

HANOVER INSURANCE GROUP, INC.
Form 10-Q
August 01, 2014

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 June 30, 2014

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

For the transition period from _____ to _____

Commission File Number 1-13754

THE HANOVER INSURANCE GROUP, INC.

(Exact name of registrant as specified in its charter)

Delaware 04-3263626
(State or other jurisdiction of (I.R.S. Employer

incorporation or organization) Identification No.)
440 Lincoln Street, Worcester, Massachusetts 01653

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(Address of principal executive offices) (Zip Code)

(508) 855-1000

(Registrant's telephone number, including area code)

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

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

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

(Do not check if a smaller reporting company)

Smaller reporting company

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

The number of shares outstanding of the registrant's common stock was 44,189,747 as of July 30, 2014.

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PART I - FINANCIAL INFORMATION
 ITEM 1 - FINANCIAL STATEMENTS

THE HANOVER INSURANCE GROUP, INC. AND SUBSIDIARIES
 CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)

(In millions, except per share data)	Three Months Ended		Six Months Ended	
	June 30, 2014	2013	June 30, 2014	2013
Revenues				
Premiums	\$ 1,174.7	\$ 1,090.8	\$ 2,337.7	\$ 2,185.1
Net investment income	67.0	67.9	134.0	135.2
Net realized investment gains (losses):				

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Net realized gains from sales and other	22.3	14.8	26.7	23.4
Net other-than-temporary impairment losses on investments recognized in earnings	(0.1)	(1.1)	(0.1)	(1.6)
Total net realized investment gains	22.2	13.7	26.6	21.8
Fees and other income	9.1	10.2	18.6	20.8
Total revenues	1,273.0	1,182.6	2,516.9	2,362.9
Losses and expenses				
Losses and loss adjustment expenses	725.5	692.1	1,476.0	1,375.5
Amortization of deferred acquisition costs	259.6	232.7	513.3	475.2
Interest expense	16.3	17.4	32.6	32.1
Other operating expenses	163.9	174.5	315.2	325.3
Total losses and expenses	1,165.3	1,116.7	2,337.1	2,208.1
Income before income taxes	107.7	65.9	179.8	154.8
Income tax expense (benefit):				
Current	(1.6)	(0.5)	7.6	3.5
Deferred	26.8	13.3	35.0	31.8
Total income tax expense	25.2	12.8	42.6	35.3
Income from continuing operations	82.5	53.1	137.2	119.5
Net gain from discontinued operations (net of tax benefit (expense) of \$0.1 and \$(0.1) for the three months ended June 30, 2014 and June 30, 2013 and \$0.2 for the six months ended June 30, 2014)	0.1	0.3	-	0.1
Net income	\$ 82.6	\$ 53.4	\$ 137.2	\$ 119.6
Earnings per common share:				
Basic:				
Income from continuing operations	\$ 1.87	\$ 1.21	\$ 3.12	\$ 2.70
Net gain from discontinued operations	0.01	-	-	-
Net income per share	\$ 1.88	\$ 1.21	\$ 3.12	\$ 2.70
Weighted average shares outstanding	44.1	44.0	44.0	44.3
Diluted:				
Income from continuing operations	\$ 1.84	\$ 1.19	\$ 3.06	\$ 2.65
Net gain from discontinued operations	-	-	-	0.01
Net income per share	\$ 1.84	\$ 1.19	\$ 3.06	\$ 2.66
Weighted average shares outstanding	44.9	44.8	44.8	45.0

The accompanying notes are an integral part of these interim consolidated financial statements.

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THE HANOVER INSURANCE GROUP, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (UNAUDITED)

(In millions)	Three Months		Six Months Ended	
	Ended June 30, 2014	2013	June 30, 2014	2013
Net income	\$ 82.6	\$ 53.4	\$ 137.2	\$ 119.6
Other comprehensive income (loss), net of tax:				
Available-for-sale securities and derivative instruments:				
Net appreciation (depreciation) during the period	34.3	(138.2)	81.5	(132.7)
Change in other-than-temporary impairment losses recognized in other comprehensive income	-	0.8	1.6	0.7
Total available-for-sale securities and derivative instruments	34.3	(137.4)	83.1	(132.0)
Pension and postretirement benefits:				
Amortization recognized as net periodic benefit and postretirement cost	1.6	4.1	3.4	6.0
Cumulative foreign currency translation adjustment:				
Amount recognized as cumulative foreign currency translation during the period	3.1	(0.1)	3.0	(10.1)
Total other comprehensive income (loss), net of tax	39.0	(133.4)	89.5	(136.1)
Comprehensive income (loss)	\$ 121.6	\$ (80.0)	\$ 226.7	\$ (16.5)

The accompanying notes are an integral part of these interim consolidated financial statements.

Table of ContentsTHE HANOVER INSURANCE GROUP, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS (UNAUDITED)

(In millions, except share data)	June 30, 2014	December 31, 2013
Assets		
Investments:		
Fixed maturities, at fair value (amortized cost of \$6,785.1 and \$6,815.2)	\$ 7,058.5	\$ 6,970.6
Equity securities, at fair value (cost of \$446.4 and \$366.5)	530.5	430.2
Other investments	238.5	192.5
Total investments	7,827.5	7,593.3
Cash and cash equivalents	606.2	486.2
Accrued investment income	70.0	68.0
Premiums and accounts receivable, net	1,515.9	1,324.6
Reinsurance recoverable on paid and unpaid losses and unearned premiums	2,416.7	2,335.0
Deferred acquisition costs	540.6	506.0
Deferred income taxes	145.6	239.7
Goodwill	185.2	184.9
Other assets	542.1	526.1
Assets of discontinued operations	115.0	114.9
Total assets	\$ 13,964.8	\$ 13,378.7
Liabilities		
Loss and loss adjustment expense reserves	\$ 6,448.0	\$ 6,231.5
Unearned premiums	2,689.0	2,515.8
Expenses and taxes payable	569.7	637.2
Reinsurance premiums payable	443.2	374.7
Debt	903.9	903.9
Liabilities of discontinued operations	115.9	121.1
Total liabilities	11,169.7	10,784.2
Commitments and contingencies		
Shareholders' Equity		
Preferred stock, par value \$0.01 per share; 20.0 million shares authorized; none issued	-	-
Common stock, par value \$0.01 per share; 300.0 million shares authorized; 60.5 million shares issued	0.6	0.6
Additional paid-in capital	1,824.5	1,830.1
Accumulated other comprehensive income	267.1	177.6
Retained earnings	1,451.7	1,349.1
Treasury stock at cost (16.6 and 16.8 million shares)	(748.8)	(762.9)
Total shareholders' equity	2,795.1	2,594.5
Total liabilities and shareholders' equity	\$ 13,964.8	\$ 13,378.7

The accompanying notes are an integral part of these interim consolidated financial statements.

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THE HANOVER INSURANCE GROUP, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY (UNAUDITED)

(In millions)	Six Months Ended	
	June 30, 2014	2013
Preferred Stock		
Balance at beginning and end of period	\$ -	\$ -
Common Stock		
Balance at beginning and end of period	0.6	0.6
Additional Paid-in Capital		
Balance at beginning of period	1,830.1	1,787.1
Employee and director stock-based awards and other	(5.6)	6.0
Balance at end of period	1,824.5	1,793.1
Accumulated Other Comprehensive Income (Loss), net of tax		
Net Unrealized Appreciation on Investments and Derivative Instruments:		
Balance at beginning of period	259.3	426.0
Net appreciation (depreciation) on available-for-sale securities and derivative instruments	83.1	(132.0)
Balance at end of period	342.4	294.0
Defined Benefit Pension and Postretirement Plans:		
Balance at beginning of period	(76.1)	(96.6)
Net amount recognized as net periodic benefit cost	3.4	6.0
Balance at end of period	(72.7)	(90.6)
Cumulative Foreign Currency Translation Adjustment:		
Balance at beginning of period	(5.6)	(3.6)
Amount recognized as cumulative foreign currency translation during the period	3.0	(10.1)
Balance at end of period	(2.6)	(13.7)
Total accumulated other comprehensive income	267.1	189.7
Retained Earnings		
Balance at beginning of period	1,349.1	1,211.6
Net income	137.2	119.6
Dividends to shareholders	(32.6)	(29.3)
Stock-based compensation	(2.0)	(19.5)
Balance at end of period	1,451.7	1,282.4
Treasury Stock		
Balance at beginning of period	(762.9)	(729.7)
Shares purchased at cost	(6.7)	(72.3)
Net shares reissued at cost under employee stock-based compensation plans	20.8	31.9
Balance at end of period	(748.8)	(770.1)
Total shareholders' equity	\$ 2,795.1	\$ 2,495.7

The accompanying notes are an integral part of these interim consolidated financial statements.

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THE HANOVER INSURANCE GROUP, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

(In millions)	Six Months Ended June 30, 2014	2013
Cash Flows From Operating Activities		
Net income	\$ 137.2	\$ 119.6
Adjustments to reconcile net income to net cash provided by operating activities:		
Loss on repurchase of debt	-	11.3
Net realized investment gains	(26.6)	(21.8)
Net amortization and depreciation	16.9	17.4
Stock-based compensation expense	7.3	5.7
Amortization of defined benefit plan costs	5.2	9.2
Deferred income taxes expense	34.9	31.8
Change in deferred acquisition costs	(34.6)	(20.2)
Change in premiums receivable, net of reinsurance premiums payable	(122.8)	(115.7)
Change in loss, loss adjustment expense and unearned premium reserves	352.2	80.8
Change in reinsurance recoverable	(69.9)	45.3
Change in expenses and taxes payable	(101.8)	(111.4)
Other, net	(30.6)	(18.7)
	167.4	33.3

Net cash provided by
operating activities

Cash Flows From
Investing Activities

Proceeds from disposals and maturities of fixed maturities	669.0	869.5
Proceeds from disposals of equity securities and other investments	95.3	85.1
Purchase of fixed maturities	(583.4)	(603.8)
Purchase of equity securities and other investments	(196.4)	(206.9)
Capital expenditures	(7.4)	(10.7)
Net cash (used in) provided by investing activities	(22.9)	133.2

Cash Flows From
Financing Activities

Proceeds from exercise of employee stock options	6.7	15.1
Proceeds from debt borrowings, net	-	169.5
Change in cash collateral related to securities lending program	2.0	(17.7)
Dividends paid to shareholders	(32.6)	(29.3)
Repurchases of debt	(0.1)	(96.8)
Repurchases of common stock	(6.7)	(72.3)
Other financing activities	(2.3)	(3.3)
Net cash used in financing activities	(33.0)	(34.8)
Effect of exchange rate changes on cash	8.5	(6.2)
Net change in cash and cash equivalents	120.0	125.5
Net change in cash related to discontinued operations	-	0.1
Cash and cash equivalents, beginning of period	486.2	564.8

Cash and cash equivalents, end of period	\$	606.2	\$	690.4
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The accompanying notes are an integral part of these interim consolidated financial statements.

