OneBeacon Insurance Group, Ltd.
Form 10-Q
August 04, 2017

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

FORM 10-Q

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

For the quarterly period ended June 30, 2017

OR

o 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 (State or other jurisdiction of incorporation or organization)	98-0503315 (I.R.S. Employer Identification No.)
605 North Highway 169 Plymouth, Minnesota (Address of principal executive offices)	55441 (Zip Code)

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

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

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

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

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

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. o

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

As of July 31, 2017, 22,986,618 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.

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PART I. FINANCIAL INFORMATION
ITEM 1. FINANCIAL STATEMENTS

ONEBEACON INSURANCE GROUP, LTD.
CONSOLIDATED BALANCE SHEETS

($ in millions, except per share amounts)	June 30, 2017 (Unaudited)	December 31, 2016
Assets		
Investment Securities:		
Fixed maturity investments, at fair value (amortized cost: $2,269.8 in 2017 and $2,164.4 in 2016)	$ 2,288.6	$ 2,169.1
Short-term investments, at amortized cost (which approximates fair value)	55.5	112.1
Common equity securities, at fair value (cost: $183.8 in 2017 and $182.3 in 2016)	205.5	188.7
Other investments, at fair value (cost: $107.5 in 2017 and $120.9 in 2016)	134.1	150.5
Total investment securities	2,683.7	2,620.4
Cash	71.3	69.6
Reinsurance recoverables	198.0	179.5
Premiums receivable	245.4	228.3
Deferred acquisition costs	106.9	96.3
Ceded unearned premiums	56.6	44.2
Net deferred tax asset	130.1	126.7
Investment income accrued	12.9	11.3
Accounts receivable on unsettled investment sales	5.8	1.4
Other assets	185.7	212.2
Total assets	$ 3,696.4	$ 3,589.9
Liabilities		
Unpaid loss and loss adjustment expense reserves	$ 1,411.2	$ 1,365.6
Unearned premiums	595.2	575.1
Funds held under insurance contracts	210.2	153.0
Debt	273.3	273.2
Accounts payable on unsettled investment purchases	9.3	—
Other liabilities	182.4	197.8
Total liabilities	2,681.6	2,564.7
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; 22,986,618 and 22,592,731 issued and outstanding)(Class B: par value $0.01; 200,000,000 authorized shares; 71,754,738 issued and outstanding for both periods)	1,014.5	1,013.2
Retained earnings	4.5	12.3
Accumulated other comprehensive loss (AOCL)	(3.9)	(4.2)
Total OneBeacon's common shareholders' equity	1,015.1	1,021.3
Total noncontrolling interests	(0.3)	3.9
Total OneBeacon's common shareholders' equity and noncontrolling interests	1,014.8	1,025.2
Total liabilities, OneBeacon's common shareholders' equity and noncontrolling interests	$ 3,696.4	$ 3,589.9

See Notes to Consolidated Financial Statements.

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

	Three months ended June 30,		Six months ended June 30,	
($ in millions, except per share amounts)	2017	2016	2017	2016
Revenues				
Earned premiums	$277.4	$271.4	$539.2	$550.0
Net investment income	14.5	12.1	26.7	26.5
Net realized and change in unrealized investment gains	12.3	24.7	27.3	41.3
Net other revenues	2.1	0.8	5.5	1.7
Total revenues	306.3	309.0	598.7	619.5
Expenses				
Loss and loss adjustment expenses	188.6	179.7	339.2	338.5
Policy acquisition expenses	48.4	48.7	93.7	99.7
Other underwriting expenses	59.6	50.9	111.3	106.2
General and administrative expenses	8.8	3.5	13.8	7.4
Interest expense	3.3	3.2	6.6	6.5
Total expenses	308.7	286.0	564.6	558.3
Pre-tax income (loss)	(2.4)	23.0	34.1	61.2
Income tax (expense) benefit	2.7	2.0	(1.2)	10.7
Net income, including noncontrolling interests	0.3	25.0	32.9	71.9
Less: Net income attributable to noncontrolling interests	(0.4)	(0.5)	(0.9)	(1.0)
Net income (loss) attributable to OneBeacon's common shareholders	(0.1)	24.5	32.0	70.9
Other comprehensive income, net of tax	0.2	0.2	0.3	0.2
Comprehensive income attributable to OneBeacon's common shareholders	$0.1	$24.7	$32.3	$71.1
Earnings per share attributable to OneBeacon's common shareholders—basic and diluted				
Net income attributable to OneBeacon's common shareholders per share	$—	$0.26	$0.34	$0.75
Dividends declared and paid per OneBeacon's common share	$0.21	$0.21	$0.42	$0.42

See Notes to Consolidated Financial Statements.

