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:serif; font-size:3.8mm; ">Purchase of fixed maturities

(113,587

)

(252,275

)

(678,026

)

Purchase of equity securities

(558

)

(1,037

)

(12,224

)

Proceeds from sale of fixed maturities

42,467

208,697

245,216

Proceeds from sale of equity securities

4,010

4,264

189,815

Proceeds from maturities and redemptions of investments

105,424

55,475

165,021

Cash paid for acquisition, net of cash and cash equivalents acquired

(168,903

)

Capital expenditures and other, net

(3,926

)

(4,964

)

(9,635

)

Net cash (used in) provided by investing activities

(135,073

)

10,160

(99,833

)

**Financing activities**

Issuance of common stock, net

486,670

(3,077

)

Cash paid to eligible policyholders under plan of conversion

(462,989

)

Acquisition of treasury stock

(14,152

)

(75,000

)

Dividend paid to stockholders

(11,808



)

(9,276

)

Debt issuance costs

(375

)

Payments on notes payable

(2,678

)

Proceeds from notes payable

150,000

Other

(38

)

Net cash provided by (used in) financing activities

120,949

(60,595

)

(3,077

)

Net increase in cash and cash equivalents

53,190

69,719

18,901

Cash and cash equivalents at the beginning of the year

149,703

79,984

61,083

Cash and cash equivalents at the end of the year

\$

202,893

\$

149,703

\$

79,984

Cash paid for income taxes

\$

22,526

\$

36,200

\$

72,349

Cash paid for interest

\$

1,782

\$

\$

**Schedule of non-cash transactions**

Stock issued in exchange for membership interest



\$

\$

281,073

\$

*See accompanying notes.*

**Employers Holdings, Inc. and Subsidiaries**  
**Notes to Consolidated Financial Statements**  
**December 31, 2008**

**1. Basis of Presentation and Summary of Operations**

**Nature of Operations and Organization**

Employers Holdings, Inc. (EHI), a Nevada holding company and successor to EIG Mutual Holding Company (EIG), was formed effective April 1, 2005, pursuant to an approved plan of reorganization. In the reorganization, Employers Insurance Company of Nevada (EICN) converted from a mutual insurance company to a stock company and the mutual members' rights in EICN were exchanged for members' rights in the newly formed EIG. Also in the reorganization, EIG was issued 100% of the stock of Employers Group, Inc. (EGI), a newly formed Nevada stock holding company (then known as Employers Insurance Group, Inc.), which in turn owns 100% of the issued stock of EICN. EICN commenced operations as a private mutual insurance company on January 1, 2000, when it assumed the assets, liabilities and operations of the former Nevada State Industrial Insurance System (the Fund) pursuant to legislation passed in the 1999 Nevada Legislature (the Privatization).

Effective February 5, 2007, pursuant to an approved plan of reorganization, EIG converted from a mutual insurance holding company to a Nevada stock company and completed an initial public offering (IPO) of its common stock. All policyholder membership interests in EIG were extinguished on that date, and EIG's name changed to Employers Holdings, Inc. (see Note 3).

On October 31, 2008 (Acquisition Date), the Company acquired 100% of the outstanding common stock of AmCOMP Incorporated (AmCOMP), including two insurance subsidiaries, AmCOMP Preferred Insurance Company and AmCOMP Assurance Corporation (see Note 4). On December 16, 2008, the Florida Commissioner approved the name changes of AmCOMP Preferred Insurance Company and AmCOMP Assurance Corporation to Employers Preferred Insurance Company (EPIC) and Employers Assurance Company (EAC), respectively.

Through its four wholly owned insurance subsidiaries, EICN, Employers Compensation Insurance Company (ECIC), EPIC and EAC, EHI is engaged in the commercial property and casualty insurance industry, specializing in workers compensation products and services. EICN, domiciled in Nevada, ECIC, domiciled in California, and EPIC and EAC, both domiciled in Florida, provide insurance to employers against liability for workers' compensation claims in 29 states. For the year ended December 31, 2008, approximately 69.4%, 11.6% and 1.4% of the Company's direct premiums written was in California, Nevada and Florida, respectively. Unless otherwise indicated, all references to the Company refer to EHI, together with its subsidiaries.

**Basis of Presentation**

The accompanying consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles (GAAP) and all intercompany transactions and balances have been eliminated in consolidation. The accompanying consolidated statement of income for the year ended December 31, 2008, does not include the results of AmCOMP for the period prior to the Acquisition Date.

In accordance with Statement of Financial Accounting Standards (SFAS) No. 131, *Disclosures About Segments of an Enterprise and Related Information*, the Company considers an operating segment to be any component of its business whose operating results are regularly reviewed by the Company's chief operating decision makers to make decisions about resources to be allocated to the segment and assess its performance based on discrete financial information. Currently, the Company has one operating segment, workers' compensation insurance and related services.

**2. Summary of Significant Accounting Policies**

**Use of Estimates**

The preparation of the consolidated financial statements in conformity with GAAP requires management 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 amounts of revenue and expenses during the reporting period. As a result, actual results could differ from these estimates. The most significant areas that require management judgment are the estimate of unpaid losses and loss adjustment expenses, evaluation of reinsurance recoverables, recognition of premium revenue, deferred policy acquisition costs, deferred income taxes, policyholders' dividends, the valuation of assets acquired and liabilities assumed in its business combination and the valuation of investments.

### **Cash and Cash Equivalents**

The Company considers all highly liquid investments with an initial maturity of three months or less at the date of purchase to be cash equivalents.

### **Investments**

The Company's investments in fixed maturity securities, equity securities and short-term investments, with remaining maturities of one year or less at the time of acquisition, are classified as available-for-sale and are reported at fair value with unrealized gains and losses excluded from earnings and reported as a separate component of equity, net of deferred taxes, in net accumulated other comprehensive income.

Investment income consists primarily of interest and dividends. Interest is recognized on an accrual basis, and dividends are recorded as earned at the ex-dividend date. Interest income on mortgage-backed and asset-backed securities is determined on the effective-yield method based on estimated principal repayments.

Realized capital gains and losses on investments are determined on a specific-identification basis.

When, in the opinion of management, a decline in the fair value of an investment below its cost or amortized cost is considered to be other-than-temporary, the investment's cost or amortized cost is written-down to its fair value and the amount written-down is recorded in earnings as a realized loss on investments. The determination of other-than-temporary decline includes, in addition to other relevant factors, a presumption that if the market value is below cost by a significant amount for a period of time, a write-down may be necessary unless management has the ability and intent to hold a security to recovery or maturity. The amount of any write-down is determined by the difference between cost or amortized cost of the investment and its fair value at the time the other-than-temporary decline is identified (see Note 6).

### **Recognition of Revenue and Expense**

#### ***Revenue Recognition***

Premiums are billed and collected according to policy terms, predominantly in the form of installments during the policy period. Premiums are earned pro rata over the terms of the policies. Billed premiums applicable to the unexpired terms of policies in-force are recorded in the accompanying consolidated balance sheets as a liability for unearned premiums.

Earned premiums include an estimate for earned but unbilled premiums. The Company estimates the amount of earned but unbilled premiums by analyzing the historical final premium billed compared to the original estimated amounts billed and applying this adjustment percentage against premium earned on policies that have not yet had a final billing. Estimated earned but unbilled premiums included in premiums receivable were \$6.1 million and \$20.7 million at December 31, 2008 and 2007, respectively.

The Company establishes an allowance for bad debts (bad debt allowance) on its premiums receivable through a charge to allowance for bad debt, included in underwriting and other operating expenses in the accompanying

consolidated statements of income. This bad debt allowance is determined based on estimates and assumptions to project future experience. After all collection efforts have been exhausted, the Company reduces the bad debt allowance for write-offs of premiums receivable that have been deemed uncollectible. The Company periodically reviews the adequacy of the

bad debt allowance and makes adjustments as necessary. Future additions to the bad debt allowance may be necessary based on changes in the general economic conditions and the policyholders' financial conditions. The Company had write-offs, net of recoveries of amounts previously written off, of \$1.0 million, \$0.8 million, and \$0.4 million for the years ended December 31, 2008, 2007 and 2006, respectively.

### ***Deferred Policy Acquisition Costs***

Policy acquisition costs, consisting of commissions, premium taxes and certain other underwriting costs that vary with, and are primarily related to, the production of new or renewal business, are deferred and amortized as the related premiums are earned.

A premium deficiency is recognized if the sum of expected claims costs, claims adjustment expenses, expected dividends to policyholders, unamortized acquisition costs and policy maintenance costs exceed the related unearned premiums and future investment income from related in force policies. A premium deficiency would first be recognized by charging any unamortized acquisition costs to expense to the extent required to eliminate the deficiency. If the premium deficiency was greater than unamortized acquisition costs, a liability would be accrued for the excess deficiency. There was no premium deficiency at December 31, 2008 or 2007.

Deferred policy acquisition costs were \$32.4 million and \$14.9 million at December 31, 2008 and 2007, respectively. Amortization for the years ended December 31, 2008, 2007 and 2006, was \$51.2 million, \$46.1 million and \$58.4 million, respectively.

### ***Unpaid Loss and Loss Adjustment Expense (LAE) Reserves***

Loss and LAE reserves represent management's best estimate of the ultimate net cost of all reported and unreported losses incurred for the applicable periods. The estimated reserves for losses and LAE include the accumulation of estimates for losses and claims reported prior to the balance sheet date, estimates (based on projections of relevant historical data) of claims incurred but not reported, and estimates of expenses for investigating and adjusting all incurred and unadjusted claims. Amounts reported are necessarily subject to the impact of future changes in economic, regulatory and social conditions. Management believes that, subject to the inherent variability in any such estimate, the reserves are within a reasonable and acceptable range of adequacy. Estimates for losses and claims reported prior to the balance sheet date are continually monitored and reviewed, and as settlements are made or reserves adjusted, the differences are reported in current operations. Salvage and subrogation recoveries are estimated based on a review of the level of historical salvage and subrogation recoveries.

### **Reinsurance**

In the ordinary course of business and in accordance with general insurance industry practices, the Company purchases excess of loss reinsurance to protect the Company against the impact of large and/or catastrophic losses in its workers' compensation business. Additionally, the Company is a party to a 100% quota share retroactive reinsurance agreement, (see Note 10). This reinsurance reduces the financial impact of such losses on current operations and the equity of the Company. Reinsurance makes the assuming reinsurer liable to the ceding company to the extent of the reinsurance coverage provided. It does not, however, discharge the Company from its liability to its policyholders in the event the reinsurer is unable or unwilling to meet its obligations under its reinsurance agreement with the Company.

Net earned premium and losses and LAE incurred are stated in the accompanying consolidated statements of income after deduction of amounts ceded to reinsurers. Balances due from reinsurers on unpaid losses, including an estimate of such recoverables related to reserves for incurred but not reported losses, are reported as assets and are included in reinsurance recoverables even though amounts due on unpaid losses and LAE are not recoverable from the reinsurer until such losses are paid. Recoverables from reinsurers on unpaid losses and LAE amounted to \$1.1 billion at

December 31, 2008 and 2007.

Losses and LAE on ceded premiums are accounted for on a basis consistent with those used in accounting for the original policies issued and the terms of the relevant reinsurance agreement.

The 100% quota share retroactive reinsurance agreement was entered into in 1999 by the Fund and assumed by EICN, which the Company refers to as the Loss Portfolio Transfer (LPT) Agreement (see Note 10). The Company is accounting for this transaction as retroactive reinsurance, whereby the initial deferred gain resulting from the retroactive reinsurance was recorded as a liability in the accompanying consolidated balance sheets as deferred reinsurance gain LPT Agreement and is being amortized using the recovery method, whereby the amortization is determined by the proportion of actual reinsurance recoveries to total estimated recoveries. The amortization of the deferred gain is recorded in losses and LAE incurred in the accompanying consolidated statements of income. Any adjustment to the estimated reserves ceded under the LPT agreement is recognized in earnings in the period of change with a corresponding change to reinsurance recoverables on unpaid losses and deferred reinsurance gain. A cumulative amortization adjustment is also then recognized in earnings so that the deferred reinsurance gain reflects the balance that would have existed had the revised reserves been available at the inception of the LPT Agreement.

### **Property and Equipment**

Property and equipment are stated at cost less accumulated depreciation (see Note 7). Expenditures for maintenance and repairs are charged against operations as incurred.

Electronic data processing equipment, operating software, and non-operating software are depreciated using the straight-line method over three to seven years. Leasehold improvements are carried at cost less accumulated amortization. The Company amortizes leasehold improvements using the straight-line method over the lesser of the useful life of the asset or the remaining original lease term, excluding options or renewal periods. Leasehold improvements are generally depreciated over three to five years. Other furniture and equipment and autos are depreciated using the straight-line method over three to seven years.

### **Income Taxes**

Deferred tax assets, net of any applicable valuation allowance, and deferred tax liabilities are provided for the future tax consequences attributable to temporary differences between the financial statement carrying amounts of assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The net deferred tax asset is recorded in the accompanying consolidated balance sheets as deferred income taxes, net.

### **Credit Risk**

Financial instruments that potentially subject the Company to concentrations of credit risk are primarily cash, cash equivalents, investments, instruments held through hedging activities, premiums receivable and reinsurance recoverable balances.

Cash equivalents include investments in commercial paper of companies with high credit ratings, investments in money market securities and securities backed by the U.S. government. Investments are diversified throughout many industries and geographic regions. The Company limits the amount of credit exposure with any one financial institution and believes that no significant concentration of credit risk exists with respect to cash and investments.

At December 31, 2008 and 2007, the outstanding premiums receivable balance was generally diversified due to the large number of entities composing the Company's policyholder base and their dispersion across many different industries. To reduce credit risk, the Company performs ongoing evaluations of its policyholders' financial condition, but does not generally require collateral. The Company also has recoverables from its reinsurers. Reinsurance



contracts do not relieve the Company from its obligations to claimants or policyholders. Failure of reinsurers to honor their obligations could result in losses to the Company. The Company evaluates the financial condition of its reinsurers to minimize its exposure to significant losses from reinsurer insolvencies. The Company obtains collateral

to mitigate the risks related to reinsurance insolvencies. At December 31, 2008, \$7.8 million was collateralized by cash or letter of credit and an additional \$998.4 million was in trust accounts for reinsurance related to the LPT agreement.

The Company enters into securities lending agreements with financial institutions to improve investment income. Selected securities are loaned and are secured by collateral equal to at least 102% of the fair market value of the securities. Collateral is in the form of cash or securities issued or guaranteed by the U.S. government, and the securities lending agent has provided counterparty indemnification in the event of borrower insolvency. The maximum amount loaned under our securities lending program in 2008 was \$112.1 million. As of December 31, 2008 and 2007, there were no outstanding securities lending transactions.

