OneBeacon Insurance Group, Ltd.
Form 10-Q
April 27, 2012
Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the period ended March 31, 2012

OR

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

For the transition period from to

Commission file number 1-33128

ONEBEACON INSURANCE GROUP, LTD.

(Exact name of Registrant as specified in its charter)

Bermuda (State or other jurisdiction of incorporation or organization)	**98-0503315** (I.R.S. Employer Identification No.)
601 Carlson Parkway **Minnetonka, Minnesota** (Address of principal executive offices)	**55305** (Zip Code)

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

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

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

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 o	Accelerated Filer x
Non-accelerated filer o	Smaller reporting company o

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

As of April 25, 2012, 23,613,719 Class A common shares, par value of $0.01 per share, and 71,754,738 Class B common shares, par value of $0.01 per share, were outstanding.

Table of Contents

ONEBEACON INSURANCE GROUP, LTD.

TABLE OF CONTENTS

Table of Contents

PART 1. FINANCIAL INFORMATION

ITEM 1. Financial Statements

ONEBEACON INSURANCE GROUP, LTD.

CONSOLIDATED BALANCE SHEETS

	March 31, 2012 (Unaudited)	December 31, 2011
	(in millions, except share and per share amounts)	
Assets		
Investment Securities:		
Fixed maturity investments, at fair value	$ 1,831.9	$ 1,886.2
Short-term investments, at amortized cost (which approximates fair value)	306.1	320.0
Common equity securities, at fair value	281.5	266.5
Convertible fixed maturity investments, at fair value	80.1	79.8
Other investments	155.9	155.1
Total investments	2,655.5	2,707.6
Cash	87.0	54.9
Reinsurance recoverable on unpaid losses	2,109.0	2,167.5
Reinsurance recoverable on paid losses	25.9	16.5
Premiums receivable	254.5	230.9
Deferred acquisition costs	117.9	123.5
Ceded unearned premiums	9.7	10.7
Net deferred tax asset	82.1	93.6
Investment income accrued	11.3	14.1
Accounts receivable on unsettled investment sales	1.8	0.5
Other assets	273.8	269.2
Assets held for sale		132.6
Total assets	$ 5,628.5	$ 5,821.6
Liabilities		
Loss and LAE reserves	$ 3,249.6	$ 3,358.6
Unearned premiums	557.9	528.0
Debt	269.8	269.7
Ceded reinsurance payable	22.4	23.4
Accounts payable on unsettled investment purchases	61.0	22.7
Other liabilities	315.1	397.7
Liabilities held for sale		107.6
Total liabilities	4,475.8	4,707.7
OneBeacon s common shareholders equity and noncontrolling interests		
OneBeacon s common shareholders equity:		
Common shares and paid-in surplus (par value $0.01; authorized, 200,000,000 shares; issued and outstanding, 95,368,457 and 95,068,457 shares)	1,016.6	1,002.2
Retained earnings	132.5	108.5
Accumulated other comprehensive loss, after tax:		

Other comprehensive income and loss items		(10.7)		(10.9)
Total OneBeacon s common shareholders equity		1,138.4		1,099.8
Total noncontrolling interests		14.3		14.1
Total OneBeacon s common shareholders equity and noncontrolling interests		1,152.7		1,113.9
Total liabilities, OneBeacon s common shareholders equity and noncontrolling interests	$	5,628.5	$	5,821.6

See Notes to Consolidated Financial Statements.

Table of Contents

ONEBEACON INSURANCE GROUP, LTD.

CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME

(Unaudited)

	Three months ended March 31, 2012		Three months ended March 31, 2011	
	($ in millions, except per share amounts)			
Revenues				
Earned premiums	$	272.8	$	245.1
Net investment income		14.7		21.0
Net realized and unrealized investment gains		29.8		23.1
Net other revenues		0.1		0.8
Total revenues		317.4		290.0
Expenses				
Loss and LAE		149.3		130.4
Policy acquisition expenses		57.4		49.0
Other underwriting expenses		48.8		49.3
General and administrative expenses		2.7		2.3
Interest expense on debt		4.1		6.3
Total expenses		262.3		237.3
Pre-tax income from continuing operations		55.1		52.7
Income tax expense		(10.4)		(9.7)
Net income from continuing operations		44.7		43.0
Loss from discontinued operations, net of tax		(0.1)		(0.7)
Net income including noncontrolling interests		44.6		42.3
Less: Net income attributable to noncontrolling interests		(0.6)		(0.4)
Net income attributable to OneBeacon s common shareholders		44.0		41.9
Change in other comprehensive income and loss items		0.2		0.1
Comprehensive income attributable to OneBeacon s common shareholders	$	44.2	$	42.0
Earnings per share attributable to OneBeacon s common shareholders basic and diluted				
Net income from continuing operations per share	$	0.47	$	0.46
Loss from discontinued operations, net of tax, per share				(0.01)
Net income attributable to OneBeacon s common shareholders per share		0.46		0.44
Dividends declared and paid per OneBeacon s common share	$	0.21	$	0.21

See Notes to Consolidated Financial Statements.

Table of Contents

ONEBEACON INSURANCE GROUP, LTD.

