PROASSURANCE CORP
Form 10-Q
August 07, 2017

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q
(Mark One)
ý 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
¨ Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the transition period from to
Commission file number 0-16533
ProAssurance Corporation
(Exact Name of Registrant as Specified in Its Charter)

Delaware	63-1261433
(State or Other Jurisdiction of Incorporation or Organization)	(IRS 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)	(Former Name, Former Address, and Former Fiscal Year, if Changed Since Last Report)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ý No ¨
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter), during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ý No ¨
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, 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. (Check one):

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

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. ¨
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No ý
As of July 31, 2017, there were 53,413,399 shares of the registrant's common stock outstanding.

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Glossary of Terms and Acronyms

When the following terms and acronyms appear in the text of this report, they have the meanings indicated below.

Term	Meaning
AOCI	Accumulated other comprehensive income (loss)
Board	Board of Directors of ProAssurance Corporation
BOLI	Business owned life insurance
Council of Lloyd's	The governing body for Lloyd's of London
DPAC	Deferred policy acquisition costs
Eastern Re	Eastern Re, LTD, S.P.C.
EBUB	Earned, but unbilled premium
FAL	Funds at Lloyd's
FASB	Financial Accounting Standards Board
FHLB	Federal Home Loan Bank
GAAP	Generally accepted accounting principles in the United States of America
HCPL	Healthcare professional liability
IRS	Internal Revenue Service
LLC	Limited liability company
Lloyd's	Lloyd's of London market
LP	Limited partnership
Medical technology liability	Medical technology and life sciences products liability
NAV	Net asset value
NRSRO	Nationally recognized statistical rating organization
NYSE	New York Stock Exchange
OCI	Other comprehensive income (loss)
OTTI	Other-than-temporary impairment
PCAOB	Public Company Accounting Oversight Board
Revolving Credit Agreement	ProAssurance's $250 million revolving credit agreement
ROE	Return on equity
SEC	Securities and Exchange Commission
SPC	Segregated portfolio cell
Specialty P&C	Specialty Property and Casualty
Syndicate 1729	Lloyd's of London Syndicate 1729
Syndicate Credit Agreement	Unconditional revolving credit agreement with the Premium Trust Fund of Syndicate 1729
U.K.	United Kingdom of Great Britain and Northern Ireland
ULAE	Unallocated loss adjustment expense
VIE	Variable interest entity

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Caution Regarding Forward-Looking Statements

Any statements in this Form 10-Q that are not historical facts are specifically identified as forward-looking statements. These statements are based upon our estimates and anticipation of future events and are subject to significant risks, assumptions 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," "likely," "may," "optimistic," "possible," "potential," "preliminary," "project," "should," "will" and other analogous expressions. There are numerous factors that could cause our actual results to differ materially from those in the forward-looking statements. Thus, sentences and phrases that we use to convey our view of future events and trends are expressly designated as forward-looking statements as are sections of this Form 10-Q that are identified as giving our outlook on future business.

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

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

changes in general economic conditions, including the impact of inflation or deflation and unemployment;

our ability to maintain our dividend payments;

regulatory, legislative and judicial actions or decisions that could affect our business plans or operations;

the enactment or repeal of tort reforms;

formation or dissolution of state-sponsored insurance entities providing coverages now offered by ProAssurance which could remove or add sizable numbers of insureds from or to the private insurance market;

changes in the interest and tax rate environment;

changes in U.S. laws or government regulations regarding financial markets or market activity that may affect the U.S. economy and our business;

changes in the ability of the U.S. government to meet its obligations that may affect the U.S. economy and our business;

performance of financial markets affecting the fair value of our investments or making it difficult to determine the value of our investments;

changes in requirements or accounting policies and practices that may be adopted by our regulatory agencies, the FASB, the SEC, the PCAOB or the NYSE that may affect our business;

changes in laws or government regulations affecting the financial services industry, the property and casualty insurance industry or particular insurance lines underwritten by our subsidiaries;

