

PROASSURANCE CORP  
Form 10-Q  
May 09, 2007

**Table of Contents**

**UNITED STATES SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549  
FORM 10-Q**

(Mark One)

**Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934  
For the quarterly period ended March 31, 2007 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 of 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  No

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 (Check one):

Large Accelerated Filer  Accelerated Filer  Non-Accelerated Filer

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

As of April 27, 2007 there were 33,335,826 shares of the registrant's common stock outstanding.

**Table of Contents**

**Forward-Looking Statements**

Any statements in this Form 10Q 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 10Q 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:

- 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.

**TABLE OF CONTENTS**

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

ITEM 4. CONTROLS AND PROCEDURES

Part II Other Information

ITEM 1. LEGAL PROCEEDINGS

ITEM 1A. RISK FACTORS

ITEM 6. EXHIBITS

SIGNATURE

EX-31.1 SECTION 302 CERTIFICATION OF THE CEO

EX-31.2 SECTION 302 CERTIFICATION OF THE CFO

EX-32.1 SECTION 906 CERTIFICATION OF THE CEO

EX-32.2 SECTION 906 CERTIFICATION OF THE CFO

---

**Table of Contents**

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

	<b>March 31</b> <b>2007</b> <b>(Unaudited)</b>	December 31 2006
<b>Assets</b>		
Investments		
Fixed maturities available for sale, at fair value	<b>\$3,080,872</b>	\$3,136,222
Fixed maturities, trading, at fair value	<b>49,665</b>	49,218
Equity securities, available for sale, at fair value	<b>6,898</b>	7,220
Equity securities, trading, at fair value	<b>8,217</b>	7,638
Short-term investments	<b>326,611</b>	184,280
Business owned life insurance	<b>59,293</b>	58,721
Investment in unconsolidated subsidiaries	<b>10,198</b>	9,331
Other	<b>72,530</b>	39,468
<b>Total investments</b>	<b>3,614,284</b>	3,492,098
Cash and cash equivalents	<b>1,477</b>	29,146
Premiums receivable	<b>123,204</b>	113,023
Receivable from reinsurers on unpaid losses and loss adjustment expenses	<b>373,374</b>	370,763
Prepaid reinsurance premiums	<b>18,766</b>	18,954
Deferred taxes	<b>109,039</b>	112,201
Real estate, net	<b>23,079</b>	23,135
Other assets	<b>194,233</b>	183,533
	<b>\$4,457,456</b>	\$4,342,853
<b>Liabilities and Stockholders Equity</b>		
Liabilities		
Policy liabilities and accruals:		
Reserve for losses and loss adjustment expenses	<b>\$2,633,624</b>	\$2,607,148
Unearned premiums	<b>288,994</b>	253,773
Reinsurance premiums payable	<b>110,355</b>	106,176
<b>Total policy liabilities</b>	<b>3,032,973</b>	2,967,097
Other liabilities	<b>81,221</b>	78,032
Long-term debt	<b>179,288</b>	179,177
<b>Total liabilities</b>	<b>3,293,482</b>	3,224,306
Commitments and contingencies		
Stockholders Equity		
Common stock, par value \$0.01 per share 100,000,000 shares authorized, 33,456,764 and 33,398,028 shares issued, respectively	<b>335</b>	334
Additional paid-in capital	<b>501,020</b>	495,848
Accumulated other comprehensive income (loss), net of deferred tax expense (benefit) of \$866 and \$62, respectively	<b>1,605</b>	111

Edgar Filing: PROASSURANCE CORP - Form 10-Q

Retained earnings	<b>661,070</b>	622,310
	<b>1,164,030</b>	1,118,603
Less treasury stock, at cost, 121,765 shares	<b>(56)</b>	(56)
Total stockholders' equity	<b>1,163,974</b>	1,118,547
	<b>\$4,457,456</b>	\$4,342,853

