PROASSURANCE CORP
Form 10-K
March 01, 2007

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

(Mark One)

þ **Annual report pursuant to section 13 or 15(d) of the Securities Exchange Act of 1934 [Fee Required]**
for the fiscal year ended December 31, 2006, or

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

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

Delaware	63-1261433
(State of incorporation or organization)	(I.R.S. Employer Identification No.)
100 Brookwood Place, Birmingham, AL	35209
(Address of principal executive offices)	(Zip Code)

(205) 877-4400
(Registrant s Telephone Number, Including Area Code)

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

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

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

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

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

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

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

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

Large Accelerated Filer þ Accelerated Filer o Non-Accelerated Filer o

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

The aggregate market value of voting stock held by non-affiliates of the registrant at June 30, 2006 was $1,503,008,007.

As of February 15, 2007, the registrant had outstanding approximately 33,281,390 shares of its common stock.

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Documents incorporated by reference in this Form 10-K

(i) The definitive proxy statement for the 2007 Annual Meeting of the Stockholders of ProAssurance Corporation (File No. 001-16533) is incorporated by reference into Part III of this report.

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

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

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

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

(vi) The ProAssurance Corporation Quarterly Report on Form 10-Q for the quarter ended June 30, 2001 (Commission File No. 001-16533) is incorporated by reference into Part IV of this report.

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

(viii) The Registration Statement on Form S-3 of ProAssurance Corporation (Commission File No. 333-100526) is incorporated by reference into Part IV of this report.

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

(x) The ProAssurance Corporation Annual Report on form 10-K for the year ended December 31, 2004 (File No. 001-16533) is incorporated by reference into Part IV of this report.

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

(xii) The ProAssurance Corporation Current Report on Form 8-K for event occurring on March 31, 2005 (File No. 001-16533) is incorporated by reference into Part IV of this report.

(xiii) The ProAssurance Corporation Current Report on Form 8-K for event occurring on May 18, 2005 (File No. 001-16533) is incorporated by reference into Part IV of this report.

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

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

(xvi) The ProAssurance Corporation Annual Report on Form 10-K for the year ended December 31, 2005 is incorporated by reference in Part IV of this report.

(xvii) The ProAssurance Corporation Current Report on Form 8-K for event occurring on May 17, 2006 (File No. 001-16533) is incorporated by reference into Part IV of this report.

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

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

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PART I

ITEM 1. BUSINESS.

General / Corporate Overview

We are a holding company for property and casualty insurance companies focused on professional liability insurance. Our executive offices are located at 100 Brookwood Place, Birmingham, Alabama 35209 and our telephone number is (205) 877-4400. Our stock trades on the New York Stock Exchange under the symbol PRA. Our website is www.ProAssurance.com.

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

In addition to federal filings, on our website, we make available the financial statements we file with state regulators, news releases that we issue, and certain investor presentations. We believe these documents provide important additional information about our financial condition and operations.

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

Because the insurance business uses certain terms and phrases that carry special and specific meanings, we urge you to read the Glossary included in this section prior to reading this report.

Caution Regarding Forward-Looking Statements

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

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

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

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general economic conditions, either nationally or in our market area, that are worse than anticipated;

regulatory and legislative actions or decisions that adversely affect our business plans or operations;

inflation and changes in the interest rate environment;

performance of financial markets and/or changes in the securities markets that adversely affect the fair value of our investments or operations;

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

changes to our ratings assigned by rating agencies;

the effects of health care changes, including managed care;

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

bad faith litigation which may arise from our involvement in the settlement of claims;

post-trial motions which may produce rulings adverse to us and/or appeals we undertake that may be unsuccessful;

significantly increased competition among insurance providers and related pricing weaknesses in some markets;

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

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

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

changes in our organization, compensation and benefit plans.