the effect on our insureds, particularly the insurance needs of our insureds, and our loss costs, of changes in the healthcare delivery system and/or changes in the U.S. political climate that may affect healthcare policy or our business;

consolidation of our insureds into or under larger entities which may be insured by competitors, or may not have a risk profile that meets our underwriting criteria or which may not use external providers for insuring or otherwise managing substantial portions of their liability risk;

uncertainties inherent in the estimate of our loss and loss adjustment expense reserve and reinsurance recoverable;

changes in the availability, cost, quality or collectability of insurance/reinsurance;

the results of litigation, including pre- or post-trial motions, trials and/or appeals we undertake;

effects on our claims costs from mass tort litigation that are different from that anticipated by us;

allegations of bad faith which may arise from our handling of any particular claim, including failure to settle;

loss or consolidation of independent agents, agencies, brokers or brokerage firms;

changes in our organization, compensation and benefit plans;

changes in the business or competitive environment may limit the effectiveness of our business strategy and impact our revenues;
our ability to retain and recruit senior management;

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- the availability, integrity and security of our technology infrastructure or that of our third-party providers of technology infrastructure, including any susceptibility to cyber-attacks which might result in a loss of information or operating capability;
- the impact of a catastrophic event, as it relates to both our operations and our insured risks;
- the impact of acts of terrorism and acts of war;
- the effects of terrorism-related insurance legislation and laws;
- guaranty funds and other state assessments;
- our ability to achieve continued growth through expansion into new markets or through acquisitions or business combinations;
- changes to the ratings assigned by rating agencies to our insurance subsidiaries, individually or as a group;
- provisions in our charter documents, Delaware law and state insurance laws may impede attempts to replace or remove management or may impede a takeover;
- state insurance restrictions may prohibit assets held by our insurance subsidiaries, including cash and investment securities, from being used for general corporate purposes;
- taxing authorities can take exception to our tax positions and cause us to incur significant amounts of legal and accounting costs and, if our defense is not successful, additional tax costs, including interest and penalties; and
- expected benefits from completed and proposed acquisitions may not be achieved or may be delayed longer than expected due to business disruption; loss of customers, employees or key agents; increased operating costs or inability to achieve cost savings; and assumption of greater than expected liabilities, among other reasons.

Additional risks, assumptions and uncertainties that could arise from our membership in the Lloyd's of London market and our participation in Syndicate 1729 include, but are not limited to, the following:

- members of Lloyd's are subject to levies by the Council of Lloyd's based on a percentage of the member's underwriting capacity, currently a maximum of 3%, but can be increased by Lloyd's;
- Syndicate operating results can be affected by decisions made by the Council of Lloyd's which the management of Syndicate 1729 has little ability to control, such as a decision to not approve the business plan of Syndicate 1729, or a decision to increase the capital required to continue operations, and by our obligation to pay levies to Lloyd's;
- Lloyd's insurance and reinsurance relationships and distribution channels could be disrupted or Lloyd's trading licenses could be revoked making it more difficult for Syndicate 1729 to distribute and market its products;
- rating agencies could downgrade their ratings of Lloyd's as a whole; and
- Syndicate 1729 operations are dependent on a small, specialized management team and the loss of their services could adversely affect the Syndicate’s business. The inability to identify, hire and retain other highly qualified personnel in the future, could adversely affect the quality and profitability of Syndicate 1729’s business.

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

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

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ProAssurance Corporation and Subsidiaries
Condensed Consolidated Balance Sheets (Unaudited)
(In thousands, except share data)

