

OneBeacon Insurance Group, Ltd.  
Form 10-Q  
November 02, 2015

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2015

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 1-33128

ONEBEACON INSURANCE GROUP, LTD.

(Exact name of Registrant as specified in its charter)

Bermuda

98-0503315

(State or other jurisdiction of

(I.R.S. Employer

incorporation or organization)

Identification No.)

605 North Highway 169

55441

Plymouth, Minnesota

(Zip Code)

(Address of principal executive offices)

Registrant's telephone number, including area code: (952) 852-2431

601 Carlson Parkway

Minnetonka, Minnesota 55305

(Former address of principal executive offices)

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  Smaller reporting company

(Do not check if a

smaller reporting company)

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

As of October 29, 2015, 23,509,098 Class A common shares, par value \$0.01 per share, and 71,754,738 Class B common shares, par value \$0.01 per share, were outstanding.

ONEBEACON INSURANCE GROUP, LTD.

TABLE OF CONTENTS

	Page	
<u>PART I</u>	<u>FINANCIAL INFORMATION</u>	
<u>ITEM 1.</u>	<u>Financial Statements (Unaudited)</u>	
	<u>Consolidated Balance Sheets:</u>	
	<u>As of September 30, 2015 and December 31, 2014</u>	1
	<u>Consolidated Statements of Operations and Comprehensive Income (Loss):</u>	
	<u>For the three and nine months ended September 30, 2015 and 2014</u>	2
	<u>Consolidated Statements of Common Shareholders' Equity:</u>	
	<u>For the nine months ended September 30, 2015 and 2014</u>	3
	<u>Consolidated Statements of Cash Flows:</u>	
	<u>For the nine months ended September 30, 2015 and 2014</u>	4
	<u>Notes to Consolidated Financial Statements</u>	5
<u>ITEM 2.</u>	<u>Management's Discussion and Analysis of Financial Condition and Results of</u>	49
	<u>Operations</u>	
	<u>Results of Operations</u>	50
	<u>Liquidity and Capital Resources</u>	63
	<u>Critical Accounting Estimates</u>	67
	<u>Forward-Looking Statements</u>	67
<u>ITEM 3.</u>	<u>Quantitative and Qualitative Disclosures About Market Risk</u>	68
<u>ITEM 4.</u>	<u>Controls and Procedures</u>	68
<u>PART II</u>	<u>OTHER INFORMATION</u>	68
<u>ITEM 1.</u>	<u>Legal Proceedings</u>	68
<u>ITEM 1A.</u>	<u>Risk Factors</u>	68
<u>ITEM 2.</u>	<u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	69
<u>ITEM 6.</u>	<u>Exhibits</u>	69
<u>SIGNATURES</u>		70

---

Table of Contents

## PART I. FINANCIAL INFORMATION

## ITEM 1. FINANCIAL STATEMENTS (UNAUDITED)

## ONEBEACON INSURANCE GROUP, LTD.

## CONSOLIDATED BALANCE SHEETS

(Unaudited)

(\$ in millions, except per share amounts)	September 30, 2015	December 31, 2014
Assets		
Investment Securities:		
Fixed maturity investments, at fair value	\$2,054.0	\$1,799.8
Short-term investments, at amortized cost (which approximates fair value)	100.3	202.2
Common equity securities, at fair value	284.4	320.0
Convertible fixed maturity investments, at fair value	—	5.0
Other investments	164.3	198.8
Total investment securities	2,603.0	2,525.8
Cash	96.7	87.0
Reinsurance recoverables	236.8	173.8
Premiums receivable	268.8	241.5
Funds held under reinsurance contracts	4.6	37.1
Deferred acquisition costs	104.5	103.2
Ceded unearned premiums	41.3	17.9
Net deferred tax asset	147.8	131.8
Investment income accrued	10.2	10.0
Accounts receivable on unsettled investment sales	5.7	7.2
Other assets	188.4	184.8
Assets held for sale	—	58.1
Total assets	\$3,707.8	\$3,578.2
Liabilities		
Unpaid loss and loss adjustment expense reserves	\$1,427.4	\$1,342.2
Unearned premiums	625.7	588.3
Funds held under insurance contracts	100.3	81.0
Debt	274.8	274.7
Accounts payable on unsettled investment purchases	20.2	0.5
Other liabilities	255.5	242.2
Total liabilities	2,703.9	2,528.9
OneBeacon's common shareholders' equity and noncontrolling interests		
OneBeacon's common shareholders' equity		
Preference shares (Par value \$0.01; 80,000,000 authorized shares; none issued or outstanding)	—	—
Common shares and paid-in surplus (Class A: par value \$0.01; 200,000,000 authorized shares; 23,509,098 and 23,541,649 issued and outstanding)(Class B: par value \$0.01; 200,000,000 authorized shares; 71,754,738 issued and outstanding for both periods)	1,023.6	1,023.7
Retained earnings (deficit)	(18.6	) 27.3
Accumulated other comprehensive loss	(4.6	) (5.2
Total OneBeacon's common shareholders' equity	1,000.4	1,045.8
Total noncontrolling interests	3.5	3.5
Total OneBeacon's common shareholders' equity and noncontrolling interests	1,003.9	1,049.3
	\$3,707.8	\$3,578.2

Total liabilities, OneBeacon's common shareholders' equity and noncontrolling interests

See Notes to Consolidated Financial Statements.