Our results may differ materially from those we expect and discuss in any forward-looking statements. The principal risk factors that may cause these differences are described in various documents we file with the Securities and Exchange Commission, including the Registration Statement filed on February 15, 2006 and updated on June 2, 2006, as well as in our periodic reports filed with the Securities and Exchange Commission, such as our current reports on Form 8-K, and our regular reports on Forms 10-Q and 10-K, particularly in Item 1A, Risk Factors.

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

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GLOSSARY OF SELECTED INSURANCE AND RELATED FINANCIAL TERMS

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

Accident year	The accounting period in which an insured event becomes a liability of the insurer.
Admitted company; admitted basis	An insurance company licensed and authorized to do business in a particular state. An admitted company doing business in a state is said to operate on an admitted basis and is subject to all state insurance laws and regulations pertaining to its operations. (See: Non-admitted company)
Adverse selection	The tendency of those exposed to a higher risk to seek more insurance coverage than those at a lower risk. Insurers react either by charging higher premiums or not insuring at all, as in the case of floods. Adverse selection can be seen as concentrating risk instead of spreading it.
Agent	An individual or firm that represents an insurer under a contractual or employment agreement for the purpose of selling insurance. There are two types of agents: independent agents, who represent one or more insurance companies but are not employed by those companies and are paid on commission, and exclusive or captive agents, who by contract are required to represent or favor only one insurance company and are either salaried or work on commission. Insurance companies that use employee or captive agents are called direct writers. Agents are compensated by the insurance company whose products they sell. By definition, with respect to a given insurer, an agent is not a broker (See: Broker)
Alternative markets	Mechanisms used to fund self-insurance. This includes captives, which are insurers owned by one or more insureds to provide owners with coverage. Risk-retention groups, formed by members of similar professions or businesses to obtain liability insurance, are also a form of self-insurance.
Assets; admitted; non-admitted	Property owned, in this case by an insurance company, including stocks, bonds, and real estate. Because insurance accounting is concerned with solvency and the ability to pay claims, insurance regulators require a conservative valuation of assets, prohibiting insurance

companies from listing assets on their balance sheets

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	whose values are uncertain, such as furniture, fixtures, debit balances, and accounts receivable that are more than 90 days past due (these are non-admitted assets). Admitted assets are those assets that can be easily sold in the event of liquidation or borrowed against, and receivables for which payment can be reasonably anticipated.
Bodily injury	Physical harm, sickness, disease or death resulting from any of these.
Broker	An intermediary between a customer and an insurance company. Brokers typically search the market for coverage appropriate to their clients and they usually sell commercial, not personal, insurance. Brokers are compensated by the insureds on whose behalf they are working. With respect to a given insurer, a broker is not an agent. (See: Agent)
Bulk reserves	Reserves for losses that have occurred but have not been reported as well as anticipated changes to losses on reported claims. Bulk reserves are the difference between (i) the sum of case reserves and paid losses and (ii) an actuarially determined estimate of the total losses necessary for the ultimate settlement of all reported and incurred but not reported claims, including amounts already paid. (See: Case Reserves)
Capacity	For an individual insurer, the maximum amount of premium or risk it can underwrite based on its financial condition. The adequacy of an insurer s capital relative to its exposure to loss is an important measure of solvency.
Capital	Stockholders equity (for publicly-traded insurance companies) and policyholders surplus (for mutual insurance companies). Capital adequacy is linked to the riskiness of an insurer s business. (See: Risk-Based Capital, Surplus, Solvency)
Case reserves	Reserves for future losses for reported claims as established by an insurer s claims department.
Casualty insurance	Insurance which is primarily concerned with the losses caused by injuries to third persons (in other words, persons other than the policyholder) and the legal liability imposed on the insured resulting therefrom. (See: Professional liability insurance, Medical professional liability insurance)

