HANOVER INSURANCE GROUP, INC.
Form 10-Q
November 04, 2010
Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the quarterly period ended September 30, 2010

¨ **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

(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. Yesx 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 x 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	x	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 x

The number of shares outstanding of the registrant s common stock was 45,109,681 as of November 1, 2010.

TABLE OF CONTENTS

PART I. FINANCIAL INFORMATION

Item 1.	Financial Statements	
	Consolidated Statements of Income	3
	Consolidated Balance Sheets	5
	Consolidated Statements of Shareholders Equity	6
	Consolidated Statements of Comprehensive Income	7
	Consolidated Statements of Cash Flows	8
	Notes to Interim Consolidated Financial Statements	9
Item 2.	Management s Discussion and Analysis of Financial Condition and Results of Operations	35
Item 3.	Quantitative and Qualitative Disclosures About Market Risk	78
Item 4.	Controls and Procedures	78

PART II. OTHER INFORMATION

Item 1.	Legal Proceedings	79
Item 1A.	Risk Factors	80
Item 2.	Unregistered Sales of Equity Securities and Use of Proceeds	85
Item 6.	Exhibits	85

SIGNATURES 86

Table of Contents

PART I - FINANCIAL INFORMATION

ITEM 1 - FINANCIAL STATEMENTS

THE HANOVER INSURANCE GROUP, INC.

CONSOLIDATED STATEMENTS OF INCOME

	(Unaudited)		(Unaudited)	
	Quarter Ended		Nine months Ended	
	September 30,		September 30,	
(In millions except per share data)	**2010**	**2009**	**2010**	**2009**
REVENUES				
Premiums	**$ 728.0**	$ 637.4	**$ 2,092.3**	$ 1,899.4
Net investment income	**61.3**	62.1	**184.2**	188.3
Net realized investment gains (losses):				
Net realized gains from sales and other	**7.1**	6.1	**24.3**	19.6
Total other-than-temporary impairment losses on securities	**(0.2)**	(4.5)	**(3.5)**	(39.1)
Portion of loss transferred (from) to other comprehensive income	**(1.2)**	(1.6)	**(4.0)**	9.8
Net other than temporary impairment losses on securities recognized in earnings	**(1.4)**	(6.1)	**(7.5)**	(29.3)
Total net realized investment gains (losses)	**5.7**	-	**16.8**	(9.7)
Fees and other income	**9.0**	9.0	**25.6**	25.8
Total revenues	**804.0**	708.5	**2,318.9**	2,103.8
LOSSES AND EXPENSES				
Losses and loss adjustment expenses	**454.6**	403.0	**1,384.6**	1,225.1
Policy acquisition expenses	**173.4**	146.8	**490.8**	434.7
Gain from retirement of debt	**-**	(0.2)	**-**	(34.5)
Other operating expenses	**102.9**	91.4	**308.0**	281.1
Total losses and expenses	**730.9**	641.0	**2,183.4**	1,906.4
Income before federal income taxes	**73.1**	67.5	**135.5**	197.4
Federal income tax expense (benefit):				
Current	**21.2**	17.8	**(8.5)**	42.8
Deferred	**0.5**	1.1	**48.2**	22.7
Total federal income tax expense	**21.7**	18.9	**39.7**	65.5
Income from continuing operations	**51.4**	48.6	**95.8**	131.9
Discontinued operations (See Note 3):				
Gain from discontinued FAFLIC business (net of tax benefit of $0.3 and $0.3 for the quarters ended September 30, 2010 and 2009 and $0.3 and $0.3 for the nine months ended September 30, 2010 and 2009)	**0.5**	0.4	**0.4**	6.3

Gain (loss) from operations of discontinued accident and health insurance business (net of income tax benefit (expense) of $0.1 and ($0.4) or the quarters ended September 30, 2010 and 2009 and $0.3 and ($0.5) for the nine months ended September 30, 2010 and 2009)		**0.2**		0.7		**(0.9)**		(2.4)
Gain on disposal of variable life and annuity business		**0.1**		-		**1.0**		4.1
Other discontinued operations		**0.1**		-		**0.1**		-
Net income	**$**	**52.3**	$	49.7	**$**	**96.4**	$	139.9

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

3

Table of Contents

THE HANOVER INSURANCE GROUP, INC.

CONSOLIDATED STATEMENTS OF INCOME (*CONTINUED*)

	(Unaudited) Quarter Ended September 30,		(Unaudited) Nine months Ended September 30,	
	2010	**2009**	**2010**	**2009**
PER SHARE DATA				
Basic				
Income from continuing operations	**$ 1.14**	$ 0.96	**$ 2.09**	$ 2.59
Discontinued operations:				
Gain from discontinued FAFLIC business (net of income tax benefit of $0.01 and $0.01 for the quarters ended September 30, 2010 and 2009 and $0.01 and $0.01 for the nine months ended September 30, 2010 and 2009)	**0.01**	0.01	**0.01**	0.12
Gain (loss) from operations of discontinued accident and health insurance business (net of income tax benefit (expense) of $0.01 and ($0.01) for the quarters ended September 30, 2010 and 2009 and $0.01 and ($0.01) for the nine months ended September 30, 2010 and 2009)	**0.01**	0.01	**(0.02)**	(0.04)
Gain on disposal of variable life insurance and annuity business	**-**	-	**0.03**	0.08
Net income per share	**$ 1.16**	$ 0.98	**$ 2.11**	$ 2.75
Weighted average shares outstanding	**44.9**	50.7	**45.7**	51.0
Diluted				
Income from continuing operations	**$ 1.12**	$ 0.95	**$ 2.06**	$ 2.57
Discontinued operations:				
Gain from discontinued FAFLIC business (net of income tax benefit of $0.01 and $0.01 for the quarters ended September 30, 2010 and 2009 and $0.01 and $0.01 for the nine months ended September 30, 2010 and 2009)	**0.02**	0.01	**0.01**	0.12
Gain (loss) from operations of discontinued accident and health insurance business (net of income tax benefit (expense) of $0.01 and ($0.01) for the quarters ended September 30, 2010 and 2009 and $0.01 and ($0.01) for the nine months ended September 30, 2010 and 2009)	**0.01**	0.01	**(0.02)**	(0.05)
Gain on disposal of variable life insurance and annuity business	**-**	-	**0.03**	0.08
Net income per share	**$ 1.15**	$ 0.97	**$ 2.08**	$ 2.72
Weighted average shares outstanding	**45.7**	51.2	**46.4**	51.4

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

Table of Contents

THE HANOVER INSURANCE GROUP, INC .

CONSOLIDATED BALANCE SHEETS

(In millions, except per share data)	(Unaudited) September 30, 2010	December 31, 2009
ASSETS		
Investments:		
Fixed maturities, at fair value (amortized cost of $4,588.8 and $4,520.3)	**$ 4,904.6**	$ 4,615.6
Equity securities, at fair value (cost of $112.3 and $57.3)	**125.7**	69.2
Mortgage loans and other long-term investments	**41.2**	32.3
Total investments	**5,071.5**	4,717.1
Cash and cash equivalents	**271.6**	316.5
Accrued investment income	**53.5**	52.3
Premiums, accounts and notes receivable, net	**807.8**	590.8
Reinsurance receivable on paid and unpaid losses and ceded unearned premiums	**1,230.3**	1,197.9
Deferred policy acquisition costs	**346.0**	286.3
Deferred federal income taxes	**116.2**	228.6
Goodwill	**179.4**	171.4
Other assets	**386.3**	351.2
Assets of discontinued operations	**134.1**	130.6
Total assets	**$ 8,596.7**	$ 8,042.7
LIABILITIES		
Policy liabilities and accruals:		
Losses and loss adjustment expenses	**$ 3,232.1**	$ 3,153.9
Unearned premiums	**1,553.6**	1,300.5
Total policy liabilities and accruals	**4,785.7**	4,454.4
Expenses and taxes payable	**523.7**	603.2
Reinsurance premiums payable	**33.2**	58.5
Long-term debt	**640.0**	433.9
Liabilities of discontinued operations	**135.3**	134.1
Total liabilities	**6,117.9**	5,684.1
Commitments and contingencies (Note 14)		
SHAREHOLDERS EQUITY		
Preferred stock, $0.01 par value, 20.0 million shares authorized, none issued	**-**	-
Common stock, $0.01 par value, 300.0 million shares authorized, 60.5 million shares issued	**0.6**	0.6
Additional paid-in capital	**1,798.6**	1,808.5

Accumulated other comprehensive income		**203.2**		28.8
Retained earnings		**1,201.3**		1,141.1
Treasury stock at cost (15.6 and 13.0 million shares)		**(724.9)**		(620.4)
Total shareholders equity		**2,478.8**		2,358.6
Total liabilities and shareholders equity	**$**	**8,596.7**	$	8,042.7

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

Table of Contents

THE HANOVER INSURANCE GROUP, INC.

CONSOLIDATED STATEMENTS OF SHAREHOLDERS EQUITY

	(Unaudited)	
	Nine months Ended September 30,	
(In millions)	**2010**	**2009**
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	**1,808.5**	1,803.8
Employee and director stock-based awards and other	**(9.9)**	4.0
Balance at end of period	**1,798.6**	1,807.8
ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)		
NET UNREALIZED APPRECIATION (DEPRECIATION) ON INVESTMENTS:		
Balance at beginning of period	**107.7**	(276.1)
Cumulative effect of change in accounting principle	**-**	(33.3)
Balance at beginning of period, as adjusted	**107.7**	(309.4)
Net appreciation during the period:		
Net appreciation on available-for-sale securities	**227.1**	428.8
(Provision) benefit for deferred federal income taxes	**(57.4)**	(30.2)
	169.7	398.6
Balance at end of period	**277.4**	89.2
DEFINED BENEFIT PENSION AND POSTRETIREMENT PLANS:		
Balance at beginning of period	**(78.9)**	(108.7)
Amounts arising in the period	**-**	(1.6)
Amortization during the period:		
Amount recognized as net periodic benefit cost	**7.3**	14.9
Provision for deferred federal income taxes	**(2.6)**	(4.6)
	4.7	8.7
Balance at end of period	**(74.2)**	(100.0)
Total accumulated other comprehensive income (loss)	**203.2**	(10.8)

RETAINED EARNINGS				
Balance at beginning of period		**1,141.1**		949.8
Cumulative effect of change in accounting principle		**-**		33.3
Balance at beginning of period, as adjusted		**1,141.1**		983.1
Net income		**96.4**		139.9
Dividends to shareholders		**(35.9)**		-
Treasury stock issued for less than cost		**(7.9)**		(4.1)
Recognition of share-based compensation		**7.6**		2.5
Balance at end of period		**1,201.3**		1,121.4
TREASURY STOCK				
Balance at beginning of period		**(620.4)**		(482.2)
Shares purchased at cost		**(126.0)**		(36.2)
Net shares reissued at cost under employee stock-based compensation plans		**21.5**		6.5
Balance at end of period		**(724.9)**		(511.9)
Total shareholders equity	**$**	**2,478.8**	$	2,407.1

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

Table of Contents

THE HANOVER INSURANCE GROUP, INC.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(In millions)	(Unaudited) Quarter Ended September 30,		(Unaudited) Nine months Ended September 30,	
	2010	**2009**	**2010**	**2009**
Net income	**$ 52.3**	49.7	**$ 96.4**	$ 139.9
Other comprehensive income:				
Available-for-sale securities:				
Net appreciation during the period	**101.4**	189.4	**227.1**	428.8
Provision for deferred federal income taxes	**(25.9)**	(30.4)	**(57.4)**	(30.2)
Total available-for-sale securities	**75.5**	159.0	**169.7**	398.6
Pension and postretirement benefits:				
Amounts arising in the period	**-**	-	**-**	(1.6)
Amortization recognized as net periodic benefit costs:				
Net actuarial loss	**4.3**	6.8	**12.9**	20.4
Prior service cost	**(1.5)**	(1.5)	**(4.4)**	(4.3)
Transition asset	**(0.4)**	(0.4)	**(1.2)**	(1.2)
Total amortization recognized as net periodic benefit costs	**2.4**	4.9	**7.3**	14.9
Provision for deferred federal income taxes	**(0.9)**	(1.7)	**(2.6)**	(4.6)
Total pension and postretirement benefits	**1.5**	3.2	**4.7**	8.7
Other comprehensive income	**77.0**	162.2	**174.4**	407.3
Comprehensive income	**$ 129.3**	$ 211.9	**$ 270.8**	$ 547.2

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

Table of Contents

THE HANOVER INSURANCE GROUP, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

	(Unaudited)	
	Nine months Ended September 30,	
(In millions)	**2010**	**2009**
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	**$ 96.4**	$ 139.9
Adjustments to reconcile net income to net cash (used in) provided by operating activities:		
Gain on disposal of variable life insurance and annuity business	**(1.0)**	(4.1)
Gain from sale of FAFLIC	**(0.4)**	(6.3)
Gain from retirement of debt	**-**	(34.5)
Net realized investment (gains) losses	**(16.4)**	13.0
Net amortization and depreciation	**12.0**	9.0
Stock-based compensation expense	**8.6**	8.9
Amortization of deferred benefit plan costs	**7.4**	14.9
Deferred federal income taxes	**48.1**	22.7
Change in deferred acquisition costs	**(58.5)**	(20.4)
Change in premiums and notes receivable, net of reinsurance premiums payable	**(241.9)**	(35.1)
Change in accrued investment income	**(0.9)**	(1.2)
Change in policy liabilities and accruals, net	**276.2**	(36.5)
Change in reinsurance receivable	**(14.7)**	27.2
Change in expenses and taxes payable	**(104.6)**	(80.8)
Other, net	**(25.3)**	10.2
Net cash (used in) provided by operating activities	**(15.0)**	26.9
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from disposals and maturities of available-for-sale fixed maturities	**998.6**	1,749.2
Proceeds from disposals of equity securities and other investments	**36.1**	1.4
Proceeds from mortgages sold, matured or collected	**8.8**	10.7
Proceeds from the sale of FAFLIC	**-**	105.8
Cash transferred with sale of FAFLIC	**-**	(108.1)
Purchase of available-for-sale fixed maturities	**(981.7)**	(2,078.4)
Purchase of other investments	**(95.3)**	(31.0)
Net cash used for business acquisitions	**(13.3)**	-
Capital expenditures	**(6.6)**	(6.6)
Other investing items	**-**	1.5
Net cash used in investing activities	**(53.4)**	(355.5)
CASH FLOWS FROM FINANCING ACTIVITIES		
Exercise of options	**9.3**	1.6
Proceeds from long term debt	**205.6**	125.0
Change in collateral related to securities lending program	**(23.4)**	75.8
Dividends paid to shareholders	**(35.9)**	-
Repurchase of long-term debt	**(0.4)**	(125.9)
Repurchases of common stock	**(130.6)**	(36.1)

Other financing activities		**0.1**		0.1
Net cash provided by financing activities		**24.7**		40.5
Net change in cash and cash equivalents		**(43.7)**		(288.1)
Net change in cash related to discontinued operations		**(1.2)**		123.6
Cash and cash equivalents, beginning of period		**316.5**		397.7
Cash and cash equivalents, end of period	**$**	**271.6**	$	233.2

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

Table of Contents

THE HANOVER INSURANCE GROUP, INC.