Table of Contents

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

	Total	Accumulated Other Comprehensive Income (Loss)	Retained Earnings	Other Capital Accounts
Balance at December 31, 2006	\$1,118,547	\$ 111	\$622,310	\$496,126
Cumulative effect of accounting change	2,670		2,670	
Net income	36,090		36,090	
Change in net unrealized gains (losses) on investments, after tax, net of reclassification adjustments	1,494	1,494		
Common stock issued as compensation	2,736			2,736
Stock-based compensation	2,253			2,253
Common stock options exercised	184			184
Balance at March 31, 2007	\$1,163,974	\$ 1,605	\$661,070	\$501,299

	Total	Accumulated Other Comprehensive Income (Loss)	Retained Earnings	Other Capital Accounts
Balance at December 31, 2005	\$765,046	\$ (8,834)	\$385,885	\$387,995
Net income	137,276		137,276	
Change in net unrealized gains (losses) on investments, after tax, net of reclassification adjustments:				
Continuing operations	(15,652)	(15,652)		
Discontinued operations	373	373		
Common stock issued as compensation	2,477			2,477
Stock-based compensation:				



Edgar Filing: PROASSURANCE CORP - Form 10-Q

Continuing operations	1,995			1,995
Discontinued operations	642			642
Common stock options exercised	114			114
Balance at March 31, 2006	\$892,271	\$(24,113)	\$523,161	\$393,223
	4			

---

**Table of Contents**

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

	<b>Three Months Ended March 31</b>	
	<b>2007</b>	<b>2006</b>
Revenues:		
Gross premiums written	<b>\$ 185,302</b>	\$ 182,187
Net premiums written	<b>\$ 171,459</b>	\$ 172,632
Premiums earned	<b>\$ 150,685</b>	\$ 152,748
Premiums ceded	<b>(13,508)</b>	(10,318)
Net premiums earned	<b>137,177</b>	142,430
Net investment income	<b>42,571</b>	32,881
Equity in earnings of unconsolidated subsidiaries	<b>867</b>	1,481
Net realized investment gains (losses)	<b>(3,162)</b>	144
Other income	<b>1,424</b>	1,255
Total revenues	<b>178,877</b>	178,191
Expenses:		
Losses and loss adjustment expenses	<b>129,601</b>	121,598
Reinsurance recoveries	<b>(30,554)</b>	(10,466)
Net losses and loss adjustment expenses	<b>99,047</b>	111,132
Underwriting, acquisition and insurance expenses	<b>26,827</b>	26,453
Interest expense	<b>2,959</b>	2,556
Total expenses	<b>128,833</b>	140,141
Income from continuing operations before income taxes	<b>50,044</b>	38,050
Provision for income taxes:		
Current expense (benefit)	<b>11,598</b>	13,474
Deferred expense (benefit)	<b>2,356</b>	(3,259)
	<b>13,954</b>	10,215
Income from continuing operations	<b>36,090</b>	27,835
Income from discontinued operations, net of tax		109,441

Net income	<b>\$ 36,090</b>	\$137,276
Basic earnings per share:		
Income from continuing operations	<b>\$ 1.08</b>	\$ 0.89
Income from discontinued operations		3.51
Net income	<b>\$ 1.08</b>	\$ 4.40
Diluted earnings per share:		
Income from continuing operations	<b>\$ 1.02</b>	\$ 0.84
Income from discontinued operations		3.21
Net income	<b>\$ 1.02</b>	\$ 4.05
Weighted average number of common shares outstanding:		
Basic	<b>33,294</b>	31,155
Diluted	<b>36,157</b>	34,050

Table of Contents

**ProAssurance Corporation and Subsidiaries**  
**Condensed Consolidated Statements of Comprehensive Income (Unaudited)**  
**(In thousands)**

	<b>Three Months Ended</b>	
	<b>March 31</b>	
	<b>2007</b>	2006
Comprehensive income, after tax:		
Continuing operations:		
Income from continuing operations	<b>\$36,090</b>	\$ 27,835
Change in net unrealized gains (losses) on investments, after tax, net of reclassification adjustments	<b>1,494</b>	(15,652)
Comprehensive income, continuing operations	<b>\$37,584</b>	\$ 12,183
Discontinued operations:		
Income from discontinued operations	<b>\$</b>	\$109,441
Change in net unrealized gains (losses) on investments, after tax, net of reclassification adjustments		373
Comprehensive income, discontinued operations	<b>\$</b>	\$109,814