CONSOLIDATED STATEMENTS OF COMMON SHAREHOLDERS EQUITY

(Unaudited)

	OneBeacon s Common Shareholders Equity				
($ in millions)	Common shareholders equity	Common shares and paid-in surplus	Retained earnings	Accum. other comprehensive (loss) income, after tax	Noncontrolling interests, after tax
Balances at January 1, 2012	$ 1,099.8	$ 1,002.2	$ 108.5	$ (10.9)	$ 14.1
Net income	44.0		44.0		0.6
Amortization of restricted share awards	0.4	0.4			
Issuance of common shares					0.2
Dividends	(20.0)		(20.0)		(0.6)
Other comprehensive income, after tax	0.2			0.2	
Gain on sale of OneBeacon Holdings (Luxembourg) S.à r.l.	14.0	14.0			
Balances at March 31, 2012	$ 1,138.4	$ 1,016.6	$ 132.5	$ (10.7)	$ 14.3

	OneBeacon s Common Shareholders Equity				
($ in millions)	Common shareholders equity	Common shares and paid-in surplus	Retained earnings	Accum. other comprehensive income, after tax	Noncontrolling interests, after tax
Balances at January 1, 2011	$ 1,229.0	$ 1,000.5	$ 228.2	$ 0.3	$ 19.9
Net income	41.9		41.9		0.4
Amortization of option awards	0.1	0.1			
Issuance of common shares					0.3
Dividends	(19.8)		(19.8)		(0.9)
Other comprehensive income, after tax	0.1			0.1	
Balances at March 31, 2011	$ 1,251.3	$ 1,000.6	$ 250.3	$ 0.4	$ 19.7

See Notes to Consolidated Financial Statements.

Table of Contents

ONEBEACON INSURANCE GROUP, LTD.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

	Three months ended March 31, 2012	Three months ended March 31, 2011
	($ in millions)	
Cash flows from operations:		
Net income including noncontrolling interests	$ 44.6	$ 42.3
Charges (credits) to reconcile net income to cash flows used for operations:		
Net loss from discontinued operations	0.1	0.7
Net realized and unrealized investment gains	(29.8)	(23.1)
Deferred income tax expense	12.0	10.6
Other operating items:		
Net change in loss and LAE reserves	(109.0)	(66.4)
Net change in unearned premiums	29.9	(40.7)
Net change in ceded reinsurance payable	(1.0)	(58.9)
Net change in ceded unearned premiums	1.0	55.5
Net change in premiums receivable	(23.6)	12.5
Net change in reinsurance recoverable on paid and unpaid losses	49.1	55.4
Net change in other assets and liabilities	(56.9)	(51.0)
Net cash used for operations continuing operations	(83.6)	(63.1)
Net cash (used for) provided from operations discontinued operations	(2.0)	1.4
Net cash used for operations	(85.6)	(61.7)
Cash flows from investing activities:		
Net maturities, purchases and sales of short-term investments	(54.7)	55.3
Maturities of fixed maturity investments	68.3	126.3
Sales of fixed maturity investments	644.5	395.9
Sales of common equity securities	12.3	15.6
Sales of convertible fixed maturity investments	5.3	17.2
Distributions and redemptions of other investments	5.6	18.2
Purchases of fixed maturity investments	(574.0)	(528.6)
Purchases of common equity securities	(18.9)	(29.1)
Purchases of convertible fixed maturity investments	(1.7)	(13.6)
Contributions for other investments	(1.5)	(3.5)
Net change in unsettled investment purchases and sales	37.0	28.9
Net acquisitions of property and equipment	(0.5)	(2.1)
Net cash provided from investing activities continuing operations	121.7	80.5
Net cash provided from investing activities discontinued operations		
Net cash provided from investing activities	121.7	80.5
Cash flows from financing activities:		
Gain on sale of OneBeacon Holdings (Luxembourg) S.à r.l.	14.0	
Cash dividends paid to common shareholders	(20.0)	(19.8)
Net cash used for financing activities continuing operations	(6.0)	(19.8)
Net cash used for financing activities discontinued operations		
Net cash used for financing activities	(6.0)	(19.8)
Net increase (decrease) in cash during period	30.1	(1.0)
Cash reclassified from assets held for sale	5.5	
Cash transferred as part of the AutoOne Transaction	(3.5)	
Net increase (decrease) excluding cash relating to the AutoOne Transaction	32.1	(1.0)
Cash balance at beginning of period	54.9	33.6

Cash balance at end of period	$	87.0	$	32.6
Supplemental cash flows information:				
Interest paid	$		$	
Net tax (refunds) payments to state and national governments		(0.1)		0.3

See Notes to Consolidated Financial Statements.

Table of Contents

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1. Nature of Operations and Summary of Significant Accounting Policies

Basis of presentation

These interim consolidated financial statements include the accounts of OneBeacon Insurance Group, Ltd. (the Company or the Registrant) and its subsidiaries (collectively, OneBeacon) and have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP). The Company is an exempted Bermuda limited liability company. The OneBeacon operating companies are U.S.-based property and casualty insurance writers, most of which operate in a multi-company pool. OneBeacon offers a wide range of specialty insurance products and services through independent agencies, regional and national brokers, wholesalers and managing general agencies.

OneBeacon was acquired by White Mountains Insurance Group, Ltd. (White Mountains) from Aviva plc (Aviva) in 2001 (the OneBeacon Acquisition). White Mountains is a holding company whose businesses provide property and casualty insurance, reinsurance and certain other products. As of March 31, 2012, White Mountains owned 75.2% of the Company s common shares. Within this report, the term OneBeacon is used to refer to one or more entities within the consolidated organization, as the context requires. The Company s headquarters are located at 14 Wesley Street, 5th Floor, Hamilton HM 11, Bermuda. The Company s U.S. corporate headquarters are located at 601 Carlson Parkway, Minnetonka, Minnesota 55305 and its registered office is located at Clarendon House, 2 Church Street, Hamilton HM 11, Bermuda.