### **Fair Value of Financial Instruments**

Estimated fair value amounts, defined as the quoted market price of a financial instrument, have been determined using available market information and other appropriate valuation methodologies. However, considerable judgments are required in developing the estimates of fair value where quoted market prices are not available. Accordingly, these estimates are not necessarily indicative of the amounts that could be realized in a current market exchange. The use of different market assumptions or estimating methodologies may have an effect on the estimated fair value amounts.

The following methods and assumptions were used by the Company in estimating the fair value disclosures for financial instruments in the accompanying consolidated financial statements and in these notes:

*Cash and cash equivalents, premiums receivable, and accrued expenses and other liabilities.* The carrying amounts for these financial instruments as reported in the accompanying consolidated balance sheets approximate their fair values.

*Investments.* The estimated fair values for available-for-sale securities generally represent quoted market value prices for securities traded in the public marketplace or estimated values for securities not traded in the public marketplace. Additional data with respect to fair values of the Company's investment securities is disclosed in Note 6.

*Derivatives.* The fair value of the Company's interest rate swap is derived by using an industry standard swap valuation model, with market based inputs for swaps having similar characteristics (see Note 12).

*Notes Payable.* The Company's notes payable is composed of floating rate long-term debt. Accordingly, the carrying amount is estimated to approximate fair value.

The estimated fair values of the Company's financial instruments are as follows:

	<b>Carrying Value</b>	<b>Estimated Fair Value</b>
	(in thousands)	
<b>Financial assets</b>		
Investments (Note 6)	\$ 2,042,941	\$ 2,042,941
Cash and cash equivalents	202,893	202,893
<b>Financial liabilities</b>		
Notes payable (Note 11)	182,000	182,000
Derivative (Note 12)	3,868	3,868

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As of December 31, 2007, the carrying value of cash and cash equivalents and investments equaled the estimated fair value on the accompanying consolidated balance sheet. Other financial instruments qualify as insurance-related products and are specifically exempted from fair value disclosure requirements.

## Goodwill and Other Intangible Assets

The Company accounts for goodwill and other intangible assets in accordance with SFAS No. 142, *Goodwill and Other Intangible Assets* (SFAS No. 142). Goodwill represents the excess of the purchase price over the fair value of the net tangible and identifiable intangible assets acquired in a business combination, and is not subject to amortization. SFAS No. 142 requires that goodwill be tested for impairment on an annual basis, or more frequently if circumstances indicate that a possible impairment has occurred. The assessment of impairment involves a two step process whereby an initial assessment for potential impairment is performed, followed by a measurement of the amount of impairment, if any. The Company has determined that there was no impairment as of December 31, 2008.

The Company acquired intangible assets in the acquisition of AmCOMP (the Acquisition) (see Note 4) comprised of state licenses, insurance relationships and other intangible assets. The intangible assets related to state licenses are not subject to amortization, and the remaining intangibles are being amortized over periods ranging from six months to ten years. SFAS No. 144, *Accounting for the Impairment for Disposal of Long-Lived Assets*, also requires intangible assets to be reviewed for impairment.

The following table presents the gross carrying value, accumulated amortization and net carrying value for the Company's intangible assets, by major class, as of December 31, 2008:

	<b>Gross Carrying Value</b>	<b>Accumulated Amortization</b> (in thousands)	<b>Net Carrying Value</b>
State licenses	\$ 7,700	\$	\$ 7,700
Insurance relationships	9,400	(256 )	9,144
Other	1,700	(326 )	1,374
Balance, December 31, 2008	\$ 18,800	(582 )	\$ 18,218

During the year ended December 31, 2008, the Company recognized \$0.6 million in amortization expense and is included in the accompanying consolidated statements of income as underwriting and other operating expenses. Amortization expense for the next five years related to amortizable intangible assets is expected to be as follows:

<b>Year</b>	<b>Amount</b> (in thousands)
2009	\$ 2,777
2010	2,163
2011	1,550
2012	1,170
2013	873
Thereafter	1,985
	\$ 10,518

There was no change to the recorded goodwill from the Acquisition Date to December 31, 2008.

**Stock-Based Compensation**

On January 1, 2006, the Company adopted SFAS No. 123(R) *Share-based Payment* (SFAS) No. 123(R). Prior to 2007, neither EHI nor its predecessor, EIG, had any outstanding shares of common stock, and therefore no stock-based payments were made. During 2008 and 2007 the Company issued stock-based payments, and under SFAS No. 123(R), those payments are recognized in the consolidated statements of income based on their fair values over the employees' service period (see Note 15).

**New Accounting Standards**

In December 2007, the FASB issued SFAS No. 141 (Revised 2007), *Business Combinations* (SFAS No. 141(R)). SFAS No. 141(R) significantly changes the accounting for business combinations

and requires the acquiring entity in the transaction to recognize the acquired assets and assumed liabilities at the acquisition-date fair value with limited exceptions. SFAS No. 141(R) was adopted by the Company January 1, 2009 and its adoption will have an impact on the consolidated financial statements for any future business combinations. Early adoption was prohibited.

In March 2008, the FASB issued SFAS No. 161 *Disclosures About Derivative Instruments and Hedging Activities* an amendment of FASB No. 133 (SFAS No. 161). SFAS No. 161 expands the disclosure requirements in SFAS 133 *Accounting for Derivative Instruments and Hedging Activities* about an entity's derivative instruments and hedging activities. SFAS No. 161 requires qualitative disclosures about objectives and strategies for using derivatives, quantitative disclosures about fair value amounts of gains and losses on derivative instruments and disclosures about credit-risk related contingent features in derivative agreements. The Company adopted SFAS No. 161 on January 1, 2009, and the adoption did not have a significant impact on the consolidated financial statements.

On October 10, 2008, the FASB issued FSP FAS 157-3, *Determining the Fair Value of a Financial Asset When the Market for That Asset Is Not Active* (FSP FAS 157-3). FSP FAS 157-3 clarifies the application of SFAS No. 157 in a market that is not active and provides an example to illustrate key considerations in determining the fair value of a financial asset when the market for that financial asset is not active. FSP FAS 157-3 was effective upon issuance, including prior periods for which financial statements have not been issued. The Company adopted FSP FAS 157-3 for the period ended September 30, 2008 and the adoption did not have a significant impact on the consolidated financial statements.

### **3. Conversion and Initial Public Offering**

Effective February 5, 2007, under the terms of a plan of conversion, EIG converted from a mutual insurance holding company to a stock company. All membership interests in EIG were extinguished on that date and eligible members of EIG received, in aggregate, 22,765,407 shares of EHI's common stock and \$463.0 million of cash.

In addition, effective February 5, 2007, EHI completed its IPO in which it issued 30,762,500 shares of its common stock at a price of \$17.00 per share. The cash proceeds of the IPO, after underwriting discounts and commission of \$34.0 million and offering and conversion costs of \$16.3 million, were \$472.7 million, of which \$9.7 million was retained by EHI and was used for working capital, payment of dividends on common stock, repurchase of shares of common stock and other general corporate purposes.

Upon completion of EHI's IPO, the capitalized issuance costs related to the IPO of \$5.4 million were netted against the IPO proceeds in additional paid-in capital in the accompanying consolidated balance sheets. The costs related to the conversion were \$10.9 million, of which \$0.9 million was incurred in the period from January 1, 2007 through February 5, 2007 and \$10.0 million was incurred during the year ended December 31, 2006. Conversion expenses consisted primarily of printing and mailing costs and the aggregate cost of engaging independent accounting, actuarial, financial, investment banking, legal and other consultants. These costs have no tax benefit and were expensed as incurred and are included in the underwriting and other operating expenses in the accompanying consolidated statements of income.

### **4. Acquisition of AmCOMP**

On October 31, 2008 EHI acquired 100% of the outstanding common stock of AmCOMP for \$188.4 million. The Company believes the Acquisition will provide significant opportunity to accelerate the execution of its strategic goals and achieve its vision of being the leader in the property and casualty insurance industry specializing in workers compensation.

Pursuant to the terms of Amendment No. 2 to the Agreement and Plan of Merger (Amended Merger Agreement), executed on August 29, 2008, the Company paid a cash amount of \$12.15 per share in exchange for the 15,295,462

outstanding shares of AmCOMP common stock. The 844,650 AmCOMP stock options that were outstanding immediately prior to the effective time of the Acquisition were vested by virtue of the Acquisition and exchanged for the right to receive cash

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consideration equal to the net amount of the excess, if any, of \$12.15 per share over the exercise price per share of the option. The following table summarizes the purchase price of the Acquisition:

<b>Purchase Price</b>	
(in thousands)	
Cash for outstanding shares	\$ 185,840
Cash for stock options	2,529
Total cash used to acquire the outstanding equity interest in AmCOMP	188,369
Acquisition related costs	5,154
Total purchase price	\$ 193,523

The Company allocated the purchase price to tangible and identifiable intangible assets acquired and liabilities assumed based on their estimated fair values as of October 31, 2008. The excess of purchase price over the aggregate fair values of \$36.2 million was recorded as goodwill and is not deductible for United States federal income tax purposes. \$18.8 million was assigned to identifiable intangible assets acquired, based on estimates and assumptions determined by the Company.

Certain of AmCOMP's senior executives were party to employment agreements providing for severance benefits in connection with the Acquisition and, in the case of one senior executive, a retention payment became payable upon completion of the Acquisition. Included in liabilities assumed was \$4.1 million in restructuring charges related to these agreements.

The allocation of the purchase price is as follows:

<b>Amount</b>	
(in thousands)	
Cash and cash equivalents	\$ 24,520
Investments	397,407
Premiums receivable	77,369
Reinsurance recoverable	64,152
Business in-force	21,399
Deferred tax assets	18,775
Intangible assets	18,800
Goodwill	36,192



Other assets	18,992
Loss and LAE reserves	(308,748 )
Unearned premiums	(95,857 )
Policyholders dividends accrued	(8,694 )
Accounts payable and accrued expenses	(22,182 )
Notes payable	(34,678 )
Other liabilities	(13,924 )

Total preliminary purchase price allocation      \$      193,523

Business in-force is included in deferred policy acquisition costs on the consolidated balance sheets and is amortized over the remaining policy periods for the policies acquired. Intangible assets consist primarily of state licenses, insurance relationships and other intangibles. The state licenses relate to AmCOMP's ability to sell workers compensation products in 29 states and the District of Columbia. Insurance relationships include both customer and broker relationships. The following table presents details of the purchased intangible assets acquired as part of the Acquisition:

	<b>Estimated Useful Life</b> (in years)	<b>Purchase Price Allocation</b> (in thousands)
State licenses	Indefinite	\$ 7,700
Insurance relationships	10.0	9,400
Other	0.5-1.5	1,700
<b>Total</b>		<b>\$ 18,800</b>

**Unaudited pro forma financial information**

The unaudited financial information in the table below summarizes the combined results of operations of EHI and AmCOMP, on a pro forma basis, as though the companies had been combined as of the beginning of each of the periods presented. The unaudited pro forma financial information is presented for information purposes only and is not indicative of the results that would have been achieved if the Acquisition had taken place at the beginning of the periods presented, nor is the pro forma information intended to be indicative of the Company's future results of operations.

The unaudited pro forma financial information for the year ended December 31, 2008 combines the results for EHI for the year ended December 31, 2008, which includes the results of AmCOMP subsequent to the Acquisition Date, and the historical results of AmCOMP for the period January 1, 2008 through October 31, 2008, including a charge of \$8.0 million for realized Florida excessive profits for accident years 2003-2006. The unaudited pro forma financial information for the year ended December 31, 2007 combines the historical results for EHI with the historical results of AmCOMP for that period. The historical financial information has been adjusted to give effect to pro forma items that are directly attributable to the Acquisition and are expected to have a continuing impact on the consolidated results. These items include adjustments for amortization of intangible assets acquired, increases in interest expense and decreases in underwriting and other expenses for integration and restructuring savings. The following table summarizes the pro forma financial information:

	<b>Years Ended December 31,</b>	
	<b>2008</b>	<b>2007</b>
	(in thousands except per share data)	
Net premiums earned	\$ 495,080	\$ 580,283
Net income	105,770	134,298
Earnings per common share basic	2.15	2.60
Earnings per common share diluted	2.15	2.59

**5. Fair Value of Financial Instruments**

On January 1, 2008, the Company adopted SFAS No. 157, *Fair Value Measurements* (SFAS No. 157), which provides a common definition of fair value and establishes a framework to make the measurement of fair value more consistent and comparable. The Company's adoption of SFAS No. 157 did not have a material impact on its consolidated financial statements or results of operations.

Additionally on January 1, 2008, the Company adopted SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities Including an Amendment of FASB Statement No. 115, Accounting for Certain Investments in Debt and Equity Securities* (SFAS No. 159). SFAS No. 159 permits an entity to choose to measure many financial instruments and certain items at fair value. The Company's adoption of SFAS No. 159 did not have a material impact on its consolidated financial statements or results of operations.

The Company's estimates of fair value for financial assets and financial liabilities are based on the framework established in SFAS No. 157. The framework is based on the inputs used in valuation and gives the highest priority to quoted prices in active markets and requires that observable inputs be used in the valuations when available. The disclosure of fair value estimates in the SFAS No. 157 hierarchy is based on whether the significant inputs into the valuation are observable. In determining the level of the hierarchy in which the estimate is disclosed, the highest priority is given to unadjusted quoted prices in active markets and the lowest priority to unobservable inputs that reflect the Company's significant market assumptions. The three levels of the hierarchy are as follows:

Level

1 Unadjusted  
quoted  
market prices  
for identical  
assets or  
liabilities in  
active  
markets that  
the Company  
has the  
ability to  
access.

Level

2 Quoted  
prices for  
similar assets  
or liabilities  
in active  
markets;  
quoted prices  
for identical  
or similar  
assets or  
liabilities in  
inactive  
markets; or  
valuations  
based on  
models  
where the  
significant  
inputs are  
observable  
(e.g., interest  
rates, yield  
curves,  
prepayment  
speeds,  
default rates,  
loss  
severities,  
etc.) or can  
be  
corroborated  
by  
observable  
market data.



Level  
3 Valuations  
based on  
models where  
significant  
inputs are not  
observable.  
The  
unobservable  
inputs reflect  
the  
Company's  
own  
assumptions  
about the  
assumptions  
that market  
participants  
would use.

**Valuation of Investments** For investments that have quoted market prices in active markets, the Company uses the quoted market prices as fair value and includes these prices in the amounts disclosed in Level 1 of the hierarchy. When quoted market prices are unavailable, the Company estimates fair value based on objectively verifiable information, if available. The fair value estimates determined by using objectively verifiable information are included in the amount disclosed in Level 2 of the hierarchy. If quoted market prices and an estimate determined by using objectively verifiable information are unavailable, the Company produces an estimate of fair value based on internally developed valuation techniques, which, depending on the level of observable market inputs, will render the fair value estimate as Level 2 or Level 3. The Company bases all of its estimates of fair value for assets on the bid price as it represents what a third party market participant would be willing to pay in an arm's length transaction. The following section describes the valuation methods used by the Company for each type of financial instrument it holds that is carried at fair value.