**Table of Contents**

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

	<b>Three Months Ended March 31</b>	
	<b>2007</b>	<b>2006</b>
<b>Continuing Operations:</b>		
<b>Operating Activities</b>		
Income from continuing operations	\$ 36,090	\$ 27,835
Depreciation and amortization	3,923	5,591
Net realized investment (gains) losses and net purchases of trading portfolio securities	2,892	(446)
Stock-based compensation	2,253	1,995
Changes in assets and liabilities:		
Premiums receivable	(10,181)	(7,159)
Reserve for losses and loss adjustment expenses	26,477	52,261
Unearned premiums	35,222	29,501
Reinsurance related assets and liabilities	1,756	(745)
Other	(11,410)	6,963
Net cash provided by operating activities	<b>87,022</b>	115,796
<b>Investing Activities</b>		
Purchases of:		
Fixed maturities available for sale	(370,347)	(768,140)
Equity securities available for sale	(95)	
Other investments	(1,571)	(364)
Proceeds from sale or maturities of:		
Fixed maturities available for sale	400,629	713,564
Equity securities available for sale	315	235
Other investments	53	
Net (increase) decrease in short-term investments	(142,331)	(431,154)
Proceeds from sale of discontinued operations, net of sales expense paid of \$4,080		371,037
Other	(1,469)	(51)
Net cash used by investing activities of continuing operations	<b>(114,816)</b>	(114,873)
<b>Financing Activities</b>		
Cash received from options exercises	116	119
Excess tax benefit from options exercises	9	602
Net cash provided by financing activities of continuing operations	<b>125</b>	721

Edgar Filing: PROASSURANCE CORP - Form 10-Q

Increase (decrease) in cash and cash equivalents	<b>(27,669)</b>	1,644
Cash and cash equivalents at beginning of period	<b>29,146</b>	34,506
Cash and cash equivalents at end of period	<b>\$ 1,477</b>	\$ 36,150

**Significant Non-cash Transactions:**

Fixed maturities securities received as proceeds from sale of discontinued operations	<b>\$</b>	\$ 24,819
Fixed maturity securities transferred, at fair value, to other investments	<b>\$ 34,732</b>	\$

**Table of Contents**

**ProAssurance Corporation and Subsidiaries**  
**Notes to Condensed Consolidated Financial Statements (Unaudited)**  
**March 31, 2007**

**1. Basis of Presentation**

The accompanying unaudited condensed consolidated financial statements include the accounts of ProAssurance Corporation and its consolidated subsidiaries (ProAssurance). The financial statements have been prepared in accordance with accounting principles generally accepted in the United States (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, consisting of normal recurring adjustments, considered necessary for a fair presentation have been included. Operating results for the three months ended March 31, 2007 are not necessarily indicative of the results that may be expected for the year ending December 31, 2007. The accompanying condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes contained in ProAssurance's December 31, 2006 report on Form 10-K.

**Reclassifications/Investment in Unconsolidated Subsidiaries**

In 2007, due to anticipated changes to the significance of the amounts involved, ProAssurance has separately reported its investments in unconsolidated subsidiaries and its equity in the earnings of unconsolidated subsidiaries. Previously, investments in unconsolidated subsidiaries were included as a component of other investments, and earnings of unconsolidated subsidiaries were considered as a component of net investment income. Prior period balances in this report have been reclassified to conform to the 2007 presentation. The reclassification had no effect on income from continuing operations, net income or total assets.

Investments in unconsolidated subsidiaries consist of ownership interests in non-public investment entities. ProAssurance uses the equity method of accounting for investments in entities in which its ownership interest does not require consolidation but for which ProAssurance's ownership interest is a greater than minor interest. ProAssurance includes its proportionate share of the income (losses) of its unconsolidated subsidiaries in its results of operations as a separate line item in its Consolidated Statements of Income.