	June 30, 2017	December 31, 2016
Assets		
Investments		
Fixed maturities, available for sale, at fair value; amortized cost, $2,505,953 and $2,586,821, respectively	$2,546,107	$2,613,406
Equity securities, trading, at fair value; cost, $377,336 and $353,744, respectively	410,906	387,274
Short-term investments	263,701	442,084
Business owned life insurance	61,031	60,134
Investment in unconsolidated subsidiaries	330,329	340,906
Other investments, $30,814 and $31,501 at fair value, respectively, otherwise at cost or amortized cost	80,466	81,892
Total Investments	3,692,540	3,925,696
Cash and cash equivalents	117,463	117,347
Premiums receivable	235,117	223,480
Receivable from reinsurers on paid losses and loss adjustment expenses	5,967	5,446
Receivable from reinsurers on unpaid losses and loss adjustment expenses	280,332	273,475
Prepaid reinsurance premiums	47,711	39,723
Deferred policy acquisition costs	50,209	46,809
Deferred tax asset, net	5,919	10,256
Real estate, net	32,611	31,814
Intangible assets	81,592	84,406
Goodwill	210,725	210,725
Other assets	101,530	96,004
Total Assets	$4,861,716	$5,065,181
Liabilities and Shareholders’ Equity		
Liabilities		
Policy liabilities and accruals		
Reserve for losses and loss adjustment expenses	$1,991,865	$1,993,428
Unearned premiums	397,495	372,563
Reinsurance premiums payable	38,076	30,001
Total Policy Liabilities	2,427,436	2,395,992
Other liabilities	169,810	422,285
Debt less debt issuance costs	426,374	448,202
Total Liabilities	3,023,620	3,266,479
Shareholders’ Equity		
Common shares, par value $0.01 per share, 100,000,000 shares authorized, 62,822,081 and 62,660,234 shares issued, respectively	628	627
Additional paid-in capital	379,587	376,518
Accumulated other comprehensive income (loss), net of deferred tax expense (benefit) of $14,358 and $9,894, respectively	26,064	17,399
Retained earnings	1,851,745	1,824,088
Treasury shares, at cost, 9,408,925 shares and 9,408,977 shares, respectively	(419,928)	(419,930)
Total Shareholders’ Equity	1,838,096	1,798,702
Total Liabilities and Shareholders’ Equity	$4,861,716	$5,065,181

See accompanying notes.

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ProAssurance Corporation and Subsidiaries
Condensed Consolidated Statements of Changes in Capital (Unaudited)
(In thousands)

	Common Stock	Additional Paid-in Capital	Accumulated Other Comprehensive Income (Loss)	Retained Earnings	Treasury Stock	Total
Balance at December 31, 2016	$ 627	$376,518	$ 17,399	$1,824,088	$(419,930)	$1,798,702
Cumulative-effect adjustment-ASU 2016-09 adoption*	—	425	—	(276)	—	149
Common shares reacquired	—	—	—	—	—	—
Common shares issued for compensation and effect of shares reissued to stock purchase plan	—	1,876	—	—	2	1,878
Share-based compensation	—	6,092	—	—	—	6,092
Net effect of restricted and performance shares issued and stock options exercised	1	(5,324)	—	—	—	(5,323)
Dividends to shareholders	—	—	—	(33,040)	—	(33,040)
Other comprehensive income (loss)	—	—	8,665	—	—	8,665
Net income	—	—	—	60,973	—	60,973
Balance at June 30, 2017	$ 628	$379,587	$ 26,064	$1,851,745	$(419,928)	$1,838,096

	Common Stock	Additional Paid-in Capital	Accumulated Other Comprehensive Income (Loss)	Retained Earnings	Treasury Stock	Total
Balance at December 31, 2015	$ 625	$365,399	$ 23,855	$1,988,035	$(419,560)	$1,958,354
Common shares reacquired	—	—	—	—	(2,106)	(2,106)
Common shares issued for compensation and effect of shares reissued to stock purchase plan	1	2,194	—	—	—	2,195
Share-based compensation	—	5,813	—	—	—	5,813
Net effect of restricted and performance shares issued and stock options exercised	1	(2,982)	—	—	—	(2,981)
Dividends to shareholders	—	—	—	(32,913)	—	(32,913)
Other comprehensive income (loss)	—	—	37,434	—	—	37,434
Net income	—	—	—	62,399	—	62,399
Balance at June 30, 2016	$ 627	$370,424	$ 61,289	$2,017,521	$(421,666)	$2,028,195

* See Note 1 of the Notes to Condensed Consolidated Financial Statements for discussion of accounting guidance adopted during the period.
See accompanying notes.