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Cede, cedant; ceding company	When a party reinsures its liability with another, it "cedes business and is referred to as the "cedant or "ceding company.
Claim	Written or oral demands, as well as civil and administrative proceedings.
Claims-made policy; coverage	A form of insurance that pays claims presented to the insurer during the term of the policy or within a specific term after its expiration. It limits a liability insurers exposure to unknown future liabilities. Under a claims-made policy, an insured event becomes a liability when the event is first reported to the insurer.
Combined ratio	The sum of the underwriting expense ratio and net loss ratio, determined in accordance with either Statutory Accounting Principles (SAP) or Generally Accepted Accounting Principles (GAAP).
Commission	Fee paid to an agent or insurance salesperson as a percentage of the policy premium. The percentage varies widely depending on coverage, the insurer, and the marketing methods.
Consent to settle	Clause provided in some professional liability insurance policies requiring the insurer to receive authority from an insured before settling a claim.
Damages; economic, non-economic and punitive	Monies awarded to a plaintiff or claimant. Economic damages are intended to compensate a plaintiff or claimant for quantifiable past and future losses, such as lost wages and/or medical costs. Non-economic damages are those awarded separately and apart from economic damages, that are intended to compensate the claimant or plaintiff for non-quantifiable losses such as pain and suffering or loss of consortium. Punitive damages are non-economic damages intended to punish the defendant for perceived outrageous conduct.
Direct premiums written	Premiums charged by an insurer for the policies that it underwrites, excluding any premiums that it receives as a reinsurer.
Direct writer(s)	Insurance companies that sell directly to the public using exclusive agents or their own employees.
Domestic insurance company	Term used by a state to refer to any company incorporated there.

Excess & surplus lines; surplus lines	Property/casualty insurance coverage that isn t generally available from insurers licensed in the state (See: Admitted

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	company) and must be purchased from a non-admitted company . Examples include risks of an unusual nature that require greater flexibility in policy terms and conditions than exist in standard forms or where the highest rates allowed by state regulators are considered inadequate by admitted companies. Laws governing surplus lines vary by state.
Excess coverage; excess limits	An insurance policy that provides coverage limits above another policy with similar coverage terms, or above a self-insured amount.
Extended reporting endorsement	Also known as a tail policy, or tail coverage. Provides protection for future claims filed after a claims-made policy has lapsed. Typically requires payment of an additional premium, the tail premium. Tail coverage may also be granted if the insured becomes disabled, dies or permanently retired from the covered occupation (i.e., the practice of medicine in medical liability policies.)
Facultative reinsurance	A generic term describing reinsurance where the reinsurer assumes all or a portion of a single risk. Each risk is separately evaluated and each contract is separately negotiated by the reinsurer.
Frequency	Number of times a loss occurs per unit of risk or exposure. One of the criteria used in calculating premium rates.
Front, fronting	A procedure in which a primary insurer acts as the insurer of record by issuing a policy, but then passes all or virtually all of the risk to a reinsurer in exchange for a commission. Often, the fronting insurer is licensed to do business in a state or country where the risk is located, but the reinsurer is not. The reinsurer in this scenario is often a captive or an independent insurance company that cannot sell insurance directly in a particular country.
Generally Accepted Accounting Principles; GAAP	A set of widely accepted accounting standards, set primarily by the Financial Accounting Standards Board (FASB), and used to standardize financial accounting of public companies.
Gross premiums written	Total premiums for direct insurance written and assumed reinsurance during a given period. The sum of direct and assumed premiums written.

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Guaranty fund; assessment(s)	The mechanism by which all 50 states, the District of Columbia and Puerto Rico ensure that solvent insurers fund the payment of claims against insurance companies that fail. The type and amount of claim covered by the fund varies from state to state.
Incurred but not reported (IBNR)	Actuarially estimated reserves for estimated losses that have been incurred by insureds and reinsureds but not yet reported to the insurer or reinsurer including unknown future developments on losses which are known to the insurer or reinsurer. Insurance companies regularly adjust reserves for such losses as new information becomes available.
Incurred losses	Losses covered by the insurer within a fixed period, whether or not adjusted or paid during the same period, plus changes in the estimated value of losses from prior periods.
Insolvent; insolvency	Insurer s inability to pay debts. Typically the first sign of problems is inability to pass the financial tests regulators administer as a routine procedure. (See: Risk-based capital)
Investment income	Income generated by the investment of assets. Insurers have two sources of income, underwriting (premiums less claims and expenses) and investment income.
Liability insurance	A line of casualty insurance for amounts a policyholder is legally obligated to pay because of bodily injury or property damage caused to another person. (See: Bodily Injury, Casualty insurance, Professional liability insurance, Medical professional liability insurance)
Limits	The maximum amount payable under an insurance policy for a covered loss.
Long-tail	The long period of time between collecting the premium for insuring a risk and the ultimate payment of losses. This allows insurance companies to invest the premiums until losses are paid, thus producing a higher level of invested assets and investment income as compared to other lines of property and casualty business. Medical professional liability is considered a long tail line of insurance. (See: Medical professional liability, Professional liability)
Loss adjustment expenses (LAE)	

