAREHOLDERS EQUITY**

(In millions)	(Unaudited) Six Months Ended June 30,	
	2009	2008
PREFERRED STOCK		
Balance at beginning and end of period	\$	\$
COMMON STOCK		
Balance at beginning and end of period	0.6	0.6
ADDITIONAL PAID-IN CAPITAL		
Balance at beginning of period	1,803.8	1,822.6
Tax benefit from stock options		0.3
Employee and director stock-based awards	1.3	(22.7)
Balance at end of period	1,805.1	1,800.2
ACCUMULATED OTHER COMPREHENSIVE LOSS		
NET UNREALIZED (DEPRECIATION) APPRECIATION ON AVAILABLE FOR SALE SECURITIES AND DERIVATIVE INSTRUMENTS:		
Balance at beginning of period	(276.1)	5.5
Cumulative effect of change in accounting principle, adoption of FSP FAS 115-2 and FAS 124-2	(33.3)	
Balance at beginning of period, as adjusted	(309.4)	5.5
Net appreciation (depreciation) during the period:		
Net appreciation (depreciation) on available-for-sale securities and derivative instruments	250.8	(80.5)
Portion of other-than-temporary impairment losses recognized in other comprehensive income	(11.4)	
Benefit for deferred federal income taxes	0.2	2.2
	239.6	(78.3)
Balance at end of period	(69.8)	(72.8)
DEFINED BENEFIT PENSION AND POSTRETIREMENT PLANS:		
Balance at beginning of period	(108.7)	(25.9)
Amounts arising in the period	(1.6)	(0.8)
Amortization during the period:		
Amount recognized as net periodic benefit cost	10.0	(1.8)
(Provision) benefit for deferred federal income taxes	(2.9)	0.9
	5.5	(1.7)
Balance at end of period	(103.2)	(27.6)
Total accumulated other comprehensive loss	(173.0)	(100.4)

Edgar Filing: HANOVER INSURANCE GROUP, INC. - Form 10-Q

RETAINED EARNINGS

Balance at beginning of period	949.8	946.9
Cumulative effect of change in accounting principle, adoption of FSP FAS 115-2 and FAS 124-2	33.3	
Balance at beginning of period, as adjusted	983.1	946.9
Net income	90.2	48.3
Treasury stock issued for less than cost	(2.2)	(6.9)
Recognition of share-based compensation	2.2	13.4
Balance at end of period	1,073.3	1,001.7

TREASURY STOCK

Balance at beginning of period	(482.2)	(450.7)
Shares purchased at cost	(7.1)	(58.5)
Net shares reissued at cost under employee stock-based compensation plans	4.4	19.8
Balance at end of period	(484.9)	(489.4)
Total shareholders' equity	\$ 2,221.1	\$ 2,212.7

The accompanying notes are an integral part of these consolidated financial statements.

Table of Contents

THE HANOVER INSURANCE GROUP, INC.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(In millions)	(Unaudited) Quarter Ended		(Unaudited) Six Months Ended	
	June 30, 2009	June 30, 2008	June 30, 2009	June 30, 2008
Net income (loss)	\$ 64.4	\$ (10.2)	\$ 90.2	\$ 48.3
Other comprehensive income (loss):				
Available-for-sale securities:				
Net appreciation (depreciation) during the period	202.2	(76.8)	250.8	(80.1)
Portion of other-than-temporary impairment losses recognized in other comprehensive income	(11.4)		(11.4)	
Benefit for deferred federal income taxes		1.0	0.2	2.1
Total available-for-sale securities	190.8	(75.8)	239.6	(78.0)
Derivative instruments:				
Net depreciation during the period		(0.1)		(0.4)
Benefit for deferred federal income taxes				0.1
Total derivative instruments		(0.1)		(0.3)
	190.8	(75.9)	239.6	(78.3)
Pension and postretirement benefits:				
Amounts arising in the period	(1.0)	(0.7)	(1.6)	(0.8)
Amortization recognized as net periodic benefit costs:				
Net actuarial loss	6.8	1.2	13.6	1.5
Prior service cost	(1.4)	(1.4)	(2.8)	(2.5)
Transition asset	(0.4)	(0.4)	(0.8)	(0.8)
Total amortization recognized as net periodic benefit costs	5.0	(0.6)	10.0	(1.8)
(Provision) benefit for deferred federal income taxes	(1.4)	0.5	(2.9)	0.9
Total pension and postretirement benefits	2.6	(0.8)	5.5	(1.7)
Other comprehensive income (loss)	193.4	(76.7)	245.1	(80.0)
Comprehensive income (loss)	\$ 257.8	\$ (86.9)	\$ 335.3	\$ (31.7)

The accompanying notes are an integral part of these consolidated financial statements.