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

	OneBeacon's Common Shareholders' Equity						
($ in millions)	Common shares outstanding	Common shares and paid-in surplus	Retained earnings	AOCL	Total OneBeacon common shareholders' equity	Noncontrolling interests, after tax	Total OneBeacon's common shareholders' equity and noncontrolling interests
Balances at January 1, 2017	94,347,469	$1,013.2	$ 12.3	$(4.2)	$ 1,021.3	$ 3.9	$ 1,025.2
Comprehensive income:							
Net income	—	—	32.0	—	32.0	0.9	32.9
Other comprehensive income, net of tax	—	—	—	0.3	0.3	—	0.3
Total comprehensive income	—	—	32.0	0.3	32.3	0.9	33.2
Amortization of restricted share awards	—	2.4	—	—	2.4	—	2.4
Issuance of common shares	461,160	—	—	—	—	—	—
Repurchase and retirement of common shares	(67,273)	(1.1)	—	—	(1.1)	(4.1)	(5.2)
Dividends	—	—	(39.8)	—	(39.8)	(1.0)	(40.8)
Balances at June 30, 2017	94,741,356	$1,014.5	$ 4.5	$(3.9)	$ 1,015.1	$ (0.3)	$ 1,014.8

	OneBeacon's Common Shareholders' Equity						
($ in millions)	Common shares outstanding	Common shares and paid-in surplus	Retained earnings	AOCL	Total OneBeacon common shareholders' equity	Noncontrolling interests, after tax	Total OneBeacon's common shareholders' equity and noncontrolling interests
Balances at January 1, 2016	95,089,240	$1,022.0	$(15.9)	$(5.2)	$ 1,000.9	$ 3.6	$ 1,004.5
Comprehensive income:							
Net income	—	—	70.9	—	70.9	1.0	71.9
Other comprehensive income, net of tax	—	—	—	0.2	0.2	—	0.2
Total comprehensive income	—	—	70.9	0.2	71.1	1.0	72.1
Amortization of restricted share awards	—	1.3	—	—	1.3	—	1.3
Issuance of common shares	173,559	—	—	—	—	0.1	0.1
Repurchase and retirement of common shares	(915,330)	(11.5)	—	—	(11.5)	—	(11.5)
Dividends		—	(39.6)	—	(39.6)	(1.0)	(40.6)
Balances at June 30, 2016	94,347,469	$1,011.8	$ 15.4	$(5.0)	$ 1,022.2	$ 3.7	$ 1,025.9

See Notes to Consolidated Financial Statements.

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

	Six months ended June 30,	
($ in millions)	2017	2016
Cash flows from operations:		
Net income including noncontrolling interests	$32.9	$71.9
Charges (credits) to reconcile net income to cash flows provided from operations:		
Net realized and change in unrealized investment gains	(27.3)	(41.3)
Deferred income tax (benefit) expense	(2.6)	19.2
Other operating items:		
Net change in loss and LAE reserves	45.6	(13.2)
Net change in unearned premiums	20.1	(3.9)
Net change in ceded unearned premium	(12.4)	(5.0)
Net change in premiums receivable	(17.1)	(19.9)
Net change in reinsurance recoverables on paid and unpaid losses	(18.5)	10.0
Net change in funds held under insurance contracts	57.2	3.2
Net change in other assets and liabilities	8.3	(38.3)
Net cash provided from (used for) operations	86.2	(17.3)
Cash flows from investing activities:		
Net maturities, purchases and sales of short-term investments	56.6	(45.4)
Maturities of fixed maturity investments	158.6	229.5
Sales of fixed maturity investments	686.1	200.5
Sales of common equity securities	5.8	174.4
Return of capital and distributions of other investments	13.5	7.0
Purchases of fixed maturity investments	(957.9)	(449.4)
Purchases of common equity securities	(6.2)	(109.5)
Contributions for other investments	(0.9)	(0.4)
Net change in unsettled investment purchases and sales	4.8	42.5
Acquisitions of property and equipment	(4.0)	(2.1)
Net cash (used for) provided from investing activities	(43.6)	47.1
Cash flows from financing activities:		
Cash dividends paid to common shareholders	(39.8)	(39.6)
Repurchases and retirements of common stock	(1.1)	(11.5)
Payments on capital lease obligation	—	(1.0)
Net cash used for financing activities	(40.9)	(52.1)
Net increase (decrease) in cash during period	1.7	(22.3)
Cash balance at beginning of period	69.6	95.2
Cash balance at end of period	$71.3	$72.9

See Notes to Consolidated Financial Statements.

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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"). 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 75.7% 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 26 Reid Street, 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.
On May 2, 2017, Intact Financial Corporation (“Intact”), which is based in Toronto, Ontario, Canada and is the largest provider of property and casualty insurance in Canada, and the Company announced that they had entered into a definitive merger agreement ("Merger Agreement") which provides for the merger of an indirect subsidiary of Intact with and into the Company, following the satisfaction of various closing conditions, including approval by the Company’s shareholders and approval by applicable insurance regulatory authorities (the “OneBeacon Acquisition”). See Note 2—"OneBeacon Acquisition".
OneBeacon's reportable segments are Specialty Products, Specialty Industries and Investing, Financing and Corporate. The Specialty Products segment is comprised of ten 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. The Specialty Industries segment is comprised of six 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 holding company subsidiaries. See Note 7—"Segment Information" for changes to underwriting operating and reportable segments during the three months ended March 31, 2017. Prior periods have been restated to conform to the current presentation of segment information.
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 2016 Annual Report on Form 10-K filed with the U.S. Securities and Exchange Commission (the "SEC") on February 27, 2017. 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 2016 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.
Derivatives
During 2017, OneBeacon began purchasing foreign currency forward contracts in order to provide an economic hedge against fluctuations in certain foreign-denominated fixed maturity securities that were purchased during the same time period. These foreign currency forward contracts are considered derivative financial instruments and they have not been designated or accounted for under hedge accounting. OneBeacon recognizes these derivatives as either assets or liabilities, measured at fair value, in the consolidated balance sheets. Changes in the fair value of derivative instruments, or realized gains and losses from the sale or maturity of the forward contracts, are recognized as

components of investment results in current period pre-tax income.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
NOTE 1. Nature of Operations and Summary of Significant Accounting Policies