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ProAssurance Corporation and Subsidiaries
Condensed Consolidated Statements of Income and Comprehensive Income (Unaudited)
(In thousands, except per share data)

	Three Months Ended June 30		Six Months Ended June 30	
	2017	2016	2017	2016
Revenues				
Net premiums earned	$180,353	$176,732	$363,256	$354,312
Net investment income	22,677	24,583	45,863	50,023
Equity in earnings (loss) of unconsolidated subsidiaries	2,516	376	4,324	(3,259)
Net realized investment gains (losses):				
OTTI losses	—	—	(419)	(10,734)
Portion of OTTI losses recognized in other comprehensive income before taxes	—	—	248	1,068
Net impairment losses recognized in earnings	—	—	(171)	(9,666)
Other net realized investment gains (losses)	(2,219)	10,929	11,232	12,244
Total net realized investment gains (losses)	(2,219)	10,929	11,061	2,578
Other income	2,250	2,181	4,071	4,535
Total revenues	205,577	214,801	428,575	408,189
Expenses				
Net losses and loss adjustment expenses	115,550	106,899	234,701	217,854
Underwriting, policy acquisition and operating expenses				
Operating expense	34,972	32,456	69,454	67,802
DPAC amortization	22,913	21,578	45,540	43,121
Segregated portfolio cells dividend expense (income)	8,811	1,523	11,186	2,699
Interest expense	4,145	3,851	8,278	7,537
Total expenses	186,391	166,307	369,159	339,013
Income before income taxes	19,186	48,494	59,416	69,176
Provision for income taxes				
Current expense (benefit)	6,700	3,321	(1,579)	2,670
Deferred expense (benefit)	(7,032)	2,092	22	4,107
Total income tax expense (benefit)	(332)	5,413	(1,557)	6,777
Net income	19,518	43,081	60,973	62,399
Other comprehensive income (loss), after tax, net of reclassification adjustments	5,741	14,174	8,665	37,434
Comprehensive income	$25,259	$57,255	$69,638	$99,833
Earnings per share:				
Basic	$0.37	$0.81	$1.14	$1.17
Diluted	$0.36	$0.81	$1.14	$1.17
Weighted average number of common shares outstanding:				
Basic	53,402	53,205	53,359	53,182
Diluted	53,607	53,428	53,571	53,395
Cash dividends declared per common share	$0.31	$0.31	$0.62	$0.62

See accompanying notes.

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ProAssurance Corporation and Subsidiaries
Condensed Consolidated Statements of Cash Flows (Unaudited)
(In thousands)

	Six Months Ended June 30	
	2017	2016
Operating Activities		
Net income	$60,973	$62,399
Adjustments to reconcile income to net cash provided by operating activities:		
Depreciation and amortization, net of accretion	13,949	16,971
(Increase) decrease in cash surrender value of BOLI	(897)	(899)
Net realized investment (gains) losses	(11,061)	(2,578)
Share-based compensation	6,092	5,813
Deferred income taxes	22	4,107
Policy acquisition costs, net amortization (net deferral)	(3,400)	(3,325)
Equity in (earnings) loss of unconsolidated subsidiaries	(4,324)	3,259
Other	(438)	(1,247)
Other changes in assets and liabilities:		
Premiums receivable	(11,637)	(10,991)
Reinsurance related assets and liabilities	(7,291)	(10,786)
Other assets	(2,613)	16,019
Reserve for losses and loss adjustment expenses	(1,563)	(12,525)
Unearned premiums	24,932	23,148
Other liabilities	(8,730)	(3,134)
Net cash provided (used) by operating activities	54,014	86,231
Investing Activities		
Purchases of:		
Fixed maturities, available for sale	(359,080)	(373,180)
Equity securities, trading	(101,854)	(59,336)
Other investments	(8,879)	(11,382)
Funding of qualified affordable housing tax credit limited partnerships	(320)	(956)
Investment in unconsolidated subsidiaries	(19,787)	(28,096)
Proceeds from sales or maturities of:		
Fixed maturities, available for sale	434,075	387,496
Equity securities, trading	85,907	42,227
Other investments	12,689	7,216
Distributions from unconsolidated subsidiaries	34,024	5,180
Net sales or maturities (purchases) of short-term investments	172,250	(87,517)
Unsettled security transactions, net change	12,714	25,720
Purchases of capital assets	(6,593)	(5,219)
Other	(75)	1,573
Net cash provided (used) by investing activities	255,071	(96,274)