Table of Contents

THE HANOVER INSURANCE GROUP, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(In millions)	(Unaudited) Six Months Ended June 30,	
	2009	2008
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	\$ 90.2	\$ 48.3
Adjustments to reconcile net income to net cash (used in) provided by operating activities:		
Gain on disposal of variable life insurance and annuity business	(4.1)	(5.4)
(Gain) estimated loss from sale of FAFLIC	(5.9)	66.1
Gain on sale of AMGRO, Inc.		(11.1)
Gain on tender offer	(34.3)	
Net realized investment losses	12.9	15.3
Net amortization and depreciation	5.1	9.3
Stock-based compensation expense	5.7	6.1
Amortization of deferred benefit plan costs	9.9	(2.6)
Deferred federal income taxes	21.6	33.6
Change in deferred acquisition costs	(7.4)	(10.6)
Change in premiums and notes receivable, net of reinsurance premiums payable	(22.5)	42.5
Change in accrued investment income	1.8	1.6
Change in policy liabilities and accruals, net	(47.5)	(115.6)
Change in reinsurance receivable	3.7	71.2
Change in expenses and taxes payable	(74.1)	(91.2)
Other, net	(0.2)	5.9
Net cash (used in) provided by operating activities	(45.1)	63.4
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from disposals and maturities of available-for-sale fixed maturities	1,335.9	475.0
Proceeds from disposals of equity securities and other investments		10.1
Proceeds from mortgages sold, matured or collected	4.9	3.5
Proceeds from collections of installment finance and notes receivable		192.2
Proceeds from the sale of FAFLIC	105.8	
Cash transferred with sale of FAFLIC	(108.1)	
Net cash used to acquire Verlan Holdings, Inc		(26.3)
Purchase of available-for-sale fixed maturities	(1,424.6)	(420.2)
Purchase of equity securities and other investments	(15.2)	(12.3)
Capital expenditures	(4.2)	(6.0)
Disbursements to fund installment finance and notes receivable		(178.6)
Other investing items	2.8	0.7
Net cash (used in) provided by investing activities	(102.7)	38.1
CASH FLOWS FROM FINANCING ACTIVITIES		
Exercise of options	0.4	4.1
Change in collateral related to securities lending program	30.7	3.8
Repurchase of long-term debt	(125.0)	
Treasury stock purchased at cost	(7.1)	(58.5)
Other financing activities	0.1	0.1
Net cash used in financing activities	(100.9)	(50.5)

Edgar Filing: HANOVER INSURANCE GROUP, INC. - Form 10-Q

Net change in cash and cash equivalents	(248.7)	51.0
Net change in cash related to discontinued operations	132.0	47.1
Cash and cash equivalents, beginning of period	397.7	210.6
Cash and cash equivalents, end of period	\$ 281.0	\$ 308.7

The accompanying notes are an integral part of these consolidated financial statements.

Table of Contents

THE HANOVER INSURANCE GROUP, INC.

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

1. Basis of Presentation and Principles of Consolidation

The accompanying unaudited consolidated financial statements of The Hanover Insurance Group, Inc. (THG or the Company) have been prepared in accordance with generally accepted accounting principles for interim financial information and with the requirements of Form 10-Q.

The interim consolidated financial statements of THG include the accounts of The Hanover Insurance Company (Hanover Insurance), and Citizens Insurance Company of America (Citizens), THG's principal property and casualty companies; and certain other insurance and non-insurance subsidiaries. These legal entities conduct their operations through several business segments discussed in Note 10. All significant intercompany accounts and transactions have been eliminated. The Company's results of operations also included the results of First Allmerica Financial Life Insurance Company (FAFLIC) through December 31, 2008. On January 2, 2009, the Company sold FAFLIC to Commonwealth Annuity and Life Insurance Company (Commonwealth Annuity) a subsidiary of the Goldman Sachs Group, Inc. (Goldman Sachs). Accordingly, the FAFLIC business was classified as a discontinued operation in accordance with Statement of Financial Accounting Standards No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets* (Statement No. 144) and prior periods in the consolidated Statements of Income have been reclassified to conform to this presentation. Additionally, as of December 31, 2008, a portion of FAFLIC's accounts were classified as assets and liabilities of discontinued operations in the consolidated Balance Sheets (See Note 3 Discontinued Operations of FAFLIC Business).