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THE HANOVER INSURANCE GROUP, INC. AND SUBSIDIARIES

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

1. Basis of Presentation and Principles of Consolidation

The accompanying unaudited consolidated financial statements of The Hanover Insurance Group, Inc. and subsidiaries (“THG” or the “Company”) have been prepared in accordance with generally accepted accounting principles in the United States of America (“U.S. GAAP”) for interim financial information and with the requirements of Form 10-Q. Certain financial information that is provided in annual financial statements, but is not required in interim reports, has been omitted.

The interim consolidated financial statements of THG include the accounts of The Hanover Insurance Company (“Hanover Insurance”) and Citizens Insurance Company of America, THG’s principal U.S. domiciled property and casualty companies; Chaucer Holdings plc (“Chaucer”), a specialist insurance underwriting group which operates through the Society and Corporation of Lloyd’s (“Lloyd’s”) and certain other insurance and non-insurance subsidiaries. These legal entities conduct their operations through several business segments discussed in Note 8 – “Segment Information”. Additionally, the interim consolidated financial statements include the Company’s discontinued operations, consisting primarily of the Company’s former life insurance businesses and its accident and health business. All intercompany accounts and transactions have been eliminated.

The preparation of financial statements in conformity with U.S. GAAP requires the Company to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amount of revenues and expenses during the reporting period. Actual results could differ from those estimates.

In the opinion of the Company’s management, the accompanying interim consolidated financial statements reflect all adjustments, consisting of normal recurring items, necessary for a fair presentation of the financial position and results of operations. The results of operations for the three and six months ended June 30, 2014 are not necessarily indicative of the results to be expected for the full year. These financial statements should be read in conjunction with the Company’s 2013 Annual Report on Form 10-K filed with the Securities and Exchange Commission (“SEC”) on February 25, 2014.

2. New Accounting Pronouncements

Recently Implemented Standards

In July 2013, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Codification (“ASC”) Update No. 2013-11 (Topic 740) Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists (a consensus of the FASB Emerging Issues Task Force). This ASC update clarifies the applicable guidance for the presentation of an unrecognized tax benefit when a net operating loss carryforward, a similar tax loss, or a tax credit carryforward exists. An unrecognized tax benefit, or a portion of an unrecognized tax benefit, should be presented in the financial statements as a reduction to a deferred tax asset for a net operating loss carryforward, a similar tax loss, or a tax credit carryforward as long as it is available, at the reporting date under the tax law of the applicable jurisdiction, to settle any additional income taxes that would result from the disallowance of a tax position (with certain exceptions). The assessment of whether a deferred tax asset is available is based on the unrecognized tax benefit and deferred tax asset that exist at the reporting date and should be made presuming disallowance of the tax position at the reporting date. This guidance was applicable for reporting periods beginning after December 15, 2013, with early adoption permitted, and was to be

applied prospectively to all unrecognized tax benefits that existed at the effective date. Retrospective application to all prior periods upon the date of adoption was permitted. The Company implemented this guidance effective January 1, 2014. The effect of implementing this guidance was not material to the Company's financial position or results of operations.

In March 2013, the FASB issued ASC Update No. 2013-05 (Topic 830) Foreign Currency Matters-Parent's Accounting for the Cumulative Translation Adjustment upon Derecognition of Certain Subsidiaries or Groups of Assets within a Foreign Entity or of an Investment in a Foreign Entity (a consensus of the FASB Emerging Issues Task Force). This ASC update clarifies the applicable guidance for the release of the cumulative translation adjustment into net income when a parent either sells all or a portion of its investment in a foreign entity. This guidance is also required to be applied when an entity no longer holds a controlling financial interest in a subsidiary or group of assets that is a nonprofit activity or a business within a foreign entity (with certain exceptions). Additionally, this update clarifies that the sale of an investment in a foreign entity includes events that result in an acquirer obtaining control of an acquiree in which it held an equity interest immediately before the acquisition date in a business combination achieved in stages. This guidance was applicable for reporting periods beginning after December 15, 2013, with early adoption permitted, and was to be applied prospectively to derecognition events occurring after the effective date. The Company implemented this guidance effective January 1, 2014. The effect of implementing this guidance was not material to the Company's financial position or results of operations.

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Recently Issued Standards

In April 2014, the FASB issued ASC Update No. 2014-08 (Topic 205 and Topic 360) Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity. This ASC update modifies the definition of discontinued operations by limiting discontinued operations reporting to disposals of components of an entity that represent strategic shifts that have (or will have) a major effect on an entity's operations and financial results. Also, this update requires additional financial statement disclosures about discontinued operations, as well as disposals of an individually significant component of an entity that do not qualify for discontinued operations presentation. This ASC update is effective for all disposals (or classifications as held for sale) of components of an entity that occur within annual and interim periods beginning on or after December 15, 2014 and for all businesses that, on acquisition, are classified as held for sale that also occur within interim and annual periods beginning on or after December 15, 2014. Early adoption is permitted for disposals (or classifications as held for sale) that have not been reported in financial statements previously issued or available for issuance. The Company does not expect the adoption of ASC Update 2014-08 to have a material impact on its financial position or results of operations.

In May 2014, the FASB issued ASC Update No. 2014-09 (Topic 606) Revenue from Contracts with Customers. This ASC was issued to clarify the principles for recognizing revenue. Insurance Contracts and financial instrument transactions are not within the scope of this updated guidance, and; therefore, only an insignificant amount of the Company's revenue is subject to this updated guidance. The updated guidance is effective for periods beginning after December 15, 2016 and is not expected to have a material effect on the Company's financial position or results of operations.

3. Income Taxes

Income tax expense for the six months ended June 30, 2014 and 2013 has been computed using estimated annual effective tax rates. These rates are revised, if necessary, at the end of each successive interim period to reflect current estimates of the annual effective tax rates.

For the six months ended June 30, 2014, the tax provision is comprised of a \$24.7 million U.S. federal income tax expense and a \$17.9 million foreign income tax expense. For the six months ended June 30, 2013, the tax provision was comprised of a \$17.6 million U.S. federal income tax expense and a \$17.7 million foreign income tax expense. Income tax expense for the six months ended June 30, 2014 included a benefit of \$4.4 million related to foreign exchange losses that will be deductible on the Company's 2013 U.S. tax return. This permanent tax item is not otherwise recognized in the Company's U.S. GAAP financial statements.

Although most of the Company's non-U.S. income is subject to U.S. federal income tax, certain of its non-U.S. income is not subject to U.S. federal income tax until repatriated. Foreign taxes on this non-U.S. income are accrued at the local foreign tax rate, as opposed to the higher U.S. statutory rate, since these earnings currently are expected to be indefinitely reinvested overseas. This assumption could change as a result of a sale of the subsidiaries, the receipt of dividends from the subsidiaries, a change in management's intentions, or as a result of various other events. The Company has not made a provision for U.S. taxes on \$5.6 million and \$10.3 million of non-U.S. income for the six months ended June 30, 2014 and 2013, respectively. However, in the future, if such earnings were distributed to the Company, taxes of \$14.9 million would be payable on such undistributed earnings and would be reflected in the tax provision for the year in which these earnings are no longer intended to be indefinitely reinvested overseas, assuming all foreign tax credits are realized.

In May 2014, the Company reached a final settlement with the IRS for years 2007 and 2008, related to the disallowance of deductions for certain loss reserves. As a result, a liability for uncertain tax positions was established for \$4.8 million, with an offsetting deferred tax asset. The IRS audits of the years 2009 and 2010 commenced in June 2012 and final settlement was reached in May 2014 with no additional tax liability.

The Company or its subsidiaries files income tax returns in the U.S. federal jurisdiction and various state jurisdictions, as well as foreign jurisdictions. With few exceptions, the Company and its subsidiaries are no longer subject to U.S. federal income tax examinations by tax authorities for years before 2011. The Company and its subsidiaries are still subject to U.S. state income tax examinations by tax authorities for years after 2006 and foreign examinations for years after 2011.

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4. Investments

A. Fixed maturities and equity securities

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

(in millions)	June 30, 2014				
	Amortized Cost or Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	OTTI Unrealized Losses
Fixed maturities:					
U.S. Treasury and government agencies	\$ 403.5	\$ 6.0	\$ 6.3	\$ 403.2	\$ -
Foreign government	319.7	2.6	1.3	321.0	-
Municipal	1,080.4	59.5	6.4	1,133.5	-
Corporate	3,718.3	205.4	15.0	3,908.7	7.4
Residential mortgage-backed	697.3	22.1	5.8	713.6	0.4
Commercial mortgage-backed	395.1	12.5	1.5	406.1	-
Asset-backed	170.8	1.7	0.1	172.4	-
Total fixed maturities	\$ 6,785.1	\$ 309.8	\$ 36.4	\$ 7,058.5	\$ 7.8
Equity securities	\$ 446.4	\$ 84.9	\$ 0.8	\$ 530.5	\$ -

(in millions)	December 31, 2013				
	Amortized Cost or Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	OTTI Unrealized Losses
Fixed maturities:					
U.S. Treasury and government agencies	\$ 417.5	\$ 3.3	\$ 14.2	\$ 406.6	\$ -
Foreign government	304.5	2.1	1.6	305.0	-
Municipal	1,108.0	37.4	19.1	1,126.3	-
Corporate	3,690.2	171.5	37.5	3,824.2	8.6
Residential mortgage-backed	722.8	20.1	14.1	728.8	1.6

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Commercial mortgage-backed	405.9	10.5	4.8	411.6	-
Asset-backed	166.3	2.0	0.2	168.1	-
Total fixed maturities	\$ 6,815.2	\$ 246.9	\$ 91.5	\$ 6,970.6	\$ 10.2
Equity securities	\$ 366.5	\$ 66.9	\$ 3.2	\$ 430.2	\$ -

Other-than-temporary impairments (“OTTI”) unrealized losses in the tables above represent OTTI recognized in accumulated other comprehensive income. This amount excludes net unrealized gains on impaired securities relating to changes in the value of such securities subsequent to the impairment measurement date of \$14.4 million and \$16.4 million as of June 30, 2014 and December 31, 2013, respectively.

The amortized cost and fair value by maturity periods for fixed maturities are shown below. Actual maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties, or the Company may have the right to put or sell the obligations back to the issuers.