**Accounting Changes**

In June 2006, the Financial Accounting Standards Board (FASB) issued Interpretation No. 48, *Accounting for Uncertainty in Income Taxes, an interpretation of FAS 109, Accounting for Income Taxes* (FIN 48), to create a single model to address accounting for uncertainty in tax positions. FIN 48 clarifies the accounting for income taxes, by prescribing a minimum recognition threshold that a tax position is required to meet before being recognized in the financial statements. FIN 48 also provides guidance on derecognition, measurement, classification, interest and penalties, accounting for interim periods, disclosure and transition. FIN 48 is effective for fiscal years beginning after December 15, 2006. ProAssurance adopted FIN 48 as of January 1, 2007. The cumulative effect of adopting FIN 48 increased retained earnings and reduced tax liabilities by \$2.7 million.

**Recent Accounting Developments**

In September 2006, the FASB issued Statement of Financial Accounting Standard (SFAS) 157, *Fair Value Measurements* (SFAS 157). The standard establishes a framework for measuring fair value under GAAP and expands disclosures about fair value measurements. SFAS 157 is applicable to other accounting pronouncements that require or permit fair value measurements but does not require any new fair value measurements. The statement is effective for fiscal years beginning after November 15, 2007, unless early adopted. ProAssurance will adopt SFAS 157 on its effective date, and does not expect the implementation of SFAS 157 to have a material effect on its results of operation or financial condition.

**Table of Contents**

**ProAssurance Corporation and Subsidiaries**  
**Notes to Condensed Consolidated Financial Statements (Unaudited)**  
**March 31, 2007**

**1. Basis of Presentation (continued)**

In February 2007, the FASB issued SFAS 159, *The Fair Value Option for Financial Assets and Financial Liabilities Including an Amendment of FASB Statement No. 115* (SFAS 159). SFAS 159 allows many financial assets and liabilities and other items to be reported at fair value that are not currently measured at fair value; unrealized gains and losses on items for which the fair value option has been elected would be reported in earnings at each subsequent reporting date. SFAS 159 also establishes new disclosure requirements with respect to fair values. SFAS 159 is effective for fiscal years beginning after November 15, 2007, unless early adopted. ProAssurance will adopt SFAS 159 on its effective date, but has not completed its determination of the effect, if any, of adoption on its results of operation or financial condition.

**2. Acquisitions**

ProAssurance acquired 100% of the outstanding shares of Physicians Insurance Company of Wisconsin, Inc. (PIC Wisconsin) on August 1, 2006 as a means of expanding its operations geographically. PIC Wisconsin is an insurance company that focuses on medical professional insurance; its largest premium states are Wisconsin and Iowa.

The acquisition was a stock-for-stock transaction accounted for as a purchase transaction in accordance with SFAS 141. The aggregate purchase price of \$103.7 million was allocated to the assets acquired and liabilities assumed based on their respective fair values at the date of acquisition. Goodwill of \$42.7 million was recognized equal to the excess of the purchase price over the fair values of the identifiable net assets acquired.

For additional information regarding the acquisition of PIC Wisconsin see Note 2 of the Notes to the Consolidated Financial Statements in ProAssurance's December 31, 2006 Annual Report on Form 10K.

**3. Discontinued Operations**

Effective January 1, 2006 ProAssurance sold its wholly owned subsidiaries, MEEMIC Insurance Company, Inc. and MEEMIC Insurance Services (collectively, the MEEMIC Companies) to Motors Insurance Corporation, a subsidiary of GMAC Insurance Holdings, Inc., for total consideration of \$400 million before taxes and transaction expenses.

The MEEMIC Companies were the only active entities of ProAssurance's personal lines operations. In accordance with SFAS 144, the assets, liabilities and operating results attributed to the personal lines operations are reported as discontinued operations in the Condensed Consolidated Financial Statements. In 2006, income from discontinued operations consists solely of the gain recognized on the sale of \$164.0 million net of related taxes of \$54.6 million.

For additional information regarding the sale of the MEEMIC Companies see Note 3 of the Notes to the Consolidated Financial Statements in ProAssurance's December 31, 2006 Annual Report on Form 10K.