**Equity Securities** The Company utilizes market quotations for equity securities that have quoted prices in active markets.

**Fixed Maturities, Short-Term Investments and Derivative** Estimates of fair value measurements for these securities are estimated using relevant inputs, including available relevant market information, benchmark curves, benchmarking of like securities, sector groupings, and matrix pricing. Additionally, an Option Adjusted Spread model is used to develop prepayment and interest rate scenarios. Industry standard models are used to analyze and value securities with embedded options or prepayment sensitivities.

Each asset class is evaluated based on relevant market information, relevant credit information, perceived market movements and sector news. The market inputs utilized in the pricing evaluation include: benchmark yields, reported trades, broker/dealer quotes, issuer spreads, two-sided markets, benchmark securities, bids, offers, reference data, and industry and economic events. The extent of the use of each market input depends on the asset class and the market conditions. Depending on the security, the priority of the use of inputs may change or some market inputs may not be relevant. For some securities, additional inputs may be necessary.

This method of valuation will only produce an estimate of fair value if there is objectively verifiable information to produce a valuation. If objectively verifiable information is not available, the Company would be required to produce an estimate of fair value using some of the same methodologies, but would have to make assumptions for market

based inputs that are unavailable due to market conditions.

Because the fair value estimates of most fixed maturity investments are determined by evaluations that are based on observable market information rather than market quotes, most estimates of fair value for fixed maturities and short term investments are based on estimates using objectively verifiable information and are included in the amount disclosed in Level 2 of the hierarchy. The fair value estimates for determining Level 3 pricing include the Company's assumption about risk assessments and market participant assumptions based on the best information available, including quotes from market makers and other broker/dealers recognized as market participants, using standard or trade derived inputs, new issue data, monthly payment information, cash flow generation, prepayment speeds, spread adjustments and/or rating updates.

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The following table presents the items on the accompanying consolidated balance sheet that are stated at fair value and the fair value measurements used as of December 31, 2008:

	Available-for-Sale Securities			Derivative
	Fixed Income	Equity Securities	Short-Term Investments	Other Liabilities
	(in thousands)			
Level 1: Quoted prices in active markets for identical assets	\$	\$ 58,526	\$	\$
Level 2: Significant other observable inputs	1,904,441		75,024	(3,868 )
Level 3: Unobservable inputs	4,950			
Balance, December 31, 2008	\$ 1,909,391	\$ 58,526	\$ 75,024	\$ (3,868 )

The following table provides a reconciliation of the beginning and ending balances, for the above items, that are measured using Level 3: Unobservable inputs, for the year ended December 31, 2008:

	Fixed Maturities
	(in thousands)
Balance, January 1, 2008	\$ 7,384
Unrealized losses in other comprehensive income	(96 )
Purchases, issuances and settlements, net	(2,340 )
Amortization of discount in net investment income	2
Balance, December 31, 2008	\$ 4,950

## 6. Investments

The amortized cost, gross unrealized gains, gross unrealized losses and estimated fair value of the Company's investments were as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
	(in thousands)			
<b>At December 31, 2008</b>				
U.S. government	\$ 266,028	\$ 28,821	\$	\$ 294,849
All other governments	1,881	15		1,896
States and political subdivisions	581,938	13,247	(6,719 )	588,466

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Special revenue	393,450	8,408	(12,109 )	389,749
Public utilities	24,985	348	(417 )	24,916
Industrial and miscellaneous	223,352	7,441	(5,153 )	225,640
Mortgaged-backed securities	378,593	12,939	(7,657 )	383,875
Total fixed maturity investments	1,870,227	71,219	(32,055 )	1,909,391
Short-term investments	74,952	306	(234 )	75,024
Total fixed maturity and short-term investments	1,945,179	71,525	(32,289 )	1,984,415
Equity securities	43,014	16,532	(1,020 )	58,526
Total Investments	\$ 1,988,193	\$ 88,057	\$ (33,309 )	\$ 2,042,941



	<b>Amortized Cost</b>	<b>Gross Unrealized Gains</b>	<b>Gross Unrealized Losses</b>	<b>Estimated Fair Value</b>
	(in thousands)			
<b>At December 31, 2007</b>				
U.S. government	\$ 277,270	\$ 10,917	\$ (10 )	\$ 288,177
All other governments	4,842		(22 )	4,820
States and political subdivisions	547,153	6,957	(1,050 )	553,060
Special revenue	337,669	6,026	(1,293 )	342,402
Public utilities	19,313	274	(50 )	19,537
Industrial and miscellaneous	160,255	2,601	(557 )	162,299
Mortgaged-backed securities	247,657	1,949	(998 )	248,608
<b>Total fixed maturity investments</b>	<b>1,594,159</b>	<b>28,724</b>	<b>(3,980 )</b>	<b>1,618,903</b>
Equity securities	60,551	48,018	(1,192 )	107,377
<b>Total investments</b>	<b>\$ 1,654,710</b>	<b>\$ 76,742</b>	<b>\$ (5,172 )</b>	<b>\$ 1,726,280</b>

The amortized cost and estimated fair value of fixed maturity investments and short-term investments at December 31, 2008, by contractual maturity are shown below. Expected maturities differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	<b>Amortized Cost</b>	<b>Estimated Fair Value</b>
	(in thousands)	
Due in one year or less	\$ 152,389	\$ 153,883
Due after one year through five years	460,937	477,808
Due after five years through ten years	511,539	531,640
Due after ten years	441,721	437,209
Mortgage-backed securities	378,593	383,875
<b>Total</b>	<b>\$ 1,945,179</b>	<b>\$ 1,984,415</b>

The following is a summary of investments with unrealized losses and their corresponding fair values at December 31, 2008 and 2007:

	<b>Less than 12 Months December 31,</b>	
	<b>2008</b>	<b>2007</b>

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	<b>Estimated Fair Value</b>	<b>Gross Unrealized Losses</b>	<b>Number of Securities</b>	<b>Estimated Fair Value</b>	<b>Gross Unrealized Losses</b>	<b>Number of Securities</b>
(in thousands, except number of issues data)						
<b>Fixed maturity</b>						
U.S. government	\$	\$		\$ 2,023	\$ (2)	1
State and political subdivisions, all other governments, special revenue and public utilities	142,645	(4,498)	55	89,918	(1,411)	29
Industrial and miscellaneous	225,370	(11,157)	131	20,150	(313)	15
Mortgage-backed securities	32,385	(4,042)	25	21,007	(63)	20
<b>Equity securities</b>	7,756	(1,020)	65	5,662	(780)	49
<b>Total</b>	\$ 408,156	\$ (20,717)	276	\$ 138,760	\$ (2,569)	114

**12 Months or Greater  
December 31,**

	<b>2008</b>		<b>2007</b>			
	<b>Estimated Fair Value</b>	<b>Gross Unrealized Losses</b>	<b>Number of Securities</b>	<b>Estimated Fair Value</b>	<b>Gross Unrealized Losses</b>	<b>Number of Securities</b>
(in thousands, except number of issues data)						
<b>Fixed maturity</b>						
U.S. government	\$	\$		\$ 4,298	\$ (8 )	5
State and political subdivisions, all other governments, special revenue and public utilities	27,620	(2,221 )	9	142,690	(1,004 )	51
Industrial and miscellaneous	58,026	(6,756 )	25	30,636	(244 )	26
Mortgage-backed securities	28,197	(3,615 )	23	84,418	(935 )	139
<b>Equity securities</b>				1,257	(412 )	9
<b>Total</b>	<b>\$ 113,843</b>	<b>\$ (12,592 )</b>	<b>57</b>	<b>\$ 263,299</b>	<b>\$ (2,603 )</b>	<b>230</b>

**Total December 31,**

	<b>2008</b>		<b>2007</b>			
	<b>Estimated Fair Value</b>	<b>Gross Unrealized Losses</b>	<b>Number of Securities</b>	<b>Estimated Fair Value</b>	<b>Gross Unrealized Losses</b>	<b>Number of Securities</b>
(in thousands, except number of issues data)						
<b>Fixed maturity</b>						
U.S. government	\$	\$		\$ 6,321	\$ (10 )	6
State and political subdivisions all other governments, special revenue and public utilities	170,265	(6,719 )	64	232,608	(2,415 )	80
Industrial and miscellaneous	283,396	(17,913 )	156	50,786	(557 )	41

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Mortgage-backed securities	60,582	(7,657 )	48	105,425	(998 )	159
<b>Equity securities</b>	7,756	(1,020 )	65	6,919	(1,192 )	58
<b>Total</b>	<b>\$ 521,999</b>	<b>\$ (33,309 )</b>	<b>333</b>	<b>\$ 402,059</b>	<b>\$ (5,172 )</b>	<b>344</b>

The Company reviews its investment portfolio for securities that may have incurred an other-than-temporary impairment (OTTI) quarterly. For any investment security deemed to have an OTTI, the investment's cost or amortized cost is written down to its fair value and the amount written down is recorded in earnings as a realized loss on investments.

During 2008, based on reviews of the fixed maturity investments included in the tables above, the Company determined that the unrealized losses were primarily a result of the interest rate environment and not the credit quality of the issuers with the exception of primarily one fixed maturity security that resulted in a \$1.9 million OTTI. The remaining fixed maturity investments, including those held at December 31, 2007, whose fair value was less than amortized cost were not considered to be other-than-temporarily impaired given the severity and duration of the impairment, the credit quality of the issuers, and the Company's intent and ability to hold the securities until fair value recovers above cost, or to maturity.

Based on a review of the equity securities, during the years ended December 31, 2008 and 2007, the Company recognized impairments of \$10.8 million and \$1.2 million in the fair values of 86 and 13 securities, respectively, as a result of the severity and duration of the change in fair value of those securities. For its other equity securities, the Company determined that the unrealized losses were not considered to be other-than-temporary due to the financial condition and near term prospects of the issuers.

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Net realized and unrealized investment (losses) gains on fixed maturity investments and equity securities were as follows:

	<b>Year Ended December 31,</b>		
	<b>2008</b>	<b>2007</b>	<b>2006</b>
	(in thousands)		
<b>Net realized (losses) gains</b>			
Fixed maturity investments	\$ (560 )	\$ (120 )	\$ (441 )
Equity securities	(10,964 )	300	54,718
<b>Total</b>	<b>\$ (11,524 )</b>	<b>\$ 180</b>	<b>\$ 54,277</b>
<b>Change in fair value over cost or amortized cost</b>			
Fixed maturity investments	\$ 14,420	\$ 18,670	\$ 1,932
Equity securities	(31,314 )	8,015	(21,008 )
Short-term investments	72		
<b>Total</b>	<b>\$ (16,822 )</b>	<b>\$ 26,685</b>	<b>\$ (19,076 )</b>

Net investment income was as follows:

	<b>Years Ended December 31,</b>		
	<b>2008</b>	<b>2007</b>	<b>2006</b>
	(in thousands)		
Fixed maturity investments	\$ 72,602	\$ 72,408	\$ 62,448
Equity securities	1,855	1,920	4,055
Short-term investments and cash equivalents	6,017	6,453	3,701
	80,474	80,781	70,204
Investment expenses	(2,412 )	(2,158 )	(2,017 )
<b>Net investment income</b>	<b>\$ 78,062</b>	<b>\$ 78,623</b>	<b>\$ 68,187</b>

The Company is required by various state laws and regulations to keep securities or letters of credit on deposit with the states in a depository account. At December 31, 2008 and 2007, securities having a fair market value of \$582.1 million and \$516.0 million respectively, were on deposit. Additionally, certain reinsurance contracts require Company funds to be held in trust for the benefit of the ceding reinsurer to secure the outstanding liabilities assumed by the Company. The fair market value of securities held in trusts at December 31, 2008 and 2007, was \$6.7 million and \$4.9 million, respectively.

## 7. Property and Equipment

Property and equipment consists of the following:

	<b>As of December 31,</b>	
	<b>2008</b>	<b>2007</b>
Land	\$ 95	\$ 95
Furniture and equipment	3,840	6,004
Leasehold improvements	4,149	4,134
Computers and software	27,149	23,288
Automobiles	156	
	35,389	33,521
Accumulated depreciation	(21,291 )	(19,388 )
Property and equipment, net	\$ 14,098	\$ 14,133

Depreciation expense for the years ended December 31, 2008, 2007 and 2006, was \$6.5 million, \$6.4 million, and \$4.2 million, respectively. During 2008 and 2007, the Company retired \$4.6 million and \$4.4 million of fully depreciated equipment, respectively. Internally developed software costs of \$1.1 million were capitalized during the year ended December 31, 2008.

**8. Income Taxes**

The Company files a consolidated federal income tax return. The insurance subsidiaries pay premium taxes on gross premiums written in lieu of some states' income or franchise taxes.

The provision for income taxes consisted of the following:

	<b>Years Ended December 31,</b>		
	<b>2008</b>	<b>2007</b>	<b>2006</b>
	(in thousands)		
<b>Current tax expense:</b>			
Federal	\$ 5,591	\$ 25,824	\$ 76,742
State	172		
<b>Total current tax expense</b>	<b>5,763</b>	<b>25,824</b>	<b>76,742</b>
<b>Deferred tax expense (benefit):</b>			
Federal	4,561	4,779	5,980
State	(58 )		
<b>Total deferred tax expense</b>	<b>4,503</b>	<b>4,779</b>	<b>5,980</b>
<b>Income tax expense</b>	<b>\$ 10,266</b>	<b>\$ 30,603</b>	<b>\$ 82,722</b>

The difference between the statutory federal tax rate of 35% and the Company's effective tax rate on income before tax as reflected in the consolidated statements of income was as follows:

	<b>Years Ended December 31,</b>		
	<b>2008</b>	<b>2007</b>	<b>2006</b>
	(in thousands)		
Expense computed at statutory rate	\$ 39,218	\$ 52,810	\$ 89,002
State income taxes	67		
Dividends received deduction and tax-exempt interest	(11,197 )	(10,765 )	(8,975 )
LPT Agreement	(6,447 )	(6,312 )	(6,781 )
Pre-privatization reserve adjustments	(2,394 )		2,875
Impact of previously unrecognized tax benefits	(10,155 )	(4,793 )	
Other	1,174	(337 )	6,601
<b>Income tax expense</b>	<b>\$ 10,266</b>	<b>\$ 30,603</b>	<b>\$ 82,722</b>

Prior to the Privatization, the Fund was a part of the State of Nevada and therefore was not subject to federal income tax; accordingly, it did not take an income tax deduction with respect to the establishment of its unpaid loss and LAE

reserves. Due to favorable loss experience after the Privatization, it was determined that certain of the pre-Privatization unpaid loss and LAE reserves assumed by EICN as part of the Privatization were no longer necessary and the unpaid loss and LAE reserves were reduced accordingly. Such downward adjustments of pre-Privatization unpaid loss reserves increases GAAP net income but does not increase taxable income. For the year ended December 31, 2008, there were downward adjustments of pre-Privatization unpaid loss reserves that increased GAAP net income, but did not increase taxable income for the period. For the year ended December 31, 2006, there was an increase to the pre- Privatization unpaid loss reserves that decreased GAAP net income, but did not decrease taxable income for the period.