(in millions)	June 30, 2014	
	Amortized Cost	Fair Value
Due in one year or less	\$ 400.6	\$ 404.8
Due after one year through five years	2,329.2	2,437.4
Due after five years through ten years	2,116.5	2,215.1
Due after ten years	675.6	709.1
	5,521.9	5,766.4
Mortgage-backed and asset-backed securities	1,263.2	1,292.1
Total fixed maturities	\$ 6,785.1	\$ 7,058.5

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B. Securities in an unrealized loss position

The following tables provide information about the Company's fixed maturities and equity securities that were in an unrealized loss position at June 30, 2014 and December 31, 2013.

(in millions)	June 30, 2014					
	12 months or less		Greater than 12 months		Total	
	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value
Fixed maturities:						
Investment grade:						
U.S. Treasury and government agencies	\$ -	\$ 6.4	\$ 6.3	\$ 152.0	\$ 6.3	\$ 158.4
Foreign governments	0.8	100.7	0.5	56.1	1.3	156.8
Municipal	0.4	53.3	5.7	158.9	6.1	212.2
Corporate	2.6	198.4	10.1	259.7	12.7	458.1
Residential mortgage-backed	0.5	39.7	5.3	135.5	5.8	175.2
Commercial mortgage-backed	0.1	31.3	1.4	65.4	1.5	96.7
Asset-backed	-	10.7	0.1	14.2	0.1	24.9
Total investment grade	4.4	440.5	29.4	841.8	33.8	1,282.3
Below investment grade:						
Municipal	0.3	4.4	-	-	0.3	4.4
Corporate	0.5	16.2	1.8	25.0	2.3	41.2
Total below investment grade	0.8	20.6	1.8	25.0	2.6	45.6
Total fixed maturities	5.2	461.1	31.2	866.8	36.4	1,327.9
Equity securities	-	10.0	0.8	3.4	0.8	13.4
Total	\$ 5.2	\$ 471.1	\$ 32.0	\$ 870.2	\$ 37.2	\$ 1,341.3

(in millions)	December 31, 2013					
	12 months or less		Greater than 12 months		Total	
	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value

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Fixed maturities:

Investment grade:

U.S. Treasury and government agencies	\$ 12.3	\$ 247.9	\$ 1.9	\$ 18.8	\$ 14.2	\$ 266.7
Foreign governments	1.5	129.0	0.1	17.3	1.6	146.3
Municipal	14.8	345.3	4.3	39.9	19.1	385.2
Corporate	21.4	872.7	11.6	87.7	33.0	960.4
Residential mortgage-backed	10.3	321.1	3.4	29.5	13.7	350.6
Commercial mortgage-backed	4.2	155.4	0.6	10.2	4.8	165.6
Asset-backed	0.2	31.0	-	0.3	0.2	31.3
Total investment grade	64.7	2,102.4	21.9	203.7	86.6	2,306.1
Below investment grade:						
Corporate	2.9	71.9	1.6	21.4	4.5	93.3
Residential mortgage-backed	0.1	2.0	0.3	1.5	0.4	3.5
Total below investment grade	3.0	73.9	1.9	22.9	4.9	96.8
Total fixed maturities	67.7	2,176.3	23.8	226.6	91.5	2,402.9
Equity securities	2.8	45.2	0.4	0.7	3.2	45.9
Total	\$ 70.5	\$ 2,221.5	\$ 24.2	\$ 227.3	\$ 94.7	\$ 2,448.8

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The Company views gross unrealized losses on fixed maturities and equity securities as being temporary since it is its assessment that these securities will recover in the near term, allowing the Company to realize the anticipated long-term economic value. The Company employs a systematic methodology to evaluate declines in fair value below amortized cost for fixed maturity securities or cost for equity securities. In determining OTTI of fixed maturity and equity securities, the Company evaluates several factors and circumstances, including the issuer's overall financial condition; the issuer's credit and financial strength ratings; the issuer's financial performance, including earnings trends, dividend payments and asset quality; any specific events which may influence the operations of the issuer; the general outlook for market conditions in the industry or geographic region in which the issuer operates; and the length of time and the degree to which the fair value of an issuer's securities remains below the Company's cost. With respect to fixed maturity investments, the Company considers any factors that might raise doubt about the issuer's ability to make contractual payments as they come due and whether the Company expects to recover the entire amortized cost basis of the security. With respect to equity securities, the Company considers its ability and intent to hold the investment for a period of time to allow for a recovery in value.

C. Proceeds from sales

The proceeds from sales of available-for-sale securities and gross realized gains and losses on those sales, were as follows:

(in millions)	Three Months Ended June 30,					
	2014			2013		
	Proceeds	Gross	Gross	Proceeds	Gross	Gross
	Sales	Gains	Losses	Sales	Gains	Losses
Fixed maturities	\$ 70.5	\$ 1.1	\$ 1.1	\$ 148.5	\$ 3.0	\$ 0.4
Equity securities	\$ 60.0	\$ 22.2	\$ 0.7	\$ 44.4	\$ 10.4	\$ 0.3

(in millions)	Six Months Ended June 30,					
	2014			2013		
	Proceeds	Gross	Gross	Proceeds	Gross	Gross
	Sales	Gains	Losses	Sales	Gains	Losses
Fixed maturities	\$ 208.1	\$ 3.3	\$ 2.3	\$ 285.7	\$ 4.6	\$ 1.0
Equity securities	\$ 72.4	\$ 24.1	\$ 0.8	\$ 78.9	\$ 17.0	\$ 0.3

D. Other-than-temporary impairments

For the three and six months ended June 30, 2014, OTTI of fixed maturities recognized in earnings was \$0.1 million, which was transferred from unrealized losses in accumulated other comprehensive income.

For the three months ended June 30, 2013, total OTTI of fixed maturities and equity securities were \$1.3 million. Of this amount, \$1.1 million was recognized in earnings and the remaining \$0.2 million was recorded as unrealized losses in accumulated other comprehensive income. For the first six months of 2013, total OTTI of fixed maturities and equities were \$2.0 million. Of this amount, \$1.6 million was recognized in earnings and the remaining \$0.4 million was recorded as unrealized losses in accumulated other comprehensive income.

There were no credit impairments in 2014. The methodology and significant inputs used to measure the amount of credit losses on fixed maturities in 2013 were as follows:

Asset-backed securities, including commercial and residential mortgage-backed securities – the Company utilized cash flow estimates based on bond specific facts and circumstances that include collateral characteristics, expectations of delinquency and default rates, loss severity, prepayment speeds and structural support, including subordination and guarantees.

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The following table provides rollforwards of the cumulative amounts related to the Company's credit loss portion of the OTTI losses on fixed maturity securities for which the non-credit portion of the loss is included in other comprehensive income.

(in millions)	Three Months		Six Months	
	Ended June 30, 2014	2013	Ended June 30, 2014	2013
Credit losses at beginning of period	\$ 5.3	\$ 8.6	\$ 7.8	\$ 8.6
Credit losses for which an OTTI was not previously recognized	-	0.1	-	0.3
Additional credit losses on securities for which an OTTI was previously recognized	-	-	-	0.2
Reductions for securities sold, matured or called	(0.6)	(1.4)	(3.1)	(1.8)
Reductions for securities reclassified as intended to sell	(0.4)	-	(0.4)	-
Credit losses at the end of period	\$ 4.3	\$ 7.3	\$ 4.3	\$ 7.3

E. Funds at Lloyd's

In accordance with Lloyd's operating guidelines, the Company deposits funds at Lloyd's to support underwriting operations. These funds are available only to fund claim obligations. These assets consisted of approximately \$403 million of fixed maturities and \$75 million of cash and cash equivalents as of June 30, 2014. The Company also deposits funds with various state and governmental authorities in the U.S. For a discussion of the Company's deposits with state and governmental authorities, see also Note 3 – "Investments" of the Notes to Consolidated Financial Statements in our Annual Report on Form 10-K for the year ended December 31, 2013.

5. Fair Value

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability, i.e., exit price, in an orderly transaction between market participants. The Company emphasizes the use of observable market data whenever available in determining fair value. Fair values presented for certain financial instruments are estimates which, in many cases, may differ significantly from the amounts that could be realized upon immediate liquidation. A hierarchy of the three broad levels of fair value are as follows, with the highest priority given to Level 1 as these are the most observable, and the lowest priority given to Level 3:

Level 1 – Unadjusted quoted prices in active markets for identical assets or liabilities.

Level 2 – Quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active, or other inputs that are observable or can be corroborated by observable market data, including model-derived valuations.

Level 3 – Unobservable inputs that are supported by little or no market activity.

When more than one level of input is used to determine fair value, the financial instrument is classified as Level 2 or 3 according to the lowest level input that has a significant impact on the fair value measurement.

The following methods and assumptions were used to estimate the fair value of each class of financial instruments and have not changed since last year.

Cash and Cash Equivalents

The carrying amount approximates fair value. Cash equivalents primarily consist of money market instruments, which are generally valued using unadjusted quoted prices in active markets that are accessible for identical assets and are classified as Level 1.

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Fixed Maturities

Level 1 securities generally include U.S. Treasury issues and other securities that are highly liquid and for which quoted market prices are available. Level 2 securities are valued using pricing for similar securities and pricing models that incorporate observable inputs including, but not limited to yield curves and issuer spreads. Level 3 securities include issues for which little observable data can be obtained, primarily due to the illiquid nature of the securities, and for which significant inputs used to determine fair value are based on the Company's own assumptions. Non-binding broker quotes are also included in Level 3.

The Company utilizes a third party pricing service for the valuation of the majority of its fixed maturity securities and receives one quote per security. When quoted market prices in an active market are available, they are provided by the pricing service as the fair value and such values are classified as Level 1. Since fixed maturities other than U.S. Treasury securities generally do not trade on a daily basis, the pricing service prepares estimates of fair value for those securities using pricing applications based on a market approach. Inputs into the fair value pricing common to all asset classes include: benchmark U.S. Treasury security yield curves; reported trades of identical or similar fixed maturity securities; broker/dealer quotes of identical or similar fixed maturity securities and structural characteristics such as maturity date, coupon, mandatory principal payment dates, frequency of interest and principal payments, and optional redemption features. Inputs into the fair value applications that are unique by asset class include, but are not limited to:

- U.S. government agencies – determination of direct versus indirect government support and whether any contingencies exist with respect to the timely payment of principal and interest.
- Foreign government – estimates of appropriate market spread versus underlying related sovereign treasury curve(s) dependent on liquidity and direct or contingent support.
- Municipals – overall credit quality, including assessments of the level and variability of: sources of payment such as income, sales or property taxes, levies or user fees; credit support such as insurance; state or local economic and political base; natural resource availability; and susceptibility to natural or man-made catastrophic events such as hurricanes, earthquakes or acts of terrorism.
- Corporate fixed maturities – overall credit quality, including assessments of the level and variability of: economic sensitivity; liquidity; corporate financial policies; management quality; regulatory environment; competitive position; ownership; restrictive covenants; and security or collateral.
- Residential mortgage-backed securities – estimates of prepayment speeds based upon: historical prepayment rate trends; underlying collateral interest rates; geographic concentration; vintage year; borrower credit quality characteristics; interest rate and yield curve forecasts; government or monetary authority support programs; tax policies; delinquency/default trends; and, in the case of non-agency collateralized mortgage obligations, severity of loss upon default and length of time to recover proceeds following default.
- Commercial mortgage-backed securities – overall credit quality, including assessments of the value and supply/demand characteristics of: collateral type such as office, retail, residential, lodging, or other; geographic concentration by region, state, metropolitan statistical area and locale; vintage year; historical collateral performance including defeasance, delinquency, default and special servicer trends; and capital structure support features.
- Asset-backed securities – overall credit quality, including assessments of the underlying collateral type such as credit card receivables, auto loan receivables and equipment lease receivables; geographic diversification; vintage year; historical collateral performance including delinquency, default and casualty trends; economic conditions influencing

use rates and resale values; and contract structural support features.