The expenses of settling claims, including legal and other fees and the portion of general expenses allocated to claim settlement costs.

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Loss costs	The portion of an insurance rate used to cover claims and the costs of adjusting claims. Insurance companies typically determine their rates by estimating their future loss costs and adding a provision for expenses, profit, and contingencies.
Loss ratio	The ratio of incurred losses and loss-adjustment expenses to net premiums earned. This ratio helps measure the company s underlying profitability, or loss experience, on its total book of business.
Loss reserves	Liabilities established by insurers to reflect the estimated cost of claims payments and the related expenses that the insurer will ultimately be required to pay in respect of insurance or reinsurance it has written. They represent a liability on the insurer s balance sheet.
Medical malpractice	An act or omission by a health care provider that falls below a recognized standard of care. (See: Standard of Care)
Medical professional liability insurance	Insurance for the legal liability of an insured (and against loss, damage or expense incidental to a claim of such liability) arising out of death, injury or disablement of a person as the result of negligent deviation from the standard of care or other misconduct in rendering professional service.
National Association of Insurance Commissioners	Generally referred to as the NAIC. The organization of insurance regulators from the 50 states, the District of Columbia and the four U.S. territories. The NAIC provides a forum for the development of uniform policy when uniformity is appropriate.
Net loss ratio	The net loss ratio measures the ratio of net losses to net earned premiums determined in accordance with SAP or GAAP.
Net premium earned	The portion of premium that is recognized for accounting purposes as income during a particular period. Equal to net premiums written plus the change in net unearned premiums during the period.
Net premiums written	Gross premiums written for a given period less premiums ceded to reinsurers during such period.
Non-admitted company; basis	Insurers licensed in some states, but not others. States where an insurer is not licensed call that insurer

non-admitted. Non-admitted companies sell coverage that is unavailable from licensed insurers within a state and are generally exempt from most

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	state laws and regulations related to rates and coverages. Policyholders of such companies generally do not have the same degree of consumer protection and financial recourse as policyholders of admitted companies. Non-admitted companies are said to operate on a non-admitted basis.
Nose coverage	See: Prior acts coverage.
Occurrence policy; coverage	Insurance that pays claims arising out of incidents that occur during the policy term, even if they are filed many years later. Under an occurrence policy the insured event becomes a liability when the event takes place.
Operating ratio	The operating ratio is the combined ratio, less the ratio of investment income (exclusive of realized gains and losses) to net earned premiums, if determined in accordance with GAAP. While the combined ratio strictly measures underwriting profitability, the operating ratio incorporates the effect of investment income.
Paid Loss Ratio	The ratio of paid losses and loss-adjustment expenses to net premiums earned. (See Loss ratio)
Paid to Incurred Ratio	The ratio of paid losses to incurred losses, which is computed by dividing paid losses for the period by incurred losses.
Policy	A written contract for insurance between an insurance company and policyholder stating details of coverage.
Premium	The price of an insurance policy; typically charged annually or semiannually.
Premiums written	The total premiums on all policies written by an insurer during a specified period of time, regardless of what portions have been earned.
Premium tax	A state tax on premiums for policies issued in the state, paid by insurers.
Primary company	In a reinsurance transaction, the insurance company that is reinsured.
Prior acts coverage	An additional coverage for claims-made policies, optionally made available by an insurer, that covers an insured for claims that occurred, but were not reported

prior to the inception date, or retroactive date, of the policy. Sometimes called Nose Coverage.