Recently Adopted Changes in Accounting Principles
Stock Compensation
Effective January 1, 2017, OneBeacon adopted ASU 2016-09, Improvements to Employee Share-Based Payment Accounting (ASC 718) which simplifies certain aspects of the accounting for share-based compensation. The new guidance provides an accounting policy election to account for forfeitures by either applying an assumption, as required under existing guidance, or by recognizing forfeitures when they actually occur. At adoption, OneBeacon did not change its accounting policy for forfeitures, which is to apply an assumed forfeiture rate. The new guidance has also changed the threshold for partial cash settlement to settle statutory withholding requirements for equity classified awards, increasing the threshold up to the maximum statutory tax rate.
In addition, the new guidance changed the treatment for excess tax benefits which arise from the difference between the deduction for tax purposes and the compensation costs recognized for financial reporting. Previously, excess tax benefits were recognized through other comprehensive income. Under the new guidance, OneBeacon will recognize excess tax benefits or expense in current period earnings.
Short-Duration Contracts
Effective December 31, 2016, OneBeacon adopted ASU 2015-09, Disclosures about Short Duration Contracts (ASC 944) which requires expanded footnote disclosures about loss and loss adjustment expense ("LAE") reserves. Upon adoption, OneBeacon modified its disclosures in the Company's 2016 Annual Report on Form 10-K to include loss development tables on a disaggregated basis by accident year and a reconciliation of loss development data to the loss and LAE reserves reflected on the balance sheet. The footnote disclosures were also expanded to include information about claim frequency data, including a description of how the claims frequency data is measured. Prior year disclosures were modified to conform to the new disclosures. There was no impact upon adoption to the financial statements contained herein as OneBeacon was already disclosing the new required loss rollforward. See Note 3—"Unpaid Loss and Loss Adjustment Expense (LAE) Reserves".
Recently Issued Accounting Pronouncements
Cash Flow Statement
In August 2016, the FASB issued ASU 2016-15, Statement of Cash Flows: Classification of Certain Cash Receipts and Cash Payments (ASC 230), which addresses the classification and presentation of certain items, including debt prepayment and extinguishment costs, contingent consideration payments made after a business combination and distributions received from equity method investees, for which there was diversity in practice.
In November 2016, the FASB issued ASU 2016-18, Statement of Cash Flows: Restricted Cash (ASC230). Under current guidance, restricted amounts of cash or cash equivalents are excluded from the cash flow statement. The new guidance requires restricted cash and restricted cash equivalents to be included in the reconciliation of beginning and end-of-period amounts presented on the statement of cash flows. In addition, the new guidance requires a description of the nature of the changes in restricted cash and cash equivalents during the periods presented.
The updated guidance in ASU 2016-15 and ASU 2016-18 are both effective for interim and annual reporting periods beginning after December 15, 2017, with early adoption permitted. OneBeacon does not expect the adoption of this guidance to have a material impact on its consolidated statement of cash flows.
Credit Losses
In June 2016, the FASB issued ASU 2016-13, Measurement of Credit Losses on Financial Instruments (ASC 326), which establishes new guidance for the recognition of credit losses for financial assets measured at amortized cost. The new ASU, which applies to financial assets that have the contractual right to receive cash requires reporting entities to estimate the credit losses expected over the life of a credit exposure using historical information, current information, and reasonable and supportable forecasts that affect the collectability of the financial asset. The types of assets included in the scope of the new guidance includes premium receivables, reinsurance recoverables, and loans. ASU 2016-13 is effective for annual periods beginning after January 1, 2020, including interim periods. OneBeacon measures financial assets at fair value with changes therein recognized in current period earnings and accordingly,

does not expect adoption to have a significant impact on its financial statements.
Leases
In February 2016, the FASB issued ASU 2016-02, Leases (ASC 842). The new guidance requires lessees to recognize lease assets and liabilities on the balance sheet for both operating and financing leases, with the exception of leases with an

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
NOTE 1. Nature of Operations and Summary of Significant Accounting Policies

original term of 12 months or less. Under existing guidance recognition of lease assets and liabilities is not required for operating leases. The lease assets and liabilities to be recognized are both measured initially based on the present value of the lease payments. Under the new guidance, a sale-leaseback transaction must meet the recognition criteria under ASC 606, Revenues in order to be accounted for as a sale. The new guidance is effective for OneBeacon for years beginning after December 15, 2018, including interim periods therein. OneBeacon is evaluating the expected impact of this new guidance and available adoption methods.