1

---

Table of Contents

ONEBEACON INSURANCE GROUP, LTD.  
CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME (LOSS)  
(Unaudited)

(\$ in millions, except per share amounts)	Three months ended		Nine months ended		
	September 30,		September 30,		
	2015	2014	2015	2014	
Revenues					
Earned premiums	\$281.4	\$305.4	\$887.3	\$872.8	
Net investment income	12.4	10.8	33.0	33.4	
Net realized and change in unrealized investment gains	(29.9	) (16.0	) (29.7	) 24.8	
Net other revenues (expenses)	3.9	1.3	(0.4	) 3.3	
Total revenues	267.8	301.5	890.2	934.3	
Expenses					
Loss and loss adjustment expenses	167.5	185.2	527.9	520.7	
Policy acquisition expenses	53.8	54.6	161.2	150.9	
Other underwriting expenses	56.4	51.2	165.2	152.3	
General and administrative expenses	3.7	2.4	12.0	9.3	
Interest expense	3.2	3.2	9.7	9.7	
Total expenses	284.6	296.6	876.0	842.9	
Pre-tax income (loss) from continuing operations	(16.8	) 4.9	14.2	91.4	
Income tax benefit (expense)	3.5	1.1	1.0	(11.9	)
Net income (loss) from continuing operations	(13.3	) 6.0	15.2	79.5	
Loss from discontinued operations, net of tax	(0.1	) (0.3	) (0.4	) (0.9	)
(Loss) gain from sale of discontinued operations, net of tax	—	(7.0	) 0.3	(7.5	)
Net income (loss), including noncontrolling interests	(13.4	) (1.3	) 15.1	71.1	
Less: Net income attributable to noncontrolling interests	—	—	(1.0	) (0.9	)
Net income (loss) attributable to OneBeacon's common shareholders	(13.4	) (1.3	) 14.1	70.2	
Other comprehensive income, net of tax	0.2	—	0.6	0.1	
Comprehensive income (loss) attributable to OneBeacon's common shareholders	\$(13.2	) \$(1.3	) \$14.7	\$70.3	
Earnings (loss) per share attributable to OneBeacon's common shareholders—basic and diluted					
Net income (loss) from continuing operations, per share	\$(0.14	) \$0.05	\$0.15	\$0.82	
Loss from discontinued operations, net of tax, per share	—	(0.07	) —	(0.09	)
Net income (loss) attributable to OneBeacon's common shareholders per share	\$(0.14	) \$(0.02	) \$0.15	\$0.73	
Dividends declared and paid per OneBeacon's common share	\$0.21	\$0.21	\$0.63	\$0.63	

See Notes to Consolidated Financial Statements.

Table of Contents

ONEBEACON INSURANCE GROUP, LTD.  
CONSOLIDATED STATEMENTS OF COMMON SHAREHOLDERS' EQUITY  
(Unaudited)

(\$ in millions)	OneBeacon's Common Shareholders' Equity					Total OneBeacon's common shareholders' equity and noncontrolling interests
	Common shares and paid-in surplus	Retained earnings	Accum. other comprehensive income (loss)	Total OneBeacon common shareholders' equity	Noncontrolling interests, after tax	
Balances at January 1, 2015	\$1,023.7	\$27.3	\$ (5.2 )	\$ 1,045.8	\$ 3.5	\$ 1,049.3
Comprehensive income:						
Net income	—	14.1	—	14.1	1.0	15.1
Other comprehensive income, net of tax	—	—	0.6	0.6	—	0.6
Total comprehensive income	—	14.1	0.6	14.7	1.0	15.7
Amortization of restricted share awards	1.5	—	—	1.5	—	1.5
Issuance of common shares	—	—	—	—	0.1	0.1
Repurchase and retirement of common shares	(1.6 )	—	—	(1.6 )	—	(1.6 )
Dividends	—	(60.0 )	—	(60.0 )	(1.1 )	(61.1 )
Balances at September 30, 2015	\$1,023.6	\$ (18.6 )	\$ (4.6 )	\$ 1,000.4	\$ 3.5	\$ 1,003.9

(\$ in millions)	OneBeacon's Common Shareholders' Equity					Total OneBeacon's common shareholders' equity and noncontrolling interests
	Common shares and paid-in surplus	Retained earnings	Accum. other comprehensive income	Total OneBeacon common shareholders' equity	Noncontrolling interests, after tax	
Balances at January 1, 2014	\$1,022.5	\$74.4	\$ 6.8	\$ 1,103.7	\$ 3.1	\$ 1,106.8
Comprehensive income:						
Net income	—	70.2	—	70.2	0.9	71.1
Other comprehensive income, net of tax	—	—	0.1	0.1	—	0.1
Total comprehensive income	—	70.2	0.1	70.3	0.9	71.2
Amortization of restricted share awards	2.3	—	—	2.3	—	2.3
Issuance of common shares	—	—	—	—	0.2	0.2
Repurchase and retirement of common shares	(1.8 )	—	—	(1.8 )	—	(1.8 )
Dividends	—	(60.0 )	—	(60.0 )	(0.9 )	(60.9 )
Balances at September 30, 2014	\$1,023.0	\$ 84.6	\$ 6.9	\$ 1,114.5	\$ 3.3	\$ 1,117.8

See Notes to Consolidated Financial Statements.