The accompanying interim consolidated financial statements reflect, in the opinion of the Company's management, all adjustments necessary for a fair presentation of the financial position and results of operations. The results of operations for the six months ended June 30, 2009 are not necessarily indicative of the results to be expected for the full year. These financial statements should be read in conjunction with the Company's 2008 Annual Report on Form 10-K filed with the Securities and Exchange Commission.

The preparation of financial statements in conformity with generally accepted accounting principles requires the Company to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amount of revenues and expenses during the reporting period. Actual results could differ from those estimates. Certain prior year amounts have been reclassified to conform to current year presentation.

2. New Accounting Pronouncements

Recently Adopted Standards

In May 2009, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 165, *Subsequent Events* (Statement No. 165). Statement No. 165 is consistent with current auditing standards in defining a subsequent event. Additionally, it provides for disclosure regarding the existence and timing of a company's evaluation of its subsequent events. Statement No. 165 defines two types of subsequent events, recognized and non-recognized . Recognized subsequent events provide additional evidence about conditions that existed at the date of the balance sheet and are required to be reflected in the financial statements. Non-recognized subsequent events provide evidence about conditions that did not exist at the date of the balance sheet but arose after that date and, therefore; are not required to be reflected in the financial statements. However, certain non-recognized subsequent events may require disclosure to prevent the financial statements from being misleading. This statement is effective prospectively for interim or annual financial periods ending after June 15, 2009. The Company has adopted this statement as of April 1, 2009. The effect of adopting Statement No. 165 was not material to the Company's financial position or results of operations.

Table of Contents

In May 2008, the FASB issued Statement of Financial Accounting Standards No. 163, *Accounting for Financial Guarantee Insurance Contracts an interpretation of FASB Statement No. 60* (Statement No. 163). Statement No. 163 provides for changes to both the recognition and measurement of premium revenues and claim liabilities for financial guarantee insurance contracts that are within the scope of Statement of Financial Accounting Standards No. 60, *Accounting and Reporting by Insurance Enterprises* and that do not qualify as a derivative instrument in accordance with Statement of Financial Accounting Standards No. 133, *Accounting for Derivative Instruments and Hedging Activities*. This statement also expands the disclosure requirements related to financial guarantee insurance contracts to include such items as a company's method of tracking insured financial obligations with credit deterioration, financial information about the insured financial obligations, and management's policies for placing and monitoring the insured financial obligations. Statement No. 163 is effective for fiscal years beginning after December 15, 2008, except for certain disclosures related to the insured financial obligations, which were effective for the third quarter of 2008. The Company adopted Statement No. 163 on January 1, 2009. The Company does not have financial guarantee insurance products, and, accordingly the adoption of Statement No. 163 did not have an effect on the Company's results of operations or financial position.

In December 2007, the FASB issued Statement of Financial Accounting Standards No. 141 (revised 2007), *Business Combinations* (Statement No. 141(R)). This Statement requires the acquiring entity in a business combination to recognize all assets acquired and liabilities assumed in a transaction at the acquisition-date fair value, with certain exceptions. Additionally, the statement requires changes to the accounting treatment of acquisition related items, including, among other items, transaction costs, contingent consideration, restructuring costs, indemnification assets and tax benefits. Statement No. 141(R) also provides for a substantial number of new disclosure requirements. In April 2009, the FASB issued FSP FAS 141(R)-1, *Accounting for Assets Acquired and Liabilities Assumed in a Business Combination That Arise from Contingencies* (FSP FAS 141(R)-1). This FSP amends and clarifies Statement No. 141(R) to address application issues regarding initial recognition and measurement, subsequent measurement and accounting, and disclosure of assets and liabilities arising from contingencies in a business combination. Statement No. 141(R) and FSP FAS 141(R)-1 are effective for business combinations initiated on or after the first annual reporting period beginning after December 15, 2008. The Company adopted Statement No. 141(R) and FSP FAS 141(R)-1 effective January 1, 2009. The adoption of Statement No. 141(R) and FSP FAS 141(R)-1 did not have an effect on the Company's financial position or results of operations; however they will likely have an impact on the Company's accounting for future business combinations, but the effect is dependent upon acquisitions, if any, that are made in the future.