Generally, all prices provided by the pricing service, except actively traded securities with quoted market prices, are reported as Level 2.

The Company holds privately placed fixed maturity securities and certain other fixed maturity securities that do not have an active market and for which the pricing service cannot provide fair values. The Company determines fair values for these securities using either matrix pricing utilizing the market approach or broker quotes. The Company will use observable market data as inputs into the fair value applications, as discussed in the determination of Level 2 fair values, to the extent it is available, but is also required to use a certain amount of unobservable judgment due to the illiquid nature of the securities involved. Unobservable judgment reflected in the Company's matrix model accounts for estimates of additional spread required by market participants for factors such as issue size, structural complexity, high bond coupon or other unique features. These matrix-priced securities are reported as Level 2 or Level 3, depending on the significance of the impact of unobservable judgment on the security's value. Additionally, the Company may obtain non-binding broker quotes which are reported as Level 3.

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Equity Securities

Level 1 consists of publicly traded securities, including exchange traded funds, valued at quoted market prices. Level 2 includes securities that are valued using pricing models that incorporate observable inputs. Level 3 consists of common or preferred stock of private companies for which observable inputs are not available. Non-binding broker quotes are also included in Level 3.

The Company utilizes a third party pricing service for the valuation of the majority of its equity securities and receives one quote for each equity security. When quoted market prices in an active market are available, they are provided by the pricing service as the fair value and such values are classified as Level 1. The Company holds certain equity securities that have been issued by privately-held entities that do not have an active market and for which the pricing service cannot provide fair values. Generally, the Company estimates fair value for these securities based on the issuer's book value and market multiples. These securities are reported as Level 2 or Level 3 depending on the significance of the impact of unobservable judgment on the security's value.

Other Investments

Other investments consist primarily of overseas trust funds, for which fair values are provided by the investment manager based on quoted prices for similar instruments in active markets and are reported as Level 2. Also included in other investments are mortgage and other loans and cost basis limited partnerships. Fair values of mortgage and other loans are estimated by discounting the future contractual cash flows using the current rates at which similar loans would be made to borrowers with similar credit ratings and are reported as Level 2. The fair values of cost basis limited partnerships are based on the net asset value provided by the general partner and recent financial information and are reported as Level 3.

Debt

The fair value of debt is estimated based on quoted market prices. If a quoted market price is not available, fair values are estimated using discounted cash flows that are based on current interest rates and yield curves for debt issuances with maturities and credit risks consistent with the debt being valued. Debt is reported as Level 2.

The estimated fair value of the financial instruments were as follows:

(in millions)	June 30, 2014		December 31, 2013	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Financial Assets				
Cash and cash equivalents	\$ 606.2	\$ 606.2	\$ 486.2	\$ 486.2
Fixed maturities	7,058.5	7,058.5	6,970.6	6,970.6
Equity securities	530.5	530.5	430.2	430.2
Other investments	218.4	220.9	173.1	173.7
Total financial assets	\$ 8,413.6	\$ 8,416.1	\$ 8,060.1	\$ 8,060.7
Financial Liabilities				
Debt	\$ 903.9	\$ 1,030.7	\$ 903.9	\$ 961.7

The Company has processes designed to ensure that the values received from its third party pricing service are accurately recorded, that the data inputs and valuation techniques utilized are appropriate and consistently applied and that the assumptions are reasonable and consistent with the objective of determining fair value. The Company performs a review of the fair value hierarchy classifications and of prices received from its pricing service on a quarterly basis. The Company reviews the pricing services' policies describing its methodology, processes, practices and inputs, including various financial models used to value securities. Also, the Company reviews the portfolio pricing, including securities with changes in prices that exceed a defined threshold being verified to independent sources, if available. If upon review, the Company is not satisfied with the validity of a given price, a pricing challenge would be submitted to the pricing service along with supporting documentation for its review. The Company does not adjust quotes or prices obtained from the pricing service unless the pricing service agrees with the Company's challenge. During 2014 and 2013, the Company did not adjust any prices received from brokers or its pricing service.

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Changes in the observability of valuation inputs may result in a reclassification of certain financial assets or liabilities within the fair value hierarchy. Reclassifications between levels of the fair value hierarchy are reported as of the beginning of the period in which the reclassification occurs. As previously discussed, the Company utilizes a third party pricing service for the valuation of the majority of its fixed maturities and equity securities. The pricing service has indicated that it will only produce an estimate of fair value if there is objectively verifiable information to produce a valuation. If the pricing service discontinues pricing an investment, the Company will use observable market data to the extent it is available, but may also be required to make assumptions for market based inputs that are unavailable due to market conditions.

The following tables provide, for each hierarchy level, the Company's assets that were measured at fair value on a recurring basis.

(in millions)	June 30, 2014			
	Total	Level 1	Level 2	Level 3
Fixed maturities:				
U.S. Treasury and government agencies	\$ 403.2	\$ 160.5	\$ 242.7	\$ -
Foreign government	321.0	42.8	278.2	-
Municipal	1,133.5	-	1,106.7	26.8
Corporate	3,908.7	-	3,895.5	13.2
Residential mortgage-backed, U.S. agency backed	586.2	-	586.2	-
Residential mortgage-backed, non-agency	127.4	-	127.4	-
Commercial mortgage-backed	406.1	-	383.6	22.5
Asset-backed	172.4	-	172.4	-
Total fixed maturities	7,058.5	203.3	6,792.7	62.5
Equity securities	521.2	520.0	-	1.2
Other investments	138.5	-	134.9	3.6
Total investment assets at fair value	\$ 7,718.2	\$ 723.3	\$ 6,927.6	\$ 67.3

(in millions)	December 31, 2013			
	Total	Level 1	Level 2	Level 3
Fixed maturities:				
U.S. Treasury and government agencies	\$ 406.6	\$ 167.2	\$ 239.4	\$ -
Foreign government	305.0	45.6	259.4	-
Municipal	1,126.3	-	1,100.7	25.6

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Corporate	3,824.2	-	3,811.2	13.0
Residential mortgage-backed, U.S. agency backed	573.2	-	573.2	-
Residential mortgage-backed, non-agency	155.6	-	155.1	0.5
Commercial mortgage-backed	411.6	-	388.7	22.9
Asset-backed	168.1	-	168.1	-
Total fixed maturities	6,970.6	212.8	6,695.8	62.0
Equity securities	420.9	382.3	-	38.6
Other investments	153.2	-	149.6	3.6
Total investment assets at fair value	\$ 7,544.7	\$ 595.1	\$ 6,845.4	\$ 104.2

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The following tables provide, for each hierarchy level, the Company's estimated fair values of financial instruments that were not carried at fair value:

(in millions)	June 30, 2014			
	Total	Level 1	Level 2	Level 3
Assets:				
Cash and cash equivalents	\$ 606.2	\$ 606.2	\$ -	\$ -
Equity securities	9.3	-	9.3	-
Other investments	82.4	-	58.6	23.8
Liabilities:				
Debt	\$ 1,030.7	\$ -	\$ 1,030.7	\$ -

(in millions)	December 31, 2013			
	Total	Level 1	Level 2	Level 3
Assets:				
Cash and cash equivalents	\$ 486.2	\$ 486.2	\$ -	\$ -
Equity securities	9.3	-	9.3	-
Other investments	20.5	-	2.7	17.8
Liabilities:				
Debt	\$ 961.7	\$ -	\$ 961.7	\$ -

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The tables below provide a reconciliation for all assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3).

(in millions)	Fixed Maturities		Residential mortgage-backed non-agency	Commercial mortgage-backed	Total	Equity and Other	Total Assets
	Municipal	Corporate					
Three Months Ended June 30, 2014							
Balance April 1, 2014	\$ 29.6	\$ 13.2	\$ -	\$ 22.5	\$ 65.3	\$ 4.8	\$ 70.1
Transfers out of Level 3	(2.6)	-	-	-	(2.6)	-	(2.6)
Total gains: Included in other comprehensive income - net appreciation on available-for-sale securities	0.3	-	-	0.4	0.7	-	0.7
Sales	(0.5)	-	-	(0.4)	(0.9)	-	(0.9)
Balance June 30, 2014	\$ 26.8	\$ 13.2	\$ -	\$ 22.5	\$ 62.5	\$ 4.8	\$ 67.3
Three Months Ended June 30, 2013							
Balance April 1, 2013	\$ 28.8	\$ 22.8	\$ 0.6	\$ 24.8	\$ 77.0	\$ 28.6	\$ 105.6
Transfers out of Level 3	-	(2.2)	-	-	(2.2)	-	(2.2)
Total gains (losses): Included in other comprehensive income - net (depreciation) appreciation on available-for-sale securities	(0.4)	(0.9)	-	(0.9)	(2.2)	3.7	1.5
Sales	(0.5)	(0.2)	-	(0.3)	(1.0)	-	(1.0)
Balance June 30, 2013	\$ 27.9	\$ 19.5	\$ 0.6	\$ 23.6	\$ 71.6	\$ 32.3	\$ 103.9

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(in millions)	Fixed Maturities					Total	Equity and Other	Total Assets
	Municipal	Corporate	Residential mortgage-backed non-agency	Commercial mortgage-backed	Asset-backed			
Six Months Ended June 30, 2014								
Balance January 1, 2014	\$ 25.6	\$ 13.0	\$ 0.5	\$ 22.9	\$ -	\$ 62.0	\$ 42.2	\$ 104.2
Transfers into Level 3	2.2	-	-	-	-	2.2	-	2.2
Transfers out of Level 3	(2.6)	-	-	-	-	(2.6)	(37.4)	(40.0)
Total gains (losses):						-		
Included in other comprehensive income-net appreciation on available-for-sale securities	0.6	0.2	-	0.7	-	1.5	-	1.5
Purchases and sales:						-		
Purchases	2.5	-	-	-	-	2.5	-	2.5
Sales	(1.5)	-	(0.5)	(1.1)	-	(3.1)	-	(3.1)
Balance June 30, 2014	\$ 26.8	\$ 13.2	\$ -	\$ 22.5	\$ -	\$ 62.5	\$ 4.8	\$ 67.3
Six Months Ended June 30, 2013								
Balance January 1, 2013	\$ 19.4	\$ 26.4	\$ 0.7	\$ 26.7	\$ 1.5	\$ 74.7	\$ 28.0	\$ 102.7
Transfers into Level 3	9.7	0.2	-	-	-	9.9	-	9.9
Transfers out of Level 3	-	(2.2)	-	-	(1.5)	(3.7)	(0.9)	(4.6)
Total gains (losses):								
Included in earnings	-	0.4	-	-	-	0.4	-	0.4
Included in other comprehensive income-net (depreciation) appreciation on available-for-sale securities	(0.3)	(1.0)	-	(1.4)	-	(2.7)	5.2	2.5
Sales	(0.9)	(4.3)	(0.1)	(1.7)	-	(7.0)	-	(7.0)
Balance June 30, 2013	\$ 27.9	\$ 19.5	\$ 0.6	\$ 23.6	\$ -	\$ 71.6	\$ 32.3	\$ 103.9

During the three and six months ended June 30, 2014 and 2013, the Company transferred fixed maturities between Level 2 and Level 3 primarily as a result of assessing the significance of unobservable inputs on the fair value measurement. There were no transfers between Level 1 and Level 2 during the three months or six months ended June 30, 2014 or 2013.