As of December 31, 2006, the Company had recorded, as a liability for tax contingencies, \$14.9 million (including interest of \$1.6 million). The adoption of FIN 48 did not result in any change in the amount of the unrecognized tax benefit. Further, the Company elected to continue to record both interest and penalties related to any unrecognized tax benefits as a component of income tax expense.



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The following is a reconciliation of the beginning and ending amounts for unrecognized tax benefits and related interest for the year ended:

	<b>December 31,</b>	
	<b>2008</b>	<b>2007</b>
	(in thousands)	
Balance, January 1	\$ 10,155	\$ 14,948
Gross amount of interest accrued	406	999
Less:		
Recognition of tax benefits	(8,274 )	(5,084 )
Gross amount of related interest accrued	(2,287 )	(708 )
 Balance, December 31	 \$	 \$ 10,155

During the third quarter of the years ended December 31, 2008 and 2007, the Company reversed \$10.6 million and \$5.8 million of liabilities for previously unrecognized tax benefits (including \$2.3 million and \$0.7 million of related accrued interest), respectively, as a result of certain statutory periods expiring. The total amount of the reversals reduced the effective tax rate during both years.

Tax years 2005 through 2007 are subject to examination by the federal taxing authority. There are no income tax examinations currently in progress.

The significant components of deferred income taxes, net, were as follows as of December 31:

	<b>2008</b>		<b>2007</b>	
	<b>Deferred Tax</b>		<b>Deferred Tax</b>	
	<b>Assets</b>	<b>Liabilities</b>	<b>Assets</b>	<b>Liabilities</b>
	(in thousands)			
Unrealized capital gains, net	\$	\$ 13,734	\$	\$ 25,050
Deferred policy acquisition costs		15,602		9,558
Intangible assets		6,467		
Loss reserve discounting for tax reporting	86,265		80,675	
Unearned premiums	15,215		10,361	
Allowance for bad debt	3,279		2,571	
Accrued liabilities	13,736		3,463	
Other	1,891	3,615	212	2,944
 Total	 \$ 120,386	 \$ 39,418	 \$ 97,282	 \$ 37,552
 Net deferred tax asset	 \$ 80,968		 \$ 59,730	

At December 31, 2008, the Company had no net operating loss carry forward.

FASB No. 109, *Accounting for Income Taxes*, requires that deferred tax assets be reduced by a valuation allowance if it is more likely than not that some portion or all of the deferred tax asset will not be realized. Realization of the deferred income tax asset is dependent on the Company generating sufficient taxable income in future years as the deferred income tax charges become currently deductible for tax reporting purposes. Although realization is not assured, management believes that it is more likely than not that the net deferred income tax asset will be realized.

**9. Unpaid Losses and Loss Adjustment Expenses**

The following table represents a reconciliation of changes in the liability for unpaid losses and LAE:

	<b>2008</b>	<b>December 31, 2007</b> (in thousands)	<b>2006</b>
Unpaid losses and LAE, gross of reinsurance, at beginning of period	\$ 2,269,710	\$ 2,307,755	\$ 2,349,981
Less reinsurance recoverable, excluding bad debt allowance, on unpaid losses and LAE	1,052,641	1,098,103	1,141,500
Net unpaid losses and LAE at beginning of period	1,217,069	1,209,652	1,208,481
Losses and LAE, net of reinsurance, acquired in business combination	247,006		
Losses and LAE, net of reinsurance, incurred in:			
Current year	226,643	221,347	256,257
Prior years	(71,707 )	(60,011 )	(107,129 )
Total net losses and LAE incurred during the period	154,936	161,336	149,128
Deduct payments for losses and LAE, net of reinsurance, related to:			
Current year	53,397	44,790	41,098
Prior years	135,486	109,129	106,859
Total net payments for losses and LAE during the period	188,883	153,919	147,957
Ending unpaid losses and LAE, net of reinsurance	1,430,128	1,217,069	1,209,652
Reinsurance recoverable, excluding bad debt allowance, on unpaid losses and LAE	1,076,350	1,052,641	1,098,103
Unpaid losses and LAE, gross of reinsurance, at end of period	\$ 2,506,478	\$ 2,269,710	\$ 2,307,755

The above table excludes the impact of the amortization of the deferred reinsurance gain LPT Agreement and the reduction of the ceded reserves on the LPT Agreement (Note 10), which are reflected in losses and LAE incurred in the consolidated statements of income.

Estimates of incurred losses and LAE attributable to insured events of prior years decreased due to continued favorable development in such prior accident years (actual losses and LAE paid and current projections of unpaid

losses and LAE were less than the Company originally anticipated). The reduction in the liability for unpaid losses and LAE was \$71.7 million, \$60.0 million and \$107.1 million for the years ended December 31, 2008, 2007 and 2006, respectively.

The major sources of this favorable development include actual paid losses being less than expected, and the impact of recalibration of selected patterns of claims emergence and claims payment used in the projection of future loss payments.

In California, in particular, where the Company's operations began on July 1, 2002, management's initial expectations of both the ultimate level of its losses and patterns of loss emergence and loss payment necessarily were based on benchmarks derived from analyses of historical insurance industry data in California, as no historical data from the Company's insurance subsidiaries existed, and although some historical data was available for the prior years of some of the market segments the Company entered in California, that data was limited as to the number of loss reserve evaluation points available. The industry-based benchmarks were adjusted judgmentally for the anticipated impact of significant environmental changes, specifically the enactment of major changes to the statutory workers' compensation benefit structure and the manner in which claims are administered and adjudicated in California. The actual emergence and payment of California claims by the Company's insurance subsidiaries has been more favorable than those initial expectations, due at least in part to what the Company believes are the impact of enactment of the major changes in the California workers' compensation environment. Other insurance companies writing California workers' compensation insurance also have experienced emergence and payment of claims more favorable than anticipated. At each evaluation date, the projected claim activity underlying the prior loss reserves has been replaced

by the actual claim activity, and the expectation of future emergence and payment of California claims underlying the actuarial projections was reevaluated during 2008, 2007 and 2006 based both on the Company's insurance subsidiaries emerging experience and on updating the benchmarks that are derived from observing and analyzing the insurance industry data for California workers' compensation. Given the dramatically changing environmental conditions in California, the Company has used prudent judgment in balancing long-term data and recent information. As patterns and trends recur consistently over a period of time, greater implicit weight is given to more current patterns and trends in the selection of reserve levels.

In Nevada, the Company has access to an extensive history of workers' compensation claims based on the business of the predecessor Fund, but the emergence and payment of claims in recent years has been more favorable than in the long-term history in Nevada with the predecessor Fund. The expected patterns of claim payment and emergence used in the projection of the Company's ultimate claims payments are based on both the long-term and the short-term historical data. Also, in 2008, 2007 and 2006, the projected claim payments underlying the prior loss reserves were replaced by the actual claim payment activity that occurred during the calendar year. In Nevada, based on the observed changes in claims emergence and payment patterns in recent years, greater weight has been given to such changes in the Company's projections.

The estimate of the future cost of handling claims, or LAE, depends primarily on examining the relationship between the aggregate amount that has been spent on LAE historically, as compared with the dollar volume of claims activity for the corresponding historical periods. For the Company's business in Nevada, as a result of operational improvements and reductions in staff count to align with the current and anticipated volume of business in the state, the Company's expenditures on LAE in recent years have been lower than historical levels. As these operational improvements and staffing levels have been reflected in the actual emerging LAE expenditures and in the projection of future LAE, the estimates of future LAE have been reduced in recent years. For the Company's operations in California, initial expectations of LAE when operations commenced in California were based on the assumptions used by the Company in pricing the California business, and on some limited historical data for the market segments the Company was entering. As the Company's operations in California have matured, and as data relating to the Company's and industry claim handling expenses reflective of the new workers' compensation benefit environment in California have become available, the expectations of LAE underlying the projection of future LAE have been adjusted to reflect that actual costs of administering claims relative to the cost of losses themselves have been greater than initial expectations. Although the Company's revised LAE expectations resulted in an increase in the projected future cost of administering California claims relative to losses at December 31, 2008, 2007 and 2006, given the significant decrease in the estimated projected costs of losses in California, the overall impact has been a decrease in LAE reserves.

The Company continues to develop its own loss experience and will rely more on its experience and less on historical industry data in projecting its reserve requirements as such data becomes available. As the actual experience of the Company emerges, it will continue to evaluate prior estimates, which may result in additional adjustments in reserves.

Loss reserves shown in the consolidated balance sheets are net of \$12.9 million and \$10.9 million for anticipated subrogation recoveries as of December 31, 2008 and 2007, respectively.

## **10. Reinsurance**

The Company is involved in the cession and assumption of reinsurance with non-affiliated companies. Risks are reinsured with other companies on both a quota share and excess of loss basis.

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Reinsurance transactions reflected in the accompanying consolidated statements of income were as follows:

	Years Ended December 31,					
	2008		2007		2006	
	Written	Earned	Written	Earned	Written	Ea
	(in thousands)					
Direct premiums	\$ 320,348	\$ 335,547	\$ 346,274	\$ 353,689	\$ 392,676	\$ 3
Assumed premiums	2,574	3,475	4,422	5,322	9,080	
Gross premiums	322,922	339,022	350,696	359,011	401,756	4
Ceded premiums	(10,075 )	(10,075 )	(12,127 )	(12,127 )	(14,572 )	(
Net premiums	\$ 312,847	\$ 328,947	\$ 338,569	\$ 346,884	\$ 387,184	\$ 3
Ceded losses and LAE incurred	\$ 23,558		\$ 16,326		\$ 21,268	

Ceded losses and LAE incurred includes the amortization of the gain on the LPT Agreement, as described below.

### Excess of Loss Reinsurance

The Company maintains reinsurance for losses from a single occurrence or event in excess of \$5.0 million and up to \$200.0 million, subject to certain exclusions. The reinsurance coverage includes coverage for acts of terrorism, excluding nuclear, biological, chemical and radiological events. Any liability outside the coverage limits of the reinsurance program is retained by the Company.

### LPT Agreement

Recoverables from reinsurers on unpaid losses and LAE amounted to \$1.1 billion at December 31, 2008 and 2007. At December 31, 2008 and 2007, approximately \$0.9 billion and \$1.0 billion, respectively, of the recoverables related to the LPT Agreement entered into in 1999 by the Fund and assumed by EICN. Under the LPT Agreement, substantially all of the Fund's losses and LAE on claims incurred prior to July 1, 1995, have been ceded to three unaffiliated reinsurers on a 100% quota share basis. Investments have been placed in trust by the three reinsurers as security for payment of the reinsured claims. Under the LPT Agreement, \$1.5 billion in liabilities for the incurred but unpaid losses and LAE related to claims incurred prior to July 1, 1995, were reinsured for consideration of \$775 million. The LPT Agreement provides coverage up to \$2.0 billion. Through December 31, 2008, the Company has paid losses and LAE claims totaling \$447.9 million related to the LPT Agreement.

The initial deferred gain resulting from the LPT Agreement was recorded as a liability in the accompanying consolidated balance sheets and is being amortized using the recovery method, whereby the amortization is

determined by the proportion of actual reinsurance recoveries to total estimated recoveries. The Company amortized \$18.4 million, \$18.0 million, and \$19.4 million of the deferred gain for the years ended December 31, 2008, 2007 and 2006, respectively. There were no adjustments to the direct reserves ceded under the LPT Agreement or related adjustment to the deferred gain for the years ended December 31, 2008, 2007 and 2006. The amortization of the deferred gain and adjustments due to development in the reserves are recorded in losses and LAE incurred in the accompanying consolidated statements of income. The remaining deferred gain was \$406.6 million and \$425.0 million as of December 31, 2008 and 2007, respectively, which is included in the accompanying consolidated balance sheets as deferred reinsurance gain LPT Agreement.

The LPT Agreement allows the Company to receive a contingent profit commission from the participating reinsurers based on the actual loss experience of the ceded business. Pursuant to the LPT Agreement and based on both actual results to date and projections of ultimate losses under the agreement, the Company recorded no change for the 12 months ended December 31, 2008, an increase of \$2.5 million for the 12 months ended December 31, 2007 and a decrease of \$0.2 million for 2006, in its estimate of the ultimate contingent profit commission. The changes in the ultimate contingent profit commission are recorded in commission expense in the accompanying consolidated statements of income. Due to payments received under the terms of the LPT Agreement, the Company had a net

payable balance of \$3.8 million as of December 31, 2008 and 2007 which is included in other liabilities on the accompanying consolidated balance sheets.

## 11. Notes Payable

Notes payable is comprised of the following:

	<b>December 31, 2008</b>
	(in thousands)
Amended Credit Facility, due April 30, 2009 with variable interest of 125 basis points above LIBOR	\$ 150,000
<b>Acquired notes payable</b>	
Dekania Surplus Note, due April 30, 2034 with variable interest of 425 basis points above 90-day LIBOR	10,000
ICONS Surplus Note, due May 26, 2034 with variable interest of 425 basis points above 90-day LIBOR	12,000
Alesco Surplus Note, due December 15, 2034 with variable interest of 405 basis points above 90-day LIBOR	10,000
Balance, December 31, 2008	\$ 182,000

The Company had no outstanding debt as of December 31, 2007. Effective September 30, 2008, EHI and Wells Fargo Bank, National Association (Wells Fargo) entered into a Second Amended and Restated Secured Revolving Credit Facility (Amended Credit Facility). The Amended Credit Facility provides the Company with a: (a) \$150.0 million line of credit through December 31, 2009; (b) \$100.0 million line of credit from January 1, 2010 through December 31, 2010; and (c) \$50.0 million line of credit from January 1, 2011 through March 26, 2011. Amounts outstanding bear interest at a rate equal to, at the Company's option: (a) a fluctuating rate of 1.25% above Wells Fargo's prime rate or (b) a fixed rate that is 1.25% above the LIBOR rate then in effect. The Company paid a non-refundable commitment fee of \$375.0 thousand, which is being amortized over the contractual life of the Amended Credit Facility. In addition, the Company is required to pay a quarterly commitment fee equal to a per annum rate of 0.10% on any portion of the Amended Credit Facility that is unused. The Amended Credit Facility contains customary non-financial covenants and requires EHI to maintain \$7.5 million of cash and cash equivalents.