In December 2007, the FASB issued Statement of Financial Accounting Standards No. 160, *Noncontrolling Interests in Consolidated Financial Statements, an amendment of ARB No. 51* (Statement No. 160), which establishes new standards governing the accounting for and reporting of noncontrolling interests (previously referred to as minority interests). This statement establishes reporting requirements which include, among other things, that noncontrolling interests be reflected as a separate component of equity, not as a liability. It also requires that the interests of the parent and the noncontrolling interest be clearly identifiable. Additionally, increases and decreases in a parent's ownership interest that leave control intact shall be reflected as equity transactions, rather than step acquisitions or dilution gains or losses. This statement also requires changes to the presentation of information in the financial statements and provides for additional disclosure requirements. Statement No. 160 is effective for fiscal years beginning on or after December 15, 2008. The Company adopted Statement No. 160 as of January 1, 2009. The effect of adopting Statement No. 160 was not material to the Company's financial position or results of operations.

In February 2007, the FASB issued Statement of Financial Accounting Standards No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities Including an amendment of FASB Statement No. 115* (Statement No. 159). Statement No. 159 permits a company to choose, at specified election dates, to measure at fair value certain eligible financial assets and liabilities that are not currently required to be measured at fair value. The specified election dates include, but are not limited to, the date when an entity first recognizes the item, when an entity enters into a firm commitment or when changes in the financial instrument causes it to no longer qualify for fair value accounting under a different accounting standard. An entity may elect the fair value option for eligible items that exist at the effective date. At that date, the difference between the carrying amounts and the fair values of eligible items for which the fair value option is elected should be recognized as a cumulative effect adjustment to the opening balance of retained earnings. The fair value option may be elected for each entire financial instrument, but need not be applied to all similar instruments. Once the fair value option has been elected, it is irrevocable. Unrealized gains and losses on items for which the fair value option has been elected will be reported in earnings. Statement No. 159 was effective as of the beginning of fiscal years that begin after November 15, 2007. The Company did not elect to implement the fair value option for eligible financial assets and liabilities as of January 1, 2008.

Table of Contents

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157, *Fair Value Measurements* (Statement No. 157). This statement creates a common definition of fair value to be used throughout generally accepted accounting principles. Statement No. 157 will apply whenever another standard requires or permits assets or liabilities to be measured at fair value, with certain exceptions. The standard establishes a hierarchy for determining fair value which emphasizes the use of observable market data whenever available. The statement also requires expanded disclosures which include the extent to which assets and liabilities are measured at fair value, the methods and assumptions used to measure fair value and the effect of fair value measures on earnings. In April 2009, the FASB issued FSP FAS No. 157-4, *Determining Fair Value when the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly* (FSP FAS No. 157-4). This FSP provides additional guidance for estimating fair value in accordance with Statement No. 157, when the volume and level of activity for the asset or liability have significantly decreased. The emphasis of the FSP is that fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between willing market participants, under current market conditions. This FSP also further clarifies the guidance to be considered when determining whether or not a transaction is orderly. The FSP was effective for interim and annual reporting periods ending after June 15, 2009. In October 2008, the FASB issued FSP FAS No. 157-3, *Determining the Fair Value of a Financial Asset When the Market for That Asset Is Not Active* (FSP FAS No. 157-3). This FSP clarifies how Statement No. 157 should be applied when valuing securities in markets that are not active. This Statement provides guidance on how companies may use judgment, in addition to market information, in certain circumstances to value assets which have inactive markets. This FSP is effective upon issuance, including prior periods that financial statements have not yet been issued. Statement No. 157 was effective for fiscal years beginning after November 15, 2007 and interim periods within those fiscal years. The difference between the carrying amounts and fair values of those financial instruments held at the date this statement is initially applied should be recognized as a cumulative effect adjustment to the opening balance of retained earnings for the fiscal year in which this statement is initially applied. Additionally, in February 2008, the FASB issued Staff Position FAS 157-2, *Effective Date of FASB Statement No. 157*, which delayed the effective date of Statement No. 157 for all non-recurring fair value measurements of nonfinancial assets and nonfinancial liabilities until the fiscal year beginning after November 15, 2008. As a result, the Company partially applied the provisions of Statement No. 157 upon adoption at January 1, 2008 and adopted the remaining provisions relating to certain nonfinancial assets and liabilities on January 1, 2009. The Company adopted FSP FAS No. 157-4 as of April 1, 2009. The effect of adopting Statement No. 157 and the related FSPs for both financial and non-financial assets and liabilities, was not material to the Company's financial position or results of operations. See further disclosure in Note 6 Fair Value.