There were no Level 3 liabilities held by the Company for the six months ended June 30, 2014 and 2013. The following table summarizes gains and losses due to changes in fair value that were recorded in net income for Level 3 assets:

	Three Months		Six Months	
	Ended June 30		Ended June 30	
	2014	2013	2014	2013
Net Realized Investment Gains				
(Losses)				
(in millions)				
Level 3 Assets:				
Fixed maturities:				
Corporate	\$ -	\$ -	\$ -	\$ 0.4

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The following table provides quantitative information about the significant unobservable inputs used by the Company in the fair value measurements of Level 3 assets. Where discounted cash flows were used in the valuation of fixed maturities, the internally-developed discount rate was adjusted by the significant unobservable inputs shown in the table. Valuations for securities based on broker quotes for which there was a lack of transparency as to inputs used to develop the valuations have been excluded.

(in millions)	Valuation Technique	Significant Unobservable Inputs	June 30, 2014		December 31, 2013	
			Fair Value	Range (Wtd Average)	Fair Value	Range (Wtd Average)
Fixed maturities:						
Municipal	Discounted cash flow	Discount for: Small issue size Above-market coupon	\$ 26.8	0.6-4.0% (2.1%) 0.3-1.0% (0.4%)	\$ 25.6	1.0-4.0% (2.3%) 0.3-1.0% (0.5%)
Corporate	Discounted cash flow	Discount for: Above-market coupon Small issue size	12.9	0.3-0.8% (0.6%) 0.3-1.0% (0.5%)	12.8	0.3-0.8% (0.6%) 0.3-1.0% (0.5%)
Residential mortgage-backed, non-agency	Discounted cash flow	Discount for: Small issue size	-	N/A	0.5	0.5% (0.5%)
Commercial mortgage-backed	Discounted cash flow	Discount for: Above-market coupon Credit stress Small issue size Lease structure Net tangible asset	22.5	0.5-0.8% (0.5%) 0.5% (0.5%) 0.5% (0.5%) 0.3% (0.3%)	22.9	0.5-0.8% (0.6%) 0.5% (0.5%) 0.5% (0.5%) 0.3% (0.3%)
Equity securities	Market comparables	market multiples	1.1	1.0X (1.0X)	38.5	1.3X (1.3X)
Other	Discounted cash flow	Discount rate	3.6	18.0% (18.0%)	3.6	18.0% (18.0%)

Significant increases (decreases) in any of the above inputs in isolation would result in a significantly lower (higher) fair value measurement. There were no interrelationships between these inputs which might magnify or mitigate the effect of changes in unobservable inputs on the fair value measurement.

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6. Pension and Other Postretirement Benefit Plans

The components of net periodic pension cost for defined benefit pension and other postretirement benefit plans included in the Company's results of operations are as follows:

	Three Months Ended June 30,			
	2014	2013	2014	2013
(in millions)	Pension Plans		Postretirement Plans	
Service cost - benefits earned during the period	\$ 0.3	\$ 0.5	\$ -	\$ 0.1
Interest cost	8.5	8.0	0.2	0.3
Expected return on plan assets	(9.1)	(8.9)	-	-
Recognized net actuarial loss	2.9	3.6	-	-
Amortization of prior service cost	0.1	-	(0.5)	(1.0)
Net settlement gain	-	-	-	(1.6)
Net periodic pension cost (benefit)	\$ 2.7	\$ 3.2	\$ (0.3)	\$ (2.2)

	Six Months Ended June 30,			
	2014	2013	2014	2013
(in millions)	Pension Plans		Postretirement Plans	
Service cost - benefits earned during the period	\$ 0.7	\$ 0.9	\$ -	\$ 0.1
Interest cost	16.9	15.9	0.4	0.8
Expected return on plan assets	(18.3)	(17.8)	-	-
Recognized net actuarial loss	5.8	7.3	-	0.1
Amortization of prior service cost	0.1	-	(0.9)	(1.9)
Net settlement gain	-	-	-	(1.6)
Net periodic pension cost (benefit)	\$ 5.2	\$ 6.3	\$ (0.5)	\$ (2.5)

In May 2013, the Company settled and defeased the life insurance portion of its postretirement benefits by decreasing the level of death benefits and concurrently fully funding the remaining benefits through the purchase of life insurance policies for the plan beneficiaries from an unaffiliated life insurer, resulting in a net settlement gain.

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7. Other Comprehensive Income

The following table provides changes in other comprehensive income.

(in millions)	Three Months Ended June 30, 2014			2013		
	Pre-Tax	Tax	Net of Tax	Pre-Tax	Tax	Net of Tax
		Benefit (Expense)			Benefit (Expense)	
Unrealized gains (losses) on available-for-sale securities and derivative instruments:						
Unrealized gains (losses) arising during period (net of pre-tax, ceded unrealized gains (losses) of \$0.7 million and (\$0.8) million for the three months ended June 30, 2014 and 2013)	\$ 83.2	(29.2)	54.0	\$ (190.0)	\$ 66.7	\$ (123.3)
Less:						
Amount of realized gains from sales and other	(22.4)	2.6	(19.8)	(15.0)	0.2	(14.8)
Portion of other-than-temporary impairment losses recognized in earnings	0.1	-	0.1	1.1	(0.4)	0.7
Net unrealized gains (losses)	60.9	(26.6)	34.3	(203.9)	66.5	(137.4)
Pension and postretirement benefits:						
Amortization of net actuarial loss and prior service cost recognized as net periodic benefit cost	2.5	(0.9)	1.6	6.3	(2.2)	4.1
Cumulative foreign currency translation adjustment:						
Foreign currency translation recognized during the period	4.8	(1.7)	3.1	(0.1)	-	(0.1)
Other comprehensive income (loss)	\$ 68.2	\$ (29.2)	\$ 39.0	\$ (197.7)	\$ 64.3	\$ (133.4)

(in millions)	Six Months Ended June 30, 2014			2013		
	Pre-Tax	Tax	Net of Tax	Pre-Tax	Tax	Net of Tax
		Benefit (Expense)			Benefit (Expense)	
Unrealized gains (losses) on available-for-sale securities and derivative instruments:						
Unrealized gains (losses) arising during period (net of pre-tax, ceded unrealized gains (losses) of \$1.2 million						

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and (\$0.8) million for the six months ended June
30, 2014
and 2013)

	\$ 166.5	\$ (55.3)	\$ 111.2	\$ (165.0)	\$ 57.9	\$ (107.1)
Less:						
Amount of realized gains from sales and other	(26.7)	(1.5)	(28.2)	(23.8)	(2.1)	(25.9)
Portion of other-than-temporary impairment losses						
recognized in earnings	0.1	-	0.1	1.6	(0.6)	1.0
Net unrealized gains (losses)	139.9	(56.8)	83.1	(187.2)	55.2	(132.0)
Pension and postretirement benefits:						
Amortization of net actuarial loss and prior service cost						
recognized as net periodic benefit cost	5.2	(1.8)	3.4	9.2	(3.2)	6.0
Cumulative foreign currency translation adjustment:						
Foreign currency translation recognized during the period	4.7	(1.7)	3.0	(15.5)	5.4	(10.1)
Other comprehensive income (loss)	\$ 149.8	\$ (60.3)	\$ 89.5	\$ (193.5)	\$ 57.4	\$ (136.1)

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Reclassifications out of accumulated other comprehensive income were as follows:

	Three Months		Six Months		
	Ended		Ended		
(in millions)	June 30,		June 30,		
	2014	2013	2014	2013	
Details about Accumulated Other Comprehensive Income Components	Amount Reclassified from Accumulated Other Comprehensive Income				Affected Line Item in the Statement Where Net Income is Presented
Unrealized gains on available-for-sale securities and derivative instruments	\$ 22.4	\$ 15.1	\$ 26.7	\$ 23.8	Net realized gains from sales and other Net other-than-temporary impairment (losses) on investments recognized in earnings
Other	(0.1)	(1.1)	(0.1)	(1.6)	
	-	(0.1)	-	-	
	22.3	13.9	26.6	22.2	Total before tax
	(2.6)	0.2	1.5	2.7	Tax (expense) benefit
	19.7	14.1	28.1	24.9	Net of tax
Amortization of defined benefit pension and postretirement plans	(2.5)	(6.3)	(5.2)	(9.2)	Loss adjustment expenses and other operating expenses
	0.9	2.2	1.8	3.2	Tax benefit
	(1.6)	(4.1)	(3.4)	(6.0)	Net of tax
Total reclassifications for the period	\$ 18.1	\$ 10.0	\$ 24.7	\$ 18.9	Net of tax

The amount reclassified from accumulated other comprehensive income for the pension and postretirement benefits was allocated approximately 40% to loss adjustment expenses and 60% to other operating expenses for the six months ended June 30, 2014 and 2013.