Financial Instruments - Recognition and Measurement

In January 2016, the FASB issued ASU 2016-01, Recognition and Measurement of Financial Assets and Financial Liabilities (ASC 825-10). The new ASU modifies the guidance for financial instruments, including investments in equity securities. Under the new guidance, all equity securities with readily determinable fair values are required to be measured at fair value with changes therein recognized through current period earnings. In addition, the new ASU requires a qualitative assessment for equity securities without readily determinable fair values to identify impairment, and for impaired equity securities to be measured at fair value. ASU 2016-01 is effective for fiscal years beginning after December 15, 2017, with early adoption permitted. OneBeacon measures its portfolio of investment securities at fair value with changes therein recognized through current period earnings accordingly, does not expect the adoption of ASU 2016-01 to have a significant impact on its financial statements.

Stock Compensation

In May 2017, the FASB issued ASU 2017-09, Stock Compensation: Scope of Modification Accounting (ASC 718), which narrows the scope of transactions subject to modification accounting to changes in terms of an award that result in a change in the award's fair value, vesting conditions, or classification. ASU 2017-09 is effective for fiscal years beginning after December 15, 2017. OneBeacon does not expect the adoption of this guidance to have a material impact on its financial statements.

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. Under ASU 2014-09, revenue is to be recognized at an amount that reflects the consideration to which an entity expects to be entitled in exchange for goods and services transferred to customers. The new guidance sets forth the steps to be followed to recognize revenue: (i) identify the contract(s) with a customer, (ii) identify the performance obligations in the contract, (iii) determine the transaction price, (iv) allocate the transaction price to the performance obligations in the contract, and (v) recognize revenue when (or as) the entity satisfies a performance obligation. Subsequently, the FASB issued additional ASUs clarifying the guidance in and providing implementation guidance for ASU 2014-09. In August 2015, the FASB issued ASU 2015-14, Revenue from Contracts with Customers (ASC 606), which delays the effective date of ASU 2014-09 and all related ASUs to annual and interim periods beginning after December 15, 2017. Most of OneBeacon's revenue from customer relates to insurance contracts, which are excluded from the scope of ASU 2014-09, as are investment income and investment gains and losses. However, the new guidance is applicable to some of OneBeacon's revenue streams, including certain fee arrangements as well as commissions and other non-insurance revenues. OneBeacon is evaluating the new guidance, but does not expect ASU 2014-09 to have a significant effect on recognition of OneBeacon's non-insurance revenues from customers.

NOTE 2. OneBeacon Acquisition

As described in Note 1—"Nature of Operations and Summary of Significant Accounting Policies", on May 2, 2017, Intact and the Company announced the OneBeacon Acquisition. The subsidiaries of White Mountains Insurance Group, Ltd. that own the Company's common stock have executed a voting agreement in support of the OneBeacon Acquisition. Under the terms of the Merger Agreement, which has been approved by the board of directors of both companies, the Company’s shareholders will be entitled to receive $18.10 for each outstanding share of the Company’s common stock. Aggregate cash consideration to Company shareholders is anticipated to be approximately $1.7 billion. The OneBeacon Acquisition is expected to be completed in the third quarter or early in the fourth quarter of

2017.

The closing of the OneBeacon Acquisition is subject to the satisfaction of various closing conditions, including the approval by the Company’s shareholders, which occurred on July 18, 2017, as well as the approval of various insurance regulatory authorities and other closing conditions customary for a transaction of this type. Pursuant to the Merger Agreement, the Company is required to carry on its business in the ordinary course consistent with past practice, in all material respects; however, certain actions are restricted or may not be taken without Intact's prior written consent.

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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 six months ended June 30, 2017 and 2016:

	Three months ended June 30,		Six months ended June 30,	
($ in millions)	2017	2016	2017	2016
Gross beginning balance	$1,368.8	$1,343.8	$1,365.6	$1,389.8
Less beginning reinsurance recoverables on unpaid losses	(174.7)	(150.4)	(172.9)	(186.0)
Net beginning loss and LAE reserves	1,194.1	1,193.4	1,192.7	1,203.8
Loss and LAE incurred relating to:				
Current year losses	181.3	164.3	331.9	323.1
Prior year losses	7.3	15.4	7.3	15.4
Total incurred loss and LAE	188.6	179.7	339.2	338.5
Loss and LAE paid relating to:				
Current year losses	(36.4)	(37.1)	(57.7)	(59.1)
Prior year losses	(132.1)	(122.2)	(260.0)	(269.4)
Total loss and LAE payments	(168.5)	(159.3)	(317.7)	(328.5)
Net ending loss and LAE reserves	1,214.2	1,213.8	1,214.2	1,213.8
Plus ending reinsurance recoverables on unpaid losses	197.0	162.8	197.0	162.8
Gross ending loss and LAE reserves	$1,411.2	$1,376.6	$1,411.2	$1,376.6

Loss and LAE development

Loss and LAE development—2017

During the three months ended June 30, 2017, OneBeacon experienced $7.3 million net unfavorable loss and LAE reserve development on prior accident year reserves driven by Programs. The unfavorable development in Programs was driven by increased loss activity, including numerous mid-size losses, across most accounts, including auto-related programs.

During the six months ended June 30, 2017, OneBeacon experienced $7.3 million net loss and LAE reserve development on prior accident year reserves as unfavorable reserve development, primarily in Healthcare due to an adverse settlement on a single managed care errors and omissions claim, and in Programs driven by increased loss activity, including numerous mid-size losses, across most accounts, including auto-related programs, with the unfavorable development partially offset by favorable reserve development driven in part by Technology and Accident & Health resulting from favorable loss experience.