Table of Contents

ONEBEACON INSURANCE GROUP, LTD.  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
(Unaudited)

(\$ in millions)	Nine months ended September 30,	
	2015	2014
Cash flows from operations:		
Net income including noncontrolling interests	\$15.1	\$71.1
Charges (credits) to reconcile net income to cash flows provided from operations:		
Net loss from discontinued operations	0.4	0.9
Net (gain) loss from sale of discontinued operations	(0.3	) 7.5
Net realized and change in unrealized investment gains	29.7	(24.8
Net adjustment to gain on sale of business	3.7	—
Deferred income tax (benefit) expense	(14.2	) 8.6
Other operating items:		
Net change in loss and LAE reserves	85.2	105.3
Net change in unearned premiums	37.4	80.3
Net change in ceded unearned premium	(23.4	) (0.4
Net change in premiums receivable	(27.3	) (55.5
Net change in reinsurance recoverables on paid and unpaid losses	(63.0	) (24.2
Net change in funds held under reinsurance contracts	32.5	(33.3
Net change in funds held under insurance contracts	19.3	13.5
Net change in other assets and liabilities	31.7	(2.1
Net cash provided from operations—continuing operations	126.8	146.9
Net cash used for operations—discontinued operations	(0.4	) (44.8
Net cash provided from operations	126.4	102.1
Cash flows from investing activities:		
Net maturities, purchases and sales of short-term investments	101.9	(81.5
Maturities of fixed maturity investments	196.8	202.6
Sales of fixed maturity investments	511.2	1,459.6
Sales of common equity securities	294.4	97.5
Sales of convertible fixed maturity investments	6.1	20.6
Return of capital and distributions of other investments	24.4	11.1
Purchases of fixed maturity investments	(971.6	) (1,641.2
Purchases of common equity securities	(278.2	) (63.0
Purchases of convertible fixed maturity investments	(0.8	) (11.3
Contributions for other investments	(2.8	) (3.6
Net change in unsettled investment purchases and sales	21.3	(6.8
Proceeds from sale of property and equipment	56.8	—
Net acquisitions of property and equipment	(10.9	) (0.9
Net cash used for investing activities	(51.4	) (16.9
Cash flows from financing activities:		
Cash dividends paid to common shareholders	(60.0	) (60.0
Repurchases and retirements of common stock	(1.8	) (1.8
Payments on capital lease obligation	(3.5	) (4.0
Net cash used for financing activities	(65.3	) (65.8
Net increase in cash during period	9.7	19.4
Cash balance at beginning of period	87.0	168.1

Cash balance at end of period	\$96.7	\$187.5
-------------------------------	--------	---------

See Notes to Consolidated Financial Statements.

4

---

Table of Contents

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1. Nature of Operations and Summary of Significant Accounting Policies

Basis of presentation

These interim consolidated financial statements include the accounts of OneBeacon Insurance Group, Ltd. (the "Company" or the "Registrant") and its subsidiaries (collectively, "OneBeacon") and have been prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP"). The Company is an exempted Bermuda limited liability company with U.S.-based underwriting operating companies that are property and casualty insurance writers and a Bermuda-based reinsurance company, Split Rock Insurance, Ltd. ("Split Rock"), which reinsures certain risks of affiliated entities. OneBeacon offers a wide range of specialty insurance products and services primarily through independent agencies, regional and national brokers, wholesalers and managing general agencies.

OneBeacon is 75.3% owned by White Mountains Insurance Group, Ltd. ("White Mountains"), a holding company whose businesses provide property and casualty insurance, reinsurance and certain other products. The Company's headquarters are located at 14 Wesley Street, 5th Floor, Hamilton HM 11, Bermuda. The Company's U.S. corporate headquarters are located at 605 North Highway 169, Plymouth, Minnesota 55441 and its registered office is located at Clarendon House, 2 Church Street, Hamilton HM 11, Bermuda. During the second quarter of 2015 OneBeacon sold its building in Canton, Massachusetts, which is presented as held for sale in the December 31, 2014 consolidated balance sheets.

On December 23, 2014, OneBeacon completed the sale of its run-off business to a subsidiary of Armour Group Holdings Limited ("Armour"). See Note 2—"Acquisitions and Dispositions" and Note 15—"Discontinued Operations." The run-off business included the results of OneBeacon's non-specialty commercial lines business and certain other run-off business, including the vast majority of asbestos and environmental reserves, as well as certain purchase accounting adjustments related to the run-off business (the "Runoff Business," the sale of which is referred to as the "Runoff Transaction"). The Runoff Business has been presented as discontinued operations in the consolidated statements of operations for the three and nine months ended September 30, 2015 and 2014 and in the consolidated statements of cash flows for the nine months ended September 30, 2015 and 2014. The Runoff Business disposal group excludes investing and financing activities from amounts classified as discontinued operations. OneBeacon's investing and financing operations are conducted on an overall consolidated level and, accordingly, there are no separately identifiable investing or financing cash flows associated with the Runoff Business. The legal entities included in the sale held an agreed upon level of invested assets and capital at closing.

OneBeacon's reportable segments are Specialty Products, Specialty Industries and Investing, Financing and Corporate. The Specialty Products segment is comprised of nine active underwriting operating segments, representing an aggregation based on those that offer distinct products and tailored coverages and services to a broad customer base across the United States. During the first quarter of 2015, the Company restructured its former Professional Insurance underwriting operating segment into four separate underwriting operating segments, which are included in Specialty Products: Healthcare, Management Liability, Financial Services and Other Professional Lines. The Specialty Products segment also includes the Crop underwriting operating segment which was exited in the third quarter of 2015.