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8. Segment Information

The Company's primary business operations include insurance products and services provided through four operating segments. The domestic operating segments are Commercial Lines, Personal Lines and Other, and the Company's international operating segment is Chaucer. Commercial Lines includes commercial multiple peril, commercial automobile, workers' compensation, and other commercial coverages, such as specialty program business, inland marine, management and professional liability and surety. Personal Lines includes personal automobile, homeowners and other personal coverages. Chaucer includes marine and aviation, energy, property, U.K. motor, and casualty and other coverages (which includes international liability, specialist coverages, and syndicate participations). Included in Other are Opus Investment Management, Inc., which markets investment management services to institutions, pension funds and other organizations; earnings on holding company assets; and, a voluntary pools business which is in run-off. The separate financial information is presented consistent with the way results are regularly evaluated by the chief operating decision maker in deciding how to allocate resources and in assessing performance.

The Company reports interest expense related to debt separately from the earnings of its operating segments. This consists of interest on the Company's senior debentures, subordinated debentures, collateralized borrowings with the Federal Home Loan Bank of Boston, and letter of credit facility. Management evaluates the results of the aforementioned segments based on operating income (loss) before taxes which also excludes interest expense on debt. Operating income (loss) before taxes excludes certain items which are included in net income (loss), such as net realized investment gains and losses (including gains and losses on certain derivative instruments). Such gains and losses are excluded since they are determined by interest rates, financial markets and the timing of sales. Also, operating income (loss) before taxes excludes net gains and losses on disposals of businesses, gains and losses related to the repayment of debt, discontinued operations, costs to acquire businesses, restructuring costs, extraordinary items, the cumulative effect of accounting changes and certain other items. Although the items excluded from operating income (loss) before taxes may be important components in understanding and assessing the Company's overall financial performance, management believes that the presentation of operating income (loss) before taxes enhances an investor's understanding of the Company's results of operations by highlighting net income (loss) attributable to the core operations of the business. However, operating income (loss) before taxes should not be construed as a substitute for income (loss) before income taxes and operating income (loss) should not be construed as a substitute for net income (loss).

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Summarized below is financial information with respect to the Company's business segments.

(in millions)	Three Months		Six Months Ended	
	Ended June 30, 2014	2013	June 30, 2014	2013
Operating revenues:				
Commercial Lines	\$ 556.9	\$ 523.7	\$ 1,108.9	\$ 1,038.4
Personal Lines	371.4	388.9	742.4	780.0
Chaucer	320.6	253.5	635.1	517.4
Other	1.9	2.8	3.9	5.3
Total	1,250.8	1,168.9	2,490.3	2,341.1
Net realized investment gains	22.2	13.7	26.6	21.8
Total revenues	\$ 1,273.0	\$ 1,182.6	\$ 2,516.9	\$ 2,362.9
Operating income (loss) before income taxes:				
Commercial Lines:				
GAAP underwriting gain (loss)	\$ 7.3	\$ (9.5)	\$ (14.0)	\$ (12.6)
Net investment income	37.2	36.0	74.5	72.1
Other expense	(0.3)	(0.3)	(0.2)	(0.3)
Commercial Lines operating income	44.2	26.2	60.3	59.2
Personal Lines:				
GAAP underwriting income (loss)	3.6	(0.3)	5.7	9.8
Net investment income	18.0	19.1	35.9	38.1
Other income	1.1	1.1	2.7	2.5
Personal Lines operating income	22.7	19.9	44.3	50.4
Chaucer:				
GAAP underwriting income	24.3	24.7	60.8	57.7
Net investment income	10.7	10.7	21.2	21.2
Other income (expense)	3.1	1.5	5.3	(1.1)
Chaucer operating income	38.1	36.9	87.3	77.8
Other:				
GAAP underwriting loss	(0.9)	(1.0)	(1.4)	(2.1)
Net investment income	1.1	2.1	2.4	3.8
Other net expenses	(3.0)	(3.0)	(5.7)	(5.8)
Other operating loss	(2.8)	(1.9)	(4.7)	(4.1)
Operating income before interest expense and income taxes	102.2	81.1	187.2	183.3
Interest on debt	(16.3)	(17.4)	(32.6)	(32.1)
Operating income before income taxes	85.9	63.7	154.6	151.2
Non-operating income items:				
Net realized investment gains	22.2	13.7	26.6	21.8
Net loss from repayment of debt	-	(11.3)	-	(19.1)
Net (costs) benefit related to acquired businesses	(0.2)	(0.2)	(1.1)	0.2
Net foreign exchange (losses) gains	(0.2)	-	(0.3)	0.7

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Income before income taxes	\$ 107.7	\$ 65.9	\$ 179.8	\$ 154.8
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The Company recognized \$5.1 million in net foreign currency transaction gains in the Statements of Income during the three months ended June 30, 2014 compared to \$5.6 million in net foreign currency losses during the three months ended June 30, 2013. The Company recognized \$5.8 million in net foreign currency transaction gains in the Statements of Income during the six months ended June 30, 2014 compared to \$7.7 million in net foreign currency losses during the six months ended June 30, 2013.

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The following table provides identifiable assets for the Company's business segments and discontinued operations:

	June 30, 2014	December 31, 2013
(in millions)	Identifiable Assets	
U.S. Companies	\$ 9,176.9	\$ 8,962.6
Chaucer	4,672.9	4,301.2
Discontinued operations	115.0	114.9
Total	\$ 13,964.8	\$ 13,378.7

The Company reviews the assets of its U.S. Companies collectively and does not allocate them between the Commercial Lines, Personal Lines and Other segments.

9. Stock-based Compensation

On May 20, 2014 the shareholders approved the adoption of The Hanover Insurance Group 2014 Long-Term Incentive Plan (the "2014 Stock Plan"). With respect to new share-based award issuances, the 2014 Stock Plan replaced The Hanover Insurance Group, Inc. 2006 Long-Term Incentive Plan (the "2006 Stock Plan") and provided authorization for 6,100,000 shares in a new share pool plus any shares from the 2006 Stock Plan that may become available as a result of the cash settlement, forfeiture, expiration or cancellation of such awards. The 2014 Stock Plan provides for the granting of the same types of awards as the 2006 Stock Plan, which includes stock options and SARS, restricted and unrestricted stock, stock units, performance based stock awards and cash awards. In accordance with the 2014 Stock Plan, the issuance of one share of common stock in the form of an option or SAR will reduce the share pool by one share, whereas the issuance of one share of common stock for the other types of stock awards provided by the plan will reduce the pool by 3.8 shares. As of June 30, 2014, there were 6,096,349 shares available for grants under the 2014 Stock Plan.

Additionally, on May 20, 2014, the shareholders approved The Hanover Insurance Group 2014 Employee Stock Purchase plan (the "ESPP Plan") and the Chaucer Share Incentive Plan (the "SIP Plan"), authorizing the issuance of 2,500,000 and 750,000 shares, respectively, under such plans. As of June 30, 2014, 23,105 shares and 2,737 shares have been issued under the ESPP Plan and the SIP Plan, respectively.

Compensation cost and the related tax benefits were as follows:

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(in millions)	Three Months Ended		Six Months Ended	
	June 30, 2014	June 30, 2013	June 30, 2014	June 30, 2013
Stock-based compensation expense	\$ 3.8	\$ 2.1	\$ 7.3	\$ 5.7
Tax benefit	(1.4)	(0.7)	(2.6)	(2.0)
Stock-based compensation expense, net of taxes	\$ 2.4	\$ 1.4	\$ 4.7	\$ 3.7
Stock Options				

Information on the Company's stock option plans is summarized below.

(in whole shares and dollars)	Six Months Ended June 30, 2014		2013	
	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price
Outstanding, beginning of period	2,049,173	\$ 41.18	2,892,882	\$ 38.28
Granted	683,200	58.02	537,300	42.51
Exercised	(243,491)	38.66	(798,790)	32.84
Forfeited or cancelled	(34,085)	41.84	(164,500)	41.74
Outstanding, end of period	2,454,797	46.10	2,466,892	40.74

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Restricted Stock Units

The following tables summarize activity information about employee restricted stock units:

(in whole shares and dollars)	Six Months Ended June 30, 2014		2013	
	Shares	Weighted Average Grant Date Fair Value	Shares	Weighted Average Grant Date Fair Value
Time-based restricted stock units:				
Outstanding, beginning of period	525,980	\$ 41.20	750,837	\$ 40.15
Granted	94,240	58.02	130,912	42.80
Vested	(202,006)	42.09	(259,440)	39.60
Forfeited	(9,300)	40.73	(37,257)	40.49
Outstanding, end of period	408,914	44.65	585,052	40.96
Performance-based and market-based restricted stock units:				
Outstanding, beginning of period	184,626	\$ 40.42	132,775	\$ 39.97
Granted	60,338	55.73	79,850	41.67
Vested	(22,826)	44.78	-	-
Forfeited	(3,800)	37.90	(22,700)	40.83
Outstanding, end of period	218,338	44.24	189,925	40.58

Performance based restricted stock units are based upon the achievement of the performance metric at 100%. These units have the potential to range from 0% to 200% of the shares disclosed, which varies based on grant year and individual participation level. Increases above the 100% target level are reflected as granted in the period in which performance-based stock unit goals are achieved. Decreases below the 100% target level are reflected as forfeited. Included in the amounts granted above for the performance-based restricted stock units were 1,013 shares related to awards that a performance metric in excess of 100% was achieved. These awards vested in the first quarter of 2014.

In the first six months of 2014 and 2013, the Company granted market-based awards totaling 56,625 and 76,175, respectively, to certain members of senior management, which are included in the table above as performance and market-based restricted stock activity. The vesting of these stock units is based on the relative total shareholder return ("TSR") of the Company. This metric is generally based on relative TSR for a three-year period, as compared to a Property and Casualty Index of peer companies. The fair value of market based awards was estimated at the date of grant using a valuation model. These units have the potential to range from 0% to 150% of the shares disclosed. Included in the amount granted above were 1,875 shares related to market-based awards that achieved a payout in excess of 100%. These awards vested in the first quarter of 2014.

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10. Earnings Per Share and Shareholders' Equity Transactions

The following table provides weighted average share information used in the calculation of the Company's basic and diluted earnings per share:

	Three Months		Six Months Ended	
	Ended June 30,	June 30,	June 30,	June 30,
(in millions, except per share data)	2014	2013	2014	2013
Basic shares used in the calculation of earnings per share	44.1	44.0	44.0	44.3
Dilutive effect of securities:				
Employee stock options	0.4	0.4	0.4	0.3
Non-vested stock grants	0.4	0.4	0.4	0.4
Diluted shares used in the calculation of earnings per share	44.9	44.8	44.8	45.0
Per share effect of dilutive securities on income from continuing operations	\$ (0.03)	\$ (0.02)	\$ (0.06)	\$ (0.05)
Per share effect of dilutive securities on income from net income	\$ (0.04)	\$ (0.02)	\$ (0.06)	\$ (0.04)

Diluted earnings per share for the three months ended June 30, 2014 excludes 0.7 million of common shares issuable under the Company's stock compensation plans, because their effect would be antidilutive. All of the common shares issuable under the Company's stock compensation plan were included in the diluted earnings per share for the three months ended June 30, 2013. Diluted earnings per share for both the six months ended June 30, 2014 and 2013 excludes 0.7 million of common shares issuable under the Company's stock compensation plans, because their effect would be antidilutive.