On September 30, 2008, EHI borrowed \$150.0 million through the Amended Credit Facility. The proceeds borrowed under the Amended Credit Facility were used to finance the acquisition of AmCOMP (see Note 4) and for general working capital purposes. The interest rate on the Amended Credit facility at December 31, 2008 was 3.16% and interest paid during the year ended December 31, 2008, including the interest rate swap (see Note 12), totaled \$1.2 million. The Amended Credit Facility is secured by fixed maturity securities which had a fair value of \$210.5 million at December 31, 2008.

### Notes Payable Acquired in the Acquisition

In connection with the Acquisition, the Company assumed \$34.7 million in additional notes payable on October 31, 2008 (see Note 4). The acquired notes payable were comprised of three surplus notes and a loan from Regions Bank. Additionally, AmCOMP had an unused \$30.0 million secured credit facility with Regions Bank. On December 22, 2008, the Company terminated the Restated Loan and Security Agreement, related to the loan, and the Loan and



Security Agreement, related to the credit facility. In connection with the termination of the Restated Loan and Security Agreement, the Company repaid the outstanding principal of \$2.7 million. Interest paid during the two months ended December 31, 2008 totaled less than \$0.1 million.

EPIC has outstanding a \$10.0 million surplus note to Dekania CDO II, Ltd., issued as part of a pooled transaction (Dekania Surplus Note). The note matures in 2034 and is callable by the Company in the second quarter of 2009. The terms of the note provide for quarterly interest payments at a rate 425 basis points in excess of the 90-day LIBOR. Both the payment of interest and repayment of the principal under this note and the surplus notes described in the succeeding two paragraphs are subject to the prior approval of the Florida Department of Financial Services. Interest paid during the two

months ended December 31, 2008 totaled \$0.2 million. Interest accrued as of December 31, 2008 was \$0.1 million.

EPIC has outstanding a \$12.0 million surplus note, to ICONS, Inc., issued as part of a pooled transaction (ICONS Surplus Note). The note matures in 2034 and is callable by the Company in the second quarter of 2009. The terms of the note provide for quarterly interest payments at a rate 425 basis points in excess of the 90-day LIBOR. Interest paid during the two months ended December 31, 2008 totaled \$0.2 million. Interest accrued as of December 31, 2008 was \$0.1 million.

EPIC has outstanding a \$10.0 million surplus note, to Alesco Preferred Funding V, LTD, issued as part of a pooled transaction (Alesco Surplus Note). The note matures in 2034 and is callable by the Company in the fourth quarter of 2009. The terms of the note provide for quarterly interest payments at a rate 405 basis points in excess of the 90-day LIBOR. Interest paid during the two months ending December 31, 2008 totaled \$0.2 million. Interest accrued as of December 31, 2008 totaled less than \$0.1 million.

Principle payment obligations on notes payable outstanding at December 31, 2008, were as follows:

<b>Year</b>	<b>Principal Due</b> (in thousands)
2009	\$ 50,000
2010	50,000
2011	50,000
2012	
2013	
Thereafter	32,000
	\$ 182,000

## 12. Derivative

### Interest Rate Swap

On September 30, 2008, the Company, in connection with the borrowings made under the Amended Credit Facility (Note 11), executed an interest rate swap with Wells Fargo with a notional amount of \$100.0 million. Execution of the interest rate swap established a fixed interest rate of 4.84%, on the notional amount, through September 30, 2010. The Company uses its interest rate swap to mitigate the risks associated with unexpected cash outflows resulting from shifts in variable interest rates. As of December 31, 2008, the interest rate swap had a liability fair value of \$3.9 million and is included in other liabilities on the accompanying consolidated balance sheet. The corresponding unrealized loss of \$3.9 million is included in accumulated other comprehensive income, net.

## 13. Commitments and Contingencies

### Leases

The Company leases facilities in 14 states. At December 31, 2008, remaining lease terms ranged from one month to approximately ten years. The minimum lease payments for the next five years and thereafter on these non-cancelable operating leases at December 31, 2008, were as follows:

<b>Year</b>	<b>Rental Expense</b>
	(in thousands)
2009	\$ 7,702
2010	6,485
2011	5,038
2012	4,694
2013	2,174
Thereafter	7,988
	\$ 34,081

Net rent expense was \$5.9 million, \$4.7 million, and \$4.3 million for the years ended December 31, 2008, 2007 and 2006, respectively. Certain rental commitments have renewal options extending through 2018. Some of these renewals are subject to adjustments in future periods.

### **Contingencies Surrounding Insurance Assessments**

The Company writes workers' compensation insurance in California in which unpaid workers' compensation liabilities from insolvent insurers are the responsibility of the California Insurance Guarantee Association (CIGA). The Company passes through the CIGA assessment to its policyholders via a surcharge based upon the estimated annual premium at the policy's inception and has received, and expects to continue to receive, these guarantee fund assessments which are paid to CIGA based on premiums written by the Company. As of December 31, 2008 and 2007, the Company recorded an asset of \$7.7 million and \$9.1 million, respectively, for assessments paid to the CIGA that includes prepaid policy surcharges still to be collected in the future from policyholders.

The Company also writes workers' compensation insurance in other states with similar obligations as those in California. In these states, the Company is directly responsible for payment of the assessment. Generally, assessments are levied by guaranty associations within the state up to prescribed limits on all insurers doing business in that state on the basis of the proportionate share of premiums written by insurers doing business in that state in the lines of business in which the impaired, insolvent or failed insurer is engaged. The Company accrues a liability for estimated assessments as direct premiums are written and defers these costs and recognizes them as an expense as the related premiums are earned. The Company is continually notified of assessments from various states relating to insolvencies in that particular state; however, the Company estimates the potential future assessment in the absence of an actual assessment. As of December 31, 2008 and 2007, the Company recorded an estimate of \$4.6 million and \$1.1 million, respectively, for its expected liability for guaranty fund assessments, in states other than California. The guaranty fund assessments are expected to be paid within two years of recognition.

Additionally, as of December 31, 2008, guarantee fund receivable assets, excluding CIGA, of \$1.4 million are included in other assets, as they can be used as a credit against future premium taxes owed. Maximum contributions required by law in any one state in which the Company offers insurance vary between 0.2% and 2.0% of direct premiums written.

### **Second Injury Fund Assessments and Recoveries**

Many states have laws that established second injury funds to provide compensation to injured employees for aggravation of a prior condition or injury. Funding is provided either by assessments based on paid losses or premium surcharges. The Company accrues a liability for second injury fund assessments as net premiums are written or as losses are incurred based on individual state guidelines, and for premium based assessments, the Company defers these costs and recognizes them as an expense as the related premiums are earned. For the twelve months ended December 31, 2008, the Company recognized a benefit related to Second Injury Fund of \$0.1 million.

The Company submits claims to the appropriate state's second injury fund for recovery of applicable claims paid on behalf of the Company's insureds. Because of the uncertainty of the collectability of such amounts, second injury fund recoverables are reported in the accompanying consolidated financial statements when received. Cash collections from the second injury funds were \$1.5 million during the year ending December 31, 2008.

The Florida Second Disability Trust Fund (Florida SDTF) currently has significant unfunded liabilities. It is not possible to predict how the Florida SDTF will operate, if at all, in the future after further legislative review. Changes in the Florida SDTF's operations could decrease the availability of recoveries from the Florida SDTF, increase Florida SDTF assessments payable by the Company and/or result in the discontinuation of the Florida SDTF and thus could have an adverse effect on the Company's business, financial condition, and its operations. Under current law, future assessments are capped at 4.52% of net written premiums, and no recoveries can be made for losses or submitted on

claims occurring after January 1, 1998.

## 14. Stockholders Equity

### Stock Repurchase Program

On February 21, 2008, the EHI Board of Directors authorized a stock repurchase program (the 2008 Program). The 2008 Program authorizes the Company to repurchase up to \$100.0 million of the Company's common stock through June 30, 2009. On February 25, 2009, the EHI Board of Directors extended the 2008 program through December 31, 2009. As of December 31, 2008, the Company repurchased 786,795 shares at a cost of \$14.2 million. EHI expects the shares may be repurchased from time to time at prevailing market prices in open market or private transactions. The Company suspended the 2008 Program in September 2008, due to the credit conditions in the financial markets.

On May 10, 2007, the EHI Board of Directors authorized a stock repurchase program (the Program). The Program authorized the Company to use up to \$75.0 million in assets for the discretionary repurchase of its common stock during the remainder of 2007. The Program was completed on October 17, 2007, and resulted in the repurchase of 3,911,272 shares of common stock.

As of December 31, 2008, all 4,698,067 shares of common stock repurchased were still held by the Company and are reported as treasury stock, at cost, in the accompanying consolidated balance sheets.

### 15. Stock-Based Compensation

On October 3, 2006, the Company's Board of Directors approved the Employers Holdings, Inc. Equity and Incentive Plan (the Plan), effective as of the close of the Company's IPO. The Plan is administered by the Compensation Committee of the Board of Directors, which is authorized to grant, at its discretion, awards to officers, employees, non-employee directors, consultants and independent contractors. The maximum number of common shares reserved for grants of awards under the Plan is 3,605,838 shares, or 3% of EHI's outstanding common shares as of February 5, 2007. The Plan provides for the grant of stock options (both incentive stock options and nonqualified stock options), stock appreciation rights, restricted stock, restricted stock units, stock-based performance awards and other stock-based awards.

As of December 31, 2008, nonqualified stock options, restricted stock units, and performance share awards have been granted, but no incentive stock options, stock appreciation rights or restricted stock have been granted under the Plan.

Net stock-based compensation expense recognized in the accompanying consolidated statements of income is as follows:

	<b>Year Ended December 31,</b>	
	<b>2008</b>	<b>2007</b>
	(in thousands)	
Stock-based compensation expense related to:		
Nonqualified stock options	\$ 1,254	\$ 951
Restricted stock units	902	200
Performance shares	1,005	569
<b>Total</b>	<b>3,161</b>	<b>1,720</b>
Less: related tax benefit	1,096	602

Net stock-based compensation expense	\$ 2,065	\$ 1,118
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### Nonqualified Stock Options

During the year ended December 31, 2007, the Company made founders grants to employees, excluding senior officers, in the form of 186,000 nonqualified stock options and also awarded 420,916 nonqualified stock options to its officers. The founders grants awards vest pro rata on each of the first three anniversaries of the effective date of EHI s IPO. The options awarded to the officers of the Company vested 25% on February 8, 2008 and the remaining 75% will vest pro rata on the subsequent three anniversaries of such date. All options granted in 2007 have an exercise price equal to the fair

market value of the Company's common stock on the date of grant and expire seven years from the date of grant.

On May 29, 2008, the Company awarded 475,167 options to the officers of the Company. These options have a service vesting period of four years and vest 25% on May 29, 2009, and the subsequent three anniversaries of such date. The options are subject to accelerated vesting in certain limited circumstances, such as: death or disability, or in connection with a change of control of the Company. The options expire seven years from the date of grant. The per share exercise price of these options is equal to the fair value of the stock on the grant date, or \$19.21.

The fair value of the stock options granted is estimated using a Black-Scholes option pricing model that uses the assumptions noted in the following table. Due to EHI's limited public history, the expected stock price volatility was based on a weighted average of the Company's historical stock price volatility since the initial public offering of its common stock and the historical volatility of peer companies' stock for a period of time equal to the expected term of the option. EHI believes that the use of historical volatility of this peer group, along with its own historical stock price volatility, is currently the best estimate of expected volatility of the market price of EHI's common stock. The expected term of the options granted is calculated using the plain-vanilla calculation provided in the guidance of the SEC's Staff Accounting Bulletin No. 107. The dividend yield was calculated using amounts authorized by the Board of Directors. The risk-free interest rate is the yield on the grant dates of the options of U.S. Treasury zero coupon securities with a maturity comparable to the expected term of the options.

The Company anticipates issuing new shares upon exercise of stock options.

The fair market value of the stock options granted during the years ended December 31, 2008 and 2007, was calculated using the following weighted average assumptions:

	2008	2007
Expected volatility	34.9 %	32.5 %
Expected life (in years)	4.8	4.6
Dividend yield	1.3 %	1.3 %
Risk-free interest rate	3.4 %	4.7 %
Weighted average grant date fair values of options granted	\$ 6.01	\$ 5.68

Changes in outstanding stock options for the year ended December 31, 2008 were as follows:

	Number of Options	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Life (in years)
Options outstanding at January 1, 2008:	584,850	\$ 18.29	5.4
Granted	475,167	19.21	6.4
Exercised	(300 )	17.00	
Expired	(5,280 )	17.78	
Forfeited	(30,352 )	18.39	
Options outstanding at December 31, 2008	1,024,085	18.72	5.9



Exercisable at December 31, 2008	158,827	18.18	5.2
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The fair market value of options that vested in 2008 was \$0.9 million and as of December 31, 2008, none of the outstanding options had any intrinsic value. At December 31, 2008, the Company had yet to recognize \$3.8 million in deferred compensation related to nonqualified stock options grants and expects to recognize these costs on a straight-line basis over the next 41 months.

### **Performance Share Awards**

On August 8, 2007, officers of the Company were awarded, in aggregate, 140,311 performance share awards (PSAs) for a performance period ending December 31, 2009. These PSAs are subject to certain performance targets with payouts that range from 0% up to 150% of the target award. The fair market value of the PSAs on the date of grant was \$2.6 million. At December 31, 2008, the Company

had yet to recognize \$1.0 million in deferred compensation related to the PSAs and expects to recognize these costs over the next year.

### Restricted Stock Units

On May 29, 2008, 23,760 restricted stock units (RSUs), awarded to the non-employee members of the Board of Directors during 2007, vested in connection with the annual stockholders meeting. The vested RSUs will be settled in common stock six months following the awardee's termination of service from the Board of Directors. Prior to settlement, dividend equivalents are paid with respect to these vested RSUs and are credited as additional vested RSUs. During the year ended December 31, 2008, in connection with the Company's dividend to its stockholders, an aggregate of 240 RSUs were credited to vested RSU holders.

Additionally, on May 29, 2008, the Company awarded the non-employee members of the Board of Directors, in aggregate, 24,984 RSUs. These RSUs vest on May 29, 2009, except for accelerated vesting in the case of death or disability of the director or in connection with a change of control. Vested RSUs will be settled in common stock within 30 days after the vesting date or can be deferred until six months following the awardee's termination of service from the Board of Directors, at the awardee's election. In the event of a deferral election, dividend equivalents are paid with respect to vested RSUs and are credited as additional vested RSUs. The aggregate fair value of the RSUs on the date of grant was \$0.5 million.