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

1. Basis of Presentation and Principles of Consolidation

The accompanying unaudited consolidated financial statements of The Hanover Insurance Group, Inc. (THG or the Company) have been prepared in accordance with generally accepted accounting principles for interim financial information and with the requirements of Form 10-Q.

The interim consolidated financial statements of THG include the accounts of The Hanover Insurance Company (Hanover Insurance), and Citizens Insurance Company of America (Citizens), THG s principal property and casualty companies; and certain other insurance and non-insurance subsidiaries. These legal entities conduct their operations through several business segments discussed in Note 11. All significant intercompany accounts and transactions have been eliminated. On January 2, 2009, the Company sold First Allmerica Financial Life Insurance Company (FAFLIC) to Commonwealth Annuity and Life Insurance Company (Commonwealth Annuity), a subsidiary of the Goldman Sachs Group, Inc. (Goldman Sachs). Results related to the sale of FAFLIC are reported as discontinued operations. Accounts associated with the accident and health insurance business that was retained by the Company have been classified as assets and liabilities of discontinued operations in the consolidated Balance Sheets (See Note 3 Discontinued Operations).

The accompanying interim consolidated financial statements reflect, in the opinion of the Company s management, all adjustments necessary for a fair presentation of the financial position and results of operations. The results of operations for the nine months ended September 30, 2010 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 2009 Annual Report on Form 10-K filed with the Securities and Exchange Commission.

The preparation of financial statements in conformity with generally accepted accounting principles 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.

2. New Accounting Pronouncements

Recently Implemented Standards

Accounting Standards Codification (ASC) 105, *Generally Accepted Accounting Principles* (ASC 105) reorganized by topic existing accounting and reporting guidance issued by the Financial Accounting Standards Board (FASB) into a single source of authoritative generally accepted accounting principles (GAAP) to be applied by nongovernmental entities. All guidance contained in the ASC carries an equal level of authority. Rules and interpretive releases of the Securities and Exchange Commission (SEC) under authority of federal securities laws are also sources of authoritative GAAP for SEC registrants. Accordingly, all other accounting literature will be deemed non-authoritative . ASC 105 is effective on a prospective basis for financial statements issued for interim and annual periods ending after September 15, 2009. The Company has implemented the guidance included in ASC 105 as of July 1, 2009. The implementation of this guidance changed the Company s references to GAAP authoritative guidance but did not impact the Company s financial position or results of operations.

As of April 1, 2009, the Company adopted the guidance included in ASC 320, *Investments - Debt and Equity Securities* (ASC 320), which modifies the assessment of other-than-temporary impairments (OTTI) for fixed maturity securities, as well as the method of recording and reporting OTTI. Under the new guidance, if a company intends to sell or more likely than not will be required to sell a fixed maturity security before recovery of its amortized cost basis, the amortized cost of the security is reduced to its fair value, with a corresponding charge to earnings. If a company does not intend to sell the fixed maturity security, or more likely than not will not be required to sell it, the company is required to separate the other-than-temporary impairment into the portion which represents the credit loss and the amount related to all other factors. The amount of the estimated loss attributable to credit is recognized in earnings and the amount related to non-credit factors is recognized in accumulated other comprehensive income, net of applicable taxes. A cumulative effect adjustment was recognized by the Company upon adoption of this guidance to reclassify the non-credit component of previously recognized impairments from retained earnings to accumulated other comprehensive income. The Company increased the amortized cost basis of these fixed maturity securities and recorded a cumulative effect adjustment of $33.3 million as an increase to retained earnings and reduction to accumulated other comprehensive income. (See further disclosure in Note 8 Investments).

ASC 805, *Business Combinations* (ASC 805) contains guidance which was intended to provide additional clarification of application issues regarding initial recognition and measurement, subsequent measurement and accounting, and disclosure of assets and liabilities arising from contingencies in a business combination. ASC 805 was effective for business combinations initiated on or after

Table of Contents

the first annual reporting period beginning after December 15, 2008. The Company implemented this guidance effective January 1, 2009. Implementing this guidance did not have an effect on the Company s financial position or results of operations; however, it will likely have an impact on the Company s accounting for future business combinations, but the effect is dependent upon acquisitions, if any, that are made in the future.

In December 2009, the FASB issued ASC Update 2009-17, *Consolidation* (Topic 810) *Improvements to Financial Reporting by Enterprises Involved with Variable Interest Entities* (ASC Update 2009-17) which codified Statement of Financial Accounting Standards No. 167, *Amendments to FASB Interpretation No. 46(R)*. This guidance amends FASB Interpretation No. 46R, *Consolidation of Variable Interest Entities an interpretation of ARB No. 51* to require an analysis to determine whether a company has a controlling financial interest in a variable interest entity. This analysis identifies the primary beneficiary of a variable interest entity as the enterprise that has a) the power to direct the activities of a variable interest entity that most significantly impact the entity s economic performance and b) the obligation to absorb losses of the entity that could potentially be significant to the variable interest entity or the right to receive benefits from the entity that could potentially be significant to the variable interest entity. The statement requires an ongoing assessment of whether a company is the primary beneficiary of a variable interest entity when the holders of the entity, as a group, lose power, through voting or similar rights, to direct the actions that most significantly affect the entity s economic performance. This statement also enhances disclosures about a company s involvement in variable interest entities. ASC Update 2009-17 is effective as of the beginning of the first annual reporting period that begins after November 15, 2009. The Company implemented this guidance as of January 1, 2010. The effect of implementing this guidance was not material to the Company s financial position or results of operations.

ASC 820, *Fair Value Measurements and Disclosures* (ASC 820) includes guidance that was issued by the FASB which is to be considered when determining whether or not a transaction is orderly and clarifies the valuation of securities in markets that are not active. This guidance includes information related to a company s use of judgment, in addition to market information, in certain circumstances to value assets which have inactive markets. This fair value guidance in ASC 820 was effective for interim and annual reporting periods ending after June 15, 2009.

In August 2009, the FASB issued ASC Update No. 2009-05, *Fair Value Measurements and Disclosures (Topic 820): Measuring Liabilities at Fair Value*. This update amends ASC 820, *Fair Value Measurements and Disclosures* and provides further guidance on measuring the fair value of a liability. The guidance establishes the types of valuation techniques to be used to value a liability when a quoted market price in an active market for the identical liability is not available, such as the use of an identical or similar liability when traded as an asset. The guidance also further clarifies that a quoted price in an active market for the identical liability at the measurement date and the quoted price for the identical liability when traded as an asset in an active market when no adjustments to the quoted price of the asset are required are both Level 1 fair value measurements. If adjustments are required to be applied to the quoted price, it results in a level 2 or 3 fair value measurement. The guidance provided in the update is effective for the first reporting period (including interim periods) beginning after issuance.

In September 2009, the FASB issued ASC Update No. 2009-12, *Fair Value Measurements and Disclosures (Topic* 820): *Investments in Certain Entities that Calculate Net Asset Value per Share* (or Its Equivalent) (ASC Update No. 2009-12). This update sets forth guidance on using the net asset value per share provided by an investee to estimate the fair value of an alternative investment. Specifically, the update permits a reporting entity to measure the fair value of this type of investment on the basis of the net asset value per share of the investment (or its equivalent) if all or substantially all of the underlying investments used in the calculation of the net asset value is consistent with ASC 820. The update also requires additional disclosures by each major category of investment, including, but not limited to, fair value of underlying investments in the major category, significant investment strategies, redemption restrictions, and unfunded commitments related to investments in the major category. The amendments in this update are effective for interim and annual periods ending after December 15, 2009.

In January 2010, the FASB issued ASC Update 2010-06 (Topic 820) *Improving Disclosures about Fair Value Measurements* (ASC Update 2010-06). This update amends ASC 820 and requires new and clarified disclosures for fair value measurements. The guidance requires that transfers in and out of Levels 1 and 2 be disclosed separately, including a description of the reasons for such transfers. Additionally, the reconciliation of fair value measurements of Level 3 assets should separately disclose information about purchases, sales, issuance and settlements in a gross, rather than net disclosure presentation. The guidance further clarifies that fair value disclosures should be separately presented for each class of assets and liabilities and disclosures should be provided for valuation techniques and inputs for both recurring and non-recurring fair value measurements related to Level 2 and Level 3 categories. The disclosure guidance provided in the update is effective for reporting periods beginning after December 15, 2009. The Company implemented this guidance effective at January 1, 2010. Implementing this guidance did not have an effect on the Company s financial position or results of operations.

The Company applied the provisions of ASC 820 to its financial assets and liabilities upon adoption at January 1, 2008 and adopted the remaining provisions relating to certain nonfinancial assets and liabilities on January 1, 2009. The difference between the carrying amounts and fair values of those financial instruments held upon initial adoption, on January 1, 2008, was recognized as a cumulative effect adjustment to the opening balance of retained earnings and was not material to the Company s financial position or results of operations. The Company implemented the guidance related to orderly transactions under current market conditions as of April 1, 2009, which also was not material to the Company s financial position or results of operations. Furthermore, the implementation as of October 1, 2009 of ASC Update No. 2009-05 and ASC Update No. 2009-12 did not have a material effect on the Company s financial position or results of operations. (See further disclosure in Note 9 Fair Value).

ASC 855, *Subsequent Events* (ASC 855), and as modified by ASC update 2010-9, *Amendments to Certain Recognition and Disclosure Requirements*, includes guidance that was issued by the FASB in May 2009, and is consistent with current auditing standards in defining a subsequent event. Additionally, the guidance provides for disclosure regarding the existence of a company s evaluation of its subsequent events. ASC 855 defines two types of subsequent events, recognized and non-recognized . Recognized subsequent events provide additional evidence about conditions that existed at the date of the balance sheet and are required to be reflected in the financial statements. Non-recognized subsequent events provide evidence about conditions that did not exist at the date of the balance sheet but arose after that date and, therefore, are not required to be reflected in the financial statements. However, certain non-recognized subsequent events may require disclosure to prevent the financial statements from being misleading. This guidance was effective prospectively for interim or annual financial periods ending after June 15, 2009. The Company implemented the guidance included in ASC 855 as of April 1, 2009 and the updated guidance as of December 31, 2009. The effect of implementing the guidance was not material to the Company s financial position or results of operations.

In December 2009, the FASB issued ASC Update 2009-16 *Transfers and Servicing* (Topic 860) - *Accounting for Transfers of Financial Assets* (ASC Update 2009-16) which codified Statement of Financial Accounting Standards No. 166, *Accounting for Transfers of Financial Assets an amendment of FASB Statement No. 140*. This guidance revises FASB Statement of Financial Accounting Standards No. 140, *Accounting for Transfers and Extinguishment of Liabilities a replacement of FASB Statement 125* and requires additional disclosures about transfers of financial assets, including securitization transactions, and any continuing exposure to the risks related to transferred financial assets. It also eliminates the concept of a qualifying special-purpose entity , changes the requirements for derecognizing financial assets, and enhances disclosure requirements. ASC Update 2009-16 is effective prospectively, for annual periods beginning after November 15, 2009, and interim and annual periods thereafter. The Company has implemented this guidance as of January 1, 2010. The effect of implementing this guidance was not material to the Company s financial position or results of operations.

Recently Issued Standards

In October 2010, the FASB issued ASC Update 2010-26 (Topic 944) *Accounting for Costs Associated with Acquiring or Renewing Insurance Contracts (a consensus of the FASB Emerging Issues Task Force)*. This update provides clarity in defining which costs relating to the acquisition of new or renewal insurance contracts qualify for deferral, commonly known as deferred acquisition costs. Additionally, this update specifies that only costs associated with the successful acquisition of a policy or contract may be deferred, whereas current industry practice often includes costs relating to unsuccessful contract acquisitions. This ASC Update is effective for fiscal years beginning after December 15, 2011. The Company is currently assessing the impact of this guidance to its financial position and results of operations.

3. Discontinued Operations

Discontinued operations primarily consist of: (i) FAFLIC s discontinued operations, including both the loss associated with the sale of FAFLIC on January 2, 2009 and the loss or income resulting from its prior business operations; (ii) losses or gains associated with the sale of the variable life insurance and annuity business in 2005; and (iii) the discontinued accident and health insurance business.