Since October 2007 and through June 2014, the Company's Board of Directors has authorized aggregate repurchases of the Company's common stock of up to \$600 million. As of June 30, 2014, the Company has \$130.3 million available for repurchases under these repurchase authorizations. Repurchases may be executed using open market purchases, privately negotiated transactions, accelerated repurchase programs or other transactions. The Company is not required to purchase any specific number of shares or to make purchases by any certain date under this program. During the first six months of 2014, the Company purchased 0.1 million shares of the Company's common stock at a cost of \$6.7 million.

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11. Commitments and Contingencies

Legal Proceedings

Durand Litigation

On March 12, 2007, a putative class action suit captioned Jennifer A. Durand v. The Hanover Insurance Group, Inc., and The Allmerica Financial Cash Balance Pension Plan was filed in the United States District Court for the Western District of Kentucky. The named plaintiff, a former employee who received a lump sum distribution from the Company's Cash Balance Plan (the "Plan") at or about the time of her termination, claims that she and others similarly situated did not receive the appropriate lump sum distribution because in computing the lump sum, the Company and the Plan understated the accrued benefit in the calculation. The plaintiff claims that the Plan underpaid her distributions and those of similarly situated participants by failing to pay an additional so-called "whipsaw" amount reflecting the present value of an estimate of future interest credits from the date of the lump sum distribution to each participant's retirement age of 65.

The plaintiff filed an Amended Complaint adding two new named plaintiffs and additional claims on December 11, 2009. In response, the Company filed a Motion to Dismiss on January 30, 2010. In addition to the pending claim challenging the calculation of lump sum distributions, the Amended Complaint included: (a) a claim that the Plan failed to calculate participants' account balances and lump sum payments properly because interest credits were based solely upon the performance of each participant's selection from among various hypothetical investment options (as the Plan provided) rather than crediting the greater of that performance or the 30 year Treasury rate; (b) a claim that the 2004 Plan amendment, which changed interest crediting for all participants from the performance of participant's investment selections to the 30 year Treasury rate, reduced benefits in violation of the Employee Retirement Income Security Act of 1974 ("ERISA") for participants who had account balances as of the amendment date by not continuing to provide them performance-based interest crediting on those balances; and (c) claims against the Company for breach of fiduciary duty and ERISA notice requirements arising from the various interest crediting and lump sum distribution matters of which plaintiffs complain. On March 31, 2011, the District Court granted the Company and the Plan's Motion to Dismiss on statute of limitations grounds the additional claims set forth in (a) and (b) above, however, in response to a motion for reconsideration, the Court allowed the new breach of fiduciary duty claim to stand, but only as to plaintiffs' "whipsaw" claim that remained in the case. On June 22, 2012, the Company and the Plan filed a Partial Motion for Summary Judgment to dismiss the "whipsaw" claim of one of the named plaintiffs who received his lump sum distribution after December 31, 2003. On October 2, 2013, the Court granted the Company and the Plan's Partial Motion for Summary Judgment and dismissed with prejudice the "whipsaw" claim of the named plaintiff who received a lump sum distribution after December 31, 2003 and the similar claims of the putative class members he sought to represent. On December 17, 2013, the Court entered an order certifying a class to bring "whipsaw" and related breach of fiduciary duty claims consisting of all persons who received a lump sum distribution between March 1, 1997 and December 31, 2003, and a subclass to bring such claims consisting of all persons who received lump sum distributions between March 1, 1997 and March 12, 2002. On December 17, 2013, the Court also granted plaintiffs' motion for entry of a final order allowing an immediate appeal by the two named plaintiffs added in the Amended Complaint of their dismissed claims that the 2004 Plan amendment reduced benefits in violation of ERISA, and for one of them, that his post-2003 lump sum distribution should have been greater. On January 14, 2014, the Company filed a Motion to Alter or Amend the Court's December 17, 2013 Order requesting that the Court reverse its order making the dismissed claims final and appealable or, in the alternative, stay merits discovery on the claims remaining in the district court pending resolution of the dismissed plaintiffs' appeal. The Court denied this motion on April 30, 2014.

At this time, the Company is unable to provide a reasonable estimate of the potential range of ultimate liability if the outcome of the suit is unfavorable. The extent to which any of the plaintiffs' multiple theories of liability, some of

which are overlapping and others of which are quite complex and novel, are accepted and upheld on appeal will significantly affect the Plan's or the Company's potential liability. The statute of limitations applicable to the class has not yet been finally determined and the extent of potential liability, if any, will depend on this final determination. In addition, assuming for these purposes that the plaintiffs prevail with respect to claims that benefits accrued or payable under the Plan were understated, then there are numerous possible theories and other variables upon which any revised calculation of benefits as requested under plaintiffs' claims could be based. Any adverse judgment in this case against the Plan would be expected to create a liability for the Plan, with resulting effects on the Plan's assets available to pay benefits. The Company's future required funding of the Plan could also be impacted by such a liability.

Other Matters

The Company has been named a defendant in various other legal proceedings arising in the normal course of business. In addition, the Company is involved, from time to time, in examinations, investigations and proceedings by governmental and self-regulatory agencies. The potential outcome of any such action or regulatory proceedings in which the Company has been named a defendant or the subject of an inquiry or investigation, and its ultimate liability, if any, from such action or regulatory proceedings, is difficult to predict at this time. The ultimate resolutions of such proceedings are not expected to have a material effect on its financial position, although they could have a material effect on the results of operations for a particular quarter or annual period.

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Residual Markets

The Company is required to participate in residual markets in various states, which generally pertain to high risk insureds, disrupted markets or lines of business or geographic areas where rates are regarded as excessive. The results of the residual markets are not subject to the predictability associated with the Company's own managed business, and are significant to both the personal and commercial automobile lines of business, the workers' compensation line of business, and the homeowners line of business.

12. Subsequent Events

There were no subsequent events requiring adjustment to the financial statements and no additional disclosures required in the notes to the interim consolidated financial statements.

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PART I

ITEM 2

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

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Introduction

The following Management's Discussion and Analysis of Financial Condition and Results of Operations is intended to assist readers in understanding the interim consolidated results of operations and financial condition of The Hanover Insurance Group, Inc. and its subsidiaries ("THG"). Consolidated results of operations and financial condition are prepared in accordance with generally accepted accounting principles in the United States of America ("U.S. GAAP"). This discussion should be read in conjunction with the interim consolidated financial statements and related footnotes included elsewhere in this Quarterly Report on Form 10-Q and Management's Discussion and Analysis of Financial Condition and Results of Operations contained in our 2013 Annual Report on Form 10-K filed with the Securities and Exchange Commission on February 25, 2014.

Results of operations include the accounts of The Hanover Insurance Company ("Hanover Insurance") and Citizens Insurance Company of America ("Citizens"), our principal U.S. domiciled property and casualty companies; Chaucer Holdings plc ("Chaucer"), our United Kingdom (U.K.) domiciled specialist insurance underwriting group which operates through the Society and Corporation of Lloyd's ("Lloyd's"); and certain other insurance and non-insurance subsidiaries. Additionally, results of operations include our discontinued operations, consisting primarily of our former life insurance businesses and our accident and health business.

Executive Overview

Business operations consist of four operating segments: Commercial Lines, Personal Lines, Chaucer and Other.

Operating income before interest expense and income taxes was \$187.2 million for the six months ended June 30, 2014, compared to \$183.3 million in the same period in 2013, an increase of \$3.9 million. This increase is due to higher favorable development on prior years' loss and loss adjustment expense ("LAE") reserves ("prior years' loss reserves") and improved Commercial Lines current accident year results, partially offset by higher catastrophe and non-catastrophe weather-related losses in the first six months of 2014. Favorable development on prior years' loss reserves was \$48.9 million for the six months ended June 30, 2014, compared to favorable development of \$33.8 million in the same period in 2013, an increase of \$15.1 million. Pre-tax catastrophe losses were \$113.6 million for the six months ended June 30, 2014, compared to \$81.5 million in the same period in 2013, an increase of \$32.1 million.

Over recent years, weather-related catastrophe and non-catastrophe losses have been in excess of longer term averages. Pricing in our Commercial and Personal Lines remains strong as the industry continues to respond to these increased weather-related losses, as well as to the earnings impact of reduced investment income as a result of low interest rates, and other factors. We are continuing efforts to improve our underwriting results in both our Commercial and Personal Lines, through rate increases and improvements to our mix of business.

Commercial Lines

We believe our unique approach to the small commercial market, distinctiveness in the middle market, and continued development of specialty lines provides us with a diversified portfolio of products and delivers significant value to agents and policyholders. The small commercial and middle market businesses are expected to contribute to premium growth in Commercial Lines over the next several years as we continue to pursue our core strategy of developing strong partnerships with agents, distinctive products, franchise value through limited distribution, and industry segmentation. Growth in our specialty lines continues to be an important part of our strategy, including the expansion of our product offerings in these lines supported by prior acquisitions of specialized businesses.

We believe these efforts have driven, and will continue to drive, improvement in our overall mix of business and ultimately our underwriting profitability. Commercial Lines net premiums written grew by 7.5% in the first six

months of 2014, driven by our core commercial businesses. This growth is primarily due to rate increases, increased retention and targeted new business expansion.

Underwriting results declined slightly in the first six months of 2014, as compared to the same period in 2013, due to higher catastrophe losses, partially offset by improved current accident year results excluding catastrophe losses. The competitive nature of the Commercial Lines market requires us to be highly disciplined in our underwriting process to ensure that we write business at acceptable margins, and we continue to seek rate increases across our lines of business.

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Personal Lines

Personal Lines focuses on partnering with high quality, value-oriented agencies that deliver consultative selling and stress the importance of account rounding (the conversion of single policy customers to accounts with multiple policies and additional coverages). Approximately 76% of our policies in force are account business. We are focused on making investments that help maintain profitability, build a distinctive position in the market, help diversify us geographically from our historical core states of Michigan, Massachusetts, New York and New Jersey, and provide us with profitable growth opportunities.

Underwriting profit declined slightly in the first six months of 2014, as compared to the same period in 2013. Higher non-catastrophe weather related losses in the current accident year were partially offset by favorable development on prior years' loss reserves. We continue to seek additional rate increases, subject to regulatory and competitive considerations, in our personal automobile line, particularly as a result of recent trends of higher loss severity in bodily injury. We also continue to seek rate increases in our homeowners lines as a result of the weather-related losses that the industry experienced in the past several years.