OneBeacon s reportable segments are Specialty Insurance Operations, Other Insurance Operations and Investing, Financing and Corporate Operations. The Specialty Insurance Operations segment is comprised of a number of underwriting units that are aggregated into three major underwriting units for financial reporting: Managing General Agency (MGA) Business, Specialty Industries and Specialty Products. OneBeacon s Other Insurance Operations segment includes the results of the non-specialty commercial lines business, to which OneBeacon sold the renewal rights, other run-off business and certain purchase accounting adjustments relating to the OneBeacon Acquisition. Investing, Financing and Corporate Operations includes the investing and financing activities for OneBeacon on a consolidated basis, and certain other activities conducted through the Company and the intermediate subsidiaries which include OneBeacon U.S. Financial Services, Inc. and OneBeacon U.S. Holdings, Inc. (OBH), both U.S.-domiciled companies, as well as various intermediate holding companies domiciled in the United States, Gibraltar, Luxembourg and Bermuda.

On February 22, 2012, OneBeacon completed the sale of its AutoOne Insurance business (AutoOne) to Interboro Holdings, Inc. (Interboro) (the AutoOne Transaction). See Note 2. AutoOne has offered products and services to assigned risk markets primarily in New York and New Jersey. AutoOne had been included within the Other Insurance Operations segment, however, as a result of the sale, AutoOne has been presented as discontinued operations in the statements of operations and cash flows with the prior periods reclassified to conform to the current presentation. The AutoOne disposal group excludes investing and financing activities from amounts classified as discontinued operations. OneBeacon s investing and financing operations are conducted on an overall consolidated level and accordingly, there are no separately identifiable investing or financing cash flows associated with AutoOne. Pursuant to the terms of the AutoOne Transaction, at closing, the legal entities included in the sale held an agreed upon level of invested assets and capital. The assets and liabilities associated with the AutoOne business as of December 31, 2011 have been presented in the balance sheet as held for sale assuming the investing and financing steps required to effect the sale were completed as of December 31, 2011.

All significant intercompany transactions have been eliminated in consolidation. These interim financial statements include all adjustments, consisting of a normal recurring nature, considered necessary by management to fairly state the financial position, results of operations and cash flows of OneBeacon. These interim financial statements may not be indicative of financial results for the full year and should be read in conjunction with the Company s 2011 Annual Report on Form 10-K. The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Refer to the Company s 2011 Annual Report on Form 10-K for a complete discussion regarding OneBeacon s significant accounting policies. As described above, certain amounts in the prior period financial statements have been reclassified to conform to the current presentation.

Table of Contents

Recently Adopted Changes in Accounting Principles

Policy Acquisition Costs

On January 1, 2012, OneBeacon adopted Financial Accounting Standards Board (FASB) Accounting Standards Update (ASU) 2010-26, *Accounting for Costs Associated with Acquiring or Renewing Insurance Contracts*, codified within Accounting Standards Codification (ASC) 944. ASU 2010-26 changes the types of policy acquisition costs that are eligible for deferral. Specifically, ASU 2010-26 limits deferrable costs to those that are incremental direct costs of contract acquisition and certain costs related to acquisition activities performed by the insurer, such as underwriting, policy issuance and processing, medical and inspection costs and sales force contract selling. ASU 2010-26 defines incremental direct costs as those costs that result directly from and were essential to the contract acquisition and would not have been incurred absent the acquisition. Accordingly, under ASC 2010-26, deferrable acquisition costs are limited to costs related to successful contract acquisitions. Acquisition costs that are not eligible for deferral are to be charged to expense in the period incurred.

OneBeacon adopted ASU 2010-26 prospectively. As a result of adopting ASU 2010-26, $5.6 million of unamortized deferred acquisition costs as of January 1, 2012, primarily relating to a portion of profit sharing commission that had been deferred under prior guidance, have been determined to no longer be deferrable and will be recognized in expense over the original amortization period. During the three months ended March 31, 2012, $2.4 million of the $5.6 million of unamortized acquisition costs as of January 1, 2012 was recognized in expense. If OneBeacon had followed ASU 2010-26 in 2011, $1.8 million of acquisition costs that had been deferred would have been recognized in expense during the three months ended March 31, 2011.

Fair Value Measurements and Disclosures

On January 1, 2012, OneBeacon adopted ASU 2011-04, *Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in US GAAP and IFRS* (ASC 820). ASU 2011-04 clarifies existing guidance with respect to the concepts of highest and best use and valuation premise and measuring instruments classified within a reporting entity s shareholders equity. ASU 2011-04 also clarifies disclosure requirements, requiring disclosure of quantitative information about unobservable inputs used in Level 3 fair value measurements. ASU 2011-04 also amends existing guidance. In circumstances where a reporting entity manages a portfolio of financial assets and liabilities based on the net market and counterparty credit risk exposures, ASU 2011-04 permits determination of the fair value of those instruments to be based on the net risk exposure. In addition, ASU 2011-04 permits the application of premiums or discounts to be applied in a fair value measurement to the extent that market participants would consider them in valuing the financial instruments. ASU 2011-04 also expands the required disclosures for Level 3 measurements, requiring that reporting entities provide a narrative description of the sensitivity of Level 3 fair value measurements to changes in unobservable inputs and the interrelationships between those inputs, if any. As a result of adopting ASU 2011-04, OneBeacon expanded its fair value disclosures. See Note 5.

Comprehensive Income

On January 1, 2012, OneBeacon adopted ASU 2011-05, *Comprehensive Income* (ASC 220). ASU 2011-05 requires all components of comprehensive income to be reported in a continuous financial statement or in two consecutive statements displaying the components of net income and the components of other comprehensive income. Since OneBeacon already presents comprehensive income in a continuous financial statement, adoption of ASU 2011-05 had no effect on OneBeacon s financial statement presentation.

Goodwill Impairment

On January 1, 2012, OneBeacon adopted ASU 2011-08, *Testing Goodwill for Impairment* (ASC 350). ASU 2011-08 amends the guidance that requires an entity to test goodwill for impairment on at least an annual basis using a two-step quantitative test. The new guidance permits an entity to first assess facts and circumstances to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount. If the entity determines on the basis of this assessment that it is not more likely than not that the fair value of the reporting unit is less than its carrying amount, then performance of the two-step quantitative test is not required. Upon adoption, ASU 2011-08 had no effect on OneBeacon s financial position, results of operations or cash flows.

Table of Contents

Recently Issued Accounting Pronouncements

Offsetting Assets and Liabilities

On December 16, 2011, the FASB issued ASU 2011-11, *Disclosures about Offsetting Assets and Liabilities* (ASC 210). The new standard expands the required disclosures in circumstance where either balances have been offset or the right of offset exists. The required disclosures are intended to provide information to enable financial statement users to evaluate the effect or potential effect of netting arrangements on a reporting entity s financial position. Disclosures required under the new standard include the gross amount of assets and liabilities recognized; the amounts that have been offset to arrive at the amounts presented in the statement of financial position; and any amounts subject to an enforceable master netting arrangement, whether or not such amounts have been offset. In addition, a description of the rights of offset should be disclosed. ASU 2011-11 is effective for periods beginning on or after January 1, 2013. OneBeacon is currently evaluating the effect adoption will have on its disclosures, but does not expect adoption to have a material effect on its financial position, results of operations or cash flows.

NOTE 2. Acquisitions and Dispositions

On February 22, 2012, OneBeacon completed the sale of the AutoOne business to Interboro. Pursuant to the terms of the sale, at closing, OneBeacon transferred to Interboro all of the issued and outstanding shares of common stock of AutoOne Insurance Company (AOIC) and AutoOne Select Insurance Company (AOSIC), through which substantially all of the AutoOne business was written on a direct basis. At closing, OneBeacon also transferred the assets, liabilities (including loss reserves and unearned premiums) and capital of the business as well as substantially all of the AutoOne infrastructure including systems and office space as well as certain staff. The AutoOne Transaction also included the execution of a reinsurance agreement with certain subsidiaries of the Company pursuant to which OneBeacon cedes, on a 100% quota share basis, AutoOne business not directly written by AOIC and AOSIC. See Note 14 for further information regarding balances classified as held for sale and activity reported as discontinued operations.

As part of the AutoOne Transaction, Interboro LLC, the parent company of Interboro, issued a $3.0 million promissory note to OneBeacon Insurance Company (OBIC). Interboro LLC is required to repay the note in $1.0 million increments on each of the third, fourth and fifth anniversaries of the closing date, or February 22, 2015, 2016 and 2017. In addition, Interboro LLC is required to pre-pay principal in an amount equal to 100% of any dividend or distribution received from its subsidiaries, net of taxes and less $0.2 million. Interest will accrue and be payable quarterly at a rate of LIBOR plus 550 basis points.

On January 24, 2012, OneBeacon sold all of the issued and outstanding shares of common stock of OneBeacon Holdings (Luxembourg) S.à r.l. (OB Lux) to White Sands Holdings (Luxembourg) S.à r.l (White Sands), a subsidiary of White Mountains, for $24.7 million. As a result of the sale, OneBeacon recorded a gain of $14.0 million as additional paid in capital. Net of transaction costs expensed through the statement of operations, the gain was $13.6 million.

Except as described above, during the three months ended March 31, 2012 and 2011, there were no acquisitions or dispositions.

8

Table of Contents

NOTE 3. Reserves for Unpaid Loss and LAE

The following table summarizes the loss and LAE reserve activities of OneBeacon s insurance subsidiaries for the three months ended March 31, 2012 and 2011:

	Three months ended March 31,	
	2012	2011
	($ in millions)	
Gross beginning balance	$ 3,358.6	$ 3,295.5
Less beginning reinsurance recoverable on unpaid losses	(2,167.5)	(1,893.2)
Net loss and LAE reserves	1,191.1	1,402.3
Loss and LAE incurred relating to:		
Current year losses	138.8	135.5
Prior year losses	10.5	(5.1)
Total incurred loss and LAE from continuing operations	149.3	130.4
Loss and LAE paid relating to:		
Current year losses	(22.3)	(25.1)
Prior year losses	(177.5)	(142.3)
Total loss and LAE payments from continuing operations	(199.8)	(167.4)
Total incurred loss and LAE from discontinued operations	6.7	14.2
Total loss and LAE payments from discontinued operations	(7.6)	(18.8)
Net loss and LAE reserves	1,139.7	1,360.7
Net loss and LAE reserves reclassified from held for sale	64.7	
Net loss and LAE reserves sold as part of the AutoOne Transaction	(63.8)	
Net ending balance	1,140.6	1,360.7
Plus ending reinsurance recoverable on unpaid losses	2,109.0	1,864.0
Gross ending balance	$ 3,249.6	$ 3,224.7

During the three months ended March 31, 2012, OneBeacon experienced $10.5 million of unfavorable loss and LAE reserve development on prior accident year loss reserves, with $12.4 million in Other Insurance Operations, partially offset by $1.9 million of favorable loss and LAE reserve development on prior accident year loss reserves in Specialty Insurance Operations. The unfavorable loss reserve development in the run-off business was primarily driven by case incurred development on a small number of claims related to multiple peril liability lines and general liability lines and also the impact of an adverse court ruling in Mississippi regarding a disputed assessment from an involuntary pool for hurricane Katrina claims. The favorable loss reserve development was primarily due to lower than expected severity on non-catastrophe losses related to professional liability lines, multiple peril liability lines and general liability lines. During the three months ended March 31, 2011, OneBeacon experienced $5.1 million of favorable loss and LAE reserve development on prior accident year loss reserves, with $1.2 million in Specialty Insurance Operations and $3.9 million in Other Insurance Operations. The favorable loss reserve development was primarily due to lower than expected severity on non-catastrophe losses related to professional liability lines, multiple peril liability lines and general liability lines.

In connection with purchase accounting for the OneBeacon Acquisition, OneBeacon was required to adjust to fair value the loss and LAE reserves and the related reinsurance recoverables on the balance sheet. As of March 31, 2012 and December 31, 2011, the remaining fair value reductions to both loss and LAE reserves and reinsurance recoverable on unpaid losses were $160.0 million and $163.3 million, respectively. The net reduction to loss and LAE reserves is being accreted through an income statement charge ratably with and over the period the claims are settled.

9

Table of Contents

NOTE 4. Reinsurance

In the normal course of business, OneBeacon s insurance subsidiaries seek to limit losses that may arise from catastrophes or other events by reinsuring with third party reinsurers. OneBeacon remains liable for risks reinsured even if the reinsurer does not honor its obligations under reinsurance contracts.

Effective May 1, 2011, OneBeacon renewed its property catastrophe reinsurance program through April 30, 2012. The program provides coverage for OneBeacon s property business as well as certain acts of terrorism. Under the program, the first $50.0 million of losses resulting from any single catastrophe are retained and the next $175.0 million of losses resulting from the catastrophe are reinsured in three layers, although OneBeacon retains a co-participation of 26% of losses from $50.0 million to $100.0 million and 10% of losses from $100.0 million to $175.0 million. Losses from $175.0 million to $225.0 million are fully reinsured. Any loss above $225.0 million would be retained in full. In the event of a catastrophe, OneBeacon s property catastrophe reinsurance program is reinstated for the remainder of the original contract term by paying a reinstatement premium that is based on the percentage of coverage reinstated and the original property catastrophe coverage premium. OneBeacon expects to renew the property catastrophe reinsurance program on substantially similar terms.

At March 31, 2012, OneBeacon had $25.9 million of reinsurance recoverables on paid losses and $2,269.0 million (gross of $160.0 million in purchase accounting adjustments, as described in Note 3) that will become recoverable if claims are paid in accordance with current reserve estimates. Reinsurance contracts do not relieve OneBeacon of its obligations. Therefore, collectability of balances due from reinsurers is critical to OneBeacon s financial strength. OneBeacon is selective in regard to its reinsurers, principally placing reinsurance with those reinsurers with strong financial condition, industry ratings and underwriting ability. Management monitors the financial condition and ratings of its reinsurers on an ongoing basis. As a result, uncollectible amounts have historically not been significant.

The following table provides a listing of OneBeacon s top reinsurers for its insurance operations, excluding industry pools and associations and affiliates of OneBeacon, based upon recoverable amounts, the percentage of total reinsurance recoverables and the reinsurers A.M. Best Company, Inc. (A.M. Best) ratings.

($ in millions)	Balance at March 31, 2012	% of total	A.M. Best Rating(1)
National Indemnity Company and General Reinsurance Corporation(2)	$ 1,504.9	66%	A++
Hanover Insurance Company	79.9	3%	A
Tokio Marine and Nichido Fire(3)	55.0	2%	A++
Tower Insurance Company	29.9	1%	A-
Munich Reinsurance America	24.0	1%	A+

(1) A.M. Best ratings as detailed above are: A++ (Superior, which is the highest of fifteen financial strength ratings), A+ (Superior, which is the second highest of fifteen financial strength ratings), A (Excellent, which is the third highest of fifteen financial strength ratings) and A- (Excellent, which is the fourth highest of fifteen financial strength ratings).

(2) Includes $198.3 million of Third-Party Recoverables (as defined below), which NICO (as defined below) would pay under the terms of the NICO Cover (as defined below) if they are unable to collect from third-party reinsurers.

(3) Includes $29.0 million of reinsurance recoverables from various reinsurers that are guaranteed by Tokio Marine and Nichido Fire under the terms of a 100% quota share reinsurance agreement between Houston General Insurance Company and Tokio Marine and Nichido Fire.

In connection with the OneBeacon Acquisition, Aviva caused OneBeacon to purchase two reinsurance contracts from subsidiaries of Berkshire Hathaway Inc.: a reinsurance contract with National Indemnity Company (NICO), for up to $2.5 billion in old asbestos and environmental (A&E) claims and certain other exposures (the NICO Cover) and an adverse loss reserve development cover from General Reinsurance Corporation (GRC) for up to $570.0 million, comprised of $400.0 million of adverse loss reserve development occurring in years 2000 and prior (the GRC Cover) in addition to $170.0 million of reserves ceded as of the date of the OneBeacon Acquisition. The NICO Cover and GRC Cover, which were contingent on and occurred contemporaneously with the OneBeacon Acquisition, were put in place in lieu of a seller guarantee of loss and LAE reserves and are therefore accounted for under GAAP as a seller guarantee.

Table of Contents

Under the terms of the NICO Cover, NICO receives the economic benefit of reinsurance recoverables from certain of OneBeacon s third party reinsurers (Third Party Reinsurers) in existence at the time the NICO Cover was executed (Third Party Recoverables). As a result, the Third Party Recoverables serve to protect the $2.5 billion limit of NICO coverage for the benefit of OneBeacon. OneBeacon estimates that on an incurred basis it has used approximately $2.3 billion of the coverage provided by NICO at March 31, 2012. Net losses paid totaled approximately $1.4 billion as of March 31, 2012. To the extent that actual experience differs from OneBeacon s estimate of ultimate A&E losses and Third Party Recoverables, future losses could exceed the $198.3 million of protection remaining under the NICO Cover at March 31, 2012.

Pursuant to the GRC Cover, OneBeacon is not entitled to recover losses to the full contract limit if such losses are reimbursed by GRC more quickly than anticipated at the time the contract was signed. OneBeacon intends to seek reimbursement from GRC only for claims which result in payment patterns similar to those supporting its recoverables recorded pursuant to the GRC Cover. The economic cost of not submitting certain other eligible claims to GRC is primarily the investment spread between the rate credited by GRC and the rate achieved by OneBeacon on its own investments. This cost, if any, is expected to be nominal. OneBeacon has ceded estimated incurred losses of $562.0 million to GRC under the GRC Cover. As of March 31, 2012, OneBeacon has $423.7 million of reinsurance recoverable on unpaid losses outstanding under the GRC Cover.

NOTE 5. Investment Securities

OneBeacon s invested assets are comprised of securities and other investments held for general investment purposes. Refer to the Company s 2011 Annual Report on Form 10-K for a complete discussion.

In accordance with ASC 825, OneBeacon classifies its portfolio of fixed maturity investments and common equity securities, including convertible fixed maturity investments, held for general investment purposes as trading securities. Trading securities are reported at fair value as of the balance sheet date as determined by quoted market prices when available. Realized and unrealized investment gains and losses on trading securities are reported in net realized and unrealized investment gains and losses in revenues on a pre-tax basis.

Short-term investments consist of money market funds, certificates of deposit and other securities which, at the time of purchase, mature or become available for use within one year. Short-term investments are carried at amortized cost, which approximated fair value as of March 31, 2012 and December 31, 2011.

Other investments primarily include hedge funds and private equity funds. OneBeacon measures its investments in hedge funds and private equity funds at fair value with changes therein reported in net realized and unrealized investment gains and losses in revenues on a pre-tax basis. Other investments also includes an investment in a community reinvestment vehicle which is accounted for at fair value and a tax advantaged federal affordable housing development fund which is accounted for under the equity method.

OneBeacon s net investment income is comprised primarily of interest income associated with OneBeacon s fixed maturity investments, dividend income from its equity investments and interest income from its short-term investments. Net investment income for the three months ended March 31, 2012 and 2011 consisted of the following:

	Three months ended March 31, 2012	2011
	($ in millions)	
Investment income:		
Fixed maturity investments	$ 13.7	$ 20.4
Short-term investments		
Common equity securities	1.7	1.4
Convertible fixed maturity investments	1.1	1.0
Other investments	(0.1)	
Gross investment income	16.4	22.8
Less investment expenses	(1.7)	(1.8)
Net investment income, pre-tax	$ 14.7	$ 21.0

Table of Contents

The composition of net realized investment gains, a component of net realized and unrealized investment gains, consisted of the following:

	Three months ended March 31, 2012	2011
	($ in millions)	
Fixed maturity investments	$ 15.2	$ 7.2
Short-term investments		
Common equity securities	3.6	2.7
Convertible fixed maturity investments	0.9	3.3
Other investments	1.1	4.8
Net realized investment gains, pre-tax	$ 20.8	$ 18.0

The net changes in fair value for the three months ended March 31, 2012 and 2011 are as follows:

	Three months ended March 31, 2012		
	Changes in net unrealized gains and losses (1)	Changes in net foreign currency translation gains and losses (1)	Total net changes in fair value reflected in revenues (1)
		($ in millions)	
Fixed maturity investments	$ (2.1)	$ 0.1	$ (2.0)
Short-term investments			
Common equity securities	4.8		4.8
Convertible fixed maturity investments	2.4		2.4
Other investments	3.8		3.8
Total	$ 8.9	$ 0.1	$ 9.0

	Three months ended March 31, 2011		
	Changes in net unrealized gains and losses (1)	Changes in net foreign currency translation gains and losses (1)	Total net changes in fair value reflected in revenues (1)
		($ in millions)	
Fixed maturity investments	$ (2.9)	$ 0.1	$ (2.8)
Short-term investments			
Common equity securities	8.5		8.5
Convertible fixed maturity investments	(2.2)		(2.2)
Other investments	1.6		1.6
Total	$ 5.0	$ 0.1	$ 5.1

(1) Includes changes in net deferred gains and losses on sales of investments between OneBeacon and entities under White Mountains common control of $(0.1) million and $(0.4) million, pre-tax, for the three months ended March 31, 2012 and 2011, respectively.

The components of OneBeacon s ending net unrealized investment gains and losses, excluding the impact of net unrealized foreign currency translation gains and losses, on its trading investment portfolio as of March 31, 2012 and December 31, 2011 were as follows:

	March 31, 2012	December 31, 2011
	($ in millions)	
Investment securities:		
Gross unrealized investment gains	$ 121.6	$ 123.5
Gross unrealized investment losses	(10.7)	(21.6)
Net unrealized gains from investment securities	110.9	101.9
Income taxes	(36.7)	(33.9)
Total net unrealized investment gains, after tax	$ 74.2	$ 68.0

Table of Contents

The cost or amortized cost, gross unrealized investment gains and losses, net foreign currency gains and losses and carrying values of OneBeacon s fixed maturity investments as of March 31, 2012 and December 31, 2011 were as follows:

	March 31, 2012				
	Cost or amortized cost	Gross unrealized gains	Gross unrealized losses ($ in millions)	Net foreign currency gains	Carrying value
U.S. Government and agency obligations	$ 203.1	$ 1.3	$	$	$ 204.4
Debt securities issued by industrial corporations	680.7	31.4	(0.7)		711.4
Municipal obligations	2.2				2.2
Asset-backed securities	820.0	4.8	(1.4)		823.4
Foreign government obligations	7.6	0.5			8.1
Preferred stocks	78.3	4.4	(0.3)		82.4
Total fixed maturity investments	$ 1,791.9	$ 42.4	$ (2.4)	$	$ 1,831.9

	December 31, 2011(1)				
	Cost or amortized cost	Gross unrealized gains	Gross unrealized losses ($ in millions)	Net foreign currency losses	Carrying value
U.S. Government and agency obligations	$ 213.6	$ 1.8	$	$	$ 215.4
Debt securities issued by industrial corporations	725.8	34.9	(1.9)	(0.1)	758.7
Municipal obligations	2.2				2.2
Asset-backed securities	928.5	10.6	(0.8)		938.3
Foreign government obligations	7.7	0.5	(0.1)		8.1
Preferred stocks	78.3	3.2	(6.2)		75.3
Total fixed maturity investments	$ 1,956.1	$ 51.0	$ (9.0)	$ (0.1)	$ 1,998.0

(1) Carrying value includes $111.8 million of fixed maturity investments reclassified to assets held for sale in the consolidated balance sheet as part of the AutoOne Transaction.

The cost or amortized cost, gross unrealized investment gains and losses, net foreign currency gains and losses and carrying values of OneBeacon s common equity securities, convertible fixed maturity investments and other investments as of March 31, 2012 and December 31, 2011 were as follows:

	March 31, 2012				
	Cost or amortized cost	Gross unrealized gains	Gross unrealized losses ($ in millions)	Net foreign currency gains	Carrying value
Common equity securities	$ 250.8	$ 36.0	$ (5.3)	$	$ 281.5
Convertible fixed maturity investments	74.2	6.0	(0.1)		80.1
Other investments	121.6	37.2	(2.9)		155.9

	December 31, 2011				
	Cost or amortized cost	Gross unrealized gains	Gross unrealized losses	Net foreign currency gains	Carrying value
			($ in millions)		
Common equity securities	$ 240.6	$ 30.3	$ (4.4)	$	$ 266.5
Convertible fixed maturity investments	76.3	4.4	(0.9)		79.8
Other investments	124.6	37.8	(7.3)		155.1

Table of Contents

Fair value measurements

OneBeacon records its investments in accordance with ASC 820 which defines fair value, establishes a framework for measuring fair value and expands financial statement disclosure requirements for fair value information. Under ASC 820, fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants (an exit price). Fair value measurements are categorized into a hierarchy that distinguishes between inputs based on market data from independent sources (observable inputs) and a reporting entity s internal assumptions based upon the best information available when external market data is limited or unavailable (unobservable inputs). Quoted prices in active markets for identical assets or liabilities have the highest priority (Level 1), followed by observable inputs other than quoted prices, including quoted prices for similar but not identical assets or liabilities (Level 2) and unobservable inputs, including the reporting entity s estimates of the assumptions that market participants would use, having the lowest priority (Level 3).

As of March 31, 2012 and December 31, 2011, approximately 91% and 93%, respectively, of the investment portfolio recorded at fair value was priced based upon observable inputs.

OneBeacon uses brokers and outside pricing services to assist in determining fair values. For investments in active markets, OneBeacon uses the quoted market prices provided by the outside pricing services to determine fair value. The outside pricing services OneBeacon uses have indicated that they will only provide prices where observable inputs are available. In circumstances where quoted market prices are unavailable or are not considered reasonable, OneBeacon estimates the fair value using industry standard pricing models and observable inputs such as benchmark interest rates, matrix pricing, market comparables, broker quotes, issuer spreads, bids, offers, credit rating prepayment speeds and other relevant inputs. In those circumstances, such fair value measurements are considered a lower level measurement in the fair value hierarchy.

OneBeacon s investments in debt securities, including asset-backed securities, are generally valued using matrix and other pricing models. Key inputs include benchmark yields, benchmark securities, reported trades, issuer spreads, bids, offers, credit ratings and prepayment speeds. Income on mortgage-backed and asset-backed securities is recognized using an effective yield based on anticipated prepayments and the estimated economic life of the securities. When actual prepayments differ significantly from anticipated prepayments, the estimated economic life is recalculated and the remaining unamortized premium or discount is amortized prospectively over the remaining economic life.

Other investments, which are primarily comprised of hedge funds and private equity funds for which the fair value option has been elected, are carried at fair value based upon OneBeacon s proportionate interest in the underlying fund s net asset value, which is deemed to approximate fair value. The fair value of OneBeacon s investments in hedge funds and private equity funds has been estimated using net asset value because it reflects the fair value of the funds underlying investments in accordance with ASC 820. OneBeacon employs a number of procedures to assess the reasonableness of the fair value measurements, including obtaining and reviewing each fund s audited financial statements and discussing each fund s pricing with the fund s manager.

In circumstances where the underlying investments are publicly traded, such as the investments made by hedge funds, the fair value of the underlying investments is determined using current market prices. In circumstances where the underlying investments are not publicly traded, such as the investments made by private equity funds, the private equity fund managers have considered the need for a liquidity discount on each of the underlying investments when determining the fund s net asset value in accordance with ASC 820. In circumstances where OneBeacon s portion of a fund s net asset value is deemed to differ from fair value due to illiquidity or other factors associated with OneBeacon s investment in the fund, including counterparty credit risk, the net asset value is adjusted accordingly. At March 31, 2012 and December 31, 2011, OneBeacon did not record a liquidity adjustment to the net asset value related to its investments in hedge funds or private equity funds.

As of both March 31, 2012 and December 31, 2011, other investments reported at fair value represented approximately 5% of the investment portfolio recorded at fair value. Other investments accounted for at fair value as of March 31, 2012 and December 31, 2011 were comprised of $54.2 million and $53.5 million, respectively, in hedge funds, $66.1 million and $65.7 million, respectively, in private equity funds, $14.1 million for both periods of an investment in a community reinvestment vehicle. At both March 31, 2012 and December 31, 2011, OneBeacon held investments in 9 hedge funds and 14 private equity funds. The largest investment in a single fund was $12.6 million and $13.7 million, respectively, at March 31, 2012 and December 31, 2011. As of March 31, 2012 and December 31, 2011, other investments also included $21.5 million and $21.8 million, respectively, of an investment in a tax advantaged federal affordable housing development fund which is accounted for using the equity method.

Table of Contents

The fair value measurements at March 31, 2012 and December 31, 2011 and their related inputs are as follows:

	Fair value at March 31, 2012	Level 1 Inputs	Level 2 Inputs	Level 3 Inputs
		($ in millions)		
Fixed maturity investments:				
U.S. Government and agency obligations	$ 204.4	$ 204.4	$	$
Debt securities issued by corporations:				
Consumer	258.7		258.7	
Industrial	132.1		132.1	
Financial	77.9		77.9	
Communications	51.4		51.4	
Energy	50.4		50.4	
Basic materials	81.5		81.5	
Utilities	44.2		44.2	
Technology	15.2		15.2	
Debt securities issued by corporations	711.4		711.4	
Municipal obligations	2.2		2.2	
Asset-backed securities	823.4		787.5	35.9
Foreign government obligations	8.1	7.4	0.7	
Preferred stocks	82.4		12.6	69.8
Fixed maturity investments	1,831.9	211.8	1,514.4	105.7
Short-term investments	306.1	306.1		
Common equity securities:				
Financials	75.9	75.1		0.8
Basic Materials	56.2	56.2		
Consumer	74.1	74.0	0.1	
Energy	34.5	34.5		
Utilities	18.8	18.8		
Other	22.0	22.0		
Common equity securities	281.5	280.6	0.1	0.8
Convertible fixed maturity investments	80.1		80.1	
Other investments(1)	134.4			134.4
Total(1)	$ 2,634.0	$ 798.5	$ 1,594.6	$ 240.9

Table of Contents

	Fair value at December 31, 2011(2)	Level 1 Inputs	Level 2 Inputs	Level 3 Inputs
		($ in millions)		
Fixed maturity investments:				
U.S. Government and agency obligations	$ 215.4	$ 215.4	$	$
Debt securities issued by corporations:				
Consumer	299.7		299.7	
Industrial	140.1		140.1	
Financial	66.4		66.4	
Communications	53.3		53.3	
Energy	60.5		60.5	
Basic materials	81.5		81.5	
Utilities	42.5		42.5	
Technology	14.7		14.7	
Debt securities issued by corporations	758.7		758.7	
Municipal obligations	2.2		2.2	
Asset-backed securities	938.3		936.0	2.3
Foreign government obligations	8.1	7.4	0.7	
Preferred stocks	75.3		11.5	63.8
Fixed maturity investments	1,998.0	222.8	1,709.1	66.1
Short-term investments	320.0	320.0		
Common equity securities:				
Financials	69.9	69.1		0.8
Basic Materials	56.2	56.2		
Consumer	71.3	71.2	0.1	
Energy	32.5	32.5		
Utilities	17.9	17.9		
Other	18.7	18.7		
Common equity securities	266.5	265.6	0.1	0.8
Convertible fixed maturity investments	79.8		79.8	
Other investments(1)	133.3			133.3
Total(1)	$ 2,797.6	$ 808.4	$ 1,789.0	$ 200.2

(1) Excludes the carrying value of $21.5 million and $21.8 million, respectively, associated with a tax advantaged federal affordable housing development fund accounted for using the equity method as of March 31, 2012 and December 31, 2011.

(2) Fair value includes $111.8 million of fixed maturity investments reclassified to assets held for sale in the December 31, 2011 consolidated balance sheet as part of the AutoOne Transaction.

At both March 31, 2012 and December 31, 2011, OneBeacon held one private preferred stock that represented approximately 85% of its preferred stock portfolio. OneBeacon used quoted market prices for similar securities that were adjusted to reflect management s best estimate of fair value; this security is classified as a Level 3 measurement.

In addition to the investment portfolio described above, OneBeacon had $40.1 million and $36.9 million, respectively, of liabilities recorded at fair value and included in other liabilities as of March 31, 2012 and December 31, 2011. These liabilities relate to securities that have been sold short by a limited partnership that OneBeacon invests in and is required to consolidate in accordance with GAAP. As of March 31, 2012 and December 31, 2011, all of the liabilities included in the $40.1 million and $36.9 million, respectively, have been classified as Level 1 measurements.

Table of Contents

The following table summarizes the ratings of OneBeacon s corporate debt securities as of March 31, 2012 and December 31, 2011:

	March 31, 2012		December 31, 2011	
	($ in millions)			
AA	$	47.8	$	61.9
A		309.7		307.3
BBB		341.4		378.2
BB		7.4		6.2
Other		5.1		5.1
Debt securities issued by corporations	$	711.4	$	758.7

Rollforwards of Fair Value Measurements by Level

The changes in Level 1 fair value measurements for the three months ended March 31, 2012 are as follows:

Fixed maturity investments