On May 29, 2008, the Company awarded 152,564 RSUs to the officers of the Company. The RSUs have a service vesting period of four years and vest 25% on May 29, 2009, and the subsequent three anniversaries of such date. The RSUs are subject to accelerated vesting in certain limited circumstances, such as: death or disability of the holder, or in connection with a change of control of the Company. The aggregate fair value of the RSUs on the date of grant was \$2.9 million.

Changes in outstanding RSUs for the year ended December 31, 2008 were as follows:

	<b>Number of RSUs</b>	<b>Weighted Average Grant Date Fair Value</b>
RSUs outstanding at January 1, 2008	23,760	\$ 16.83
Granted	177,788	19.21
Forfeited	(1,667 )	19.21
RSUs outstanding at December 31, 2008	199,881	18.92
Vested but unsettled RSUs at December 31, 2008	24,000	16.83

## 16. Statutory Matters

### Statutory Financial Data

The combined capital stock, surplus and net income of the Company's insurance subsidiaries (EICN, ECIC, EPIC and EAC), prepared in accordance with the statutory accounting practices of the National Association of Insurance Commissioners (NAIC) as well as statutory accounting principles permitted by the State of California, Florida and

Nevada (SAP), were as follows:

	<b>December 31,</b>	
	<b>2008</b>	<b>2007</b>
	(in thousands)	
Capital stock and unassigned surplus	\$ 278,393	\$ 149,004
Paid in capital	64,900	
Special surplus funds	192,463	548,710
Surplus notes	42,000	
<b>Total statutory surplus</b>	<b>\$ 577,756</b>	<b>\$ 697,714</b>

Under SAP, the statutory operating results of EPIC and EAC are combined with EICN and ECIC's operating results for the entire year of 2008. Net income for the Company's insurance subsidiaries prepared in accordance with SAP for the years ended December 31, 2008, 2007 and 2006 was \$101.7 million, \$172.2 million and \$164.3 million, respectively.

The treatment of the LPT Agreement and the surplus notes (see Note 11) are the primary differences in the SAP-basis capital stock and total surplus of the insurance subsidiaries of \$577.8 million and \$697.7 million, and the GAAP-basis equity of the Company of \$444.7 million and \$379.5 million as of December 31, 2008 and 2007, respectively. Under SAP accounting, the retroactive reinsurance gain resulting from the LPT Agreement is recorded as a special component of surplus (special surplus funds) in the initial year of the contract, and not reported as unassigned surplus until the Company has recovered amounts in excess of the original consideration paid. The special surplus funds are also reduced by the amount of extraordinary dividends as approved by the Nevada Division of Insurance. Under GAAP accounting the gain is deferred and amortized over the period the underlying reinsured claims are paid (see Note 10). Under SAP, the surplus notes are recorded as a separate component of surplus. Under GAAP the surplus notes are considered debt.

### **Insurance Company Dividends**

Nevada law limits the payment of cash dividends by EICN to its parent by providing that payments cannot be made except from available and accumulated surplus, otherwise unrestricted (unassigned), and derived from realized net operating profits and realized and unrealized capital gains. A stock dividend may be paid out of any available surplus. A cash or stock dividend prohibited by these restrictions may only be declared and distributed as an extraordinary dividend upon the prior approval of the Nevada Commissioner of Insurance (Nevada Commissioner). Dividends that are considered extraordinary require notice to the Nevada Commissioner who must approve or disapprove the dividends or distribution within 30 days of such notice. An extraordinary dividend or distribution is defined by statute to include any dividend or distribution of cash or property whose fair market value, together with that of other dividends or distributions made within the preceding 12 months, exceeds the greater of: (a) 10% of EICN's statutory surplus as regards policyholders at the next preceding December 31; or (b) EICN's statutory net income, not including realized capital gains, for the 12-month period ending at the next preceding December 31.

As of December 31, 2008, EICN had positive unassigned surplus of \$205.9 million. As a result of approval of extraordinary dividends totaling \$355.0 million from special surplus by the Nevada Commissioner in 2008, dividends from unassigned surplus, otherwise deemed ordinary, will also require approval in 2009. The 2008 extraordinary dividends were paid to EGI, and in turn to EHI, prior to December 31, 2008 as approved by the Nevada Division of Insurance. On October 17, 2006 and December 18, 2007, EICN received approval to pay extraordinary dividends of \$55.0 million and \$38.0 million, respectively. Both of these dividends were paid on or before December 31, 2007.

The California Insurance Holding Company System Regulatory Act limits the ability of ECIC to pay dividends to its parent, EICN. California law provides that, absent prior approval of the California Insurance Commissioner, dividends can only be declared from earned surplus. Earned surplus for purposes of this statute excludes amounts: (a) derived from the net appreciation in the value of assets not yet realized or (b) derived from an exchange of assets, unless the assets received are currently realizable in cash. In addition, California law provides that the appropriate insurance regulatory authorities in the state of California must approve (or, within a 30-day notice period, not disapprove) any dividend that, together with all other such dividends paid during the preceding 12 months, exceeds the greater of: (a) 10% of the paying company's statutory earned surplus as regards policyholders at the preceding December 31 or (b) 100% of the net income for the preceding year. ECIC received approval to pay an extraordinary dividend of \$49.2 million in the second quarter of 2008. Due to this dividend, a maximum payout of \$52.5 million, without prior approval, will be available after June 2009, subject to restrictions. ECIC declared and paid a dividend of \$61.0 million on December 14, 2007.

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Under Florida law, without regulatory approval, EPIC and EAC may not pay dividends or other distributions of cash or property to its stockholders within a 12-month period with a total fair market value exceeding the larger of 10% of surplus as of the preceding December 31st or 100% of its prior

year's net income, not including realized capital gains, or net investment income plus a three-year carry forward. The maximum dividends that may be paid by EPIC and EAC in 2009, without prior approval, are \$17.7 million and \$9.5 million, respectively. These amounts represent 10% of statutory surplus, not to exceed unassigned funds.

### Regulatory Requirements and Restrictions

ECIC is subject to supervision and regulation by the California Department of Insurance (California DOI). The ability of ECIC to pay dividends was further limited by restrictions imposed by the California DOI in its approval of our October 1, 2008, reinsurance pooling agreement. Under that approval: (a) ECIC must initiate discussions of its business plan with the California DOI if its premium to policyholder surplus ratio exceeds 1.5 to 1; (b) ECIC will not exceed a ratio of premium to policyholder surplus of 2 to 1 without approval of the California DOI; (c) if at any time ECIC's policyholder surplus decreases to 80% or less than the September 30, 2008 balance, ECIC shall cease issuing new policies in California but may continue to renew existing policies until it has (i) received a capital infusion to bring its surplus position to the same level as that as of September 30, 2008 and (ii) submitted a new business plan to the California DOI; (d) ECIC will maintain a RBC level of at least 350%; (e) should ECIC fail to comply with any commitments listed herein, ECIC will consent to any request by the California DOI to cease issuing new policies in California, but may continue to renew existing policies until such time that as ECIC is able to achieve full compliance with each commitment; and (f) the obligations listed shall only terminate with the written consent of the California DOI.

EPIC and EAC are subject to comprehensive supervision and regulation by the Florida Department of Financial Services (FDfs). Florida statute Section 624.408 requires EPIC and EAC to maintain minimum capital and surplus of the greater of \$4.0 million or 10% of total liabilities. Florida statute Section 624.4095 requires EPIC and EAC to maintain a ratio of written premiums times 1.25 to surplus of no greater than 10-to-1 for gross written premiums and 4-to-1 for net written premiums. During the years ended December 31, 2008, 2007 and 2006, EPIC and EAC were in compliance with these statutes.

Additionally, EICN, ECIC, EPIC and EAC are required to comply with NAIC risk-based capital (RBC) requirements. RBC is a method of measuring the amount of capital appropriate for an insurance company to support its overall business operations in light of its size and risk profile. NAIC RBC standards are used by regulators to determine appropriate regulatory actions relating to insurers that show signs of weak or deteriorating conditions. As of December 31, 2008, 2007 and 2006, EICN, ECIC, EPIC and EAC's total adjusted capital is above all regulatory action levels.

ECIC, EPIC and EAC are subject to Florida statute 627.215 and applicable regulations related to Florida excessive profits for workers' compensation insurance companies. Florida excessive profits are calculated based upon a complex statutory formula which is applied over rolling three year periods. Companies are required to file annual excessive profits forms, and they are required to return so-called Florida excessive profits to policyholders in the form of a cash refund or credit toward the future purchase of insurance. As of December 31, 2008, the Company had no amounts accrued for estimated additional Florida excessive profits based on its statutory underwriting results for the years ended 2005-2008.

### 17. Accumulated Other Comprehensive Income, Net

Accumulated other comprehensive income, net, is comprised of unrealized appreciation on investments classified as available-for-sale and unrealized depreciation on derivative, net of deferred tax expense. The following table summarizes the components of accumulated other comprehensive income:

	<b>Years Ended December 31,</b>		
	<b>2008</b>	<b>2007</b>	<b>2006</b>

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(in thousands)

Net unrealized gain on investments, before taxes	\$ 54,748	\$ 71,570	\$ 44,885
Net unrealized loss on derivative, before taxes	(3,868 )		
Deferred tax expense	(18,076 )	(25,050 )	(15,710 )
Total accumulated other comprehensive income, net	\$ 32,804	\$ 46,520	\$ 29,175

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The following table summarizes the changes in the components of total comprehensive income:

	<b>Years Ended December 31,</b>		
	<b>2008</b>	<b>2007</b>	<b>2006</b>
	(in thousands)		
Unrealized (losses) gains during the period, before taxes	\$ (32,214 )	\$ 26,865	\$ 35,200
Less: income tax (benefit) expense	(11,007 )	9,403	12,320
Unrealized (losses) gains during the period, net of taxes	(21,207 )	17,462	22,880
Less reclassification adjustment:			
Realized (losses) gains in net income	(11,524 )	180	54,277
Income tax (benefit) expense	(4,033 )	63	18,997
Reclassification adjustment for (losses) gains realized in net income	(7,491 )	117	35,280
Other comprehensive (loss) income	(13,716 )	17,345	(12,400 )
Net income	101,785	120,283	171,570
Total comprehensive income	\$ 88,069	\$ 137,628	\$ 159,170

### 18. Employee Benefit and Retirement Plans

The Company maintains two 401(k) defined contribution plans covering all eligible Company employees. One plan covers eligible employees of the Company and its subsidiaries that existed prior to the acquisition of AmCOMP (Note 4) (the Employers 401(k) Plan). Beginning with the plan year 2007, the Company adopted a safe harbor matching contribution to the Employers 401(k) Plan. The safe harbor matching consists of a dollar-for-dollar matching contribution on salary deferrals up to 3% of compensation and then fifty-cents on the dollar matching contribution on salary deferrals from 3% to 5% of compensation. For the 2006 plan year, the Company's match was fifty-cents for every dollar contributed by the employee, up to 6% of the employee's annual salary. The Company's contribution to the Employers 401(k) Plan was \$1.5 million, \$1.4 million and \$0.9 million for the years ended December 31, 2008, 2007 and 2006, respectively.

The second plan covers all eligible employees of the companies acquired in the AmCOMP acquisition (the AmCOMP 401(k) Plan). For employees covered under the AmCOMP 401(k) Plan, the Company matches the employee's contribution dollar-for-dollar for the first 2% of salary and fifty-cents for every dollar contributed for the next 4% of salary. Expenses relating to the AmCOMP 401(k) Plan were \$0.1 million for the two month period ended December 31, 2008.

### 19. Earnings Per Share

SFAS No. 128, *Earnings per Share*, provides for the calculation of Basic and Diluted earnings per share. Basic earnings per share includes no dilution and is computed by dividing income applicable to common stockholders by the weighted average number of common shares outstanding for the period. Diluted earnings per share reflect the potential dilution of securities that could share in the earnings of equity. Diluted earnings per common share includes



common shares assumed issued under the treasury stock method, which reflects the potential dilution that would occur if outstanding options were to be exercised.

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The following table presents the net income and the weighted average shares outstanding used in the earnings per common share calculations for the stated periods:

	<b>Year Ended December 31, 2008</b>	<b>February 5, 2007 through December 31, 2007</b>
	(in thousands, except share and per share data)	
Net income available to common stockholders basic and diluted	\$ 101,785	\$ 113,812
Weighted average number of common shares outstanding basic	49,217,829	51,933,827
Effect of dilutive securities:		
Performance share awards	40,504	6,470
Restricted stock units	2,895	3,115
Dilutive potential common shares	43,399	9,585
Weighted average number of common shares outstanding diluted	49,261,228	51,943,412

**Earnings per common share:**

Basic	\$ 2.07	\$ 2.19
Diluted	\$ 2.07	\$ 2.19

The earnings per common share basic for the period February 5, 2007 through December 31, 2007 was calculated using only the net income available to common stockholders for the period after the IPO, as shown on the consolidated statements of income, and the weighted average shares outstanding during the same period. Earnings per common share diluted is based on the actual weighted shares outstanding adjusted by the number of additional common shares that would have been outstanding had potentially dilutive common shares been issued and reduced by the number of common shares that could have been purchased from the proceeds of the potentially dilutive shares. The Company's outstanding options have been excluded in computing the diluted earnings per share for the period February 5, 2007 through December 31, 2007 because their inclusion would be anti-dilutive.

The pro forma earnings per common share basic and diluted presented on the accompanying consolidated statements of income is intended to depict the impact of the conversion because neither EHI, nor its predecessor, EIG, had, prior to the conversion, any outstanding common shares. The following table presents the pro forma net income and weighted average shares outstanding used in the pro forma earnings per common share calculations for the following years:

<b>Pro Forma for the Years Ended December 31,</b>	
<b>2007</b>	<b>2006</b>
(in thousands, except share and per share data)	

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Net income available to common stockholders basic and diluted	\$	120,283	\$	171,570
Weighted average number of common shares outstanding basic		51,748,392		50,000,002
Effect of dilutive securities:				
Performance share awards		5,849		
Restricted stock units		2,816		
Dilutive potential common shares		8,665		
Weighted average number of common shares outstanding diluted		51,757,057		50,000,002
<b>Pro forma earnings per common share:</b>				
Basic	\$	2.32	\$	3.43
Diluted	\$	2.32	\$	3.43

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Pro forma earnings per common share basic for the year ended December 31, 2007 is calculated using the net income for the 12 months ended December 31, 2007, as presented on the accompanying consolidated statements of income. The weighted average shares outstanding was calculated using those shares available to eligible members in the conversion, or 50,000,002 shares, for the period prior to the IPO, and the actual weighted shares outstanding for the period after the IPO. Earnings per common share diluted is based on the pro forma weighted shares outstanding basic adjusted by the number of additional common shares that would have been outstanding had potentially dilutive common shares been issued and reduced by the number of common shares that could have been purchased from the proceeds of the potentially dilutive shares. The Company's outstanding options have been excluded in computing the diluted earnings per share for the pro forma year ended December 31, 2007, because their inclusion would be anti-dilutive.