Chaucer

Chaucer deploys specialist underwriters in over 30 major insurance and reinsurance classes, including energy, marine and aviation, U.K. motor, property, casualty and other coverages. We obtain business through Lloyd's, the leading international insurance and reinsurance market, which provides us with access to specialist business in over 200 countries and territories worldwide through its international licenses, brand reputation and strong security rating. Our underwriting strength, diverse portfolio and Lloyd's membership underpin our ability to actively manage the scale, composition and profitable development of this business.

Underwriting profits increased in the first six months of 2014, as compared to the same period in 2013, primarily due to higher favorable development on prior years' loss reserves, lower catastrophe related losses and higher earned premiums, partially offset by higher non-catastrophe losses. Chaucer net premiums written increased by 12.7% in the first six months of 2014 due to expanded underwriting capabilities in our casualty lines, specific underwriting opportunities in our marine markets and the decision to increase our economic interests in Syndicate 1084 to 100% for 2014, up from 98% in 2013 and 84% in 2012.

Chaucer has continued to experience overall downward pressure on rates during 2014. Rates in the marine and aviation, energy, property and casualty markets remained under pressure during the first half of 2014 due to high industry capacity, including new capital from a variety of sources, and a continued absence of major losses. U.K. motor market rates were modestly lower after two years of declines following significant increases in 2010 and 2011. In response to these challenging market conditions, we continue to actively manage Chaucer's underwriting portfolio, using our expertise, distinctive underwriting capabilities and market knowledge to target specific attractive underwriting opportunities.

Description of Operating Segments

Primary business operations include insurance products and services currently provided through four operating segments. Our domestic operating segments are Commercial Lines, Personal Lines, and Other. Our international operating segment is Chaucer. Commercial Lines includes commercial multiple peril, commercial automobile, workers' compensation and other commercial coverages, such as specialty program business, inland marine, management and professional liability and surety. Personal Lines includes personal automobile, homeowners and other personal coverages. Chaucer includes marine and aviation, energy, property, U.K. motor, and casualty and other coverages (which includes international liability, specialist coverages, and syndicate participations). Included in Other

are Opus Investment Management, Inc., which markets investment management services to institutions, pension funds and other organizations; earnings on holding company assets; and, a voluntary pools business which is in run-off. We present the separate financial information of each segment consistent with the manner in which our chief operating decision maker evaluates results in deciding how to allocate resources and in assessing performance.

We report interest expense on debt separately from the earnings of our operating segments. This consists of interest on our senior debentures, subordinated debentures, collateralized borrowings with the Federal Home Loan Bank of Boston (“FHLBB”), and letter of credit facility.

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Results of Operations – Consolidated

Consolidated net income for the three months ended June 30, 2014 was \$82.6 million, compared to \$53.4 million for the three months ended June 30, 2013. The increase of \$29.2 million is primarily due to improved operating results after taxes, principally in Commercial Lines, and higher realized investment gains from the sale of securities. Additionally, net income in 2013 included \$11.3 million of losses from the repayment of debt.

Consolidated net income for the six months ended June 30, 2014 was \$137.2 million, compared to \$119.6 million for the six months ended June 30, 2013. The increase of \$17.6 million is primarily due to the absence in 2014 of \$19.1 million of losses from the aforementioned repayment of debt and higher realized investment gains from the sale of securities.

In addition to consolidated net income, we assess our financial performance based upon pre-tax “operating income (loss),” and we assess the operating performance of each of our four operating segments based upon the pre-tax operating income (loss) generated by each segment. Operating income (loss) before taxes excludes interest expense on debt and certain other items which we believe are not indicative of our core operations, such as net realized investment gains and losses (including net gains and losses on certain derivative instruments). Such gains and losses are excluded since they are determined by interest rates, financial markets and the timing of sales. Also, operating income (loss) before taxes excludes net gains and losses on disposals of businesses, gains and losses related to the repayment of debt, discontinued operations, costs to acquire businesses, restructuring costs, extraordinary items, the cumulative effect of accounting changes and certain other items. Although the items excluded from operating income (loss) before taxes may be important components in understanding and assessing our overall financial performance, we believe a discussion of operating income before taxes enhances an investor’s understanding of our results of operations by highlighting net income (loss) attributable to the core operations of the business. However, operating income (loss) before taxes should not be construed as a substitute for income (loss) before income taxes and operating income (loss) should not be construed as a substitute for net income (loss).

Catastrophe losses and prior years’ reserve development are significant components in understanding and assessing the financial performance of our business. Management reviews and evaluates catastrophes and prior years’ reserve development separately from the other components of earnings. Catastrophes and prior years’ reserve development are not predictable as to timing or the amount that will affect the results of our operations and have affected our results in the past few years. Management believes that providing certain financial metrics and trends excluding the effects of catastrophes and prior years’ reserve development helps investors to understand the variability in periodic earnings and to evaluate the underlying performance of our operations.

The following table reflects operating income for each operating segment and a reconciliation of operating income to consolidated net income.

(in millions)	Three Months		Six Months Ended	
	Ended June 30, 2014	2013	June 30, 2014	2013
Operating income before interest expense and income taxes:				
Commercial Lines	\$ 44.2	\$ 26.2	\$ 60.3	\$ 59.2
Personal Lines	22.7	19.9	44.3	50.4

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Chaucer	38.1	36.9	87.3	77.8
Other	(2.8)	(1.9)	(4.7)	(4.1)
Operating income before interest expense and income taxes	102.2	81.1	187.2	183.3
Interest expense on debt	(16.3)	(17.4)	(32.6)	(32.1)
Operating income before income taxes	85.9	63.7	154.6	151.2
Income tax expense on operating income	(27.5)	(16.9)	(49.2)	(44.5)
Operating income	58.4	46.8	105.4	106.7
Net realized investment gains	22.2	13.7	26.6	21.8
Net loss from repayment of debt	-	(11.3)	-	(19.1)
Net (costs) benefit related to acquired businesses	(0.2)	(0.2)	(1.1)	0.2
Net foreign exchange (losses) gains	(0.2)	-	(0.3)	0.7
Income tax benefit on non-operating items	2.3	4.1	6.6	9.2
Income from continuing operations, net of taxes	82.5	53.1	137.2	119.5
Net gain from discontinued operations, net of taxes	0.1	0.3	-	0.1
Net income	\$ 82.6	\$ 53.4	\$ 137.2	\$ 119.6

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Results of Operations – Segments

The following is our discussion and analysis of the results of operations by business segment. The operating results are presented before interest expense, taxes and other items which management believes are not indicative of our core operations, including realized gains and losses.

The following table summarizes the results of operations for the periods indicated:

(in millions)	Three Months Ended		Six Months Ended	
	June 30, 2014	2013	June 30, 2014	2013
Operating revenues				
Net premiums written	\$ 1,276.2	\$ 1,242.6	\$ 2,448.5	\$ 2,319.3
Net premiums earned	1,174.7	1,090.8	2,337.7	2,185.1
Net investment income	67.0	67.9	134.0	135.2
Other income	9.1	10.2	18.6	20.8
Total operating revenues	1,250.8	1,168.9	2,490.3	2,341.1
Losses and operating expenses				
Losses and LAE	725.5	692.1	1,476.0	1,375.5
Amortization of deferred acquisition costs	259.6	232.7	513.3	475.2
Other operating expenses	163.5	163.0	313.8	307.1
Total losses and operating expenses	1,148.6	1,087.8	2,303.1	2,157.8
Operating income before interest expense and income taxes	\$ 102.2	\$ 81.1	\$ 187.2	\$ 183.3

Three Months Ended June 30, 2014 Compared to Three Months Ended June 30, 2013

Operating income before interest expense and income taxes was \$102.2 million in the three months ended June 30, 2014, compared to \$81.1 million for the three months ended June 30, 2013, an increase of \$21.1 million. Catastrophe related activity in the quarter was \$55.7 million, compared to \$59.8 million in the same period of 2013, a decrease of \$4.1 million. Excluding the impact of catastrophe related activity, segment earnings increased by \$17.0 million. This increase was primarily due to improved Commercial Lines current accident year results, partially offset by higher non-catastrophe weather-related losses in our homeowners line. Favorable development on prior years' loss reserves was \$29.2 million in the quarter, compared to favorable development of \$26.9 million in the same period in 2013, an increase of \$2.3 million.

Net premiums written grew by \$33.6 million in the three months ended June 30, 2014, compared to the three months ended June 30, 2013, and net premiums earned grew by \$83.9 million. Chaucer accounted for \$13.9 million of the net

premiums written increase and \$68.5 million of the net premiums earned increase. Chaucer's net premiums earned increased primarily due to the aforementioned increase in economic interests in Syndicate 1084. Growth in net premiums written in our Commercial Lines was a result of rate increases, strong retention and targeted new business expansion.

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Production and Underwriting Results

The following table summarizes premiums written on a gross and net basis, net premiums earned and loss, LAE, expense and combined ratios for the Commercial Lines, Personal Lines and Chaucer segments. Loss, LAE, catastrophe loss and combined ratios shown below include prior year reserve development. These items are not meaningful for our Other segment.

(dollars in millions)	Three Months Ended June 30, 2014						
	Gross Premiums Written	Net Premiums Written	Net Premiums Earned	Catastrophe Loss Ratios	Loss & LAE Ratios	Expense Ratios	Combined Ratios
Commercial Lines	\$ 613.0	\$ 541.0	\$ 517.6	3.3	61.8	36.6	98.4
Personal Lines	395.2	370.8	350.3	7.8	69.9	28.4	98.3
Chaucer	415.4	364.4	306.8	3.7	52.4	39.7	92.1
Total	\$ 1,423.6	\$ 1,276.2	\$ 1,174.7	4.7	61.8	35.0	96.8
(dollars in millions)	Three Months Ended June 30, 2013						
	Gross Premiums Written	Net Premiums Written	Net Premiums Earned	Catastrophe Loss Ratios	Loss & LAE Ratios	Expense Ratios	Combined Ratios
Commercial Lines	\$ 591.0	\$ 521.5	\$ 485.8	3.1	64.2	37.6	101.8
Personal Lines	397.8	370.6	366.7	8.8	72.0	27.3	99.3
Chaucer	405.6	350.5	238.3	5.2	48.6	41.0	89.6
Total	\$ 1,394.4	\$ 1,242.6	\$ 1,090.8	5.5	63.4	35.0	98.4

The following table summarizes net premiums written, and loss and LAE and catastrophe loss ratios by line of business for the Commercial Lines and Personal Lines segments. Loss and LAE and catastrophe loss ratios include prior year reserve development.

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(dollars in millions)	Three Months Ended June 30, 2014			2013		
	Net Premiums Written	Loss & LAE Ratios	Catastrophe Loss Ratios	Net Premiums Written	Loss & LAE Ratios	Catastrophe Loss Ratios