The following table summarizes the results for this discontinued business for the periods indicated:

	(Unaudited)	(Unaudited)
	Quarter Ended	Nine months Ended September 30,

	September 30,			
(In millions)	**2010**	2009	**2010**	2009
Gain from operations of discontinued FAFLIC business, net of taxes	**$ 0.5**	$ 0.4	**$ 0.4**	$ 6.3
Gain on disposal of variable life and annuity business, net of taxes	**$ 0.1**	$ -	**$ 1.0**	$ 4.1
Gain (loss) from discontinued accident and health insurance business, net of taxes	**$ 0.2**	$ 0.7	**$ (0.9)**	$ (2.4)
Other discontinued operations, net of taxes	**$ 0.1**	$ -	**$ 0.1**	$ -

FAFLIC Discontinued Operations

On January 2, 2009, THG sold its remaining life insurance subsidiary, FAFLIC, to Commonwealth Annuity, a subsidiary of Goldman Sachs. Approval was obtained from the Massachusetts Division of Insurance for a pre-close dividend from FAFLIC consisting of designated assets with a statutory book value of approximately $130 million. Total proceeds from the sale, including the dividend, were approximately $230 million, net of transaction costs. Additionally, coincident with the sale transaction, Hanover Insurance and FAFLIC entered into a reinsurance contract whereby Hanover Insurance assumed FAFLIC s discontinued accident and health insurance business. THG has also indemnified Commonwealth Annuity for certain litigation, regulatory matters and other liabilities related to the pre-closing activities of the business transferred. The Company recognized, in 2008, a $77.3 million loss associated with this transaction.

The gain from FAFLIC s discontinued operations was $0.5 million and $0.4 million, net of tax, for the quarter and $0.4 million and $6.3 million, net of tax, for the nine months ended September 30, 2010 and 2009, respectively, and resulted primarily from a change in the Company s estimate of indemnification liabilities related to the sale.

As of September 30, 2010, the Company s total gross indemnification liability provided in connection with the sale of FAFLIC was $1.2 million. The Company regularly reviews and updates this liability for legal and regulatory matter indemnities. Although the Company believes its current estimate for this liability is appropriate, there can be no assurance that these estimates will not materially increase in the future. Adjustments to this reserve are recorded in the results of the Company in the period in which they are determined.

Variable Life Insurance and Annuity Business

On December 30, 2005, the Company sold its run-off variable life insurance and annuity business to Goldman Sachs, including the reinsurance of 100% of the variable business of FAFLIC. The Company agreed to indemnify Goldman Sachs for certain litigation, regulatory matters and other liabilities relating to the pre-closing activities of the business that was sold. In the third quarter of 2010, the Company recorded gains of $0.1 million, net of tax, and in the first nine months of 2010 and 2009, respectively, the Company recorded gains of $1.0 million and $4.1 million, net of tax, primarily due to a change in the Company s estimate of indemnification liabilities.

As of September 30, 2010, the Company s total gross liability for guarantees and indemnifications provided in connection with the disposal of its variable life insurance and annuity business was $4.1 million. The Company regularly reviews and updates this liability for legal and regulatory matter indemnities. Although the Company believes its current estimate for this liability is appropriate, there can be no assurance that these estimates will not materially increase in the future. Adjustments to this reserve are recorded in the results of the Company in the period in which they are determined.

Accident and Health Insurance Business

During 1999, the Company exited its accident and health insurance business, consisting of its Employee Benefit Services business, its Affinity Group Underwriters business and its accident and health assumed reinsurance pool business. Prior to 1999, these businesses comprised substantially all of the former Corporate Risk Management Services segment. Accordingly, the operating results of the discontinued segment have been reported in accordance with Accounting Principles Board Opinion No. 30, *Reporting the Results of Operations Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions* (APB Opinion No. 30). On January 2, 2009, Hanover Insurance directly assumed a portion of the accident and health insurance business; and therefore continues to apply APB Opinion No. 30 to this business. In addition, the remainder of the FAFLIC accident and health business was reinsured by Hanover Insurance and has been reported in accordance with ASC 205.

During the quarters ended September 30, 2010 and 2009, the Company recognized gains of $0.2 million and $0.7 million, net of tax, respectively, from its discontinued accident and health insurance business. For the nine months ended September 30, 2010 and 2009, the Company recognized losses of $0.9 million and $2.4 million, net of tax, related to this business. Losses for the nine months ended September 30, 2010 were driven by increased reserves resulting from the Company s current interpretation of the provisions of the Patient Protection and Affordable Care Act, as well as realized investment losses due to impairments. These were partially offset by net investment income. Losses for the nine months ended September 30, 2009 primarily reflect realized investment losses due to impairments.

At September 30, 2010 and December 31, 2009, the portion of the discontinued accident and health insurance business that was directly assumed had assets of $58.9 million and $54.0 million, respectively, consisting primarily of invested assets, and liabilities of approximately $53.3 million and $48.7 million, respectively, consisting primarily of policy liabilities. At September 30, 2010 and December 31, 2009, the assets and liabilities of this business, as well as those of the reinsured portion of the accident and health insurance business are classified as assets and liabilities of discontinued operations in the Consolidated Balance Sheets.

4. Other Significant Transactions

On September 23, 2010, June 7, 2010 and March 22, 2010, the Company paid dividends of 25 cents per share to its issued and outstanding common stock shareholders of record at the close of business on September 10, 2010, May 24, 2010 and March 8, 2010, respectively. The total dividends paid in the quarters ended September 30, 2010, June 30, 2010 and March 31, 2010 were $11.6 million, $12.0 million and $12.3 million, respectively. On an annualized basis, these dividend payments represent a 33% increase over the annual dividend of 75 cents, paid in December 2009. The holding company receives dividends from its insurance subsidiaries; such dividends are restricted through state regulation. Both Citizens and Hanover Insurance paid dividends to their parent companies in 2009. Citizens could not pay a dividend to Hanover Insurance without the prior approval of the state regulators until June 2010. Beginning in June 2010, Citizens was able to pay up to $70.3 million without the prior approval of state regulators. In September 2010, Citizens declared a $70 million dividend to Hanover Insurance. Hanover Insurance cannot pay a dividend to the holding company without the prior approval of the state regulators until December 2010. In December 2010, the maximum dividend that Hanover Insurance can pay without the prior approval of state regulators will be $173.7 million.

On June 14, 2010, the Company purchased approximately 11 acres of developable land in Worcester, Massachusetts for $5 million. A portion of the land will be developed with the construction of a new 200,000 square foot office building and the redevelopment of an adjacent parking garage. In addition, the Company signed a 17 year lease agreement with a tenant for the new building and garage. The tenant is an unaffiliated public company with an investment grade credit rating. Through September 30, 2010, the Company capitalized $6.8 million in related lease acquisition, legal, architectural and associated costs. Development costs are estimated between $65 million and $70 million and the project will be financed, in part, through the issuance of collateralized debt through the Company s membership in the Federal Home Loan Bank of Boston (FHLBB). In July 2010, Hanover Insurance committed to borrow $46.3 million from the FHLBB to finance the project. These borrowings will be drawn in several increments from July 2010 to January 2012. On July 19, 2010, Hanover Insurance received an advance of $7.6 million from this commitment. Amounts drawn from the $46.3 million mature on July 20, 2020 and carry fixed interest rates with a weighted average of 3.88%. (See also below for further information related to participation in the FHLBB s collateralized borrowing program).

On March 31, 2010, the Company acquired Campania for a cash purchase price of approximately $24 million, subject to various terms and conditions. Campania specializes in insurance solutions for portions of the healthcare industry.

Through October 2010, the Company s Board of Directors has authorized aggregate repurchases of the Company s common stock of up to $500 million, including a recent $100 million increase in the program. Under the repurchase authorizations, the Company may repurchase its common stock from time to time, in amounts and prices and at such times as deemed appropriate, subject to market conditions and other considerations. The Company s 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. On March 30, 2010 and December 8, 2009, the Company entered into accelerated share repurchase agreements with Barclays Bank PLC, acting through its agent Barclays Capital, Inc., for the immediate repurchase of 2.3 million and 2.4 million shares, respectively, of the Company s common stock at a cost of approximately $100.9 million and $100.6 million, respectively (in each case, subject to adjustment). The Company settled its accelerated stock repurchase program initiated in December 2009 on June 23, 2010 for an additional payment of $4.6 million provided to Barclays Bank PLC. Total repurchases under these programs as of September 30, 2010 were 7.9 million shares at a cost of $338.8 million.

On February 23, 2010, the Company issued $200.0 million aggregate principal amount of 7.50% senior unsecured notes due March 1, 2020. The senior debentures are subject to certain restrictive covenants, including limitations on the issuance or disposition of capital stock of restricted subsidiaries and limitations on liens. These debentures pay interest semi-annually on March 1 and September 1.

On December 3, 2009, the Company entered into a renewal rights agreement with OneBeacon Insurance Group, LTD. (OneBeacon). Through this agreement, the Company acquired access to a portion of OneBeacon s small and middle market commercial business at renewal, including industry programs and middle market niches. This transaction included consideration of approximately $23 million, plus certain potential additional consideration, primarily representing purchased renewal rights intangible assets which are included as Other Assets in the Consolidated Balance Sheets. The agreement was effective for renewals beginning January 1, 2010.

On September 25, 2009, Hanover Insurance received an advance of $125 million through its membership in the FHLBB as part of a collateralized borrowing program. This advance bears interest at a fixed rate of 5.50% per annum over a twenty-year term. The proceeds from the borrowing were used by Hanover Insurance to acquire AIX and its subsidiaries from the holding company. As noted above, in July 2010 an additional $7.6 million advance was received from the FHLBB. As collateral to the FHLBB for all advances received as of September 30, 2010, Hanover Insurance has pledged government agency securities with a fair value of $153.7 million. Collateral pledged to the FHLBB totaled $142.0 million as of December 31, 2009. The fair value of the collateral pledged must be maintained at certain specified levels of the borrowed amount, which can vary depending on the type of assets pledged. If the fair value of this collateral declines below these specified levels, Hanover Insurance would be required to pledge additional collateral or repay outstanding borrowings. Hanover Insurance is permitted to voluntarily repay the outstanding borrowings at any time, subject to a repayment fee. As a requirement of membership in the FHLBB, Hanover Insurance acquired $2.5 million of FHLBB stock, and as a condition to participating in the FHLBB s collateralized borrowing program, it was required to purchase additional shares of FHLBB stock in an amount equal to 4.5% of its outstanding borrowings. Such purchases totaled $6.0 million through September 30, 2010.

The Company liquidated AFC Capital Trust I (the Trust) on July 30, 2009. Each holder of 8.207% Series B Capital Securities (Capital Securities) as of that date received a principal amount of the Company s Series B 8.207% Junior Subordinated Deferrable Interest Debentures (Junior Debentures) due February 3, 2027 equal to the liquidation amount of the Capital Securities held by such holder. The liquidation of the Trust did not have a material effect on the Company s results of operations or financial position.

On June 29, 2009, prior to liquidating the Trust, the Company completed a cash tender offer to repurchase a portion of its Capital Securities that were issued by the Trust and a portion of its 7.625% Senior Debentures (Senior Debentures) due in 2025 that were issued by THG. As of that date, $69.3 million of Capital Securities were tendered at a price equal to $800 per $1,000 of face value. In addition, the Company accepted for tender a principal amount of $77.3 million of Senior Debentures. Depending on the time of tender, holders of the Senior Debentures accepted for purchase received a price of either $870 or $900 per $1,000 of face value. Separately, the Company held $65.0 million of Capital Securities previously repurchased at a discount in the open market prior to the tender offer, and $1.1 million of Senior Debentures. The Company recognized a pre-tax gain of $34.5 million in 2009 as a result of such purchases. During the first quarter of 2010, the Company repurchased $0.4 million of Junior Debentures at a slight gain. As of September 30, 2010, a net principal amount of $165.3 million of their Junior Debentures and $121.4 million of their Senior Debentures, which are not held by us, remained outstanding.

5. Debt

Long-term debt consists of the following:

	(Unaudited)	
(In millions)	**September 30, 2010**	**December 31, 2009**
Senior debentures (unsecured) maturing March 1, 2020	**$ 199.3**	$ -
Senior debentures (unsecured) maturing October 16, 2025	**121.4**	121.4
Holding Company junior subordinated debentures	**165.3**	165.7
FHLBB borrowing	**132.6**	125.0
Capital securities	**17.4**	17.8
Surplus notes	**4.0**	4.0
	$ 640.0	$ 433.9

On February 23, 2010, the Company issued $200 million aggregate principal amount of 7.50% senior unsecured notes due March 1, 2020. The senior debentures are subject to certain restrictive covenants, including limitations on the issuance or disposition of capital stock of restricted subsidiaries and limitations on liens. These debentures pay interest semi-annually (See also Note 4 Other Significant Transactions). The Company is in compliance with the covenants associated with this indenture.

The Company also holds senior unsecured notes issued with a face value of $200.0 million on October 16, 1995. In 2009, the Company repurchased a portion of these senior debentures with a face value of $78.4 million. The remaining senior debentures have a $121.4 million face value, pay interest semi-annually at a rate of 7.625% and mature on October 16, 2025. The senior debentures are subject to certain restrictive covenants, including limitations on the issuance or disposition of stock of restricted subsidiaries and limitations on

liens (See also Note 4 Other Significant Transactions). The Company is in compliance with the covenants associated with this indenture.

AFC Capital Trust I issued $300.0 million of preferred securities in 1997, the proceeds of which were used to purchase junior subordinated debentures issued by the Company. The Company liquidated the Trust on July 30, 2009. Each holder of Capital Securities as of that date received a principal amount of the Company s Series B Junior Subordinated Deferrable Interest Debentures equal to the liquidation amount of the Capital Securities held by such holder. In 2010 and 2009, the Company repurchased a portion of these debentures with a face value of $0.4 million and $134.3 million, respectively. These junior subordinated debentures have a face value of $165.3 million and $165.7 million as of September 30, 2010 and December 31, 2009, respectively, and consistent with the capital securities, pay cumulative dividends semi-annually at 8.207% and mature February 3, 2027 (See also Note 4 Other Significant Transactions). These securities are subject to certain restrictive covenants, with which the Company is in compliance. In addition, the Company holds $3.0 million of capital securities related to Professionals Direct, Inc., and $14.4 million of capital securities related to AIX Holdings, Inc. as of September 30, 2010.