Loss and LAE development—2016

During both the three and six months ended June 30, 2016, OneBeacon experienced $15.4 million net unfavorable loss and LAE reserve development on prior accident year reserves. During the three months ended June 30, 2016, the Healthcare operating segment recorded $24.0 million of net unfavorable loss reserve development as a result of increasing claim frequency, as well as higher than expected paid and case activity, most notably within the senior living sub-line, which provides medical malpractice and general liability insurance for extended care facilities, including assisted living, memory care and continuing care facilities. As a result of the continuing loss activity experienced in this sub-line, we performed an in-depth claim file review, which confirmed that the increased case incurred loss activity was driven by frequency, especially in the more recent prior accident years, as opposed to other potential considerations such as changes in claims-handling practices. In addition, a thorough actuarial review was completed, including analysis of the results of enhancements made to the predictive model deployed in the senior living sub-line. Adverse financial results were primarily observed in high-risk categories of business and in difficult geographic venues identified by the predictive model data. As a result of these analyses, management increased its best estimate of prior accident year losses during the prior year period, and increased its loss provisions for the current accident year based on the updated actuarial indications. In addition, also within the Healthcare operating segment, there were two large claims within the managed care errors and omissions sub-line related to unexpected outcomes from mediation and extended costs associated with claim defense, which contributed to the unfavorable development in prior accident years. In the six months ended June 30, 2016, Healthcare recorded $34.8 million of adverse prior year development, which included prior year

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
NOTE 3. Unpaid Loss and Loss Adjustment Expense (LAE) Reserves

loss activity recorded in the first quarter of 2016 in the complex risk sub-line, which provides professional liability coverage to hospitals, physicians, and physician groups as well as physicians' extended reporting period coverage.
In addition to Healthcare, but to a lesser extent, Programs also experienced unfavorable development during the three months ended June 30, 2016 primarily as a result of two larger auto-related programs; the total unfavorable development in Healthcare and Programs, along with a few other businesses, was partially offset by favorable development in Financial Services and several other businesses.
During the six months ended June 30, 2016, net unfavorable development was driven by Healthcare. In addition, to a lesser extent, unfavorable development in Programs and a few other businesses, was partially offset by favorable development in Technology, Financial Services and Accident, as well as other businesses.

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 reinsurance coverage is discussed in Note 4—"Reinsurance" in the Company's 2016 Annual Report on Form 10-K. All of the Company's expiring reinsurance treaties were renewed during the three months ended June 30, 2017 with terms that were substantially similar to those reported in the 2016 Annual Report on Form 10-K.

Reinsurance Recoverables

As of June 30, 2017, OneBeacon had reinsurance recoverables on paid losses of $1.0 million and reinsurance recoverables on unpaid losses of $197.0 million. As reinsurance contracts do not relieve OneBeacon of its obligations, collectibility of balances due from reinsurers is important to OneBeacon's financial strength. The following table summarizes A.M. Best Company, Inc. ("A.M. Best") ratings for OneBeacon's reinsurers, excluding industry pools and associations, based upon reinsurance recoverable amounts on paid and unpaid losses and LAE:

A.M.Best's Rating[1]:	Balance at June 30, 2017 ($ in millions)	% of total
A+ or better	$ 85.9	43 %
A- to A	83.4	42 %
B, Not Rated and Other[2]	28.7	15 %
Total reinsurance recoverables	$ 198.0	100%

(1) A.M. Best's ratings as detailed above are "A+ or better" (Superior), "A- to A" (Excellent) and "B" (Fair).
(2) Includes reinsurance recoverable on unpaid losses from Bedivere Insurance Company ("Bedivere"), one of the legal entities transferred as part of the runoff transaction in 2014, of $17.2 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 2016 Annual Report on Form 10-K for a complete discussion.
OneBeacon classifies its portfolio of fixed maturity investments, common equity securities, including exchange traded funds ("ETFs"), and other 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 changes in unrealized investment gains on trading securities are reported, on a pre-tax basis, in revenues as net realized and change in unrealized investment gains.

Short-term investments consist of interest-bearing money market funds 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.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
NOTE 5. Investment Securities

Other investments consist primarily of surplus notes, hedge funds and private equity funds. Surplus notes provided in conjunction with the financing of the sale of the run-off business in 2014 are measured at estimated fair value based on a discounted expected cash flow model, with changes in fair value reported in total revenues as net realized and change in unrealized investment gains. OneBeacon measures its investments in hedge funds and private equity funds at fair value with changes therein 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, a tax advantaged federal affordable housing development fund, which is accounted for under the proportional amortization method, and beginning in the first quarter of 2017, a foreign currency forward contract 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.

OneBeacon's net investment income is comprised primarily of interest income associated with OneBeacon's fixed maturity investments and short-term investments and dividend income from its common equity securities and other investments.

Net investment income for the three and six months ended June 30, 2017 and 2016 consisted of the following:

	Three months ended June 30,		Six months ended June 30,	
($ in millions)	2017	2016	2017	2016
Fixed maturity investments	$14.1	$12.2	$26.7	$24.3
Short-term investments	0.1	0.1	0.2	0.1
Common equity securities	0.9	0.5	1.7	1.5
Other investments[1]	0.4	0.5	0.4	3.0
Gross investment income	15.5	13.3	29.0	28.9
Less investment expenses	(1.0)	(1.2)	(2.3)	(2.4)
Net investment income, pre-tax	$14.5	$12.1	$26.7	$26.5

[1] Includes an interest payment on the surplus notes of $2.4 million received in the six months ended June 30, 2016.

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

	Three months ended June 30,		Six months ended June 30,	
($ in millions)	2017	2016	2017	2016
Fixed maturity investments	$0.8	$0.4	$(0.3)	$(1.0)
Common equity securities	0.7	3.7	1.0	(1.0)
Other investments	(1.0)	(3.0)	0.2	(2.8)
Net realized investment gains (losses), pre-tax	$0.5	$1.1	$0.9	$(4.8)

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
NOTE 5. Investment Securities

The net changes in net unrealized gains for the three and six months ended June 30, 2017 and 2016 are as follows:

($ in millions)	Three months ended June 30, 2017			Six months ended June 30, 2017		
	Changes in net unrealized investment gains	Changes in net foreign currency gains (losses)	Total net changes in unrealized gains 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	$4.8	$ 1.9	$ 6.7	$12.1	$ 2.0	$ 14.1
Common equity securities	5.2	—	5.2	15.3	—	15.3
Other investments	(0.1)	—	(0.1)	(3.0)	—	(3.0)
Net change, pre-tax	$9.9	$ 1.9	$ 11.8	$24.4	$ 2.0	$ 26.4

($ in millions)	Three months ended June 30, 2016			Six months ended June 30, 2016		
	Changes in net unrealized investment gains	Changes in net foreign currency gains (losses)	Total net changes in unrealized gains 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	$12.0	$ —	$ 12.0	$27.0	$ —	$ 27.0
Common equity securities	(5.4)	—	(5.4)	4.3	—	4.3
Other investments	17.0	—	17.0	14.8	—	14.8
Net change, pre-tax	$23.6	$ —	$ 23.6	$46.1	$ —	$ 46.1

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 June 30, 2017 and December 31, 2016 were as follows:

($ in millions)	June 30, 2017	December 31, 2016
Investment securities:		
Gross unrealized investment gains	$ 72.2	$ 52.7
Gross unrealized investment losses	(7.1)	(12.0)
Total net unrealized investment gains, pre-tax	65.1	40.7
Income taxes	(20.4)	(14.0)
Total net unrealized investment gains, after-tax	$ 44.7	$ 26.7

The cost or amortized cost, gross unrealized pre-tax investment gains and losses, net foreign currency gains and losses and carrying values of OneBeacon's fixed maturity investments as of June 30, 2017 and December 31, 2016 were as follows:

($ in millions)	June 30, 2017				Carrying
	Cost or	Gross	Gross		

	amortized cost	unrealized gains	unrealized losses	Net unrealized foreign currency gains (losses)	value
U.S. Government and agency obligations	$56.0	$ —	$ (0.3)	$ —	$55.7
Debt securities issued by corporations	892.7	9.6	(0.7)	2.0	903.6
Municipal obligations	69.7	1.3	(0.4)	—	70.6
Mortgage and asset-backed securities	1,238.8	3.7	(2.4)	—	1,240.1
Foreign government obligations	4.3	0.1	—	—	4.4
Preferred stocks	8.3	5.9	—	—	14.2
Total fixed maturity investments	$2,269.8	$ 20.6	$ (3.8)	$ 2.0	$2,288.6

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
NOTE 5. Investment Securities

($ in millions)	December 31, 2016 Cost or amortized cost	Gross unrealized gains	Gross unrealized losses	Net unrealized foreign currency gains (losses)	Carrying value
U.S. Government and agency obligations	$169.6	$ —	$ (2.3)	$ —	$167.3
Debt securities issued by corporations	760.6	6.2	(3.7)	—	763.1
Municipal obligations	70.1	0.8	(0.4)	—	70.5
Mortgage and asset-backed securities	1,154.8	1.8	(3.5)	—	1,153.1
Foreign government obligations	1.0	0.2	—	—	1.2
Preferred stocks	8.3	5.6	—	—	13.9
Total fixed maturity investments	$2,164.4	$ 14.6	$ (9.9)	$ —	$2,169.1

The following table summarizes the credit ratings[(1)] of the debt securities issued by corporations owned by OneBeacon as of June 30, 2017 and December 31, 2016:

($ in millions)	at Fair value June 30, 2017	December 31, 2016
AA	$62.6	$ 63.7
A	255.7	169.1
BBB	491.4	450.8
BB	87.0	70.8
B	6.9	8.7
Debt securities issued by corporations	$903.6	$ 763.1

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(1) Credit ratings are assigned based on the following hierarchy: 1) Standard and Poor’s Financial Services LLC (“Standard and Poor’s”) and 2) Moody’s Investor Service (“Moody’s”).

The cost or amortized cost, gross unrealized pre-tax investment gains and losses, net unrealized pre-tax foreign currency gains and losses and carrying values of common equity securities and other investments as of June 30, 2017 and December 31, 2016 were as follows:

($ in millions)	June 30, 2017 Cost or amortized cost	Gross unrealized gains	Gross unrealized losses	Net unrealized foreign currency gains (losses)	Carrying value
Common equity securities	$183.8	$ 22.5	$ (0.8)	$ —	$ 205.5
Other investments	107.5	29.1	(2.5)	—	134.1
Total common equity securities and other investments	$291.3	$ 51.6	$ (3.3)	$ —	$ 339.6

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
NOTE 5. Investment Securities

	December 31, 2016				
($ in millions)	Cost or amortized cost	Gross unrealized gains	Gross unrealized losses	Net unrealized foreign currency gains (losses)	Carrying value
Common equity securities	$182.3	$ 6.9	$ (0.5)	$ —	$ 188.7
Other investments	120.9	31.2	(1.6)	—	150.5
Total common equity securities and other investments	$303.2	$ 38.1	$ (2.1)	$ —	$ 339.2

As of June 30, 2017 and December 31, 2016, the Company held unrestricted collateral from its customers, primarily relating to its surety business, of $210.2 million and $153.0 million, respectively, which is included in cash and invested assets. The obligation to return these funds is classified as funds held under insurance contracts in the consolidated balance sheets.

Fair value measurements

Fair value measurements are categorized into a hierarchy that distinguishes between inputs based on market data from independent sources ("observable inputs") and a reporting entity's internal assumptions based upon the best information available when external market data is limited or unavailable ("unobservable inputs"). Quoted prices in active markets for identical assets or liabilities have the highest priority ("Level 1"), followed by observable inputs other than quoted prices, including prices for similar but not identical assets or liabilities ("Level 2") with unobservable inputs, including the reporting entity's estimates of the assumptions that market participants would use, having the lowest priority ("Level 3"). As of both June 30, 2017 and December 31, 2016, approximately 95% of the investment portfolio recorded at fair value was priced based upon observable inputs.

Investments valued using Level 1 inputs include fixed maturity investments, primarily investments in U.S. Treasuries, common equity securities and short-term investments, which include U.S. Treasury Bills. Investments valued using Level 2 inputs are comprised primarily of fixed maturity investments, which have been disaggregated into classes, including debt securities issued by corporations, municipal obligations, mortgage and asset-backed securities, foreign government obligations and preferred stocks. Certain ETFs that track U.S. stock indices such as the S&P 500 but are traded on foreign exchanges are also considered Level 2 measurements, as management values such investments using the fund's published net asset value ("NAV") to account for the difference in market close times. Fair value estimates for investments that trade infrequently and have few or no observable market prices are classified as Level 3 measurements. Level 3 fair value estimates based upon unobservable inputs include OneBeacon's investments in surplus notes and certain fixed maturity investments and common equity securities where quoted market prices are unavailable or are not considered reasonable. OneBeacon determines when transfers between levels have occurred as of the beginning of the period.

OneBeacon uses brokers and outside pricing services to assist in determining fair values. For investments in active markets, OneBeacon uses the quoted market prices provided by outside pricing services to determine fair value. The outside pricing services used by OneBeacon have indicated that if no observable inputs are available for the security, they will not provide a price. In such circumstances, where quoted market prices are unavailable or are not considered reasonable, OneBeacon estimates the fair value using industry standard pricing methodologies and observable inputs such as benchmark yields, reported trades, broker-dealer quotes, issuer spreads, benchmark securities, bids, offers, prepayment speeds, reference data including research publications and other relevant inputs. Given that many fixed maturity investments do not trade on a daily basis, the outside pricing services evaluate a wide range of fixed maturity investments by regularly drawing parallels from recent trades and quotes of comparable securities with similar features. The characteristics used to identify comparable fixed maturity investments vary by asset type and take into account market convention.

OneBeacon's process to assess the reasonableness of the market prices obtained from the outside pricing sources covers substantially all of its fixed maturity investments and includes, but is not limited to, the evaluation of pricing methodologies and a review of the pricing services' quality control processes and procedures on at least an annual basis, comparison of our invested asset market prices to prices obtained from different independent pricing vendors on at least a semi-annual basis, monthly analytical reviews of certain prices and review of the underlying assumptions utilized by our pricing services for selected measurements on an ad hoc basis throughout the year. OneBeacon also performs back-testing of selected sales activity to determine whether there are any significant differences between the market price used to value the security prior to sale and the actual sale price on an ad-hoc basis throughout the year. Prices provided by the pricing services that vary by more than 5% and $1.0 million from the expected price based on these procedures are considered outliers. Also considered outliers are prices that have not changed from period to period and prices that have trended unusually compared to market conditions. In

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
NOTE 5. Investment Securities