The Specialty Industries segment is comprised of five active underwriting operating segments, representing an aggregation based on those that focus on solving the unique needs of a particular customer or industry group. The Investing, Financing and Corporate segment includes the investing and financing activities for OneBeacon on a consolidated basis, and certain other activities conducted through the Company and its intermediate subsidiaries. All significant intercompany transactions have been eliminated in consolidation. These interim financial statements include all adjustments considered necessary by management to fairly state the financial position, results of operations and cash flows of OneBeacon. These interim financial statements may not be indicative of financial results for the full year and should be read in conjunction with the Company's 2014 Annual Report on Form 10-K. The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Refer to the Company's 2014 Annual

Report on Form 10-K for a complete discussion regarding OneBeacon's significant accounting policies. Certain amounts in the prior period financial statements have been reclassified to conform to the current presentation.

Recently Adopted Changes in Accounting Principles

Qualified Affordable Housing Projects

Effective January 1, 2015, OneBeacon adopted ASU 2014-01, Accounting for Investments in Qualified Affordable Housing Projects ("QAHP") (ASC 323). ASU 2014-01 allows investors in QAHP to make a policy election to use the proportional amortization method. Under the proportional amortization method, the investor amortizes the initial cost of the

Table of Contents

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 1. Nature of Operations and Summary of Significant Accounting Policies

investment in proportion to the tax credits and other tax benefits received and recognizes the investment results, net of the related tax benefits, as a component of income tax expense. Prior to adoption, OneBeacon accounted for its QAHP investment under the equity method and recognized its share of its QAHP investment's losses in investment income. OneBeacon made the policy election to account for its QAHP investment using the proportional amortization method, applied retrospectively. Under the proportional amortization method, the cumulative loss recognized through December 31, 2014 increased by \$1.2 million. As a result of the retrospective adoption, OneBeacon's common shareholders equity has been reduced by \$0.6 million as of January 1, 2014. In addition, for the three and nine months ended September 30, 2014, the retrospective adoption resulted in increases of \$0.4 million and \$1.3 million, respectively, to net investment income and net increases of \$0.6 million and \$1.8 million, respectively, to income tax expense. Footnote disclosures for prior year amounts have been amended to be consistent with the restated amounts described above.

Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity

In April 2014, the Financial Accounting Standard Board ("FASB") issued ASU 2014-08, Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity (ASC 205 and ASC 360) to reduce diversity in practice for reporting discontinued operations. ASU 2014-08 limits discontinued operations treatment to disposals that represent a strategic shift and that have a major effect on a reporting entity's operations and financial results to be reported as discontinued operations. The revised guidance also requires expanded disclosure in the financial statements for discontinued operations as well as for disposals of significant components of an entity that do not qualify for discontinued operations presentation. OneBeacon has not had any transactions that occurred since ASU 2014-08 became effective on December 15, 2014.

Pushdown Accounting

ASU 2014-17, Pushdown Accounting, a consensus of the FASB Emerging Issues Task Force (ASC 805) became effective upon its issuance on November 18, 2014. The new guidance, which is applicable prospectively, gives an acquired non-public company the option to apply pushdown accounting in its separate company financial statements in the period in which it is acquired in a change of control transaction. Once pushdown accounting has been applied, the election is irreversible. Acquired entities that chose not to apply pushdown accounting at the time of acquisition, may apply pushdown accounting in a subsequent period as a change in accounting principle under ASC 250, Accounting Changes and Error Corrections. OneBeacon has not had any acquisitions since ASU 2014-17 became effective.

Unrecognized Tax Benefits

Effective January 1, 2014, OneBeacon adopted ASU 2013-11, Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists. The new ASU generally requires balance sheet presentation of an unrecognized tax benefit as a reduction of a deferred tax asset for a net operating loss ("NOL") carryforward or tax credit carryforward rather than as a liability. This adoption did not have any impact on the Company's financial position, results of operations, cash flows or financial statement presentation.

Recently Issued Accounting Pronouncements

Business Combinations - Measurement Period Adjustments

On September 25, 2015, the FASB issued ASU 2015-16, Simplifying the Accounting for Measurement-Period Adjustments. At the date of an acquisition, fair value of certain assets and liabilities may not be accurately determinable and are therefore recognized at the acquirer's best estimate. Such amounts may be updated as additional information becomes available in periods subsequent to the acquisition for up to one year. Prior to the issuance of this new ASU, subsequent adjustments had to be pushed back to the acquisition date, which required retroactive adjustments to prior period amounts. Under the new guidance, adjustments to provisional amounts that are identified during the measurement period are to be recorded in the reporting period in which the adjustment amounts are determined. ASU 2015-16 is effective for fiscal years beginning after December 15, 2015 and should be applied prospectively to adjustments to estimated purchase accounting amounts that occur after the effective date. Early

application is permitted. OneBeacon has not recognized any adjustments to estimated purchase accounting amounts for the year to date period ended September 30, 2015.

Insurance Contracts

In May 2015, the FASB issued ASU 2015-09, Disclosures about Short Duration Contracts (ASC 944) which requires expanded footnote disclosures about loss and loss adjustment expense ("LAE") reserves. Under the new guidance, some disclosures currently presented outside of OneBeacon's financial statements, such as loss development tables and a reconciliation of loss development data to the loss and LAE reserves reflected on the balance sheet, will become part of the financial statement footnotes. In addition, the loss development tables required to be presented under the new ASU must be presented on a disaggregated basis by accident year rather than by reporting year as currently presented. Some of the expanded

Table of Contents

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 1. Nature of Operations and Summary of Significant Accounting Policies

disclosures are new requirements, such as the disclosure of reserves for losses incurred but not reported ("IBNR") plus expected development on reported claims, which must be presented by accident year on a disaggregated basis. The new guidance also requires new disclosures about claim frequency data together with descriptions of the approach used to measure that data. Qualitative descriptions of methodologies and assumptions used to develop IBNR estimates must be presented together with the disaggregated amounts of IBNR to which they relate, along with a discussion of any significant changes in methodology and assumptions and the related effect upon the loss reserves. The new guidance will be effective for annual periods beginning after December 15, 2015 and interim periods within annual periods beginning after December 15, 2016 with retrospective restatement of prior periods required. OneBeacon will modify its financial statement footnote disclosures to conform to the requirements of ASU 2015-09 upon adoption, including revisions to prior year's disclosures.