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	Six Months Ended June 30	
	2017	2016
Financing Activities		
Repayments under revolving credit agreement	(22,000)	—
Repurchase of common stock	—	(2,106)
Dividends to shareholders	(282,180)	(85,893)
External capital contribution received for segregated portfolio cells	162	4,740
Other	(4,951)	(2,629)
Net cash provided (used) by financing activities	(308,969)	(85,888)
Increase (decrease) in Cash and cash equivalents	116	(95,931)
Cash and cash equivalents at beginning of period	117,347	241,100
Cash and cash equivalents at end of period	$117,463	$145,169
Significant non-cash transactions		
Dividends declared and not yet paid	$16,524	$16,461

See accompanying notes.

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ProAssurance Corporation and Subsidiaries
Notes to Condensed Consolidated Financial Statements (Unaudited)
June 30, 2017

1. Basis of Presentation

The accompanying unaudited Condensed Consolidated Financial Statements include the accounts of ProAssurance Corporation and its consolidated subsidiaries (ProAssurance, PRA or the Company). The financial statements have been prepared in accordance with GAAP for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and notes required by GAAP for complete financial statements. In the opinion of management, all adjustments considered necessary for a fair presentation, consisting of normal recurring adjustments, have been included. ProAssurance's results for the six months ended June 30, 2017 are not necessarily indicative of the results that may be expected for the year ending December 31, 2017. The accompanying Condensed Consolidated Financial Statements should be read in conjunction with the Consolidated Financial Statements and Notes contained in ProAssurance's December 31, 2016 report on Form 10-K. In connection with its preparation of the Condensed Consolidated Financial Statements, ProAssurance evaluated events that occurred subsequent to June 30, 2017 for recognition or disclosure in its financial statements and notes to financial statements.

ProAssurance operates in four reportable segments as follows: Specialty P&C, Workers' Compensation, Lloyd's Syndicate and Corporate. For more information on the nature of products and services provided and for financial information by segment, refer to Note 11 of the Notes to Condensed Consolidated Financial Statements.

Reclassifications

In the second quarter of 2017, ProAssurance began presenting separately the components of Underwriting, policy acquisition and operating expense as Operating expense and DPAC amortization on the Condensed Consolidated Statements of Income and Comprehensive Income in order to provide additional details for investors. The Condensed Consolidated Statements of Income and Comprehensive Income for the three and six months ended June 30, 2016 have been reclassified to conform to the current period presentation. Total Underwriting, policy acquisition and operating expense as well as Net income for all periods presented was not affected by the change in presentation.

Other Liabilities

Other liabilities consisted of the following:

(In thousands)	June 30, 2017	December 31, 2016
SPC dividends payable	$40,625	$ 34,289
Unpaid dividends	16,524	265,659
All other	112,661	122,337
Total other liabilities	$169,810	$ 422,285

SPC dividends payable are the cumulative undistributed earnings contractually payable to the external preferred shareholders of SPCs operated by ProAssurance's Cayman Islands subsidiary, Eastern Re.

Unpaid dividends represent common stock dividends declared by ProAssurance's Board of Directors that had not yet been paid. Unpaid dividends at December 31, 2016 reflect a special dividend declared in late 2016 that was paid in January 2017.