**Table of Contents**

**ProAssurance Corporation and Subsidiaries**  
**Notes to Condensed Consolidated Financial Statements (Unaudited)**  
**March 31, 2007**

**4. Investments**

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

	March 31, 2007			Estimated Fair Value
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized (Losses)	
	<i>In thousands</i>			
Fixed maturities	\$3,080,759	\$20,468	\$(20,355)	\$3,080,872
Equity securities	4,536	2,383	(21)	6,898
	<b>\$3,085,295</b>	<b>\$22,851</b>	<b>\$(20,376)</b>	<b>\$3,087,770</b>
	December 31, 2006			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized (Losses)	Estimated Fair Value
	<i>In thousands</i>			
Fixed maturities	\$3,138,648	\$22,725	\$(25,151)	\$3,136,222
Equity securities	4,618	2,602		7,220
	<b>\$3,143,266</b>	<b>\$25,327</b>	<b>\$(25,151)</b>	<b>\$3,143,442</b>

In January 2007, ProAssurance transferred high yield asset backed bonds (previously considered as available-for-sale securities) having a fair value of approximately \$34.7 million to an investment fund created for the purpose of managing such investments. ProAssurance maintains a direct beneficial interest in securities originally contributed to the fund, and the securities are included in the ProAssurance Balance Sheet at fair value (\$31.5 million at March 31, 2007) as a component of other investments. During the three months ended March 31, 2007 ProAssurance recognized other-than-temporary impairments of \$4.2 million related to the securities contributed to the fund.

Cash flows from this initial investment will be re-invested in an undivided interest of the fund. The equity method of accounting will be used to account for this undivided interest, as the investment will be considered an investment in an unconsolidated subsidiary.

Proceeds from sales of fixed maturities and equity securities during the three months ended March 31, 2007 and 2006 are \$326.6 million and \$660.7 million, respectively, including proceeds from sales of adjustable rate, short-duration fixed maturities of approximately \$239.0 million and \$588.3 million, respectively. Purchases of those securities approximated \$128.3 million and \$623.7 million during the same respective periods.

Net realized investment gains (losses) are comprised of the following:

	Three Months Ended March 31	
	2007	2006
	<i>In thousands</i>	
Gross realized gains	\$ 442	\$ 723

Gross realized (losses)	(182)	(67)
Other than temporary impairment (losses)	(4,174)	(571)
Trading portfolio net gains (losses)	752	59
Net realized investment gains (losses)	\$ (3,162)	\$ 144

### 5. Income Taxes

The provision for income taxes is different from that which would be obtained by applying the statutory Federal income tax rate to income before taxes primarily because a portion of ProAssurance's investment income is tax-exempt.

ProAssurance adopted the provisions of FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes, on January 1, 2007. In accordance with the guidance provided in the

**Table of Contents**

**ProAssurance Corporation and Subsidiaries**  
**Notes to Condensed Consolidated Financial Statements (Unaudited)**  
**March 31, 2007**

**5. Income Taxes (continued)**

statement, the cumulative effect of adoption, a \$2.7 million reduction in tax liabilities, was recorded as an increase to beginning retained earnings.

ProAssurance recognizes tax-related interest and penalties as a component of tax expense. No interest or penalties were accrued or paid during the three months ended March 31, 2007 nor was there any liability for such amounts at March 31, 2007.

ProAssurance files income tax returns in the U.S. federal jurisdiction and various states. With few exceptions, ProAssurance is no longer subject to examinations by authorities related to its U.S federal or state income tax filings for years before 2003. Currently, no income tax returns are under examination by the Internal Revenue Service or any state or local taxing authority.

**6. Deferred Policy Acquisition Costs**

Costs that vary with and are directly related to the production of new and renewal premiums (primarily premium taxes, commissions and underwriting salaries) are deferred to the extent they are recoverable against unearned premiums and are amortized as related premiums are earned. Income from continuing operations includes amortization of deferred policy acquisition costs, net of ceding commissions earned, of \$13.6 million and \$13.0 million for the three months ended March 31, 2007 and 2006, respectively.

**7. Reserves for Losses and Loss Adjustment Expenses**

ProAssurance establishes its reserve for losses based on estimates of individual claims and actuarially determined estimates of future losses based on ProAssurance's past loss experience, available industry data and projections as to future claims frequency, severity, inflationary trends and settlement patterns. Estimating reserves, and particularly liability reserves, is a complex process. Claims may be resolved over