Fair Value Measurements

In May 2015, the FASB issued ASU 2015-07, Fair Value Measurement - Disclosures for Investments in Certain Entities that Calculate Net Asset Value per Share (or Its Equivalent) (ASC 820) which eliminates the requirement to disclose the fair value hierarchy level for investments for which fair value is measured at net asset value using the practical expedient in ASC 820. OneBeacon measures the fair value of its investments in hedge funds and private equity funds using this practical expedient and has classified those measurements within Level 3 of the fair value hierarchy. The new guidance is effective for fiscal years beginning after December 15, 2015 and interim periods within those fiscal years.

Debt Issuance Costs

In April 2015, the FASB issued ASU 2015-03, Imputation of Interest (ASC 835) which requires debt issuance costs related to a recognized debt liability to be presented as a deduction from the carrying amount of the related debt, consistent with the treatment required for debt discounts. In August 2015, the FASB issued ASU 2015-15, Imputation of Interest (ASC 835) which addresses the presentation and subsequent measurement of debt issuance costs related to line-of-credit arrangements. ASU 2015-03 and ASU 2015-15 are effective for annual and interim reporting periods beginning after December 15, 2015. OneBeacon does not expect ASU 2015-03 or ASU 2015-15 to impact its financial position, results of operations, cash flows, presentation and disclosures.

Amendments to Consolidation Analysis

In February 2015, the FASB issued ASU 2015-02, Amendments to the Consolidation Analysis (ASC 810) which amends the guidance for determining whether an entity is a variable interest entity ("VIE"). ASU 2015-02 eliminates the separate consolidation guidance for limited partnerships and with it, the presumption that a general partner should consolidate a limited partnership. In addition, ASU 2015-02 changes the guidance for determining if fee arrangements qualify as variable interests and the effect fee arrangements have on the determination of the primary beneficiary. ASU 2015-02 is effective for annual and interim reporting periods beginning after December 15, 2015 and must be applied retrospectively. OneBeacon does not expect ASU 2015-02 to affect the consolidation analysis for any of its existing investments.

Share-Based Compensation Awards

In June 2014, the FASB issued ASU 2014-12, Share-Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved after the Requisite Service Period. The new guidance is intended to eliminate diversity in practice for employee share-based awards containing performance targets that could be achieved after the requisite service period. Some reporting entities account for performance targets that can be achieved after the requisite service period as performance conditions that affect the vesting of the award while other reporting entities treat those performance targets as non-vesting conditions that affect the grant-date fair value of the award. The updated guidance requires that a performance target that affects vesting and that can be achieved after the requisite service period be treated as a performance condition. Compensation cost should be recognized in the period it becomes probable that the performance target will be achieved and should represent the compensation cost attributable to the periods for which service has been rendered. The new guidance is effective for annual and interim

reporting periods beginning after December 15, 2015. OneBeacon does not expect adoption to have a significant impact on its financial position, results of operations, cash flows, presentation or disclosures.

7

---

Table of Contents

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 1. Nature of Operations and Summary of Significant Accounting Policies

Revenue Recognition

In May 2014, the FASB issued ASU 2014-09, Revenue from Contracts with Customers (ASC 606), which modifies the guidance for revenue recognition. The scope of the new ASU excludes insurance contracts but is applicable to certain fee arrangements, such as investment management fees. In August 2015, the FASB issued ASU 2015-14, Revenue from Contracts with Customers (ASC 606), which delayed the effective date of ASU 2014-09 by one year. As a result, the standard is effective for annual and interim periods beginning after December 15, 2017. The Company is in the process of evaluating the new guidance and has not yet determined the potential effect of adoption on its financial position, results of operations, or cash flows.

NOTE 2. Acquisitions and Dispositions

Crop Business

On July 31, 2015, the Company exited the multiple peril crop insurance ("MPCI") business and its related crop-hail business (collectively, "Crop Business") due to the sale of Climate Crop Insurance Agency ("CCIA"), a managing general agency which had an exclusive agreement with the Company, to an affiliate of AmTrust Financial Services, Inc. ("AmTrust"). As a result of the sale, OneBeacon and CCIA agreed to an early termination of the existing five year agreement. In connection with the termination of the agreement, OneBeacon received a payment of \$3.0 million (pre-tax) recorded in other revenues. Also related to the sale, OneBeacon has withdrawn its 2016 Plan of Operations, which previously authorized it to write MPCI for the 2016 Reinsurance Year, and affiliates of AmTrust agreed to reinsure the Company's remaining net Crop Business exposure for the 2015 Reinsurance Year under a related 100% quota share reinsurance agreement which, coupled with other transfer and assignment agreements as well as communications with policyholders and agents, had the effect of assumption reinsurance. As a result of this transaction, the Company has no material net exposure related to the Crop business.