Accounting Changes Adopted

Improvements to Employee Share-Based Payment Accounting

Effective for fiscal years beginning after December 15, 2016 and interim periods within those fiscal years, the FASB issued guidance that simplifies several aspects of the accounting for share-based payment transactions, including the income tax consequences, classification of cash flows, and the classification of awards as either equity or liabilities. Under the new guidance, the difference between the deduction for tax purposes and the compensation cost recognized for financial reporting purposes is to be recognized as income tax expense in the current period and included with other income tax cash flows as an operating activity. The threshold for equity classification has also been revised to permit withholdings up to the maximum statutory tax rates in the applicable jurisdictions. The update also provides an accounting policy election to account for forfeitures as they occur. ProAssurance adopted the guidance as of January 1, 2017. The primary effects of the adoption on the current period are the following: (1) using a prospective application, ProAssurance recorded unrecognized excess tax benefits of $0.3 million and $2.6 million for the three and six months ended June 30, 2017, respectively, as a current tax expense, (2) using a modified retrospective application, ProAssurance elected to recognize forfeitures as they occur and recorded a $0.4 million increase to Additional paid-in capital and a respective $0.3 million reduction to Retained earnings and a $0.1 million increase to deferred taxes to reflect the incremental share-based compensation expense, net of related tax impacts, that would have been recognized in prior years under the modified guidance and (3) excess tax benefits from share-based compensation of $2.3 million was reclassified from financing activities to operating activities in the Condensed Consolidated Statements of Cash Flows.

Interests Held Through Related Parties that are Under Common Control

Effective for fiscal years beginning after December 15, 2016 and interim periods within those fiscal years, the FASB issued additional guidance regarding consolidation of legal entities such as LPs/LLCs and securitization structures (collateralized debt obligations, collateralized loan obligations, and mortgage-backed security transactions). The new guidance modifies the criteria used by a reporting entity when determining if it is a primary beneficiary of a VIE when there are entities under common control and the reporting entity has indirect interests in the VIE through related party relationships. ProAssurance adopted the guidance as of January 1, 2017. Adoption of the guidance had no material effect on ProAssurance's results of operations or financial position.

Simplifying the Transition to the Equity Method of Accounting

Effective for fiscal years beginning after December 15, 2016 and interim periods within those fiscal years, the FASB issued guidance that eliminates the requirement for retroactive restatement when an investment qualifies for use of the equity method as a result of an increase in the level of ownership interest or degree of influence. The new guidance provides that the cost of acquiring an additional interest in an investee is to be added to the current basis of an investor's previously held interest and the equity method of accounting adopted as of the date the investment becomes qualified for equity method accounting with no retroactive adjustment of the investment. If an available-for-sale equity security qualifies for the equity method of accounting, the unrealized holding gain or loss in AOCI is to be recognized through earnings at the date the investment becomes qualified for use of the equity method. ProAssurance adopted the guidance as of January 1, 2017. Adoption of the guidance had no material effect on ProAssurance's results of operations or financial position.

Accounting Changes Not Yet Adopted

Clarifying the Definition of a Business

Effective for fiscal years beginning after December 15, 2017 and interim periods within those fiscal years, the FASB issued guidance which provides clarification of the definition of a business, affecting areas such as acquisitions, disposals, goodwill and consolidation. The new guidance intends to assist entities with determining whether a transaction should be accounted for as an acquisition or disposal of assets or a business. ProAssurance plans to early adopt the guidance during 2017 for any acquisitions or dispositions. Adoption is not expected to have a material effect on ProAssurance's results of operations or financial position.

Restricted Cash

Effective for fiscal years beginning after December 15, 2017 and interim periods within those fiscal years, the FASB issued guidance related to the classification of restricted cash presented in the statement of cash flows with the objective of reducing diversity in practice. Under the new guidance, entities are required to include restricted cash and restricted cash equivalents with cash and cash equivalents when reconciling beginning-of-period and end-of-period total amounts as presented on the statement of cash flows. ProAssurance plans to adopt the guidance beginning January 1, 2018. Adoption is not expected to have a material effect on ProAssurance's results of operations, financial position or cash flows.