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Professional liability insurance	Covers professionals for negligence and errors or omissions that cause injury or economic loss to their clients. (See: Casualty insurance, Liability insurance, Medical professional liability insurance)
Property casualty insurance	Covers damage to or loss of policyholders property and legal liability for damages caused to other people or their property.
Rate	The cost of insurance for a specific unit of exposure, such as for one physician. Rates are based primarily on historical loss experience for similar risks and may be regulated by state insurance offices.
Rating agencies	These agencies assess insurers financial strength and viability to meet claims obligations. Some of the factors considered include company earnings, capital adequacy, operating leverage, liquidity, investment performance, reinsurance programs, and management ability, integrity and experience. A high financial rating is not the same as a high consumer satisfaction rating.
Reinsurance	Insurance bought by insurance companies. In a reinsurance contract the reinsurer agrees to indemnify another insurance or reinsurance company, the ceding company, against all or a portion of the insurance or reinsurance risks underwritten by the ceding company under one or more policies. Reinsurers don t pay policyholder claims. Instead, they reimburse insurers for claims paid.
Reinsured layer; retained layer	The retained layer is the cumulative portion of each loss, on a per-claim basis, which is less than an insurer s reinsurance retention for a given coverage year. Likewise, the reinsured layer is the cumulative portion of each loss that exceeds the reinsurance retention. (See: Reinsurance, Retention)
Reserves	A company s best estimate of what it will pay at some point in the future, for claims for which it is currently responsible.
Retention	The amount or portion of risk that an insurer retains for its own account. Losses in excess of the retention level up to the outer limit, if any, are paid by the reinsurer. In proportional treaties, the retention may be a percentage of the original policy s limit. In excess of loss business, the retention is a dollar amount of loss, a loss ratio or a

percentage.

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Retroactive date	Applicable only to claims-made policies. Claims that have occurred and have not been reported prior to this date are excluded from coverage. The retroactive date is generally the date coverage was first afforded to an insured by a company under a claims-made policy form, unless extended into the past by Prior Acts Coverage. (See: Prior Acts Coverage)
Return on equity	Net Income (or if applicable, Income from Continuing Operations) divided by the average of beginning and ending stockholders equity. This ratio measures a company s overall after-tax profitability from underwriting and investment activity and shows how efficiently invested capital is being used.
Risk-Based Capital (RBC)	A regulatory measure of the amount of capital required for an insurance company, based upon the volume and inherent riskiness of the insurance sold, the composition of its investment portfolio and other financial risk factors. Higher-risk types of insurance, liability as opposed to property business, generally necessitate higher levels of capital. The NAIC s RBC model law stipulates four levels of regulatory action with the degree of regulatory intervention increasing as the level of surplus falls below a minimum amount as determined under the model law. (See: National Association of Insurance Commissioners)
Risk management	Management of the varied risks to which a business firm or association might be subject. It includes analyzing all exposures to gauge the likelihood of loss and choosing options to better manage or minimize loss. These options typically include reducing and eliminating the risk with safety measures, buying insurance, and self-insurance.
Self-insurance	The concept of assuming a financial risk oneself, instead of paying an insurance company to take it on. Every policyholder is a self-insurer in terms of paying a deductible and co-payments. Larger policyholders often self-insure frequent or predictable losses to avoid insurance overhead expenses.
Severity	The average claim cost, statistically determined by dividing dollars of losses by the number of claims.