During the three months ended September 30, 2015, the Company recorded ceded written premiums of \$35.9 million, ceded earned premiums of \$16.8 million, ceded loss and loss adjustment expenses of \$15.1 million, and ceded insurance acquisition expenses of \$2.8 million as a result of this transaction. Amounts due from AmTrust as of September 30, 2015 include \$30.6 million in reinsurance recoverable on paid and unpaid losses, ceded unearned premiums of \$11.4 million and \$17.2 million in other assets.

Runoff Business

As described in Note 1—"Nature of Operations and Summary of Significant Accounting Policies," on December 23, 2014, OneBeacon completed the sale of its Runoff Business to Armour. As described in Note 15—"Discontinued Operations," the Company recorded the final adjustment to the loss on sale of discontinued operations during the second quarter of 2015. Prior to the closing of the Runoff Transaction, OneBeacon Insurance Company, one of the entities that was sold upon the closing of the Runoff Transaction and which has since been renamed Bedivere Insurance Company ("Bedivere"), distributed Atlantic Specialty Insurance Company ("ASIC"), an indirect wholly owned insurance subsidiary of the Company, to its immediate parent, as well as cash and investments such that Bedivere contained the target capital on the date of sale pursuant to the stock purchase agreement. In conjunction with the Runoff Transaction, OneBeacon provided financing in the form of surplus notes having a par value of \$101.0 million, which had a fair value of \$64.9 million on the date of sale. As part of the Runoff Transaction, OneBeacon and Armour entered into a limited Transition Services Agreement ("TSA"), pursuant to which OneBeacon is providing certain transition services to Armour during the term of the TSA, which has an initial term of one year. See Note 15—"Discontinued Operations" for further information regarding activity reported as discontinued operations during the three and nine months ended September 30, 2015 and 2014.

Essentia Insurance Company

Effective January 1, 2013, OneBeacon completed the sale of Essentia Insurance Company ("Essentia"), an indirect wholly-owned subsidiary which wrote the collector cars and boats business, to Markel Corporation and recognized a pre-tax gain on sale of \$23.0 million (\$15.0 million after tax) in the first quarter of 2013. During the first quarter of 2015, the Company recognized in net other revenues (expenses) a \$3.7 million negative adjustment to the pre-tax gain

on sale of Essentia in connection with an assessment from the Michigan Catastrophic Claims Association (MCCA) payable to Markel Corporation pursuant to the indemnification provisions in the stock purchase agreement governing the sale of Essentia.

Except as described above, during the three and nine months ended September 30, 2015 and 2014, there were no significant acquisitions or dispositions.

8

---

Table of Contents

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

## NOTE 3. Unpaid Loss and Loss Adjustment Expense (LAE) Reserves

## Loss and LAE reserve summary

The following table summarizes the loss and LAE reserve activities of OneBeacon's insurance subsidiaries for the three and nine months ended September 30, 2015 and 2014:

(\$ in millions)	Three months ended September 30,		Nine months ended September 30,	
	2015	2014	2015	2014
Gross beginning balance	\$1,350.8	\$1,125.4	\$1,342.2	\$1,054.3
Less beginning reinsurance recoverables on unpaid losses	(147.1 )	(92.0 )	(161.6 )	(80.2 )
Net beginning loss and LAE reserves	1,203.7	1,033.4	1,180.6	974.1
Loss and LAE incurred relating to:				
Current year losses	167.5	177.9	529.7	506.4
Prior year losses	—	7.3	(1.8 )	14.3
Total incurred loss and LAE from continuing operations	167.5	185.2	527.9	520.7
Loss and LAE paid relating to:				
Current year losses	(50.6 )	(55.7 )	(115.4 )	(115.3 )
Prior year losses	(107.4 )	(104.7 )	(379.9 )	(321.3 )
Total loss and LAE payments from continuing operations	(158.0 )	(160.4 )	(495.3 )	(436.6 )
Net ending loss and LAE reserves	1,213.2	1,058.2	1,213.2	1,058.2
Plus ending reinsurance recoverables on unpaid losses	214.2	101.4	214.2	101.4
Gross ending loss and LAE reserves	\$1,427.4	\$1,159.6	\$1,427.4	\$1,159.6

## Loss and LAE development

## Loss and LAE development—2015

During the three months ended September 30, 2015, OneBeacon experienced no net loss and LAE reserve development on prior accident year reserves, as favorable development from several businesses, most notably Technology, Specialty Property and Collector Cars and Boats was offset by unfavorable development primarily due to an increase in large and small claims in Entertainment, and to a lesser extent, unusually heavy activity of both large and small claims in the ocean marine business within International Marine Underwriters (IMU), and also Programs. During the nine months ended September 30, 2015, OneBeacon experienced \$1.8 million of net favorable loss and LAE reserve development on prior accident year reserves, primarily attributable to favorable development from Technology, and to a lesser extent, from Specialty Property, Crop, Surety, Collector Cars and Boats and Government Risks. This favorable development was mostly offset by significant unfavorable development due to several large losses and small to mid-sized claims in Entertainment, and to a lesser extent, losses in the Company's inland marine business within IMU as well as Tuition Reimbursement and Programs.