Intra-Entity Transfers of Assets Other than Inventory

Effective for fiscal years beginning after December 15, 2017 and interim periods within those fiscal years, the FASB issued guidance which reduces the complexity in accounting standards related to the income tax consequences of intra-entity transfers of assets other than inventory. Under the new guidance, entities are required to recognize income tax consequences of an intra-entity transfer of assets other than inventory when the transfer occurs instead of delaying recognition until the asset has been sold to an outside party. ProAssurance is in the process of evaluating the effect the new guidance would have on its results of operations and financial position and plans to adopt the guidance beginning January 1, 2018. Adoption of the guidance is not expected to have a material effect on ProAssurance’s results of operations or financial position.

Classification of Certain Cash Receipts and Cash Payments

Effective for fiscal years beginning after December 15, 2017 and interim periods within those fiscal years, the FASB issued guidance related to the classification of certain cash receipts and cash payments presented in the statement of cash flows with the objective of reducing diversity in practice. ProAssurance plans to adopt the guidance beginning January 1, 2018. Adoption is not expected to have a material effect on ProAssurance’s results of operations, financial position or cash flows.

Revenue from Contracts with Customers
Effective for fiscal years beginning after December 15, 2017 the FASB issued guidance related to revenue from contracts with customers. The core principle of the new guidance is that revenue is recognized to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. ProAssurance plans to adopt the guidance beginning January 1, 2018. As the majority of ProAssurance's revenues come from insurance contracts which fall under the scope of other FASB standards, adoption of the guidance is not expected to have a material effect on ProAssurance’s results of operations or financial position.
Recognition and Measurement of Financial Assets and Financial Liabilities
Effective for fiscal years beginning after December 15, 2017 and interim periods within those fiscal years, the FASB issued guidance that requires equity investments (except those accounted for under the equity method of accounting, or those that result in consolidation of the investee) to be measured at fair value with changes in fair value recognized in net income. The new guidance also specifies that an entity use the exit price notion when measuring the fair value of financial instruments for disclosure purposes and present financial assets and liabilities by measurement category and form of financial asset. Other provisions of the new guidance include: revised disclosure requirements related to the presentation in comprehensive income of changes in the fair value of liabilities; elimination, for public companies, of disclosure requirements relative to the method(s) and significant assumptions underlying fair values disclosed for financial instruments measured at amortized cost; and simplified impairment assessments for equity investments without readily determinable fair values. ProAssurance plans to adopt the guidance beginning January 1, 2018. Adoption of the guidance is not expected to have a material effect on ProAssurance’s results of operations or financial position.
Modification Accounting for Employee Share-Based Payment Awards
Effective for fiscal years beginning after December 15, 2017 and interim periods within those fiscal years, the FASB issued guidance which reduces the complexity in accounting standards when there is a change in the terms or conditions of a share-based payment award. The new guidance clarifies that an entity should apply the modification accounting guidance if the value, vesting conditions or classification of the award changes. ProAssurance plans to adopt the guidance beginning January 1, 2018. Adoption of the guidance is not expected to have a material effect on ProAssurance’s results of operations or financial position.
Premium Amortization on Purchased Callable Debt Securities
Effective for fiscal years beginning after December 15, 2018 and interim periods within those fiscal years, the FASB issued guidance that will require the premium for certain callable debt securities to be amortized over a shorter period than is currently required. Currently amortization is permitted over the contractual life of the instrument and the guidance shortens the amortization to the earliest call date. The purpose of the guidance is to more closely align the amortization period of premiums to expectations incorporated in market pricing on the underlying securities. ProAssurance plans to adopt the guidance beginning January 1, 2019. Adoption of the guidance is not expected to have a material effect on ProAssurance’s results of operations or financial position.
Leases
Effective for fiscal years beginning after December 15, 2018 and interim periods within those fiscal years, the FASB issued guidance that requires a lessee to recognize for all leases (with the exception of short-term leases) a lease liability, which is a lessee's obligation to make lease payments arising from a lease, measured on a discounted basis, and a right-of-use asset, which is an asset that represents the lessee's right to use, or control the use of, a specified asset for the lease term. ProAssurance plans to adopt the guidance beginning January 1, 2019. Adoption of the guidance is not expected to have a material effect on ProAssurance’s results of operations or financial position as ProAssurance does not have any leases it believes to be material.
Simplifying the Test for Goodwill Impairment

Effective for the fiscal years beginning after December 15, 2019 and interim periods within those fiscal years, the FASB issued guidance that simplifies the requirements to test goodwill for impairment for business entities that have goodwill reported in their financial statements. The guidance eliminates the second step of the impairment test which measures a goodwill impairment loss by comparing the implied fair value of a reporting unit's goodwill with the carrying amount. In addition, the guidance also eliminates the requirements for any reporting unit with a zero or negative carrying amount to perform a qualitative assessment. ProAssurance plans to adopt the guidance beginning January 1, 2020. Adoption is not expected to have a material effect on ProAssurance’s results of operations or financial position.

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Improvements to Financial Instruments - Credit Losses

Effective for fiscal years beginning after December 15, 2019 and interim periods within those fiscal years, the FASB issued guidance that replaces the incurred loss impairment methodology, which delays recognition of credit losses until a probable loss has been incurred, with a methodology that reflects expected credit losses and requires consideration of a broader range of reasonable and supportable information to inform credit loss estimates. Under the new guidance, credit losses are required to be recorded through an allowance for credit losses account and the income statement reflects the measurement for newly recognized financial assets, as well as increases or decreases of expected credit losses that have taken place during the period. ProAssurance is in the process of evaluating the effect the new guidance would have on its results of operations and financial position and plans to adopt the guidance beginning January 1, 2020. Adoption of the guidance is not expected to have a material effect on ProAssurance’s results of operations or financial position.

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2. Fair Value Measurement

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

Level 1:	quoted (unadjusted) market prices in active markets for identical assets and liabilities. For ProAssurance, Level 1 inputs are generally quotes for debt or equity securities actively traded in exchange or over-the-counter markets.
Level 2:	market data obtained from sources independent of the reporting entity (observable inputs). For ProAssurance, Level 2 inputs generally include quoted prices in markets that are not active, quoted prices for similar assets or liabilities, and results from pricing models that use observable inputs such as interest rates and yield curves that are generally available at commonly quoted intervals.
Level 3:	the reporting entity's own assumptions about market participant assumptions based on the best information available in the circumstances (non-observable inputs). For ProAssurance, Level 3 inputs are used in situations where little or no Level 1 or 2 inputs are available or are inappropriate given the particular circumstances. Level 3 inputs include results from pricing models for which some or all of the inputs are not observable, discounted cash flow methodologies, single non-binding broker quotes and adjustments to externally quoted prices that are based on management judgment or estimation.

Fair values of assets measured at fair value on a recurring basis as of June 30, 2017 and December 31, 2016 are shown in the following tables. Where applicable, the tables also indicate the fair value hierarchy of the valuation techniques utilized to determine those fair values. For some assets, the inputs used to measure fair value may fall into different levels of the fair value hierarchy. When this is the case, the asset is categorized based on the level of the most significant input to the fair value measurement. Assessments of the significance of a particular input to the fair value measurement require judgment and consideration of factors specific to the assets being valued.

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	June 30, 2017 Fair Value Measurements Using			Total
(In thousands)	Level 1	Level 2	Level 3	Fair Value
Assets:				
Fixed maturities, available for sale				
U.S. Treasury obligations	$ —	$ 143,453	$ —	$ 143,453
U.S. Government-sponsored enterprise obligations	—	20,192	—	20,192
State and municipal bonds	—	721,836	—	721,836
Corporate debt, multiple observable inputs	2,406	1,292,473	—	1,294,879
Corporate debt, limited observable inputs	—	—	17,849	17,849
Residential mortgage-backed securities	—	206,415	—	206,415
Agency commercial mortgage-backed securities	—	11,960	—	11,960
Other commercial mortgage-backed securities	—	17,157	—	17,157
Other asset-backed securities	—	109,361	3,005	112,366
Equity securities				