In September 2009, Hanover Insurance received an advance of $125.0 million through its membership in the FHLBB as part of a collateralized borrowing program (FHLBB 2009). This advance bears interest at a fixed rate of 5.50% per annum over a twenty-year term. In July 2010, the Company committed to borrow an additional $46.3 million from FHLBB to finance the development of City Square. These borrowings will be drawn in several increments from July 2010 to January 2012. All amounts mature on July 20, 2020 and carry fixed interest rates with a weighted average of 3.88%. Through September 30, 2010, the Company has borrowed $7.6 million under this arrangement (FHLBB 2010). All interest associated with this additional $46.3 million will be capitalized through the construction phase of the City Square project. As collateral to FHLBB, Hanover Insurance has pledged government agency securities with a fair value of $153.7 million and $142.0 million as of September 30, 2010 and December 31, 2009, respectively (See also Note 4 Other Significant Transactions). The Company is in compliance with the covenants associated with these borrowings.

In June 2007, the Company entered into a $150.0 million committed syndicated credit agreement which expired in June 2010. There were no borrowings under this agreement. The agreement provided covenants, including, but not limited to, maintaining a certain level of equity and an RBC ratio in the Company s primary property and casualty companies of at least 175% (based on the Industry Scale). The Company was in compliance with the covenants of this agreement for the duration of the contract. The Company did not renew or replace this syndicated credit agreement upon expiration. Additionally, the Company had no commercial paper borrowings as of September 30, 2010 and the Company does not anticipate utilizing commercial paper in the near term.

Interest expense was $32.8 million for the nine months ended September 30, 2010 and $27.2 million for the nine months ended September 30, 2009 and included interest related to the Company s senior debentures, junior subordinated debentures, FHLBB borrowings, capital securities and surplus notes. All interest expense is recorded in other operating expenses.

6. Federal Income Taxes

Federal income tax expense for the nine months ended September 30, 2010 and 2009 has been computed using estimated 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.

The Company or its subsidiaries files income tax returns in the U.S. federal jurisdiction and various state 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 2005. In September 2009, the Company received a Revenue Agents Report for the 2005 and 2006 IRS audit. The Company has agreed to all proposed adjustments other than a disallowance of Separate Account Dividends Received Deductions for which the Company has requested an Appeals conference. Due to available net operating loss carryovers and the 2005 sale of Allmerica Financial Life Insurance and Annuity Company, the effects of the proposed adjustments do not materially affect the Company s financial position. The IRS audits of the years 2007 and 2008 commenced in April 2010. The Company and its subsidiaries are still subject to U.S. state income tax examinations by tax authorities for years after 1998.

7. Pension and Other Postretirement Benefit Plans

The Company s defined benefit pension plans, which provided retirement benefits based on a cash balance formula, were frozen as of January 1, 2005; therefore, no further cash balance allocations have been credited for plan years beginning on or after January 1, 2005. In addition, certain transition group employees were eligible for a grandfathered benefit based upon service and compensation; such benefits were also frozen at January 1, 2005 levels with an annual transition pension adjustment. The Company has additional unfunded pension plans and postretirement plans to provide benefits to certain full-time employees, former FAFLIC agents, retirees and their dependents.

Table of Contents

The components of net periodic benefit cost for pension and other postretirement benefit plans are as follows:

	(Unaudited)			
	Quarter Ended September 30,			
(In millions)	**2010**	**2009**	**2010**	**2009**
	Pension Benefits		Postretirement Benefits	
Service cost benefits earned during the period	**$ 0.1**	$ 0.1	**$ -**	$ -
Interest cost	**8.2**	8.4	**0.7**	0.7
Expected return on plan assets	**(8.8)**	(6.4)	**-**	-
Recognized net actuarial loss	**4.2**	6.7	**0.1**	0.1
Amortization of transition asset	**(0.4)**	(0.4)	**-**	-
Amortization of prior service cost	**-**	-	**(1.5)**	(1.4)
Net periodic cost (benefit)	**$ 3.3**	$ 8.4	**$ (0.7)**	$ (0.6)

	(Unaudited)			
	Nine months Ended September 30,			
	2010	**2009**	**2010**	**2009**
	Pension Benefits		Postretirement Benefits	
Service cost benefits earned during the period	**$ 0.1**	$ 0.1	**$ 0.1**	$ 0.1
Interest cost	**24.5**	25.4	**2.0**	2.1
Expected return on plan assets	**(26.3)**	(19.1)	**-**	-
Recognized net actuarial loss	**12.6**	20.2	**0.3**	0.2
Amortization of transition asset	**(1.2)**	(1.2)	**-**	-
Amortization of prior service cost	**-**	-	**(4.4)**	(4.3)
Net periodic cost (benefit)	**$ 9.7**	$ 25.4	**$ (2.0)**	$ (1.9)

On January 4, 2010, the Company made a discretionary contribution of $100.0 million to the qualified defined benefit pension plan. With this contribution, and based upon the current estimate of liabilities and certain assumptions regarding investment return and other factors, the Company s qualified defined benefit pension plan is essentially fully funded.

Table of Contents

8. Investments

A. Fixed maturities and equity securities

The Company holds investments in fixed maturities and equity securities, which are classified as available for sale, in accordance with ASC 320, *Investments Debt and Equity Securities*.

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

(Unaudited)

(In millions)	September 30, 2010				
			Gross Unrealized Losses		
	Amortized Cost (1)	Gross Unrealized Gains	Unrealized Losses	OTTI Unrealized Losses (2)	Fair Value
U.S. Treasury securities and U.S. government and agency securities	**$ 232.4**	**$ 8.3**	**$ 0.5**	**$ -**	**$ 240.2**
States and political subdivisions	**931.9**	**48.1**	**7.6**	**-**	**972.4**
Foreign governments	**3.0**	**-**	**-**	**-**	**3.0**
Corporate fixed maturities	**2,404.8**	**239.8**	**3.2**	**25.5**	**2,615.9**
Residential mortgage-backed securities	**787.0**	**48.5**	**0.7**	**8.4**	**826.4**
Commercial mortgage-backed securities	**346.2**	**21.3**	**1.2**	**-**	**366.3**
Total fixed maturities, including assets of discontinued operations	**4,705.3**	**366.0**	**13.2**	**33.9**	**5,024.2**
Less: fixed maturities of discontinued operations	**(116.5)**	**(9.1)**	**(0.2)**	**(5.8)**	**(119.6)**
Total fixed maturities, excluding discontinued operations	**$ 4,588.8**	**$ 356.9**	**$ 13.0**	**$ 28.1**	**$ 4,904.6**
Equity securities, excluding discontinued operations	**$ 112.3**	**$ 13.7**	**$ 0.3**	**$ -**	**$ 125.7**

(In millions)	December 31, 2009				
			Gross Unrealized Losses		
	Amortized Cost (1)	Gross Unrealized Gains	Unrealized Losses	OTTI Unrealized Losses (2)	Fair Value
U.S. Treasury securities and U.S. government and agency securities	$ 355.2	$ 3.2	$ 3.7	$ -	$ 354.7
States and political subdivisions	844.7	13.1	25.6	-	832.2
Foreign governments	3.0	-	-	-	3.0
Corporate fixed maturities	2,243.7	131.4	14.3	29.9	2,330.9
Residential mortgage-backed securities	858.8	29.7	3.4	10.7	874.4
Commercial mortgage-backed securities	334.5	10.1	7.4	-	337.2
Total fixed maturities, including assets of discontinued operations	4,639.9	187.5	54.4	40.6	4,732.4

Less: fixed maturities of discontinued operations	(119.6)	(6.0)	(2.0)	(6.8)	(116.8)
Total fixed maturities, excluding discontinued operations	$ 4,520.3	$ 181.5	$ 52.4	$ 33.8	$4,615.6
Equity securities, excluding discontinued operations	$ 57.3	$ 12.2	$ 0.3	$ -	$ 69.2

(1) Amortized cost for fixed maturities and cost for equity securities.

(2) Represents other-than-temporary impairments recognized in accumulated other comprehensive income. Amount excludes net unrealized gains on impaired securities relating to changes in the value of such securities subsequent to the impairment measurement date of $39.2 million and $30.1 million as of September 30, 2010 and December 31, 2009, respectively.

Table of Contents

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. Mortgage-backed securities are included in the category representing their stated maturity.

	(Unaudited)	
(In millions)	September 30, 2010	
	Amortized Cost	Fair Value
Due in one year or less	$182.9	$ 185.9
Due after one year through five years	1,218.8	1,309.3
Due after five years through ten years	1,570.5	1,716.2
Due after ten years	1,733.1	1,812.8
Total fixed maturities, including assets of discontinued operations	4,705.3	5,024.2
Less: fixed maturities of discontinued operations	(116.5)	(119.6)
Total fixed maturities, excluding assets of discontinued operations	$ 4,588.8	$ 4,904.6

B. Securities in an unrealized loss position

The following tables provide information about the Company s fixed maturities and equity securities that are in an unrealized loss position at September 30, 2010 and December 31, 2009:

	(Unaudited)					
	September 30, 2010					
	12 months or less		Greater than 12 months		Total	
(In millions)	Gross Unrealized Losses and OTTI	Fair Value	Gross Unrealized Losses and OTTI	Fair Value	Gross Unrealized Losses and OTTI (1)	Fair Value
Fixed maturities:						
Investment grade:						
U.S. Treasury securities and U.S. government and agency securities	$ -	$ 11.1	$ 0.5	$ -	$ 0.5	$ 11.1
States and political subdivisions	2.1	29.7	5.5	94.3	7.6	124.0
Corporate fixed maturities	0.3	13.7	12.3	96.9	12.6	110.6
Residential mortgage-backed securities	0.1	35.8	9.0	33.0	9.1	68.8
Commercial mortgage-backed securities	-	5.8	1.2	8.1	1.2	13.9

Total investment grade	**2.5**	**96.1**	**28.5**	**232.3**	**31.0**	**328.4**
Below investment grade (2):						
Corporate fixed maturities	**0.7**	**20.4**	**15.4**	**124.9**	**16.1**	**145.3**
Total fixed maturities	**3.2**	**116.5**	**43.9**	**357.2**	**47.1**	**473.7**
Equity securities:						
Common equity securities	**0.3**	**11.4**	**-**	**-**	**0.3**	**11.4**
Total (3)	**$ 3.5**	**$ 127.9**	**$ 43.9**	**$ 357.2**	**$ 47.4**	**$ 485.1**

(1) Includes $33.9 million unrealized loss related to other-than-temporary impairment losses recognized in other comprehensive income, of which $15.1 million are below investment grade aged greater than 12 months.

(2) Substantially all below investment grade securities with an unrealized loss had been rated by the NAIC, Standard & Poor s or Moody s at September 30, 2010.

(3) Includes discontinued accident and health insurance business of $6.0 million in total gross unrealized losses with $40.5 million in fair value at September 30, 2010.

Table of Contents

	December 31, 2009					
	12 months or less		Greater than 12 months		Total	
(In millions)	Gross Unrealized Losses and OTTI	Fair Value	Gross Unrealized Losses and OTTI	Fair Value	Gross Unrealized Losses and OTTI (1)	Fair Value
Fixed maturities:						
Investment grade:						
U.S. Treasury securities and U.S. government and agency securities	$ 3.7	$ 170.8	$ -	$ -	$ 3.7	$ 170.8
States and political subdivisions	9.0	275.2	15.6	176.5	24.6	451.7
Corporate fixed maturities	3.4	115.8	13.3	152.7	16.7	268.5
Residential mortgage-backed securities	6.6	89.1	7.5	62.6	14.1	151.7
Commercial mortgage-backed securities	0.4	13.5	7.0	30.0	7.4	43.5
Total investment grade	23.1	664.4	43.4	421.8	66.5	1,086.2
Below investment grade (2):						
States and political subdivisions	0.2	8.7	0.8	8.2	1.0	16.9
Corporate fixed maturities	10.6	84.1	16.9	150.1	27.5	234.2
Total below investment grade	10.8	92.8	17.7	158.3	28.5	251.1
Total fixed maturities	33.9	757.2	61.1	580.1	95.0	1,337.3
Equity securities:						
Common equity securities	-	-	0.3	1.4	0.3	1.4
Total (3)	$ 33.9	$ 757.2	$ 61.4	$ 581.5	$ 95.3	$ 1,338.7

(1) Includes $40.6 million unrealized loss related to other-than-temporary impairment losses recognized in other comprehensive income, of which $14.8 million are below investment grade aged greater than 12 months.
(2) Substantially all below investment grade securities with an unrealized loss had been rated by the NAIC, Standard & Poor s or Moody s at December 31, 2009.
(3) Includes discontinued accident and health insurance business of $8.8 million in total gross unrealized losses with $55.0 million in fair value at December 31, 2009.

The Company employs a systematic methodology to evaluate declines in fair value below amortized cost for all investments. The methodology utilizes a quantitative and qualitative process ensuring that available evidence concerning the declines in fair value below amortized cost is evaluated in a disciplined manner. In determining whether a decline in fair value below amortized cost is other-than-temporary, 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; a weakening of the general market conditions in the industry or geographic region in which the issuer operates; 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, any factors that might raise doubt about the issuer s ability to pay all amounts due according to the contractual terms and whether the Company expects to recover the entire amortized cost basis of the security; and with respect to equity securities, the Company s ability and

intent to hold the investment for a period of time to allow for a recovery in value. The Company applies these factors to all securities.

Table of Contents

The following tables provide information on the Company s gross unrealized losses of fixed maturity securities by credit ratings, including ratings of securities with third party guarantees, as of September 30, 2010 and December 31, 2009.

(Unaudited)

September 30, 2010

(In millions)	AAA	AA	A	BBB	Total investment grade	BB	B	CCC and below	Total below investment grade	Total
U.S. Treasury securities and U.S government and agency securities	**$ 0.5**	**$ -**	**$ -**	**$ -**	**$ 0.5**	**$ -**	**$ -**	**$ -**	**$ -**	**$ 0.5**
States and political subdivisions	**0.3**	**0.9**	**1.8**	**4.6**	**7.6**	**-**	**-**	**-**	**-**	**7.6**
Corporate fixed maturities	**-**	**0.4**	**1.8**	**10.4**	**12.6**	**6.4**	**4.6**	**5.1**	**16.1**	**28.7**
Residential mortgage-backed securities	**0.7**	**0.5**	**-**	**7.9**	**9.1**	**-**	**-**	**-**	**-**	**9.1**
Commercial mortgage-backed securities	**-**	**-**	**1.2**	**-**	**1.2**	**-**	**-**	**-**	**-**	**1.2**
Total fixed maturities, including discontinued operations	**1.5**	**1.8**	**4.8**	**22.9**	**31.0**	**6.4**	**4.6**	**5.1**	**16.1**	**47.1**
Less: losses included in discontinued operations	**-**	**-**	**-**	**(3.1)**	**(3.1)**	**(2.2)**	**(0.2)**	**(0.5)**	**(2.9)**	**(6.0)**
Total fixed maturities, excluding discontinued operations	**$ 1.5**	**$ 1.8**	**$ 4.8**	**$ 19.8**	**$ 27.9**	**$ 4.2**	**$ 4.4**	**$ 4.6**	**$ 13.2**	**$ 41.1**

December 31, 2009

(In millions)	AAA	AA	A	BBB	Total investment grade	BB	B	CCC and below	Total below investment grade	Total
U.S. Treasury securities and U.S. government and agency securities	$ 3.7	$ -	$ -	$ -	$ 3.7	$ -	$ -	$ -	$ -	$ 3.7
States and political subdivisions	4.1	7.3	4.8	8.4	24.6	0.8	-	0.2	1.0	25.6
Corporate fixed maturities	-	1.4	7.1	8.2	16.7	11.8	9.7	6.0	27.5	44.2
	2.4	1.4	7.9	2.4	14.1	-	-	-	-	14.1

Residential mortgage-backed securities										
Commercial mortgage-backed securities	0.5	0.8	6.1	-	7.4	-	-	-	-	7.4
Total fixed maturities, including discontinued operations	10.7	10.9	25.9	19.0	66.5	12.6	9.7	6.2	28.5	95.0
Less: losses included in discontinued operations	-	(0.2)	(1.4)	(3.2)	(4.8)	(0.5)	(2.8)	(0.7)	(4.0)	(8.8)
Total fixed maturities, excluding discontinued operations	$ 10.7	$ 10.7	$ 24.5	$ 15.8	$ 61.7	$ 12.1	$ 6.9	$ 5.5	$ 24.5	$ 86.2

C. Other-than-temporary impairments

For the three months ended September 30, 2010, total other-than-temporary impairments on fixed maturities were $0.2 million. Of this amount, $1.4 million was recognized in earnings, including $1.2 million that was transferred from unrealized losses in accumulated other comprehensive income, net of taxes. Of the $1.4 million loss recorded in earnings, $1.2 million related to below investment grade corporate bonds in the industrial sector that we intend to sell and $0.2 million was estimated credit losses on above investment grade residential mortgage-backed securities.

For the first nine months of 2010, total other-than-temporary impairments on fixed maturities and equity securities were $3.5 million. Of this amount, $7.5 million was recognized in earnings, including $4.0 million that was transferred from unrealized losses in accumulated other comprehensive income, net of taxes. Of the $7.5 million recorded in earnings, $3.0 million related to debt securities that the Company intends to sell, $2.6 million was estimated credit losses on debt securities and $1.9 million related to common stocks. Other-than-temporary impairments recognized on debt securities during the first nine months of 2010 primarily included $2.4 million on

Table of Contents

investment grade residential mortgage-backed securities, $1.4 million on below investment grade corporate bonds in the industrial sector and $1.2 million on investment grade corporate bonds in the industrial sector.

For the three months ended September 30, 2009, total other-than-temporary impairments on fixed maturities and equity securities were $4.5 million, of which $6.1 million was recognized in earnings, including $1.6 million that was transferred from unrealized losses in accumulated other comprehensive income, net of taxes. Of the OTTI recognized in earnings, $4.0 million was estimated credit losses, primarily on below investment grade debt securities, including $1.7 million on corporate bonds in the industrial and financial sectors, $1.4 million on residential mortgage-backed securities, and $0.8 million on a municipal bond. In addition, OTTI recognized in earnings included $1.7 million related to investment grade corporate debt securities in the financial sector that the Company intended to sell and $0.5 million from perpetual preferred securities primarily in the industrial sector.

For the nine months ended September 30, 2009, other-than-temporary impairments on fixed maturities and equity securities were $39.1 million, of which $29.3 million was recognized in earnings and the remaining $9.8 million was recorded as unrealized losses in accumulated other comprehensive income, net of taxes. Of the OTTI recognized in earnings, $13.2 million related primarily to below investment grade corporate bonds in the industrial sector that the Company intended to sell and $9.5 million were from perpetual preferred securities primarily in the finance sector. In addition, the Company recorded OTTI of $6.6 million that was estimated credit losses on below investment grade debt securities, including $3.5 million on corporate bonds that were primarily in the financial and industrial sectors, $1.7 million on residential mortgage-backed securities and $1.4 million on a municipal bond.

The methodology and significant inputs used to measure the amount of credit losses in 2010 and 2009 are 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.

Corporate bonds   the Company utilized a financial model that derives expected cash flows based on probability-of-default factors by credit rating and asset duration and loss-given-default factors based on security type. These factors are based on historical data provided by an independent third-party rating agency.

Municipals   the Company utilized cash flow estimates based on bond specific facts and circumstances that may include the political subdivision s taxing authority, the issuer s ability to adjust user fees or other sources of revenue to satisfy its debt obligations and the ability to access insurance or guarantees.

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

(In millions)	**(Unaudited) Quarter Ended September 30, 2010**	**(Unaudited) Nine months Ended September 30, 2010**	**(Unaudited) Quarter Ended September 30, 2009**	**(Unaudited) Period from April 1, 2009 to September 30, 2009[1]**
Credit losses as of the beginning of the period	**$ 21.0**	**$ 22.1**	$ 19.9	$ 17.3
Credit losses for which an OTTI was not previously recognized	**-**	**0.3**	0.9	3.5
Additional credit losses on securities for which an OTTI was previously recognized	**0.2**	**2.4**	3.1	3.1

Reductions for securities sold or matured during the period	**(3.3)**	**(6.9)**	(0.4)	(0.4)
Reductions for securities reclassified as intend to sell	**(0.4)**	**(0.4)**	-	-
Credit losses as of the end of the period	**$ 17.5**	**$ 17.5**	$ 23.5	$ 23.5

(1) The effective date of the section of ASC 320 requiring this disclosure was April 1, 2009.

Table of Contents

D. Proceeds from voluntary sales

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

	(Unaudited) Quarter Ended September 30, 2010			(Unaudited) Quarter Ended September 30, 2009		
(In millions)	**Proceeds from Voluntary Sales**	**Gross Gains**	**Gross Losses**	**Proceeds from Voluntary Sales**	**Gross Gains**	**Gross Losses**
Fixed maturities	**$ 195.2**	**$ 8.4**	**$ 0.1**	$ 247.2	$ 7.4	$ 2.0
Equity securities	**-**	**-**	**-**	-	-	-

	(Unaudited) Nine months Ended September 30, 2010			(Unaudited) Nine months Ended September 30, 2009		
(In millions)	**Proceeds from Voluntary Sales**	**Gross Gains**	**Gross Losses**	**Proceeds from Voluntary Sales**	**Gross Gains**	**Gross Losses**
Fixed maturities	**$ 371.3**	**$ 17.9**	**$ 1.4**	$ 1,243.8	$ 30.5	$ 12.0
Equity securities	**25.8**	**6.2**	**-**	-	-	-

9. Fair Value

The Company follows the guidance in ASC 820, *Fair Value Measurements and Disclosures* (ASC 820), as it relates to the fair value of its financial assets and liabilities. ASC 820 provides for a standard definition of fair value to be used in new and existing pronouncements. This guidance requires disclosure of fair value information about certain financial instruments (insurance contracts, real estate, goodwill and taxes are excluded) for which it is practicable to estimate such values, whether or not these instruments are included in the balance sheet. The 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.

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 and also provides a hierarchy for determining fair value, which emphasizes the use of observable market data whenever available. The three broad levels defined by the hierarchy are as follows, with the highest priority given to Level 1 as these are the most reliable, and the lowest priority given to Level 3.

Level 1 Quoted prices in active markets for identical assets.

Level 2 Quoted prices for similar assets in active markets, quoted prices for identical or similar assets 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 during the year:

Cash and Cash Equivalents

For these short-term investments, the carrying amount approximates fair value.

Table of Contents

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 applications which are 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 of the security, such as maturity date, coupon, mandatory principal payment dates, frequency of interest and principal payments and optional principal redemption features. Inputs into the fair value applications that are unique by asset class include, but are not limited to:

States and political subdivisions - 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: industry economic sensitivity; company financial policies; quality of management; regulatory environment; competitive position; indenture restrictive covenants; and security or collateral.

Residential mortgage-backed securities, U.S. agency pass-thrus and collateralized mortgage obligations (CMOs) - 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; U.S. government support programs; tax policies; and delinquency/default trends.

Residential mortgage-backed securities, non-agency CMOs - 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; U.S. government support programs; tax policies; delinquency/default trends; and 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 level and variability 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.

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 or broker quotes utilizing the market approach. 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, long maturity term 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.

Table of Contents

Equity Securities

Level 1 includes publicly traded securities valued at quoted market prices. Level 2 includes securities that are valued using pricing for similar securities and pricing models that incorporate observable inputs. Level 3 consists of common stock of private companies for which observable inputs are not available.

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. Generally, all prices provided by the pricing service, except quoted market prices, are reported as Level 2. Occasionally, the Company may obtain non-binding broker quotes which are reported as Level 3.

Mortgage Loans

Fair values 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.

Legal Indemnities

Fair values are estimated using probability-weighted discounted cash flow analyses.

Long-term Debt

The fair value of long-term 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.

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

	(Unaudited)			
(In millions)	**September 30, 2010**		**December 31, 2009**	
	Carrying Value	**Fair Value**	**Carrying Value**	**Fair Value**
Financial Assets				
Cash and cash equivalents	**$ 272.9**	**$ 272.9**	$ 316.7	$ 316.7
Fixed maturities	**5,024.2**	**5,024.2**	4,732.4	4,732.4
Equity securities	**125.7**	**125.7**	69.3	69.3
Mortgage loans	**5.7**	**6.0**	14.1	15.0
Total financial assets, including financial assets of discontinued operations	**5,428.5**	**5,428.8**	5,132.5	5,133.4
Less: financial assets of discontinued operations	**(120.9)**	**(120.9)**	(117.1)	(117.1)
Total financial assets of continuing operations	**$ 5,307.6**	**$ 5,307.9**	$ 5,015.4	$ 5,016.3
Financial Liabilities				

Deposit contracts	**$ -**	**$ -**	$ 2.0	$ 2.0
Legal indemnities	**5.3**	**5.3**	7.0	7.0
Long-term debt	**640.0**	**664.4**	433.9	387.9
Total financial liabilities of continuing operations (1)	**$ 645.3**	**$ 669.7**	$ 442.9	$ 396.9

(1) There were no financial liabilities associated with the discontinued operations.

The Company performs a review of the fair value hierarchy classifications and of prices received from its third party pricing service on a quarterly basis. The Company reviews the pricing services policy describing its processes, practices and inputs, including various financial models used to value securities. Also, the Company reviews the portfolio pricing. Securities with changes in prices that exceed a defined threshold are verified to independent sources such as Bloomberg. 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 the nine months ended September 30, 2010, the Company did not adjust any prices received from brokers or its pricing service.

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

Table of Contents

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 Company currently holds fixed maturity securities and equity securities for which fair value is determined on a recurring basis. The following tables present for each hierarchy level, the Company s assets that were measured at fair value at September 30, 2010 and December 31, 2009.

	(Unaudited)			
	Fair Value at September 30, 2010			
(In millions)	Total	Level 1	Level 2	Level 3
Fixed maturities:				
U.S. Treasury securities and U.S. government and agency securities	$ 240.2	$ 99.4	$ 140.8	$ -
States and political subdivisions	972.4	-	957.8	14.6
Foreign governments	3.0	-	3.0	-
Corporate fixed maturities	2,615.9	-	2,568.7	47.2
Residential mortgage-backed securities, U.S. agency backed	673.0	-	673.0	-
Residential mortgage-backed securities, non-agency	153.4	-	152.4	1.0
Commercial mortgage-backed securities	366.3	-	360.6	5.7
Total fixed maturities	5,024.2	99.4	4,856.3	68.5
Equity securities (1)	117.2	104.1	9.3	3.8
Total investment assets at fair value, including assets of discontinued operations	5,141.4	203.5	4,865.6	72.3
Investment assets of discontinued operations at fair value	(119.6)	(0.3)	(118.7)	(0.6)
Total investment assets of continuing operations at fair value	$ 5,021.8	$ 203.2	$ 4,746.9	$ 71.7

	Fair Value at December 31, 2009			
(In millions)	Total	Level 1	Level 2	Level 3
Fixed maturities:				
U.S. Treasury securities and U.S. government and agency securities	$ 354.7	$ 100.6	$ 254.1	$ -
States and political subdivisions	832.2	-	816.7	15.5
Foreign governments	3.0	-	3.0	-
Corporate fixed maturities	2,330.9	-	2,292.8	38.1
Residential mortgage-backed securities, U.S. agency backed	689.0	-	689.0	-
Residential mortgage-backed securities, non-agency	185.4	-	185.4	-
Commercial mortgage-backed securities	337.2	-	331.0	6.2
Total fixed maturities	4,732.4	100.6	4,572.0	59.8
Equity securities (1)	60.6	51.0	6.8	2.8

Total investment assets at fair value, including assets of discontinued operations	4,793.0	151.6	4,578.8	62.6
Investment assets of discontinued operations at fair value	(116.9)	(0.3)	(116.6)	-
Total investment assets of continuing operations at fair value	$ 4,676.1	$ 151.3	$ 4,462.2	$ 62.6

(1) Excludes equities carried at cost of $8.5 million at September 30, 2010 and $8.7 million at December 31, 2009, which consists primarily of Federal Home Loan Bank common stock.

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

Table of Contents

(Unaudited)

Quarter Ended September 30, 2010

(In millions)	Fixed Maturities: States and political subdivisions	Fixed Maturities: Corporate	Fixed Maturities: Residential mortgage-backed securities, non-agency	Fixed Maturities: Commercial mortgage-backed securities	Fixed Maturities: Total	Equities	Total Assets
Balance July 1, 2010	$ 14.9	$ 46.9	$ 1.1	$ 5.9	$ 68.8	$ 2.8	$ 71.6
Transfers into Level 3	-	3.8	-		3.8		3.8
Transfers out of Level 3	-	(2.7)	-	-	(2.7)	-	(2.7)
Total gains:							
Included in earnings	-	0.1	-	-	0.1	-	0.1
Included in other comprehensive income	0.1	0.7	-	-	0.8	-	0.8
Purchases and sales:							
Purchases	-	0.5	-	-	0.5	1.0	1.5
Sales	(0.4)	(2.1)	(0.1)	(0.2)	(2.8)	-	(2.8)
Balance September 30, 2010	$ 14.6	$ 47.2	$ 1.0	$ 5.7	$ 68.5	$ 3.8	$ 72.3

(Unaudited)

Quarter Ended September 30, 2009

(In millions)	Fixed Maturities: States and political subdivisions	Fixed Maturities: Corporate	Fixed Maturities: Commercial mortgage-backed securities	Fixed Maturities: Total	Equities	Total Assets
Balance July 1, 2009	$ 18.4	$ 41.6	$ 10.6	$ 70.6	$ 1.2	$ 71.8
Transfers out of Level 3	(2.1)	(3.4)	-	(5.5)	-	(5.5)
Total (losses) gains:						
Included in earnings	(0.1)	-	-	(0.1)	-	(0.1)
Included in other comprehensive income	0.2	1.6	0.3	2.1	-	2.1
Purchases and sales:						
Purchases	0.9	6.9	0.2	8.0	-	8.0
Sales	(0.2)	(1.3)	(0.2)	(1.7)	-	(1.7)
Balance September 30, 2009	$ 17.1	$ 45.4	$ 10.9	$ 73.4	$ 1.2	$ 74.6

(Unaudited)

Nine months Ended September 30, 2010

(In millions)	Fixed Maturities: States and political subdivisions	Fixed Maturities: Corporate	Fixed Maturities: Residential mortgage-backed securities, non-agency	Fixed Maturities: Commercial mortgage-backed securities	Fixed Maturities: Total	Equities	Total Assets
Balance January 1, 2010	$ 15.5	$ 38.1	$ -	$ 6.2	$ 59.8	$ 2.8	$ 62.6
Transfers into Level 3	-	17.3	-	-	17.3	-	17.3
Transfers out of Level 3	-	(4.7)	-	-	(4.7)	-	(4.7)
Total gains (losses):							

Included in earnings	-	0.2	-	-	0.2	(0.3)	(0.1)
Included in other comprehensive income	0.3	1.9	-	-	2.2	0.3	2.5
Purchases and sales:							
Purchases	-	2.8	1.4	-	4.2	1.0	5.2
Sales	(1.2)	(8.4)	(0.4)	(0.5)	(10.5)	-	(10.5)
Balance September 30, 2010	$ 14.6	$ 47.2	$ 1.0	$ 5.7	$ 68.5	$ 3.8	$ 72.3

(Unaudited)

	Nine months Ended September 30, 2009						
	Fixed Maturities						
(In millions)	States and political subdivisions	Corporate	Residential mortgage-backed securities, U.S. agency backed	Commercial mortgage backed securities	Total	Equities	Total Assets
Balance January 1, 2009	$ 18.2	$ 44.5	$ 6.9	$ 19.5	$ 89.1	$ 1.2	$ 90.3
Assets of discontinued operations sold with FAFLIC	(0.1)	(3.4)	-	(2.3)	(5.8)	-	(5.8)
Transfers out of Level 3	(2.1)	(11.9)	-	(10.0)	(24.0)	-	(24.0)
Total (losses) gains:							
Included in earnings	(0.3)	(0.4)	0.2	-	(0.5)	-	(0.5)
Included in other comprehensive income	(0.6)	3.5	-	0.9	3.8	-	3.8
Purchases and sales:							
Purchases	3.1	17.5	-	3.3	23.9	-	23.9
Sales	(1.1)	(4.4)	(7.1)	(0.5)	(13.1)	-	(13.1)
Balance September 30, 2009	$ 17.1	$ 45.4	$ -	$ 10.9	$ 73.4	$ 1.2	$ 74.6

During the nine months ended September 30, 2010 and 2009, 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 nine months ended September 30, 2010.

The following table summarizes gains and losses due to changes in fair value that are recorded in net income for Level 3 assets.

	(Unaudited)			(Unaudited)		
	Quarter Ended September 30, 2010			Quarter Ended September 30, 2009		
(In millions)	**Other-than-temporary impairments**	**Net realized investment gains**	**Total**	Other-than-temporary impairments	Net realized investment gains	Total
Level 3 Assets:						
Fixed maturities:						
States and political subdivisions	**$ -**	**$ -**	**$ -**	**$ -**	**$ (0.1)**	**$ (0.1)**
Corporate fixed maturities	**-**	**0.1**	**0.1**	**(0.1)**	**0.1**	**-**
Total assets	**$ -**	**$ 0.1**	**$ 0.1**	**$ (0.1)**	**$ -**	**$ (0.1)**

	(Unaudited)			(Unaudited)		
	Nine months Ended September 30, 2010			Nine months Ended September, 2009		
(In millions)	**Other-than-temporary impairments**	**Net realized investment gains**	**Total**	Other-than-temporary impairments	Net realized investment gains (losses)	Total
Level 3 Assets:						
Fixed maturities:						
States and political subdivisions	**$ -**	**$ -**	**$ -**	**$ -**	**$ (0.3)**	**$ (0.3)**
Corporate fixed maturities	**-**	**0.2**	**0.2**	**(0.9)**	**0.5**	**(0.4)**
Residential mortgage-backed securities, U.S. agency backed	**-**	**-**	**-**	**-**	**0.2**	**0.2**
Total fixed maturities	**-**	**0.2**	**0.2**	**(0.9)**	**0.4**	**(0.5)**
Equity securities:	**(0.3)**	**-**	**(0.3)**	**-**	**-**	**-**
Total assets	**$ (0.3)**	**$ 0.2**	**$ (0.1)**	**$ (0.9)**	**$ 0.4**	**$ (0.5)**

10. Other Comprehensive Income

The following table provides a reconciliation of gross unrealized investment gains to the net balance shown in the Consolidated Statements of Comprehensive Income:

	(Unaudited)	**(Unaudited)**
	Quarter Ended	**Nine months Ended**

(In millions)	September 30, 2010	September 30, 2009	September 30, 2010	September 30, 2009
Unrealized appreciation on available-for-sale securities:				
Unrealized holding gains arising during period, net of income tax expense of $26.4 and $26.9 for the quarters ended September 30, 2010 and 2009 and $58.1 and $26.7 for the nine months ended September 30, 2010 and 2009	**$ 84.4**	$ 162.5	**$ 187.7**	$ 389.2
Less: reclassification adjustment for gains (losses) included in net income, net of income tax (expense) benefit of $(0.5) and $3.5 for the quarters ended September 30, 2010 and 2009 and $(0.7) and $3.5 for the nine months ended September 30, 2010 and 2009	**8.9**	3.5	**18.0**	(9.4)
Other comprehensive income	**$ 75.5**	$ 159.0	**$ 169.7**	$ 398.6

27

Table of Contents

11. Segment Information

The Company s primary business operations include insurance products and services in three property and casualty operating segments. These segments are Personal Lines, Commercial Lines, and Other Property and Casualty. Personal Lines includes personal automobile, homeowners and other personal coverages, while Commercial Lines includes commercial multiple peril, commercial automobile, workers compensation, and other commercial coverages, such as inland marine, bond, specialty program business, professional liability and management liability. In addition, the Other Property and Casualty segment consists of: Opus Investment Management, Inc., which markets investment management services to institutions, pension funds and other organizations; earnings on holding company assets; as well as voluntary pools in which the Company has not actively participated since 1995. Additionally, prior to the sale of FAFLIC on January 2, 2009, the operations included the results of this run-off life insurance and annuity business as a separate segment. This business is now reflected as discontinued operations. The separate financial information of each segment 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 its debt separately from the earnings of its operating segments. The Company s debt consists of senior debentures, junior subordinated debentures, advances under the Company s collateralized borrowing program with FHLBB, capital securities and surplus notes.

Management evaluates the results of the aforementioned segments on a pre-tax basis. Segment income excludes certain items which are included in net income, such as federal income taxes and net realized investment gains and losses, because fluctuations in these gains and losses are determined by interest rates, financial markets and the timing of sales. Also, segment income excludes net gains and losses on disposals of businesses, discontinued operations, restructuring costs, extraordinary items, the cumulative effect of accounting changes and certain other items. Although the items excluded from segment income may be significant components in understanding and assessing the Company s financial performance, management believes that the presentation of segment income enhances an investor s understanding of the Company s results of operations by highlighting net income attributable to the core operations of the business. However, segment income should not be construed as a substitute for net income determined in accordance with generally accepted accounting principles.

Table of Contents

Summarized below is financial information with respect to business segments:

	(Unaudited) Quarter Ended September 30,		(Unaudited) Nine months Ended September 30,	
(In millions)	**2010**	**2009**	**2010**	**2009**
Segment revenues:				
Property and Casualty:				
Personal Lines	**$ 397.1**	$ 397.2	**$ 1,190.3**	$ 1,186.0
Commercial Lines	**397.2**	308.4	**1,099.3**	912.5
Other Property and Casualty	**5.1**	3.9	**15.9**	17.9
Total Property and Casualty	**799.4**	709.5	**2,305.5**	2,116.4
Intersegment revenues	**(1.1)**	(1.0)	**(3.4)**	(2.9)
Total segment revenues	**798.3**	708.5	**2,302.1**	2,113.5
Adjustments to segment revenues:				
Net realized investment gains (losses)	**5.7**	-	**16.8**	(9.7)
Total revenues	**$ 804.0**	$ 708.5	**$ 2,318.9**	$ 2,103.8
Segment income before federal income taxes and discontinued operations:				
Property and Casualty:				
Personal Lines:				
GAAP underwriting income (loss)	**$ 15.2**	$ (4.1)	**$ (8.7)**	$ (33.4)
Net investment income	**25.4**	27.8	**76.6**	81.4
Other income	**2.4**	3.7	**6.1**	8.1
Personal Lines segment income	**43.0**	27.4	**74.0**	56.1
Commercial Lines:				
GAAP underwriting income (loss)	**2.3**	5.2	**(22.5)**	41.3
Net investment income	**32.3**	31.9	**96.6**	93.2
Other income	**0.5**	1.6	**0.7**	2.7
Commercial Lines segment income	**35.1**	38.7	**74.8**	137.2
Other Property and Casualty:				
GAAP underwriting income	**0.4**	10.3	**0.7**	10.6
Net investment income	**3.6**	2.4	**11.0**	13.3
Other net expenses	**(2.9)**	(5.2)	**(9.0)**	(17.4)
Other Property and Casualty segment income	**1.1**	7.5	**2.7**	6.5
Total Property and Casualty	**79.2**	73.6	**151.5**	199.8
Interest expense on debt	**(11.8)**	(6.3)	**(32.8)**	(27.2)
Segment income before federal income taxes	**67.4**	67.3	**118.7**	172.6
Adjustments to segment income:				

Net realized investment gains (losses)	**5.7**	-	**16.8**	(9.7)
Gain on retirement of debt	**-**	0.2	**-**	34.5
Income from continuing operations before federal income taxes	**$ 73.1**	$ 67.5	**$ 135.5**	$ 197.4

Table of Contents

Summarized below is financial information with respect to business segments:

	Identifiable Assets (Unaudited)	
	September 30,	December 31,
(In millions)	2010	2009
Property and Casualty (1)	**$ 8,473.2**	$ 7,922.6
Assets of discontinued operations (2)	**134.1**	130.6
Intersegment eliminations	**(10.6)**	(10.5)
Total	**$ 8,596.7**	$ 8,042.7

(1) The Company reviews assets based on the total Property and Casualty Group and does not allocate between the Personal Lines, Commercial Lines and Other Property and Casualty segments.
(2) Includes assets related to the Company s discontinued accident and health insurance business.

12. Stock-based Compensation

Compensation cost and the related tax benefits were as follows:

	(Unaudited) Quarter Ended September 30,		(Unaudited) Nine months Ended September 30,	
(In millions)	2010	2009	2010	2009
Stock-based compensation expense	**$ 3.1**	$ 3.1	**$ 8.6**	$ 8.5
Tax benefit	**(1.1)**	(1.1)	**(3.0)**	(3.0)
Stock-based compensation expense, net of taxes	**$ 2.0**	$ 2.0	**$ 5.6**	$ 5.5

Stock Options

Information on the Company s stock option plan activity is summarized below.

(Unaudited)	(Unaudited)
Nine months Ended	Nine months Ended

	September 30, 2010		September 30, 2009	
(In whole shares and dollars)	**Shares**	**Weighted Average Exercise Price**	**Shares**	**Weighted Average Exercise Price**
Outstanding, beginning of period	**3,131,142**	**$ 39.16**	2,998,821	$ 41.02
Granted	**389,750**	**42.45**	530,000	34.13
Exercised	**(249,468)**	**37.07**	(49,058)	33.61
Forfeited or cancelled	**(138,760)**	**45.12**	(98,805)	44.51
Expired	**(125,400)**	**44.91**	(184,100)	52.07
Outstanding, end of period	**3,007,264**	**39.25**	3,196,858	39.24

Table of Contents

Restricted Stock and Restricted Stock Units

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

	(Unaudited) Nine months Ended September 30, 2010		(Unaudited) Nine months Ended September 30, 2009	
(In whole shares and dollars)	Shares	Weighted Average Grant Date Fair Value	Shares	Weighted Average Grant Date Fair Value
Restricted stock and restricted stock units:				
Outstanding, beginning of period	**700,904**	**$ 41.12**	470,905	$ 45.41
Granted	**352,445**	**42.62**	290,005	34.33
Vested and exercised	**(117,583)**	**47.97**	(9,391)	44.77
Forfeited	**(78,104)**	**40.58**	(40,014)	42.02
Outstanding, end of period	**857,662**	**40.85**	711,505	41.14
Performance-based restricted stock units:				
Outstanding, beginning of period (1)	**145,635**	**$ 42.79**	164,442	$ 46.10
Granted (1)	**41,250**	**42.15**	47,375	34.19
Vested and exercised	**(31,558)**	**48.46**	(40,507)	46.28
Forfeited (2)	**(31,396)**	**46.26**	(23,404)	46.78
Outstanding, end of period (1)	**119,931**	**40.05**	147,906	40.67

(1) 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 175% of the shares disclosed, which varies based on grant year and individual participation level. Increases to the 100% target level are reflected as granted in the period in which performance-based stock unit goals are achieved. Decreases from the 100% target level are reflected as forfeited in the period in which the achievement of the performance-based stock unit goals are estimated to be no longer probable.

(2) In 2010 and 2009, respectively, 11,472 and 20,654 performance-based stock units were included as forfeited due to completion levels less than 100% for units originally granted in 2007. The weighted average grant date fair value for these awards was $48.46. Additionally, in 2010, 20,044 performance-based stock units were included as forfeited due to estimated completion levels of less than 100% for units originally granted in 2008. The weighted average grant date fair value for this award was $45.21.

13. Earnings Per Share

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

	(Unaudited) Quarter Ended September 30,		(Unaudited) Nine months Ended September 30,	
(In millions, except per share data)	**2010**	**2009**	**2010**	**2009**
Basic shares used in the calculation of earnings per share	**44.9**	50.7	**45.7**	51.0
Dilutive effect of securities:				
Employee stock options	**0.3**	0.2	**0.3**	0.1
Non-vested stock grants and other	**0.5**	0.3	**0.4**	0.3
Diluted shares used in the calculation of earnings per share	**45.7**	51.2	**46.4**	51.4
Per share effect of dilutive securities on income from continuing operations	**$ (0.02)**	$ (0.01)	**$ (0.03)**	$ (0.02)
Per share effect of dilutive securities on net income	**$ (0.01)**	$ (0.01)	**$ (0.03)**	$ (0.03)

Diluted earnings per share for the quarter ended September 30, 2010 and 2009 excludes 1.1 million and 1.8 million, respectively, of common shares issuable under the Company s stock compensation plans, because their effect would be antidilutive. Diluted earnings per share for the nine months ended September 30, 2010 and 2009 excludes 1.6 million and 2.5 million, respectively, of common shares issuable under the Company s stock compensation plans, because their effect would be antidilutive.

Table of Contents

14. Commitments and Contingencies

LITIGATION

Durand Litigation

On March 12, 2007, a putative class action suit captioned Jennifer A. Durand v. The Hanover Insurance Group, Inc., 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 understated the accrued benefit in the calculation. The Company filed a Motion to Dismiss on the basis that the Plaintiff failed to exhaust administrative remedies, which motion was granted without prejudice in a decision dated November 7, 2007. This decision was reversed by an order dated March 24, 2009 issued by the United States Court of Appeals for the Sixth Circuit, and the case was remanded to the district court.

The Plaintiff filed an Amended Complaint on December 11, 2009. In response, the Company filed a Motion to Dismiss on January 30, 2010. In addition to the pending calculation of the lump sum distribution claim, the Amended Complaint includes: (a) a claim that the Plan failed to calculate participants account balances 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 for breach of fiduciary duty and ERISA notice requirements for not properly informing participants of the various interest crediting and lump sum distribution matters of which Plaintiffs complain. In the Company s judgment, the outcome is not expected to be material to its financial position, although it could have a material effect on the results of operations for a particular quarter or annual period and on the funding of the Plan.

Hurricane Katrina Litigation

The Company has been named as a defendant in various litigation including putative class actions, relating to disputes arising from damages which occurred as a result of Hurricane Katrina in 2005. As of September 30, 2010, there were approximately 50 such cases. These cases have been filed in both Louisiana state courts and federal district courts. These cases generally involve, among other claims, disputes as to the amount of reimbursable claims in particular cases (e.g. how much of the damage to an insured property is attributable to flood and therefore not covered, and how much is attributable to wind, which may be covered), as well as the scope of insurance coverage under homeowners and commercial property policies due to flooding, civil authority actions, loss of landscaping, business interruption and other matters. Certain of these cases claim a breach of duty of good faith or violations of Louisiana insurance claims handling laws or regulations and involve claims for punitive or exemplary damages.

On August 23, 2007, the State of Louisiana (individually and on behalf of the State of Louisiana, Division of Administration, Office of Community Development) filed a putative class action in the Civil District Court for the Parish of Orleans, State of Louisiana, entitled State of Louisiana, individually and on behalf of State of Louisiana, Division of Administration, Office of Community Development ex rel The Honorable Charles C. Foti, Jr., The Attorney General For the State of Louisiana, individually and as a class action on behalf of all recipients of funds as well as all eligible and/or future recipients of funds through The Road Home Program v. AAA Insurance, et al., No. 07-8970. The Complaint named as defendants over 200 foreign and domestic insurance carriers, including the Company. Plaintiff seeks to represent a class of current and former Louisiana citizens who have applied for and received or will receive funds through Louisiana s Road Home program. On August 29, 2007, Plaintiff filed an Amended Petition in this case, asserting myriad claims, including claims for breach of: contract, the implied covenant of good faith and fair dealing, fiduciary duty and Louisiana s bad faith statutes. Plaintiff seeks relief in the form of, among other things, declarations that (a) the efficient proximate cause of losses suffered by putative class members was windstorm, a covered peril under their policies; (b) the second efficient proximate cause of their losses was storm surge, which Plaintiff contends is not excluded under class members policies; (c) the damage caused by water entering affected parishes of Louisiana does not fall within the definition of flood ; (d) the damages caused by water entering Orleans Parish and the surrounding area was a result of a man-made occurrence and are properly covered under class members policies; (e) many class members suffered total losses to their residences; and (f) many class members are entitled to recover the full value for their residences stated on their policies pursuant to the Louisiana Valued Policy Law. In accordance with these requested declarations, Plaintiff seeks to recover amounts that it alleges should have been paid to policyholders under their insurance agreements, as well as penalties, attorneys fees, and costs. The case has been removed to the Federal District Court for the Eastern District of Louisiana.

32

On March 5, 2009, the court issued an Order granting in part and denying in part a Motion to Dismiss filed by Defendants. The court dismissed all claims for bad faith and breach of fiduciary duty and all claims for flood damages under policies with flood exclusions or asserted under the Valued Policy Law, but rejected the insurers' arguments that the purported assignments from individual claimants to the state were barred by anti-assignment provisions in the insurers' policies. On April 16, 2009, the court denied a Motion for Reconsideration of its ruling regarding the anti-assignment provisions, but certified the issue as ripe for immediate appeal. On April 30, 2009, Defendants filed a Petition for Permission to Appeal to the United States Court of Appeals for the Fifth Circuit (Fifth Circuit), which was granted. Defendants appeal is currently pending. On July 28, 2010, the Fifth Circuit certified the issue to the Louisiana Supreme Court.

The Company has established its loss and LAE reserves on the assumption that it will not have any liability under the Road Home or similar litigation, and that it will otherwise prevail in litigation as to the cause of certain large losses and not incur extra contractual or punitive damages.

REGULATORY AND INDUSTRY DEVELOPMENTS

Certain unfavorable economic conditions may contribute to an increase in the number of insurance companies that are under regulatory supervision. This may result in an increase in mandatory assessments by state guaranty funds, or voluntary payments by solvent insurance companies to cover losses to policyholders of insolvent or rehabilitated companies. Mandatory assessments, which are subject to statutory limits, can be partially recovered through a reduction in future premium taxes in some states. The Company is not able to reasonably estimate the potential impact of any such future assessments or voluntary payments.

Over the past three years, state-sponsored insurers, reinsurers and involuntary pools have increased significantly, particularly in those states which have Atlantic or Gulf Coast exposures. As a result, the potential assessment exposure of insurers doing business in such states and the attendant collection risks have increased, particularly, in the Company s case, in the states of Massachusetts, Louisiana and Florida. Such actions and related regulatory restrictions on rate increases, underwriting and the ability to non-renew business may limit the Company s ability to reduce the potential exposure to hurricane related losses. At this time, the Company is unable to predict the likelihood or impact of any such potential assessments or other actions.

The Governor of Michigan has endorsed a number of proposals by her appointed Automobile and Home Insurance Consumer Advocate which would, among other things, change the current rate approval process from the current file and use system to prior approval , mandate affordable rates, eliminate territorial ratings, reduce the threshold for lawsuits to be filed in at fault incidents, and prohibit the use of certain underwriting criteria such as credit-based insurance scores. The Michigan legislature is currently considering these and other proposals, including one to require insurance companies to offer low cost personal automobile prices. The Office of Financial and Insurance Regulation (OFIR) previously issued regulations prohibiting the use of credit scores to rate personal lines insurance policies, which regulations were the subject of litigation being reviewed by the Michigan Supreme Court. Pending a determination by the Michigan Supreme Court, OFIR was enjoined from disapproving rates on the basis that they were based in part on credit-based insurance scores. In a decision issued on July 8, 2010, the Michigan Supreme Court held that the regulations issued by the OFIR prohibiting the use of credit scores to rate personal lines insurance policies were invalid. On November 9, 2009, the Michigan Board of Canvassers issued preliminary approval allowing proponents to begin collecting signatures as the first step in placing a ballot initiative in front of voters in November of 2010. The proposed ballot question would have required a number of changes for the property and casualty market, including, subject to limitations, the rollback of rates by up to 20% for all lines with the exception of workers compensation and surety, and an additional 20% rollback of personal automobile rates for good drivers . Proponents of the ballot initiative, however, did not present the required number of valid signatures by the May 2010 deadline and the proposed ballot initiative failed. At this time, the Company is unable to predict the likelihood of adoption or impact on its business of any such proposals or regulations, but any such restrictions could have an adverse effect on its results of operations.

On August 1, 2010, the Michigan Supreme Court issued a decision in a case captioned McCormick v. Carrier, et. al, overturning the so-called Kreiner decision, and in so doing, the Company believes that the Court significantly expanded the circumstances under which claimants can sue for non-economic losses resulting from automobile accidents in Michigan. Although the full implications and application of the McCormick decision are not yet understood and may evolve in the future, the Company believes that the revised standard will adversely affect both past claims which are not finally resolved, as well as future claims. Although the Company s reserves reflect the Company s best estimate of the impact of this decision, in light of evolving law and the uncertain application of this new standard, the Company cannot be certain as to the adequacy of these reserves or of the Company s ability to raise rates for liability coverage of Michigan personal and commercial automobile polices to reflect the additional losses it expects to incur.

In May 2010, the Massachusetts Attorney General s Office published draft regulations purporting to provide greater consumer protections under the recently implemented managed competition system for Massachusetts private passenger automobile insurance. Hearings were held in June

and the record date for comment has been extended twice, from August 6, 2010 to September 22, 2010 and again to November 22, 2010. The proposed changes would significantly alter the current system of managed competition and change the manner in which insurers and agents operate in the market place, particularly for companies such as Hanover Insurance, which distribute

33

Table of Contents

through independent agents. At this time, the Company is uncertain as to whether the draft regulations will be revised or ultimately implemented and cannot predict the potential impact of any such regulations on its business.

From time to time, proposals have been made to establish a federal based insurance regulatory system and to allow insurers to elect either federal or state-based regulation (optional federal chartering). In light of the current economic crisis and the focus on increased regulatory controls, particularly with regard to financial institutions, there has been renewed interest in such proposals. In July 2010, the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Financial Reform Act) was enacted. The Financial Reform Act includes a provision to establish a Federal Insurance Office, with the primary purpose of collecting information to better understand insurance issues at the federal level and to resolve certain issues affecting foreign insurance companies doing business in the United States. The Financial Reform Act also contains provisions affecting financial institutions, credit rating agencies and other commercial and consumer businesses. THG is currently reviewing the legislation and while it expects that the legislation will have little direct impact on the Company s operations, it does not yet know the indirect consequences to the financial services sector, the Company s business or its Commercial Lines policyholders.

At this time, the Company is also uncertain of the various collateral consequences of the Patient Protection and Affordable Care Act on its business and on the property and casualty industry in general.

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. In the Company s opinion, based on the advice of legal counsel, the ultimate resolutions of such proceedings will not 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.

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 the workers compensation line of business, the homeowners line of business and both the personal and commercial automobile lines of business.

15. Subsequent Events

There were no subsequent events requiring adjustments to the financial statements. Additionally, there were no subsequent events requiring disclosure.

Table of Contents

PART I

ITEM 2

MANAGEMENT S DISCUSSION AND ANALYSIS OF

FINANCIAL CONDITION AND RESULTS OF OPERATIONS

TABLE OF CONTENTS

Introduction	36
Executive Overview	36
Description of Operating Segments	38
Results of Operations	38
Segment Results	40
Property and Casualty	40
Discontinued Operations	57
Other Items	58
Investment Portfolio	60
Income Taxes	65
Critical Accounting Estimates	67
Other Significant Transactions	69
Statutory Surplus of Insurance Subsidiaries	70
Liquidity and Capital Resources	70
Off-Balance Sheet Arrangements	72
Contingencies and Regulatory Matters	72
Rating Agency Actions	75
Risks and Forward-Looking Statements	75
Glossary of Selected Insurance Terms	75

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 subsidiaries (THG) and 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 the Management s Discussion and Analysis of Financial Condition and Results of Operations contained in our 2009 Annual Report on Form 10-K filed with the Securities and Exchange Commission.

Our results of operations include the accounts of The Hanover Insurance Company (Hanover Insurance) and Citizens Insurance Company of America (Citizens), our principal property and casualty companies; and certain other insurance and non-insurance subsidiaries. On January 2, 2009, we sold First Allmerica Financial Life Insurance Company (FAFLIC) to Commonwealth Annuity and Life Insurance Company (Commonwealth Annuity), a subsidiary of The Goldman Sachs Group, Inc. (Goldman Sachs). For all prior periods presented, operations from FAFLIC are reflected as discontinued operations.

Executive Overview

Our property and casualty business includes our Personal Lines segment, our Commercial Lines segment and our Other Property and Casualty segment.

With respect to segment results, during the first nine months of 2010, our pre-tax segment earnings declined from the same period in 2009, primarily as a result of increased catastrophe losses in the first nine months of 2010. Pre-tax catastrophe losses increased $51.2 million, to $143.5 million for the first nine months of 2010, compared to $92.3 million for the same period in 2009. Although third quarter catastrophe activity was consistent with the prior year, our company and the industry in general, experienced a high level of catastrophes during the first half of 2010. In addition, decreased favorable development on prior years loss and loss adjustment expense (LAE) reserves and higher underwriting expenses contributed to the overall decline. These results were partially offset by more favorable current accident year loss results.

We, and the industry in general, continue to experience pricing pressures, predominantly in Commercial Lines. We believe that our ongoing agency relationships, position in the marketplace and strong product set, position us well relative to many of our competitors in our principal markets.

Although our expense ratio is higher than that of some of our peer companies and other competitors, we have made an explicit decision to invest further in our business in support of our partner agent strategy. In Personal Lines, we are investing to improve the competitiveness of our products and in technology and systems enhancements intended to make our interactions with agents more efficient. In Commercial Lines, most of our investments are directed toward expanding our product capabilities and offerings in various niches and differentiated products, as well as investments in systems improvements. In addition, we recently started to expand our Commercial Lines offerings into selected states in the western part of the country. Our renewal rights transaction with OneBeacon Insurance Group (OneBeacon) supported both our Commercial Lines product expansion, as well as our western geographic expansion. As a result of these actions and for the first time in recent company history, our Commercial Lines net written premiums exceeded our Personal Lines net written premiums during the first nine months of 2010.

Personal Lines

In our Personal Lines business, the market continues to be very competitive, with continued pressure on agents from direct writers, as well as from the increased usage of real time comparative rating tools. We maintain our focus on partnering with high quality, value added agencies that stress the importance of account rounding (the conversion of single policy customers to accounts with multiple policies and/or additional coverages), and consultative selling. We are focused on making investments that are intended to help us maintain profitability, build a distinctive position in the market, such as through our ***Think Hanover*** initiative, and provide us with profitable growth opportunities.

Our ***Think Hanover*** initiative is intended to enhance retention and strengthen our value proposition for agents, including by introducing broad and innovative product offerings. In 2009, we introduced a substantially improved product suite (*The Hanover Household*) to make it easier for agents to write more lines of business per household. We also modified our operating model and improved our agency automation, which is intended to deliver a more competitive sales and services experience for agents (*Front Line Excellence*).

Current market conditions continue to be challenging as pricing pressures and economic conditions remain difficult and we face uncertain legal and regulatory environments, especially in Michigan and Massachusetts. These competitive and economic

pressures and legal and regulatory concerns have limited our growth and retention of business in Michigan and Massachusetts, our largest states, and elsewhere. We are working closely with our partner agents in these and our other core states to remain a significant writer with strong margins.

During the first nine months of 2010, we continued our mix management initiatives relating to our ***Connections® Auto*** product to improve the overall profitability of the business. We remain focused on reducing our growth in less profitable automobile segments and increasing our multi-car and total account business consistent with our account rounding strategy. We experienced slightly negative growth levels in our personal automobile business through the first nine months of 2010.

We believe that our ***Connections Auto*** product will help us profitably grow our market share over time. The ***Connections Auto*** product is designed to be competitively priced for a wide spectrum of drivers through its multivariate rating application, which calculates rates based upon the magnitude and correlation of multiple risk factors. At the same time, a core strategy is to broaden our portfolio offerings and write total accounts , which are accounts that include multiple personal line coverages for the same customer. Account business has historically provided us with stronger margins and superior retention. Total account business represents approximately two-thirds of our Personal Lines business.

Our homeowners product, ***Connections® Home,*** is intended to improve our competitiveness for total account business by making it easier and more efficient for our agents to write business with us and by providing more comprehensive coverage options for policyholders. In addition, in 15 states, we have introduced a more sophisticated, multivariate pricing approach to our homeowners product which is intended to better align rates with the underlying risk of each customer. We plan to continue to implement this price segmentation in our other states. We also continue to refine our products and work closely with high potential agents to increase the percentage of their business they place with us and to ensure that it is consistent with our preferred mix of business. Additionally, we remain focused on diversifying our state mix beyond our four core states of Michigan, Massachusetts, New York and New Jersey. We expect these efforts to contribute to profitable growth and improved retention in our Personal Lines segment over time.

Commercial Lines

In the Commercial Lines market, aggressive price competition requires us to be highly disciplined in our underwriting process to ensure that we write business only at acceptable margins. In certain lines of business where the weak economy may be a particularly important factor, such as surety and workers compensation, we have endeavored to adjust pricing and/or take a more conservative approach to risk selection in order to more appropriately reflect the higher risk of loss.

In December 2009, we entered into a renewal rights agreement with OneBeacon, further strengthening our competitive position and advancing our expansion efforts in the western states. Through the agreement, we acquired access to a portion of OneBeacon s small and middle market commercial business at renewal, much of which fits into our current industry specific programs and middle market niches. Additionally, the transaction allowed for the development of new segment, niche and industry-specific program business. On January 1, 2010, we began renewing these policies through a reinsurance arrangement with OneBeacon whereby such policies are underwritten on OneBeacon policy forms and using OneBeacon systems. During the second quarter of 2010, we began converting renewals to our policy forms. We expect this conversion process to continue until late 2011.

We also continue to develop our segmentation of Commercial Lines, including our specialty businesses, which on average are expected to offer higher margins over time and enable us to deliver a more complete product portfolio to our agents and policyholders. Our specialty business, including marine and bond lines, now account for over one-third of our Commercial Lines premiums written. Growth in our specialty business continues to be a significant part of our strategy. Our ongoing focus on expanding our product offerings in our specialized businesses is evidenced by our acquisitions. Over the past three years, we have acquired several specialized businesses, including Professionals Direct, Inc. (PDI), which we market as Hanover Professionals, a professional liability insurance carrier for principally small to medium-sized legal practices; Verlan Holdings, Inc. (Verlan), which we market as Hanover Specialty Industrial, a provider of property insurance to small and medium-sized chemical, paint, solvent and other manufacturing and distribution companies; and AIX Holdings, Inc. (AIX), a specialty property and casualty insurance carrier that focuses on underwriting and managing program business. In January 2010, we acquired Benchmark Professional Insurance Services, Inc., a provider of insurance solutions to the design professionals industry, including architects and engineers. We acquired Campania Holding Company, Inc. (Campania) on March 31, 2010, which specializes in insurance solutions for portions of the healthcare professionals industry, including durable medical equipment suppliers, behavioral health specialists, eldercare providers, and podiatrists. Most recently, we entered into an agreement with the Insurance Company of the West (ICW) that is expected to build our surety capabilities in our western expansion states. In addition to these businesses, we have developed several niche insurance programs, such as for schools, religious institutions, moving and storage companies and human services organizations, such as non-profit youth and community service organizations, and we have added additional segmentation to our core middle market commercial products, including real estate, hospitality and wholesale distributors. As a

complementary initiative, we have introduced products focused on management liability, specifically non-profit directors and officers liability and employment practices liability, and coverage for private company directors and officers liability.

In addition, we have made a number of enhancements to our core products and technology platforms that are intended to drive more total account placements in our small commercial business, which we believe will enhance margins. Our focus continues to be on improving and expanding our partnerships with a limited number of agents.

We believe our small commercial capabilities, distinctiveness in the middle market, and continued development of specialty business provides us with a more diversified portfolio of products and enables us to deliver significant value to our agents and policyholders. We believe these efforts will enable us to improve the overall mix of our business and ultimately our underwriting profitability.

Investment Portfolio

Our investment holdings totaled approximately $5.5 billion at September 30, 2010 and consist primarily of investment grade fixed maturities with net unrealized gains of $318.9 million, and cash and cash equivalents.

Recent developments have illustrated that the U.S. and global financial markets and economies, while continuing to recover, remain tenuous as market values have and could continue to fluctuate. Issuers of securities continue to be challenged by adverse business and liquidity circumstances and therefore unanticipated bond defaults could increase, particularly with respect to non-investment grade securities. Credit spreads of taxable municipal bonds, corporate bonds and commercial and residential mortgage-backed securities tightened during the period, resulting in increased unrealized gains in the first nine months of 2010. The first nine months of 2010 have continued the positive momentum the financial markets experienced in the latter half of 2009; however, uncertainty still exists in these markets, and with respect to the potential impact on our business of the current difficult economy.

Description of Operating Segments

Our primary business operations include insurance products and services in three property and casualty operating segments. These segments are Personal Lines, Commercial Lines and Other Property and Casualty. Personal Lines includes personal automobile, homeowners and other personal coverages, while Commercial Lines includes commercial multiple peril, commercial automobile, workers compensation and other commercial coverages, such as inland marine, bonds, specialty program business, professional liability and management liability. In addition, the Other Property and Casualty segment consists of Opus Investment Management, Inc. (Opus), which markets investment management services to institutions, pension funds and other organizations, earnings on holding company assets, as well as voluntary pools business in which we have not actively participated since 1995. Additionally, prior to the sale of FAFLIC on January 2, 2009, our operations included the results of this run-off life insurance and annuity business as a separate segment. 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 related to our debt separately from the earnings of our operating segments. Our debt consists of senior debentures, junior subordinated debentures, advances under our collateralized borrowing program with the Federal Home Loan Bank of Boston (FHLBB), capital securities and surplus notes.

Results of Operations

Our consolidated net income includes the results of our three operating segments (segment income), which we evaluate on a pre-tax basis, and our interest expense on debt. Segment income excludes certain items which we believe are not indicative of our core operations. The income of our segments excludes items such as federal income taxes and net realized investment gains and losses, because fluctuations in these gains and losses are determined by interest rates, financial markets and the timing of sales. Also, segment income excludes net gains and losses on disposals of businesses, discontinued operations, restructuring costs, extraordinary items, the cumulative effect of accounting changes and certain other items. Although the items excluded from segment income may be significant components in understanding and assessing our financial performance, we believe segment income enhances an investor s understanding of our results of operations by highlighting net income attributable to the core operations of the business. However, segment income should not be construed as a substitute for net income determined in accordance with generally accepted accounting principles (GAAP).

Catastrophe losses are a significant component in understanding and assessing the financial performance of our business. However, catastrophic events make it difficult to assess the underlying trends in this business. Management believes that providing certain financial metrics and trends excluding the effects of catastrophes helps investors to understand the variability in periodic earnings and to evaluate the underlying

performance of our operations.

Table of Contents

Our consolidated net income for the third quarter of 2010 of $52.3 million increased slightly from the same period in 2009 during which our consolidated net income was $49.7 million. The P&C group s segment earnings increased $5.6 million, which was essentially offset by a $5.5 million increase in interest expense on our debt.

Our consolidated net income for the first nine months of 2010 was $96.4 million, compared to $139.9 million for the same period in 2009. The $43.5 million decrease is primarily due a $37.2 million decline in after-tax segment income, principally driven by higher catastrophe losses, which increased $33.3 million, net of taxes. Results in 2009 included a $34.3 million pre-tax gain ($22.3 million, net of taxes) associated with a tender offer whereby we repurchased a portion of our mandatorily redeemable preferred securities and our senior debentures during the second quarter of 2009 (see also Significant Transactions). In addition, earnings from our discontinued operations decreased by $7.3 million. Partially offsetting these decreases was a $26.5 million improvement in our net realized investment position, from a loss of $9.7 million in the first nine months of 2009, to a gain of $16.8 million in the first nine months of 2010.

The following table reflects segment income as determined in accordance with generally accepted accounting principles and a reconciliation of total segment income to consolidated net income.

	Quarter Ended September 30,		Nine months Ended September 30,	
(In millions)	**2010**	**2009**	**2010**	**2009**
Segment income before federal income taxes:				
Property and Casualty				
Personal Lines	**$ 43.0**	$ 27.4	**$ 74.0**	$ 56.1
Commercial Lines	**35.1**	38.7	**74.8**	137.2
Other Property and Casualty	**1.1**	7.5	**2.7**	6.5
Total Property and Casualty	**79.2**	73.6	**151.5**	199.8
Interest expense on debt	**(11.8)**	(6.3)	**(32.8)**	(27.2)
Total segment income before federal income taxes	**67.4**	67.3	**118.7**	172.6
Federal income tax expense on segment income	**(22.7)**	(22.0)	**(40.2)**	(56.9)
Net realized investment gains (losses)	**5.7**	-	**16.8**	(9.7)
Gain on retirement of debt	**-**	0.2	**-**	34.5
Federal income tax benefit (expense) on non-segment income				