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Solvent, solvency	Insurance companies ability to pay the claims of policyholders. Regulations to promote solvency include minimum capital and surplus requirements, statutory accounting conventions, limits to insurance company investment and corporate activities, financial ratio tests, and financial data disclosure.
Standard of care	The standard by which negligence is determined. The degree of skill associated with the activities and treatment from a reasonable, prudent, ordinary practitioner acting under the same or similar circumstances.
Statutory Accounting Principles; SAP	More conservative standards than under GAAP accounting rules, they are imposed by state laws that emphasize the present solvency of insurance companies. SAP helps ensure that the company will have sufficient funds readily available to meet all anticipated insurance obligations by recognizing liabilities earlier or at a higher value than GAAP and assets later or at a lower value. For example, SAP requires that selling expenses be recorded immediately rather than amortized over the life of the policy. (See: Generally Accepted Accounting Principles, Admitted assets)
Surplus; statutory surplus	The excess of assets over total liabilities (including loss reserves) that protects policyholders in case of unexpectedly high claims. Statutory Surplus is determined in accordance with Statutory Accounting Principles.
Tail	The period of time that elapses between the occurrence of the loss event and the payment in respect thereof.
Tail Coverage	See: Extended Reporting Endorsement
Third-party coverage	Liability coverage purchased by the policyholder as a protection against possible lawsuits filed by a third party. The insured and the insurer are the first and second parties to the insurance contract.
Tort	A civil wrong which may result in damages.
Treaty reinsurance	The reinsurance of a specified type or category of risks defined in a reinsurance agreement (a "treaty) between a primary insurer and a reinsurer. Typically, in treaty reinsurance, the primary insurer or reinsured is obligated to offer and the reinsurer is obligated to accept a

specified portion of all such type or category of risks originally written by the primary insurer or reinsured.

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Underwriting	The insurer s or reinsurer s process of reviewing applications submitted for insurance coverage, deciding whether to accept all or part of the coverage requested and determining the applicable premiums.
Underwriting expense ratio	Under GAAP, the ratio of underwriting, acquisition and other insurance expenses incurred to net premiums earned (for SAP, the ratio of underwriting expenses incurred to net premiums written.)
Underwriting expenses	The aggregate of policy acquisition costs, including commissions, and the portion of administrative, general and other expenses attributable to underwriting operations.
Underwriting income; loss	The insurer s profit on the insurance sales after all expenses and losses have been paid, before investment income or income taxes. When premiums aren t sufficient to cover claims and expenses, the result is an underwriting loss.
Underwriting profit	The amount by which net earned premiums exceed claims and expenses. (See: Underwriting Income)
Unearned premium	The portion of premium that represents the consideration for the assumption of risk for a future period. Such premium is not yet earned since the risk has not yet been assumed. May also be defined as the pro-rata portion of written premiums that would be returned to policyholders if all policies were terminated by the insurer on a given date.

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Business Overview

We operate in a single business segment principally in the mid-Atlantic, Midwest and Southeast. We sell professional liability insurance primarily to physicians, dentists, other healthcare providers and healthcare facilities. We also have a small book of legal professional liability business in the Midwest.

Our top five states represented 60% of our gross premiums written for the year ended December 31, 2006. The following table shows our gross premiums written in these key states for each of the periods indicated.

	Gross Written Premiums-Years Ended December 31 *($ in thousands)*					
	2006		2005		2004[2]	
Ohio	**$ 106,267**	**18%**	$ 131,102	23%	$ 149,269	26%
Alabama	**102,998**	**18%**	111,462	19%	111,582	19%
Florida	**53,469**	**9%**	61,341	11%	69,899	12%
Michigan	**43,757**	**8%**	46,741	8%	45,578	8%
Indiana [1]	**40,335**	**7%**	41,129	7%	32,635	6%
All other states	**232,157**	**40%**	181,185	32%	164,629	29%
Total	**$ 578,983**	**100%**	$ 572,960	100%	$ 573,592	100%

(1) Not a top five state in 2004.

(2) Missouri was included in the top five states in 2004 (gross premiums written of $35,217).

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

We maintain 17 local claims and/or underwriting offices to ensure that we have a local presence in the markets we serve. This emphasis on local knowledge allows us to maintain active relationships with our customers and be more responsive to their needs.