## Loss and LAE development—2014

During the three and nine months ended September 30, 2014, OneBeacon experienced \$7.3 million and \$14.3 million, respectively, of net unfavorable loss and LAE reserve development on prior accident year reserves. Net unfavorable loss and LAE reserve development during the three months ended September 30, 2014 was primarily attributable to Other Professional Lines and, to a lesser extent, Management Liability. This unfavorable development during the three months ended September 30, 2014 was partially offset by favorable development primarily in Healthcare. Net unfavorable loss and LAE reserve development during the nine months ended September 30, 2014 was primarily attributable to the Other Professional Lines, Management Liability, and Accident, and to a lesser extent, the inland marine business in the IMU underwriting operating segment. This unfavorable development during the nine months ended September 30, 2014 was partially offset by favorable development in Healthcare, Specialty Property, and the ocean marine business in the IMU underwriting operating segment.

See Note 15—"Discontinued Operations" for a discussion of impacts to reserves for unpaid losses and LAE related to discontinued operations.

9

---

Table of Contents

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

## NOTE 4. Reinsurance

In the normal course of business, OneBeacon's insurance subsidiaries seek to limit losses that may arise from catastrophes or other events by reinsuring with third-party reinsurers. OneBeacon remains liable for risks reinsured even if the reinsurer does not honor its obligations under reinsurance contracts.

**Reinsurance Treaties**

The Company's catastrophe reinsurance coverage is discussed in Note 4—"Reinsurance" in the Company's 2014 Annual Report on Form 10-K. Except as discussed below, there have been no material changes to the Company's reinsurance coverage from that reported in the 2014 Annual Report on Form 10-K.

On July 31, 2015, OneBeacon reinsured 100% of its net retained losses for both its multi-peril crop insurance ("MPCI") and crop-hail business by entering into a quota share reinsurance agreement with an insurance operating affiliate of AmTrust for the remaining net exposure to the 2015 Crop reinsurance year. See Note 2—"Acquisitions and Dispositions" for further detail.

Effective May 1, 2015, OneBeacon renewed its property catastrophe reinsurance program through April 30, 2016. The program provides coverage for OneBeacon's property business as well as certain acts of terrorism. Under the program, the first \$20.0 million of losses resulting from any single catastrophe are retained, with 95.0% of the next \$10.0 million of losses and 100.0% of the next \$100.0 million of losses resulting from the catastrophe being reinsured. Any part of a catastrophe loss in excess of \$130.0 million would be retained in full. In the event of a catastrophe, OneBeacon's property catastrophe reinsurance program is reinstated for the remainder of the original contract term by paying a reinstatement premium that is based on the percentage of coverage reinstated and the original property catastrophe coverage premium.

Also effective May 1, 2015, OneBeacon lowered its retention on its property-per-risk reinsurance program from \$5.0 million to \$3.0 million.

Additionally, effective June 1, 2015, OneBeacon lowered its retentions on certain casualty and healthcare treaties from \$5.0 million to \$3.0 million.

Effective January 1, 2015, OneBeacon purchased an aggregate stop loss on its MPCI portfolio for the 2015 crop year, providing 52.0% of coverage in excess of a 98.0% loss ratio on premiums covered by the contract and a separate aggregate stop loss providing 80.0% of coverage in excess of a 100.0% loss ratio on its crop-hail portfolio.

OneBeacon also purchased a new quota share reinsurance contract on 30.0% of its MPCI portfolio.

In addition to the reinsurance protections outlined above, the Company also continued to purchase dedicated reinsurance protection for certain specific lines of business.

**Reinsurance Recoverables**

As of September 30, 2015, OneBeacon had reinsurance recoverables on paid losses of \$22.6 million and reinsurance recoverables on unpaid losses of \$214.2 million. As reinsurance contracts do not relieve OneBeacon of its obligations, collectibility of balances due from reinsurers is critical to OneBeacon's financial strength. The following table summarizes Standard & Poor's Financial Services, LLC ("Standard & Poor's") ratings for OneBeacon's reinsurers for its continuing insurance operations, excluding industry pools and associations, based upon reinsurance recoverable amounts on paid and unpaid losses and LAE:

(\$ in millions)	Balance at September 30, 2015	% of total	
Standard & Poor's Rating <sup>(1)</sup> :			
AA	\$60.8	26	%
A <sup>(2)</sup>	149.9	63	%
BBB, Not Rated and Other <sup>(3)</sup>	26.1	11	%
Total reinsurance recoverables	\$236.8	100	%

<sup>(1)</sup> Standard & Poor's ratings as detailed above are "AA" (Very strong), "A" (Strong) and "BBB" (Adequate).

<sup>(2)</sup>Includes reinsurance recoverable on unpaid losses from a 100% indirect wholly owned subsidiary of AmTrust related to the Crop business of \$30.6 million. AmTrust is rated "A" (Excellent) by A.M. Best Company, Inc.

<sup>(3)</sup>Includes reinsurance recoverable on unpaid losses from Bedivere of \$20.8 million.

NOTE 5. Investment Securities

OneBeacon's invested assets are comprised of securities and other investments held for general investment purposes. Refer to the Company's 2014 Annual Report on Form 10-K for a complete discussion.

Table of Contents

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

## NOTE 5. Investment Securities

OneBeacon classifies its portfolio of fixed maturity investments, common equity securities and convertible fixed maturity investments held for general investment purposes as trading securities. Trading securities are reported at fair value as of the balance sheet date as determined by quoted market prices when available. Realized and change in unrealized investment gains on trading securities are reported in total revenues as net realized and unrealized investment gains in revenues on a pre-tax basis.

Short-term investments consist of money market funds, certificates of deposit and other securities which, at the time of purchase, mature or become available for use within one year. Short-term investments are carried at amortized cost, which approximates fair value.