The pro forma earnings per common share for the year ended December 31, 2006 is calculated using only those shares available to eligible members in the conversion, or 50,000,002 shares, and does not include any shares issued to new investors in connection with EHI's IPO. EIG had no common stock equivalents outstanding that would create a dilutive effect on the pro forma earnings per common share for the year ended December 31, 2006.

## 20. Selected Quarterly Financial Data (Unaudited)

Quarterly results for the years ended December 31, 2008 and 2007 were as follows:

	<b>2008 Quarters Ended</b>			
	<b>March 31</b>	<b>June 30</b>	<b>September 30</b>	<b>December 31</b>
	(in thousands, except per share data)			
Net premiums earned	\$ 75,896	\$ 73,815	\$ 73,131	\$ 106,105
Realized losses on investment, net	(1,488 )	(219 )	(1,504 )	(8,313 )
Losses and loss adjustment expenses	30,614	24,142	25,588	56,171
Underwriting and other operating expenses	21,726	22,981	21,907	35,845
Income taxes	5,292	8,346	(289 )	(3,083 )
Net income	25,494	27,366	33,069	15,856
<b>Earnings per common share:</b>				
Basic	0.51	0.55	0.67	0.32
Diluted	0.51	0.55	0.67	0.32

	<b>2007 Quarters Ended</b>			
	<b>March 31</b>	<b>June 30</b>	<b>September 30</b>	<b>December 31</b>
	(in thousands, except per share data)			
Net premiums earned	\$ 89,792	\$ 84,117	\$ 88,527	\$ 84,448
Realized gains (losses) on investment, net	190	(658 )	146	502
Losses and loss adjustment expenses	41,667	28,802	40,867	31,966
Underwriting and other operating expenses	23,300	22,752	21,726	23,621
Income taxes	7,403	9,818	3,896	9,486
Net income	27,866	30,773	29,880	31,764

**Earnings per common share:**

Basic	0.40	0.58	0.58	0.64
Diluted	0.40	0.58	0.58	0.64

**Net Premiums Earned**

The increase in net premiums earned in the fourth quarter of 2008 was a result of the acquisition of AmCOMP (see Note 4) on October 31, 2008. The acquired business resulted in an increase in fourth quarter net premiums earned of \$31.6 million.

**Realized Losses on Investments, Net**

The net realized losses in the fourth quarter of 2008 resulted from the Company's review of the severity and duration of securities that were in an unrealized loss position. This resulted in the

recognition of an other-than-temporary impairment of primarily one fixed maturity security and 39 equity holdings.

### **Losses and Loss Adjustment Expenses**

Favorable prior accident year reserve development was recognized in each of the quarters of 2008 in the amount of \$11.4 million, \$16.9 million, \$25.0 million and \$18.4 million, first through fourth quarters, respectively. In the fourth quarter, the acquired business resulted in \$18.5 million of additional losses and LAE.

Favorable prior accident year reserve development was recognized in each of the quarters of 2007 in the amount of \$15.6 million, \$20.4 million, \$7.4 million, and \$16.6 million, first quarter through fourth quarters, respectively.

### **Underwriting and Other Operating Expenses**

The increase in fourth quarter 2008 underwriting and other operating expenses was primarily the result of the acquisition of AmCOMP (see Note 4) on October 31, 2008 in the amount of \$11.6 million. Subsequent to year end, the Company announced a strategic restructuring plan to achieve corporate and operational objectives related to the acquisition and integration of AmCOMP (see Note 21).

### **Income Taxes**

During the third quarters of 2008 and 2007, the Company reversed \$10.6 and \$5.8 million of liabilities for previously unrecognized tax benefits which includes \$2.3 million and \$0.7 million of related accrued interest, respectively, as a result of certain statutory periods expiring (see Note 8). During the fourth quarter 2008, the Company further realized a notable decrease in its effective tax rate attributable to the increased proportion of tax preferred investment income to net income before taxes.

### **Earnings Per Common Share**

Earnings per common share of \$0.40, for the first quarter of 2007, only includes earnings for the period after the Company's Conversion and IPO (see Note 3) or February 5, 2007 through March 31, 2007.

## **21. Subsequent Events**

### **Strategic Restructuring Plan**

On January 23, 2009, the Company announced a strategic restructuring plan to achieve the corporate and operational objectives set forth as part of its recently completed acquisition and integration of AmCOMP, and in response to economic conditions.

The restructuring plan includes a staff reduction of approximately 14 percent of the Company's total workforce, and consolidation of corporate activities into the Company's Reno, Nevada headquarters. The Company expects to incur restructuring charges in the first quarter 2009, primarily associated with personnel-related termination costs.

### **Stockholder Dividend**

On February 25, 2009, the Board of Directors declared a \$0.06 dividend per share, payable March 25, 2009, to stockholders of record on March 11, 2009.

## **Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure**

None.

## **Item 9A. Controls and Procedures**

### **Disclosure Controls and Procedures**

We maintain disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934, as amended (the Exchange Act )) designed to provide reasonable assurance that the information required to be reported in the Exchange Act filings is recorded, processed, summarized and reported with in the time periods specified and pursuant to SEC regulations, including controls and procedures designed to ensure that this information is accumulated and communicated to management, including its chief executive officer and chief financial officer, as appropriate, to allow timely decisions regarding the required disclosure. It should be noted that, because of inherent limitations, our disclosure controls and procedures, however well designed and operated, can provide only reasonable, and not absolute, assurance that the objectives of the disclosure controls and procedures are met.

Our management, with the participation of our chief executive officer and chief financial officer, evaluated the effectiveness of our disclosure controls and procedures as of the end of the period covered by this report. Based upon that evaluation, our chief executive officer and chief financial officer have concluded that our disclosure controls and procedures were effective at a reasonable level of assurance as of December 31, 2008.

### **Management's Report on Internal Control Over Financial Reporting**

The report of our management regarding internal control over financial reporting is set forth in Item 8 of this Annual Report on Form 10-K under the caption Management's Report on Internal Control over Financial Reporting and incorporated herein by reference.

### **Attestation Report of Independent Registered Public Accounting Firm**

The attestation report of the Company's independent registered public accounting firm regarding internal control over financial reporting is set forth in Item 8 of this Annual Report on Form 10-K under the caption Report of Independent Registered Public Accounting Firm and incorporated herein by reference.

### **Changes in Internal Control Over Financial Reporting**

There have not been any changes in our internal control over financial reporting (as such term is defined in Rules 13a-15(f) in the Exchange Act) during the fourth fiscal quarter of the year to which this report relates that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

## **Item 9B. Other Information**

None.

**PART III**

**Item 10. Directors, Executive Officers and Corporate Governance**

The information required by Item 10 with respect to our executive officers and key employees is included in Part I of this report.

The information required by Item 10 with respect to our Directors is included under the caption Election of Directors in our Proxy Statement for the 2009 Annual Meeting of Stockholders and is incorporated herein by reference. We plan to file such Proxy Statement within 120 days after December 31, 2008, the end of our fiscal year.

The information required by Item 10 with respect to compliance with Section 16 of the Exchange Act is included under the caption Section 16(a) Beneficial Ownership Reporting Compliance in our Proxy Statement for the 2009 Annual Meeting of Stockholders and is incorporated herein by reference.

The information required by Item 10 with respect to our audit committee and our audit committee financial expert is included under the caption The Board of Directors and its Committees Audit Committee in our Proxy Statement for the 2009 Annual Meeting of Stockholders and is incorporated herein by reference.

The information required by Item 10 with respect to our Code of Business Conduct and Ethics and our Code of Ethics for Senior Financial Officers is posted on our website at [www.employers.com](http://www.employers.com) in the Investors section under Governance. We will post information regarding any amendment to, or waiver from, our Code of Business Conduct and Ethics on our website in the Investor section under Governance.

**Item 11. Executive Compensation**

The information required by Item 11 is included under the captions Compensation Discussion and Analysis, Compensation Committee Report and Compensation Committee Interlocks and Insider Participation in our Proxy Statement for the 2009 Annual Meeting of Stockholders and is incorporated herein by reference.

**Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters**

The information required by Item 12 is included under the captions Security Ownership of Certain Beneficial Owners and Management and Compensation Discussion and Analysis in our Proxy Statement for the 2009 Annual Meeting of Stockholders and is incorporated herein by reference.

**Item 13. Certain Relationships and Related Transactions and Director Independence**

The information required by Item 13 is included under the captions Certain Relationships and Related Transactions and Director Independence in our Proxy Statement for the 2009 Annual Meeting of Stockholders and is incorporated herein by reference.

**Item 14. Principal Accountant Fees and Services**

The information required by Item 14 with respect to the fees and services of Ernst & Young LLP, our independent registered public accounting firm, is included under the caption Audit Matters in our Proxy Statement for the 2009 Annual Meeting of Stockholders and is incorporated herein by reference.



**PART IV****Item 15. Exhibits and Financial Statement Schedules**

The following consolidated financial statements are filed in Item 8 of Part II of this report:

	<b>Page</b>
Report of Independent Registered Public Accounting Firm	105
Consolidated Balance Sheets as of December 31, 2008 and 2007	106
Consolidated Statements of Income for each of the three years ended December 31, 2008	107
Consolidated Statements of Cash Flows for each of the three years ended December 31, 2008	109
Notes to Consolidated Financial Statements	110
<b>Financial Statement Schedules:</b>	
Schedule II. Condensed Financial Information of Registrant	144
Schedule VI. Supplemental Information Concerning Property-Casualty Insurance Operations	149
Pursuant to Rule 7-05 of Regulation S-X, Schedules I, III, IV and V have been omitted as the information to be set forth therein is included in the notes to the audited consolidated financial statements.	

**Schedule II. Condensed Financial Information of Registrant****Employers Holdings, Inc.  
Condensed Balance Sheets**

	<b>December 31,</b>	
	<b>2008</b>	<b>2007</b>
	(in thousands except share data)	
<b>Assets</b>		
Investments:		
Investment in subsidiaries	\$ 286,226	\$ 358,620
Investment in securities available-for-sale (amortized cost \$200,155 in 2008 and \$0 in 2007)	210,468	
<b>Total investments</b>	<b>496,694</b>	<b>358,620</b>
Cash	99,773	20,303
Intercompany receivable		187
Federal income taxes receivable intercompany	2,677	1,927
Deferred income taxes, net		535
Other assets	3,900	648
<b>Total assets</b>	<b>\$ 603,044</b>	<b>\$ 382,220</b>
<b>Liabilities and Equity</b>		
Accounts payable and accrued expenses	\$ 3,248	\$ 2,767
Deferred income taxes, net	812	
Intercompany payable	388	
Notes payable	150,000	
Other liabilities	3,868	
<b>Total liabilities</b>	<b>158,316</b>	<b>2,767</b>
<b>Equity</b>		
Stockholders' equity:		
Common stock, \$0.01 par value; 150,000,000 shares authorized; 53,528,207 and 53,527,907 shares issued and 48,830,140 and 49,616,635 shares outstanding at December 31, 2008 and 2007, respectively	535	535
Preferred stock, \$0.01 par value; 25,000,000 shares authorized; non issued		
Additional paid-in capital	306,032	302,862
Retained earnings	194,509	104,536
Accumulated other comprehensive income, net	32,804	46,520
	(89,152 )	(75,000 )

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Treasury stock, at cost (4,698,067 shares at December 31, 2008 and 3,911,272 shares at December 31, 2007)

Total stockholders' equity	444,728	379,453
Total liabilities and stockholders' equity	\$ 603,044	\$ 382,220

*See accompanying notes.*

**Employers Holdings, Inc.**  
**Condensed Statements of Income**

	<b>Years Ended December 31,</b>		
	<b>2008</b>	<b>2007</b>	<b>2006</b>
	(in thousands, except per share data)		
<b>Revenues</b>			
Net investment income	\$ 7,125	\$	\$
<b>Expenses</b>			
Other operating expenses	12,179	10,457	9,961
Interest expense	1,738		
Total expenses	13,917	10,457	9,961
Loss before income taxes and equity in earnings of subsidiaries	(6,792 )	(10,457 )	(9,961 )
Income tax benefit	(3,585 )	(2,462 )	
Net loss before equity in earnings of subsidiaries	(3,207 )	(7,995 )	(9,961 )
Equity in net income of subsidiaries	104,992	128,278	181,531
Net income	\$ 101,785	\$ 120,283	\$ 171,570

**Earnings per common share for the stated periods (Note 19):**

	<b>Year Ended December 31, 2008</b>	<b>February 5, 2007 through December 31, 2007</b>
Basic	\$ 2.07	\$ 2.19
Diluted	\$ 2.07	\$ 2.19

	<b>Pro Forma for the Years Ended December 31,</b>	
	<b>2007</b>	<b>2006</b>
Basic	\$ 2.32	\$ 3.43
Diluted	\$ 2.32	\$ 3.43

	<b>Years Ended December 31,</b>		
	<b>2008</b>	<b>2007</b>	<b>2006</b>
Cash dividends declared per common share	\$ 0.24	\$ 0.18	\$

*See accompanying notes.*

**Employers Holdings, Inc.**  
**Condensed Statements of Cash Flows**

	Years Ended December 31,		
	2008	2007	2006
	(in thousands)		
<b>Operating activities</b>			
Net income	\$ 101,785	\$ 120,283	\$ 171,570
Adjustments to reconcile net income to net cash provided by operating activities:			
Equity in net income of subsidiaries	(104,992 )	(128,278 )	(181,531 )
Amortization expense	148		
Stock-based compensation	3,161	1,720	
Amortization of premium or investments, net	849		
Deferred income tax expense	(907 )	(535 )	
Change in operating assets and liabilities:			
Accounts payable and accrued expense	381	1,010	1,731
Federal income taxes	(750 )	(1,927 )	
Other assets	(3,025 )	(648 )	9
Intercompany payable/receivable	575	(11,434 )	11,247
Net cash (used in) provided by operating activities	(2,775 )	(19,809 )	3,026
<b>Investing activities</b>			
Purchase of fixed maturities	(1,994 )		
Proceeds from sale of fixed maturities	997		
Cash dividends received from subsidiaries	152,995	100,511	
Capital contributions to subsidiary	(193,423 )		
Net cash (used in) provided by investing activities	(41,425 )	100,511	
<b>Financing activities</b>			
Issuance of common stock, net		486,670	(3,077 )
Cash paid to eligible policyholders under plan of conversion		(462,989 )	
Acquisition of treasury stock	(14,152 )	(75,000 )	
Dividends paid to stockholders	(11,808 )	(9,276 )	
Debt issuance costs	(375 )		
Proceeds from notes payable	150,000		
Other	5		
Net cash provided by (used in) financing activities	123,670	(60,595 )	(3,077 )

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Net increase (decrease) in cash and cash equivalents	79,470	20,107	(51 )
Cash and cash equivalents at the beginning of the period	20,303	196	247
Cash and cash equivalents at the end of the period	\$ 99,773	\$ 20,303	\$ 196

**Schedule of non-cash transactions**

Stock issued in exchange for membership interest	\$	\$ 281,073	\$
Fixed maturities transferred in for dividend	200,087		

*See accompanying notes.*

## **1. Nature of Operations and Summary of Significant Accounting Policies**

### **Operations and Basis of Presentation**

Employers Holdings, Inc. (EHI), a Nevada holding company and successor of EIG Mutual Holding Company (EIG), was formed effective April 1, 2005. Effective February 5, 2007, EIG converted from a mutual holding company to a Nevada stock company and completed an initial public offering (IPO) of its common stock. All policyholder membership interests in EIG were extinguished on that date and EIG's name changed to Employers Holdings, Inc. (See Note 2).