circumstances where the results of OneBeacon's review process do not appear to support the market price provided by the pricing services, OneBeacon challenges the price. If OneBeacon cannot gain satisfactory evidence to support the challenged price, it relies upon its own pricing methodologies to estimate the fair value of the security in question.
The valuation process above is generally applicable to all of OneBeacon's fixed maturity investments. The techniques and inputs specific to asset classes within OneBeacon's fixed maturity investments for Level 2 securities that use observable inputs are as follows:
Debt securities issued by corporations: The fair value of debt securities issued by corporations is determined from a pricing evaluation technique that uses information from market sources and integrates relative credit information, observed market movements, and sector news. Key inputs include benchmark yields, reported trades, broker-dealer quotes, issuer spreads, two-sided markets, benchmark securities, bids, offers, and reference data including sector, coupon, credit quality ratings, duration, credit enhancements, early redemption features and market research publications.
Municipal obligations: The fair value of municipal obligations is determined from a pricing evaluation technique that uses information from market makers, broker-dealers, buy-side firms, and analysts along with general market information. Key inputs include benchmark yields, reported trades, issuer financial statements, material event notices and new issue data, as well as broker-dealer quotes, issuer spreads, two-sided markets, benchmark securities, bids, offers, and reference data including type, coupon, credit quality ratings, duration, credit enhancements, geographic location and market research publications.
Mortgage and asset-backed securities: The fair value of mortgage and asset-backed securities is determined from a pricing evaluation technique that uses information from market sources and leveraging similar securities. Key inputs include benchmark yields, reported trades, underlying tranche cash flow data, collateral performance, plus new issue data, as well as broker-dealer quotes, issuer spreads, two-sided markets, benchmark securities, bids, offers, and reference data including issuer, vintage, loan type, collateral attributes, prepayment speeds, default rates, recovery rates, cash flow stress testing, credit quality ratings and market research publications.
Foreign government obligations: The fair value of foreign government obligations is determined from a pricing evaluation technique that uses feeds from data sources in each respective country, including active market makers and inter-dealer brokers. Key inputs include benchmark yields, reported trades, broker-dealer quotes, two-sided markets, benchmark securities, bids, offers, local exchange prices, foreign exchange rates and reference data including coupon, credit quality ratings, duration and market research publications.
Preferred stocks: The fair value of preferred stocks is determined from a pricing evaluation technique that calculates the appropriate spread over a comparable security for each issue. Key inputs include exchange prices (underlying and common stock of same issuer), benchmark yields, reported trades, broker-dealer quotes, issuer spreads, two-sided markets, benchmark securities, bids, offers, and reference data including sector, coupon, credit quality ratings, duration, credit enhancements, early redemption features and market research publications.
Level 3 valuations are generated from techniques that use assumptions not observable in the market. These unobservable assumptions reflect OneBeacon's assumptions that market participants would use in valuing the investment. Generally, certain securities may start out as Level 3 when they are originally issued but as observable inputs become available in the market, they may be reclassified to Level 2.
The fair value of the surplus notes is determined based on a discounted expected cash flow model using information as of the measurement date, and is classified as a Level 3 measurement. OneBeacon's other investments also include an investment in a community reinvestment vehicle and a foreign currency forward contract, which are accounted for at fair value, and a tax advantaged federal affordable housing development fund, which is accounted for under the proportional amortization method.
The fair values of OneBeacon's investments in hedge funds and private equity funds have been classified as NAV as prescribed by ASU 2015-07. OneBeacon employs a number of procedures to assess the reasonableness of the NAV

reported by the fund's manager, including obtaining and reviewing periodic and audited financial statements and discussing each fund’s pricing with the fund manager throughout the year. In the event OneBeacon believes that its estimate of NAV differs from that reported by the fund due to illiquidity or other factors, OneBeacon will adjust the fund's reported NAV to more appropriately represent the fair value of its interest in the investment. As of June 30, 2017 and December 31, 2016, OneBeacon recorded negative adjustments of $1.1 million and $5.0 million, respectively, to the reported NAV of certain investments in hedge funds and private equity funds.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
NOTE 5. Investment Securities

Fair value measurements by level

The following tables summarize the Company's fair value measurements for investments as of June 30, 2017 and December 31, 2016 by level. The major security types were based on the legal form of the securities. OneBeacon has disaggregated its fixed maturity investments based on the issuing entity type, which impacts credit quality, with debt securities issued by U.S. government entities carrying minimal credit risk, while the credit and other risks associated with other issuers, such as corporations, foreign governments, municipalities or entities issuing asset-backed securities vary depending on the nature of the issuing entity type. OneBeacon further disaggregates debt securities issued by corporations and common equity securities by industry sector because investors often reference commonly used benchmarks and their subsectors to monitor risk and performance. Accordingly, OneBeacon has further disaggregated these asset classes into subclasses based on the similar sectors and industry classifications the Company uses to evaluate investment risk and performance against commonly used benchmarks, such as the Bloomberg Barclays U.S. Intermediate Aggregate and S&P 500 indices.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
NOTE 5. Investment Securities

($ in millions)	Fair value at June 30, 2017	Level 1	Level 2	Level 3
Fixed maturity investments:				
U.S. Government and agency obligations	$ 55.7	$ 55.7	$ —	$ —
Debt securities issued by corporations:				
Consumer	187.3	—	187.3	—
Financials	154.9	—	154.9	—
Industrial	141.6	—	140.0	1.6
Health Care	122.3	—	122.3	—
Utilities	81.9	—	81.9	—
Technology	63.8	—	63.8	—
Communications	58.4	—	58.4	—
Basic materials	51.4	—	51.4	—
Energy	42.0	—	42.0	—
Debt securities issued by corporations	903.6	—	902.0	1.6
Municipal obligations	70.6	—	70.6	—
Mortgage and asset-backed securities	1,240.1	—	1,227.4	12.7
Foreign government obligations	4.4	0.6	3.8	—
Preferred stocks	14.2	—	14.2	—
Fixed maturity investments	2,288.6	56.3	2,218.0	