Other investments primarily include surplus notes, private equity funds and hedge funds. OneBeacon measures its investments in private equity funds and hedge funds at fair value with changes therein reported in total revenues as net realized and change in unrealized investment gains. Surplus notes provided in conjunction with the financing of the Runoff Transaction are measured at their estimated fair value based on discounted expected cash flows, with changes in fair value reported in total revenues as net realized and change in unrealized investment gains. Other investments also include an investment in a community reinvestment vehicle which is accounted for at fair value, with changes in fair value reported in total revenues as net realized and change in unrealized investment gains and a tax advantaged federal affordable housing development fund which is accounted for under the proportional amortization method. Prospector Partners, LLC ("Prospector"), was the primary manager of OneBeacon's publicly-traded common equity securities and convertible fixed maturity securities portfolio. The Prospector-managed separate accounts were liquidated during the second quarter of 2015, and the Prospector-managed hedge fund was redeemed, and used to purchase passive equity vehicles. As the separate accounts were liquidated, OneBeacon reinvested the majority of the proceeds into exchange traded funds ("ETFs") that seek to provide investment results that, before expenses, generally correspond to the performance of the S&P 500, Russell 1000, and Russell 1000 Value indices.

OneBeacon's net investment income is comprised primarily of interest income associated with fixed maturity investments and dividend income from its equity investments.

Net investment income for the three and nine months ended September 30, 2015 and 2014 consisted of the following:

(\$ in millions)	Three months ended		Nine months ended	
	September 30,		September 30,	
	2015	2014	2015	2014
Fixed maturity investments	\$11.2	\$10.5	\$31.7	\$31.4
Common equity securities	1.3	1.5	4.4	5.2
Convertible fixed maturity investments	—	0.5	—	0.6
Other investments	0.7	0.1	0.7	1.3
Gross investment income	13.2	12.6	36.8	38.5
Less external investment expenses	(0.8	) (1.8	) (3.8	) (5.1
Net investment income, pre-tax	\$12.4	\$10.8	\$33.0	\$33.4

The composition of net realized investment gains consisted of the following:

(\$ in millions)	Three months ended		Nine months ended	
	September 30,		September 30,	
	2015	2014	2015	2014
Fixed maturity investments	\$0.4	\$2.2	\$2.3	\$4.6
Common equity securities	(3.7	) 13.5	30.7	25.4
Convertible fixed maturity investments	—	1.0	0.3	3.3
Other investments	(1.0	) 2.6	7.1	2.6
Net realized investment gains, pre-tax	\$(4.3	) \$19.3	\$40.4	\$35.9



Table of Contents

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

## NOTE 5. Investment Securities

The net changes in fair value for the three and nine months ended September 30, 2015 and 2014 are as follows:

(\$ in millions)	Three months ended September 30, 2015			Nine months ended September 30, 2015		
	Changes in net unrealized investment gains	Changes in net foreign currency gains (losses)	Total net changes in fair value reflected in revenues	Changes in net unrealized investment gains	Changes in net foreign currency gains (losses)	Total net changes in fair value reflected in revenues
Fixed maturity investments	\$0.7	\$—	\$0.7	\$(1.8)	\$—	\$(1.8)
Short-term investments	—	—	—	—	—	—
Common equity securities	(19.3)	—	(19.3)	(50.2)	0.2	(50.0)
Convertible fixed maturity investments	—	—	—	0.1	—	0.1
Other investments	(7.0)	—	(7.0)	(18.4)	—	(18.4)
Net change, pre-tax	\$(25.6)	\$—	\$(25.6)	\$(70.3)	\$0.2	\$(70.1)
(\$ in millions)	Three months ended September 30, 2014			Nine months ended September 30, 2014		
	Changes in net unrealized investment gains	Changes in net foreign currency gains (losses)	Total net changes in fair value reflected in revenues	Changes in net unrealized investment gains	Changes in net foreign currency gains (losses)	Total net changes in fair value reflected in revenues
Fixed maturity investments	\$(8.0)	\$—	\$(8.0)	\$4.0	\$—	\$4.0
Short-term investments	—	(0.1)	(0.1)	—	(0.1)	(0.1)
Common equity securities	(21.5)	(0.4)	(21.9)	(11.8)	(0.4)	(12.2)
Convertible fixed maturity investments	(1.8)	—	(1.8)	(4.1)	—	(4.1)
Other investments	(3.5)	—	(3.5)	1.3	—	1.3
Net change, pre-tax	\$(34.8)	\$(0.5)	\$(35.3)	\$(10.6)	\$(0.5)	\$(11.1)

The components of OneBeacon's ending net unrealized investment gains and losses, excluding the impact of net unrealized foreign currency translation gains and losses, on its investment portfolio as of September 30, 2015 and December 31, 2014 were as follows:

(\$ in millions)	September 30, 2015	December 31, 2014
Investment securities:		
Gross unrealized investment gains	\$56.9	\$104.7
Gross unrealized investment losses	(31.4)	(8.9)
Total net unrealized investment gains, pre-tax	25.5	95.8
Income taxes	(12.2)	(26.9)
Total net unrealized investment gains, after tax	\$13.3	\$68.9

Table of Contents

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NOTE 5. Investment Securities

The cost or amortized cost, gross unrealized pre-tax investment gains and losses, net foreign currency losses and carrying values of OneBeacon's fixed maturity investments as of September 30, 2015 and December 31, 2014 were as follows:

(\$ in millions)	September 30, 2015				Carrying value
	Cost or amortized cost	Gross unrealized gains	Gross unrealized losses	Net unrealized foreign currency gains (losses)	
U.S. Government and agency obligations	\$43.3				