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

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

Corporate Organization and History

We were incorporated in Delaware in June 2001. Our core operating subsidiaries are The Medical Assurance Company, Inc., ProNational Insurance Company, NCRIC Insurance Company, Inc., Physicians Insurance Company of Wisconsin, Inc., and Red Mountain Casualty Insurance Company, Inc. We also write a limited amount of medical

professional liability insurance through Woodbrook Casualty Insurance, Inc. (formerly Medical Assurance of West Virginia, Inc.), which we consider to be a non-core operating subsidiary.

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

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Our predecessor company, Medical Assurance, Inc. (Medical Assurance) was founded by physicians as a mutual company in Alabama and wrote its first policy in 1977. Medical Assurance demutualized and became a public company in 1991. Medical Assurance expanded through internal growth and the acquisition of professional liability insurance companies with strong regional identities in West Virginia, Indiana and Missouri, along with books of business in Ohio and Missouri.

Professionals Group, which was combined with Medical Assurance to form ProAssurance, traces its roots to the Brown-McNeeley Fund, which was founded by the State of Michigan in 1975 to provide medical professional liability insurance to physicians. Physicians Insurance Company of Michigan, which ultimately became ProNational, was founded in 1980 to assume the business of the Fund. That company also expanded through internal growth and the acquisition of a book of business in Illinois and the acquisition of professional liability insurers in Florida and Indiana.

Recent Transactions

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

On August 3, 2005 we acquired all of the outstanding common stock of NCRIC Corporation and its subsidiaries (NCRIC) in an all stock merger. NCRIC s primary business is a single insurance company that provided medical professional liability insurance in the District of Columbia, Delaware, Maryland, Virginia and West Virginia.

These transactions strategically expanded our geographic footprint and are in keeping with our desire to expand our professional liability operations through selective acquisitions. A more detailed description of the merger transactions is included in Note 2 of the Notes to the Consolidated Financial Statements included herein.

On January 4, 2006 we sold our personal lines operations (the MEEMIC companies), effective January 1, 2006, for $400 million before taxes and transaction expenses. We recognized a gain on the sale in the first quarter of 2006 of $109.4 million after consideration of sales expenses and estimated taxes. Sale proceeds will support the capital requirements of our professional liability insurance subsidiaries and other general corporate purposes. Additional information regarding the sale of the MEEMIC companies is provided in Note 3 of the Notes to the Consolidated Financial Statements.

In April and May 2004, we received net proceeds of $44.9 million from the issuance of $46.4 million of trust preferred securities. These trust preferred securities have a 30-year maturity and are callable at par in December 2009. The interest rate on these securities adjusts quarterly to the 3-month London Interbank Offered Rate (LIBOR) plus 385 basis points.

In early July 2003 we received $104.6 million from the issuance of 3.9% Convertible Debentures, due June 2023, having a face value of $107.6 million. We utilized a substantial portion of the net proceeds from the sale of the Convertible Debentures to repay our then outstanding term loan. We used the balance of the net proceeds from the sale of the Convertible Debentures and the trust preferred securities for general corporate purposes, including contributions to the capital of our insurance subsidiaries to support the growth in insurance operations. See Note 10 of the Notes to the Consolidated Financial Statements for more information regarding the Convertible Debentures and the trust preferred securities.

In the fourth quarter of 2002 ProAssurance sold 3,025,000 shares of common stock at a price of $16.55 per share in an underwritten public offering. ProAssurance received net proceeds from the offering in the amount of approximately $46.5 million. ProAssurance used the proceeds from the offering to support the growth of the professional liability insurance business and for general corporate purposes.

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Products and Services

We sell professional liability insurance primarily to physicians, dentists, other healthcare providers and healthcare facilities. We also have a small book of legal professional liability business in the Midwest. We generate the majority of our premiums from individual and small group practices, but also insure major physician groups as well as hospitals. While most of our business is written in the standard market, our subsidiary, Red Mountain Casualty Insurance Company, Inc., offers medical professional liability insurance on an excess and surplus lines basis. We also offer professional office package and workers compensation insurance products in connection with our medical professional liability products. We are licensed to do business in every state but Connecticut, Maine, New Hampshire, New York and Vermont.