Recently Issued Standards

In June 2009, the FASB issued Statement of Financial Accounting Standards No. 168, *The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles a replacement of FASB Statement No. 162* (Statement No. 168). Statement No. 168 establishes a single source of authoritative generally accepted accounting principles (GAAP) recognized by the FASB to be applied by nongovernmental entities. All guidance contained in the Codification carries an equal level of authority. Rules and interpretive releases of the Securities and Exchange Commission (SEC) under authority of federal securities laws are also sources of authoritative GAAP for SEC registrants. Accordingly, all other accounting literature will be deemed non-authoritative . Statement No. 168 is effective on a prospective basis for financial statements issued for interim and annual periods ending after September 15, 2009. The Company does not expect that the adoption of Statement No. 168 will have a material effect on its financial position or results of operations.

In June 2009, FASB issued Statement of Financial Accounting Standards No. 167, *Amendments to FASB Interpretation No. 46(R)* (Statement No. 167). Statement No. 167 amends FASB Interpretation No. 46R, *Consolidation of Variable Interest Entities an interpretation of ARB No. 51* (FIN 46R) to require an analysis to determine whether a company has a controlling financial interest in a variable interest entity. This analysis identifies the primary beneficiary of a variable interest entity as the enterprise that has a) the power to direct the activities of a variable interest entity that most significantly impact the entity's economic performance and b) the obligation to absorb losses of the entity that could potentially be significant to the variable interest entity or the right to receive benefits from the entity that could potentially be significant to the variable interest entity. The statement requires an ongoing assessment of whether a company is the primary beneficiary of a variable interest entity when the holders of the entity, as a group, lose power, through voting or similar rights, to direct the actions that most significantly affect the entity's economic performance. This statement also enhances disclosures about a company's involvement in variable interest entities. Statement No. 167 is effective as of the beginning of the first annual reporting period that begins after November 15, 2009. The Company does not expect the adoption of Statement No. 167 to have a material impact on its financial position or results of operations.

Table of Contents

In June 2009, the FASB issued Statement of Financial Accounting Standards No. 166, *Accounting for Transfers of Financial Assets an amendment of FASB Statement No. 140* (Statement No. 166). Statement No. 166 revises FASB Statement of Financial Accounting Standards No. 140, *Accounting for Transfers and Extinguishment of Liabilities a replacement of FASB Statement 125* (Statement No. 140) and requires additional disclosures about transfers of financial assets, including securitization transactions, and any continuing exposure to the risks related to transferred financial assets. It also eliminates the concept of a qualifying special-purpose entity , changes the requirements for derecognizing financial assets, and enhances disclosure requirements. Statement No. 166 is effective prospectively, for annual periods beginning after November 15, 2009, and interim and annual periods thereafter. The Company does not expect the adoption of Statement No. 166 will have a material impact on its financial position or results of operations.

3. Discontinued Operations of FAFLIC Business

On January 2, 2009, THG sold its remaining life insurance subsidiary, FAFLIC, to Commonwealth Annuity, a subsidiary of Goldman Sachs. Approval was obtained from the Massachusetts Division of Insurance for a pre-close dividend from FAFLIC consisting of designated assets with a statutory book value of approximately \$130 million. Total proceeds from the sale, including the dividend, were approximately \$230 million, net of transaction costs. Additionally, coincident with the sale transaction, Hanover Insurance and FAFLIC entered into a reinsurance contract whereby Hanover Insurance assumed FAFLIC's discontinued accident and health insurance business. THG has also indemnified Commonwealth Annuity for certain litigation, regulatory matters and other liabilities related to the pre-closing activities of the business transferred.

The Company accounted for the disposal of its FAFLIC business as a discontinued operation in accordance with Statement of Financial Accounting Standards No. 144, *Accounting for the Impairment or Disposal of Long-lived Assets* (Statement No. 144). For the year ended December 31, 2008, the Company recognized a \$77.3 million loss associated with the sale transaction.

The following table summarizes the results for this discontinued business for the periods indicated:

(In millions)	(Unaudited)		(Unaudited)	
	Quarter Ended June 30, 2009	2008	Six Months Ended June 30, 2009	2008
Gain (loss) from discontinued FAFLIC business	\$ 0.9	\$ (67.7)	\$ 5.9	\$ (71.2)

For the quarter ended June 30, 2009, the Company recognized income from discontinued operations of \$0.9 million, primarily resulting from the Company's release of sale-related accruals. Net losses of \$67.7 million in the second quarter of 2008 primarily reflect the Company's preliminary estimate of the loss associated with the sale transaction of \$66.1 million. In addition, these losses include net realized investment losses of \$2.7 million, primarily resulting from the sale of fixed maturity securities and from impairments and a \$1.7 million tax expense; partially offset by favorable results, primarily attributable to the traditional line of business. Total revenues associated with the FAFLIC business in the second quarter of 2008 were \$17.8 million. This business also generated income before taxes of \$0.1 million during that period.

For the six months ended June 30, 2009, the Company recognized income from discontinued operations of \$5.9 million, primarily resulting from a change in the Company's estimate of indemnification liabilities related to the sale and the aforementioned release of sale-related accruals. Net losses of \$71.2 million in the first six months of 2008 primarily reflect the Company's preliminary estimate of the loss associated with the sale transaction, net realized investment losses of \$7.4 million, primarily resulting from impairments and the sale and intercompany transfer of investment assets. These losses were partially offset by favorable results, primarily attributable to both the traditional and retirement lines of business. Total revenues associated with the FAFLIC business in the first six months of 2008 were \$39.9 million. This business also generated a loss before taxes of \$5.5 million during that period.

Table of Contents

In connection with the sales transaction, the Company agreed to indemnify Commonwealth Annuity for certain legal, regulatory and other matters that existed as of the sale. Accordingly, the Company established a gross liability in accordance with FASB Interpretation No. 45, *Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others* (FIN 45) of \$9.9 million. As of June 30, 2009, the Company's total gross FIN 45 liability was \$2.9 million. The Company regularly reviews and updates its FIN 45 liability for legal and regulatory matter indemnities. Although the Company believes its current estimate for its FIN 45 liability is appropriate, there can be no assurance that these estimates will not materially increase in the future. Adjustments to this reserve are recorded in the results of the Company in the period in which they are determined.

Included in Assets of discontinued operations as of December 31, 2008 were \$1,710.4 million of assets that were included in the sale of FAFLIC. Included in Liabilities of discontinued operations as of December 31, 2008 were \$1,627.6 million of liabilities that were included in the sale of FAFLIC. In accordance with Statement No. 144, the following table details the major assets and liabilities reflected in these captions.

	December 31,
(In millions)	2008
Assets:	
Cash and investments	\$ 1,182.2
Reinsurance recoverable	241.5
Separate account assets	263.4
Other assets	49.3
Valuation allowance	(26.0)
Total assets	\$ 1,710.4
Liabilities:	
Policy liabilities	\$ 1,305.6
Separate account liabilities	263.4
Trust instruments supported by funding obligations	15.0
Other liabilities	43.6
Total liabilities	\$ 1,627.6

4. Other Significant Transactions

On June 29, 2009, the Company completed a cash tender offer to repurchase a portion of its 8.207% Series B Capital Securities (Capital Securities) that were issued by AFC Capital Trust I (the Trust) and a portion of its 7.625% Senior Debentures (Senior Debentures) due in 2025 that were issued by THG. As of that date, \$69.3 million of Capital Securities were tendered at a price equal to \$800 per \$1,000 of face value. In addition, the Company accepted for tender a principal amount of \$77.3 million of Senior Debentures. Depending on the time of tender, holders of the Senior Debentures accepted for purchase received a price ranging from \$870 to \$900 per \$1,000 of face value. Separately, the Company held \$65.0 million of Capital Securities previously repurchased at a discount in the open market prior to the tender offer. In conjunction with the completion of the tender offer, the Company announced plans to liquidate and terminate the Trust as permitted by the terms of the Trust documents. The Company assessed the remaining risks within the Trust as a result of the planned termination and determined that the previously unconsolidated Trust should be consolidated as of June 30, 2009 in accordance with FASB Interpretation No. 46, *Consolidation of Variable Interest Entities - an Interpretation of ARB No. 51*. Including the repurchase of the Senior Debentures and the consolidation of the Trust, the Company recognized a pre-tax gain of \$34.3 million in the quarter ended June 30, 2009. Subsequent to the completion of the tender offer, \$165.7 million of the Capital Securities not held by the Company and \$122.7 million principal amount of the Senior Debentures not held by the Company remained outstanding. The Company liquidated the Trust on July 30, 2009. Each holder of Capital Securities as of that date received a principal amount of our Series B 8.207% Junior Subordinated Deferrable Interest Debentures due February 3, 2027 equal to the liquidation amount of the Capital Securities held by such holder.

On November 28, 2008, the Company acquired AIX Holdings, Inc. (AIX) for approximately \$100 million, subject to various terms and conditions. AIX is a specialty property and casualty insurer that underwrites and manages program business.

Table of Contents

On June 2, 2008, the Company completed the sale of its premium financing subsidiary, AMGRO Inc., to Premium Financing Specialists, Inc. The Company recorded a gain of \$11.1 million related to this sale, which was reflected in the Consolidated Statement of Income as part of Discontinued Operations in the second quarter of 2008.

On March 14, 2008, the Company acquired all of the outstanding shares of Verlan for \$29.0 million. Verlan, now referred to as Hanover Specialty Property, is a specialty company providing property insurance to small and medium-sized manufacturing and distribution companies that are highly protected fire risks.

On October 16, 2007, the Company's Board of Directors authorized a share repurchase program of up to \$100 million. Under this repurchase authorization, the Company may repurchase its common stock from time to time, in varying amounts and prices and at such times deemed appropriate, subject to market conditions and other considerations. The Company is not required to purchase any specific number of shares or to make purchases by any certain date under this program. In the first six months of 2009, the Company repurchased 0.2 million shares at an aggregate cost of \$7.1 million. Total repurchases under this program as of June 30, 2009 were 1.6 million shares at a cost of \$67.3 million.

On December 30, 2005, the Company sold its variable life insurance and annuity business to Goldman Sachs, including the reinsurance of 100% of the variable business of FAFLIC. THG agreed to indemnify Goldman Sachs for certain litigation, regulatory matters and other liabilities related to the pre-closing activities of the business that was sold. The Company accounted for the disposal as a discontinued operation in accordance with Statement No. 144. In the first six months of 2008, the Company recognized a benefit of \$5.4 million, including \$5.8 million resulting from the release of liabilities associated with the estimated liabilities for certain contractual indemnities to Goldman Sachs recorded in accordance with FIN 45. The \$4.1 million gain in the first six months of 2009 related to a further change in the Company's estimate of indemnification liabilities.

5. Investments

A. Fixed maturities and equity securities

The Company accounts for its investments in fixed maturities and equity securities, which are classified as available-for-sale. In April 2009, the FASB issued FSP FAS 115-2 and FAS 124-2, *Recognition and Presentation of Other-Than-Temporary Impairments* (FSP FAS No. 115-2). This FSP replaces current other-than-temporary impairment guidance for debt securities specific to a company's intent and ability to hold impaired securities. (See Other-than-temporary impairments Adoption of FSP FAS 115-2 below for a further discussion).

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

(In millions)	(Unaudited) June 30, 2009				Fair Value
	Amortized Cost (1)	Gross Unrealized Gains	Unrealized Losses	OTTI Unrealized Losses (2)	
U.S. Treasury securities and U.S. government and agency securities	\$ 255.7	\$ 3.9	\$ 3.4	\$	\$ 256.2
States and political subdivisions	784.3	13.8	18.5	3.7	775.9
Foreign governments	2.7				2.7
Corporate fixed maturities	2,278.2	81.7	92.1	32.4	2,235.4
Residential mortgage-backed securities	972.0	27.0	16.9	8.6	973.5
Commercial mortgage-backed securities	276.1	3.4	23.3		256.2
Total fixed maturities, including assets of discontinued operations	4,569.0	129.8	154.2	44.7	4,499.9
Less: fixed maturities of discontinued operations	(105.3)	(10.5)	(15.3)	(4.2)	(96.3)
Total fixed maturities, excluding discontinued operations	\$ 4,463.7	\$ 119.3	\$ 138.9	\$ 40.5	\$ 4,403.6
Equity securities, excluding discontinued operations	\$ 94.6	\$ 7.0	\$ 9.5	\$	\$ 92.1

Table of Contents

(In millions)

	December 31, 2008				
	Amortized Cost (1)	Gross Unrealized Gains	Unrealized Losses	Gross Unrealized Losses	
Unrealized Losses				OTTI Unrealized Losses	Fair Value (3)
U.S. Treasury securities and U.S. government and agency securities	\$ 344.8	\$ 11.6	\$ 0.8	\$	\$ 355.6
States and political subdivisions	758.7	3.9	35.7		726.9
Foreign governments	4.6	0.2			4.8
Corporate fixed maturities	2,745.5	26.2	261.1		2,510.6
Residential mortgage-backed securities	1,097.5	23.2	21.9		1,098.8
Commercial mortgage-backed securities	480.1	0.9	50.0		431.0
Total fixed maturities, including assets of discontinued operations	5,431.2	66.0	369.5		5,127.7
Less: fixed maturities of discontinued operations (4)	(1,049.2)	(14.0)	(76.4)		(986.8)
Total fixed maturities, excluding discontinued operations	\$ 4,382.0	\$ 52.0	\$ 293.1	\$	\$ 4,140.9
Equity securities, excluding discontinued operations	\$ 97.6	\$ 3.4	\$ 24.8	\$	\$ 76.2

- (1) Amortized cost for fixed maturities and cost for equity securities.
- (2) Represents other-than-temporary impairments (OTTI) recognized in accumulated other comprehensive income, including cumulative effect of adoption of FSP FAS 115-2 of \$33.3 million.
- (3) Included \$42.2 million of trust preferred capital securities of a THG affiliated entity that are designated as held-to-maturity and carried at amortized cost.
- (4) Fixed maturities of discontinued operations as of December 31, 2008 included our discontinued FAFLIC business and discontinued accident and health business. Due to the January 2, 2009 sale of FAFLIC, fixed maturities with an amortized cost of \$949.9 million, gross unrealized gains of \$12.2 million, gross unrealized losses of \$60.7 million and fair value of \$901.4 million transferred to the buyer. The amortized cost and fair value by maturity periods for fixed maturities 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, or the Company may have the right to put or sell the obligations back to the issuers. Mortgage-backed securities are included in the category representing their stated maturity.

(In millions)	(Unaudited) June 30, 2009	
	Amortized Cost	Fair Value
Due in one year or less	\$ 126.5	\$ 127.0
Due after one year through five years	1,494.8	1,496.7
Due after five years through ten years	1,370.6	1,350.0
Due after ten years	1,577.1	1,526.2
Total fixed maturities, including assets of discontinued operations	4,569.0	4,499.9
Less: fixed maturities of discontinued operations	(105.3)	(96.3)
Total fixed maturities, excluding assets of discontinued operations	\$ 4,463.7	\$ 4,403.6

Table of Contents**B. Securities in a continuous unrealized loss position**

The following tables provide information about the Company's fixed maturities and equity securities that have been continuously in an unrealized loss position at June 30, 2009 and December 31, 2008:

(In millions)	12 months or less		(Unaudited) June 30, 2009 Greater than 12 months		Total	
	Gross Unrealized Losses and OTTI	Fair Value	Gross Unrealized Losses and OTTI	Fair Value	Gross Unrealized Losses and OTTI (1)	Fair Value
Fixed Maturities:						
Investment Grade:						
U.S. Treasury securities and U.S. government and agency securities	\$ 3.4	\$ 116.0	\$	\$	\$ 3.4	\$ 116.0
States and political subdivisions	7.1	198.9	11.4	149.1	18.5	348.0
Corporate fixed maturities	20.3	209.6	49.6	453.2	69.9	662.8
Residential mortgage-backed securities						