Through its four wholly owned subsidiaries, Employers Insurance Company of Nevada, Employers Compensation Insurance Company, Employers Preferred Insurance Company and Employers Assurance Company, EHI is engaged in the commercial property and casualty insurance industry, specializing in workers' compensation products and services.

EHI prepares its condensed financial statements in accordance with U.S. generally accepted accounting principles (GAAP), using the equity method. Under the equity method, the investment in subsidiaries is stated at cost plus equity in earnings (loss) of its subsidiaries. These condensed financial statements should be read in conjunction with EHI's consolidated financial statements included elsewhere in this Annual Report on Form 10-K.

Certain prior year amounts have been reclassified to conform with the current year presentation.

### **Estimates and Assumptions**

The preparation of the financial statements in conformity with GAAP requires management 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 amounts of revenue and expenses during the reporting period. As a result, actual results could differ from these estimates.

## **2. Conversion and Initial Public Offering**

Effective February 5, 2007, under the terms of a plan of conversion, EIG converted from a mutual insurance holding company to a stock company. All membership interests in EIG were extinguished on that date and eligible members of EIG received, in aggregate, 22,765,407 shares of EHI's common stock and \$463.0 million of cash.

In addition, effective February 5, 2007, EHI completed its IPO in which it issued 30,762,500 shares of its common stock at a price of \$17.00 per share. The cash proceeds of the IPO, after underwriting discounts and commission of \$34.0 million and offering and conversion costs of \$16.3 million, were \$472.7 million, of which \$9.7 million was retained by EHI and was used for working capital, payment of dividends on common stock, repurchase of shares of common stock and other general corporate purposes.

Upon completion of EHI's IPO, the capitalized issuance costs related to the IPO of \$5.4 million were netted against the IPO proceeds in additional paid-in capital in the accompanying consolidated balance sheets. The costs related to the conversion were \$10.9 million, of which \$0.9 million was incurred in the period from January 1, 2007 through February 5, 2007 and \$10.0 million was incurred during the year ended December 31, 2006. Conversion expenses consisted primarily of printing and mailing costs and the aggregate cost of engaging independent accounting, actuarial, financial, investment banking, legal and other consultants. These costs have no tax benefit and were expensed as incurred and are included in the underwriting and other operating expenses in the accompanying consolidated statements of income.

## **3. Income Taxes**



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EHI files a consolidated federal income tax return with its subsidiaries and has a tax allocation agreement with its subsidiaries. The equity in the undistributed earnings of subsidiaries included in the accompanying condensed statements of income are net of income taxes.

### **4. Investments**

EHI holds fixed maturity investments at December 31, 2008 for purposes of securing the Second and Amended and Restated Secured Revolving Credit Facility (Amended Credit Facility). The

amortized cost and estimated fair value of fixed maturity investments at December 31, 2008, by contractual maturity are shown below. Expected maturities differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	<b>Amortized Cost</b>	<b>Estimated Fair Value</b>
	(in thousands)	
Due in one year or less	\$ 10,051	\$ 10,378
Due after one year through five years	103,510	109,374
Due after five years through ten years	86,594	90,716
<b>Total</b>	<b>\$ 200,155</b>	<b>\$ 210,468</b>

At December 31, 2008, the fixed maturity securities had unrealized gains of \$10.3 million which are included in accumulated comprehensive income, net in the accompanying condensed balance sheets.

## 5. Notes Payable

Effective September 30, 2008, EHI and Wells Fargo Bank, National Association (Wells Fargo) entered into the Amended Credit Facility. See Note 11 of the Consolidated Financial Statements of Employers Holdings, Inc and Subsidiaries included herein for a description of the terms of the Amended Credit Facility.

On September 30, 2008, EHI borrowed \$150.0 million through the Amended Credit Facility. The proceeds borrowed under the Amended Credit Facility were used to finance the acquisition of AmCOMP Incorporated and for general working capital purposes. The interest rate on the Amended Credit Facility at December 31, 2008 was 3.16% and interest paid during the year ended December 31, 2008, including the interest rate swap (see Note 6), totaled \$1.2 million. The Amended Credit Facility is secured by fixed maturity securities which had a fair value of \$210.5 million at December 31, 2008.

## 6. Derivative

### Interest Rate Swap

On September 30, 2008, EHI, in connection with the borrowings made under the Amended Credit Facility (see Note 5), executed an interest rate swap with Wells Fargo with a notional amount of \$100.0 million. Execution of the interest rate swap established a fixed interest rate of 4.84%, on the notional amount, through September 30, 2010. EHI uses its interest rate swap to mitigate the risks associated with unexpected cash outflows resulting from shifts in variable interest rates. As of December 31, 2008, the interest rate swap had a liability fair value of \$3.9 million and is included in other liabilities on the accompanying condensed balance sheet. The corresponding unrealized loss of \$3.9 million is included in accumulated other comprehensive income, net.

## 7. Stock-Based Compensation

During 2007, EHI granted 23,760 Restricted Stock Units (RSUs) to non-employee Directors, 140,311 Performance Shares Awards to officers, 186,000 nonqualified stock options to non-officer employees and 420,916 nonqualified stock options to officers. During 2008, EHI granted 24,984 RSUs to non-employee directors and 152,564 RSUs to officers and 475,167 non-qualified stock options to officers. EHI adopted SFAS No. 123(R) *Share Based Payment*

(SFAS No. 123(R)), on January 1, 2006, and under SFAS No. 123(R), share-based payments made to employees must be recognized in the statements of income based on their fair values over the employees' service period. See Note 15 of the Consolidated Financial Statements of Employers Holdings, Inc. and Subsidiaries included herein for a detailed description of the stock-based compensation.

## **8. Subsequent Events (Unaudited)**

### **Stockholder Dividend**

On February 25, 2009, the Board of Directors declared a \$0.06 dividend per share, payable March 25, 2009, to stockholders of record on March 11, 2009.

**SCHEDULE VI. Supplemental Information Concerning Property Casualty Insurance Operations  
Employers Holdings, Inc. and Subsidiaries  
Consolidated Supplemental Information Concerning Property and Casualty Insurance Operations**

<b>Year Ended</b>	<b>Deferred Policy Acquisition Costs</b>	<b>Reserves For Unpaid Losses And Loss Adjustment Expenses</b>	<b>Unearned Premiums</b>	<b>Earned Premiums</b>	<b>Net Investment Income</b>	<b>Losses and LAE Related to Current Year</b>	<b>Lo</b>	<b>Re Pri</b>
(in thousands)								
2008	\$ 32,365	\$ 2,506,478	\$ 139,310	\$ 328,947	\$ 78,062	\$ 226,643	\$	\$
2007	\$ 14,901	\$ 2,269,710	\$ 63,924	\$ 346,884	\$ 78,623	\$ 221,347	\$	\$
2006	\$ 13,767	\$ 2,307,755	\$ 73,255	\$ 392,986	\$ 68,187	\$ 256,257	\$	\$

**Exhibits:**

<b>Exhibit No.</b>	<b>Description of Exhibit</b>	<b>Included Herewith</b>	<b>Incorporated by Reference Herein</b>		
			<b>Form</b>	<b>Exhibit</b>	<b>Filing Date</b>
2.1	Agreement and Plan of Merger by and among AmCOMP Incorporated, Employers Holdings, Inc. and Sapphire Acquisition Corp.		8-K	2.1	January 10, 2008
2.2	Amendment No. 2 to the Agreement and Plan of Merger, dated August 29, 2008, by and among AmCOMP Incorporated, Employers Holdings, Inc. and Sapphire Acquisition Corp.		8-K	2.1	August 29, 2008
3.1	Amended and Restated Articles of Incorporation of Employers Holdings, Inc.		10-K	3.1	March 30, 2007
3.2	Amended and Restated By laws of Employers Holdings, Inc.		10-K	3.1	March 30, 2007
4.1	Form of Common Stock Certificate		S-1/A	4.1	January 18, 2007
10.1	Quota Share Reinsurance Agreement, dated as of June 30, 1999, between State Industrial Insurance System of Nevada, D.B.A.: Employers Insurance Company of Nevada and the various Reinsurers as identified by the Interests and Liabilities Agreements attached thereto <sup>(1)</sup>		S-1/A	10.1	January 18, 2007
10.2	Producer Agreement, dated as of May 1, 2005, between Employers Compensation Insurance Company and Automatic Data Processing Insurance Agency, Inc. <sup>(1)</sup>		S-1/A	10.2	January 18, 2007
10.3	Joint Marketing and Network Access Agreement, dated as of January 1, 2006, between Employers Insurance Company of Nevada and Blue Cross of California, BC Life & Health Insurance Company, and Comprehensive		S-1/A	10.3	January 18, 2007



Exhibit No.	Description of Exhibit	Included Herewith	Incorporated by Reference Herein		
			Form	Exhibit	Filing Date
10.4	Joint Marketing and Network Access Agreement, dated as of July 1, 2006, between Employers Insurance Company of Nevada and Blue Cross of California, BC Life & Health Insurance Company, and Comprehensive Integrated Marketing Services <sup>(1)</sup>		S-1/A	10.4	January 18, 2007
*10.5	Employers Holdings, Inc. Equity and Incentive Plan Stock Option Agreement		8-K	10.1	August 10, 2007
*10.6	Employers Holdings, Inc. Equity and Incentive Plan Performance Share Agreement		8-K	10.2	August 10, 2007
*10.7	Employers Holdings, Inc. Amended and Restated Equity Incentive Plan		DEF14A	Appendix B	April 14, 2008
*10.8	Form of Restricted Stock Unit Agreement		8-K	10.1	June 2, 2008
10.9	Second Amended and Restated Credit Agreement, dated September 30, 2008, between Employers Holdings, Inc. and Wells Fargo Bank, National Association		8-K	10.1	October 22, 2008
10.10	Second Amended and Restated Revolving Line of Credit Note, dated September 30, 2008, between Employers Holdings Inc. and Wells Fargo Bank, National Association		8-K	10.2	October 22, 2008
* 10.11	Employment Agreement by and between Employers Holdings, Inc. and Douglas D. Dirks, dated December 17, 2008 and effective as of January 1, 2009		8-K	10.1	December 23, 2008
* 10.12	Employment Agreement by and between Employers Holdings, Inc. and Ann W. Nelson, dated December 17, 2008 and effective as of January 1, 2009		8-K	10.2	December 23, 2008
* 10.13	Employment Agreement by and between Employers Holdings, Inc. and Lenard T. Ormsby, dated December 17, 2008 and effective as of January 1, 2009		8-K	10.3	December 23, 2008
* 10.14	Employment Agreement by and between Employers Insurance Company of Nevada and Martin J. Welch, dated December 17, 2008 and effective as of January 1, 2009		8-K	10.4	December 23, 2008
* 10.15	Employment Agreement by and between Employers Holdings, Inc. and William E. Yocke, dated December 17, 2008 and effective as of January 1, 2009		8-K	10.5	December 23, 2008
21.1	Subsidiaries of Employers Holdings, Inc.	X			



Exhibit No.	Description of Exhibit	Included Herewith	Incorporated by Reference Herein		
			Form	Exhibit	Filing Date
23.1	Consent of Ernst & Young LLP, Independent Registered Public Accounting Firm	X			
31.1	Certification of Douglas D. Dirks Pursuant to Section 302	X			
31.2	Certification of William E. Yocke Pursuant to Section 302	X			
32.1	Certification of Douglas D. Dirks Pursuant to Section 906	X			
32.2	Certification of William E. Yocke Pursuant to Section 906	X			

For purposes of the incorporation by reference of documents as Exhibits, all references to Forms S-1 and S-1/A of Employers Holdings, Inc. refer to Forms S-1 and S-1/A filed with the Commission under Registration Number 333-139092.

\* Asterisks identify management contracts and compensatory plans or arrangements.

(1) Confidential treatment has been requested for certain confidential portions of this exhibit; these confidential portions have been omitted from this exhibit and filed separately with the Securities and





**SIGNATURES**

Pursuant to the requirements of Section 13 or 15(d) of the Securities Act of 1934, the Registrant has duly caused this Report to be signed on its behalf by the undersigned, thereunto duly authorized, in the City of Reno, State of Nevada on February 26, 2009.

EMPLOYERS HOLDINGS, INC.

By: /s/ Douglas D. Dirks

\_\_\_\_\_  
Name: Douglas D. Dirks  
Title: President and  
Chief Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this Report has been signed by the following persons in the capacities and on the dates indicated:

<b>Signature</b>	<b>Title</b>	<b>Date</b>
/s/ Robert J. Kolesar _____ Robert J. Kolesar	Chairman of the Board	February 26, 2009
/s/ Douglas D. Dirks _____ Douglas D. Dirks	President and Chief Executive Officer, Director (Principal Executive Officer)	February 26, 2009
/s/ William E. Yocke _____ William E. Yocke	Executive Vice President and Chief Financial Officer (Principal Financial and Accounting Officer)	February 26, 2009
/s/ Richard W. Blakey _____ Richard W. Blakey	Director	February 26, 2009
/s/ Valerie R. Glenn _____ Valerie R. Glenn	Director	February 26, 2009

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/s/ Rose E.  
McKinney-James

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Director

February 26, 2009

Rose E.  
McKinney-James

/s/ Ronald F.  
Mosher

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Director

February 26, 2009

Ronald F. Mosher

/s/ Katherine W.  
Ong

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Director

February 26, 2009

Katherine W. Ong

/s/ Michael D.  
Rumbolz

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Director

February 26, 2009

Michael D.  
Rumbolz

/s/ John P. Sande  
III

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Director

February 26, 2009

John P. Sande III

/s/ Martin J. Welch

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Director

February 26, 2009

Martin J. Welch