Marketing

We utilize both direct marketing and independent agents to write our business. In Alabama and the District of Columbia, we rely solely on direct marketing, and in Florida and Missouri, direct marketing accounts for a majority of our business. We use independent agents to market our professional liability insurance products in other markets. For the year ended December 31, 2006, we estimate that approximately 65% of our gross premiums written were produced through independent insurance agencies. These local agencies usually have one to three producers who specialize in professional liability insurance and who we believe are able to convey the factors that differentiate our professional liability insurance product. No single agent or agency accounts for more than 10% of our total direct premiums written.

Our marketing is primarily directed to physicians. We generally do not target large physician groups or facilities because of the difficulty in underwriting the individual risks within those groups and because their purchasing decision is more focused on price. Our marketing emphasizes:

- excellent claims service and the other services and communications we provide to our customers,
- the sponsorship of risk management education seminars as an accredited provider of continuing medical education,
- risk management consultation, loss prevention seminars and other educational programs,
- legislative oversight and active support of proposed legislation we believe will have a positive effect on liability issues affecting the healthcare industry,
- the dissemination of newsletters and other printed material with information of interest to the healthcare industry, and
- endorsements by, and attendance at meetings of medical societies and related organizations.

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

Underwriting

Our underwriting process is driven by individual risk selection rather than by the size or other attributes of an account. Our pricing decisions are focused on achieving rate adequacy. We assess the quality and pricing of the risk, primarily emphasizing loss history, practice specialty and location in making our underwriting decision. Our underwriters work closely with our local claims departments. This includes consulting with staff about claims histories and patterns of practice in a particular locale as well as monitoring claims activity.

Our underwriting focuses on knowledge of local market conditions and legal environments. Through our seven regional underwriting offices located in Alabama, Florida, Indiana, Missouri, Michigan, Washington, D.C., and Wisconsin, we have established a local presence within our targeted markets to obtain better information more quickly.

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Our underwriters work with our field marketing force to identify business that meets these established underwriting standards and to develop specific strategies to write the desired business. In performing this assessment, our underwriters may also consult with internal actuaries regarding loss trends and pricing and utilize loss-rating models to assess the projected underwriting results of certain insured risks.

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

Claims Management

We have claims offices in Alabama (2), Delaware, Florida (2), Illinois, Indiana, Iowa, Kentucky, Michigan, Missouri, Ohio (2), Virginia, Washington, D.C., West Virginia, and Wisconsin so that we can provide localized and timely attention to claims. Our claims department investigates the circumstances surrounding an incident from which a covered claim arises against an insured. As we investigate, our claims department establishes the appropriate case reserves for each claim and monitors the level of each case reserve as circumstances require.

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

We aggressively defend claims against our insureds that we believe have no merit or those we believe cannot be settled by reasonable good faith negotiations. Many of our claims are litigated, and we engage experienced trial attorneys in each venue to handle the litigation in defense of our policyholders.

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

Investments

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

Our overall investment strategy is to focus on maximizing current income from our investment portfolio while maintaining safety, liquidity, duration and portfolio diversification. The portfolio is generally managed by professional third party asset managers whose results are monitored and evaluated by management. The asset managers typically have the authority to make investment decisions, subject to our investment policy, within the asset class they are responsible for managing. See Note 4 to our Consolidated Financial Statements for more detail on our investments.

Rating Agencies

Our claims-paying ability and financial strength are regularly evaluated and rated by three major rating agencies, A. M. Best, Fitch and Standard & Poor s. In developing their ratings, these agencies evaluate an insurer s ability to meet its obligations to policyholders. While these ratings

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may be of interest to shareholders, these are not ratings of securities nor a recommendation to buy, hold or sell any security.

The following table presents the ratings of our group and our core subsidiaries as of February 28, 2007: