

OneBeacon Insurance Group, Ltd.  
Form 10-Q  
May 04, 2015

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended March 31, 2015

OR

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number 1-33128

ONEBEACON INSURANCE GROUP, LTD.

(Exact name of Registrant as specified in its charter)

Bermuda

(State or other jurisdiction of  
incorporation or organization)

98-0503315

(I.R.S. Employer  
Identification No.)

601 Carlson Parkway

Minnetonka, Minnesota

(Address of principal executive offices)

55305

(Zip Code)

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

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past

90 days. Yes  No

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

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

Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller reporting company   
(Do not check if a  
smaller reporting company)

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

As of April 30, 2015, 23,504,048 Class A common shares, par value \$0.01 per share, and 71,754,738 Class B common shares, par value \$0.01 per share, were outstanding.

ONEBEACON INSURANCE GROUP, LTD.  
For the Three Months Ended March 31, 2015

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## PART I. FINANCIAL INFORMATION

## ITEM 1. FINANCIAL STATEMENTS (UNAUDITED)

## ONEBEACON INSURANCE GROUP, LTD.

## CONSOLIDATED BALANCE SHEETS

(Unaudited)

(\$ in millions, except per share amounts)	March 31, 2015	December 31, 2014
Assets		
Investment Securities:		
Fixed maturity investments, at fair value	\$1,866.8	\$1,799.8
Short-term investments, at amortized cost (which approximates fair value)	194.2	202.2
Common equity securities, at fair value	312.0	320.0
Convertible fixed maturity investments, at fair value	5.1	5.0
Other investments	197.8	198.8
Total investment securities	2,575.9	2,525.8
Cash	87.9	87.0
Reinsurance recoverables	159.8	173.8
Premiums receivable	258.1	241.5
Funds held under reinsurance contracts	17.4	37.1
Deferred acquisition costs	105.5	103.2
Net deferred tax asset	131.2	131.8
Investment income accrued	9.2	10.0
Accounts receivable on unsettled investment sales	5.5	7.2
Other assets	180.2	202.7
Assets held for sale	58.0	58.1
Total assets	\$3,588.7	\$3,578.2
Liabilities		
Unpaid loss and loss adjustment expense reserves	\$1,304.0	\$1,342.2
Unearned premiums	590.3	588.3
Funds held under insurance contracts	93.0	81.0
Debt	274.7	274.7
Accounts payable on unsettled investment purchases	39.1	0.5
Other liabilities	235.5	242.2
Total liabilities	2,536.6	2,528.9
OneBeacon's common shareholders' equity and noncontrolling interests		
OneBeacon's common shareholders' equity		
Common shares and paid-in surplus (par value \$0.01; authorized, 200,000,000 shares; issued and outstanding, 95,258,786 and 95,296,387 shares)	1,022.7	1,023.7
Retained earnings	31.4	27.3
Accumulated other comprehensive income, after tax	(5.0)	(5.2)
Total OneBeacon's common shareholders' equity	1,049.1	1,045.8
Total noncontrolling interests	3.0	3.5
Total OneBeacon's common shareholders' equity and noncontrolling interests	1,052.1	1,049.3
Total liabilities, OneBeacon's common shareholders' equity and noncontrolling interests	\$3,588.7	\$3,578.2

See Notes to Consolidated Financial Statements.



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ONEBEACON INSURANCE GROUP, LTD.  
CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME  
(Unaudited)

(\$ in millions, except per share amounts)	Three months ended		
	March 31, 2015	2014	
Revenues			
Earned premiums	\$286.6	\$276.5	
Net investment income	10.5	10.4	
Net realized and change in unrealized investment gains	14.2	18.9	
Net other revenues (expenses)	(3.1	) 1.0	
Total revenues	308.2	306.8	
Expenses			
Loss and loss adjustment expenses	165.9	149.4	
Policy acquisition expenses	51.0	46.7	
Other underwriting expenses	55.9	49.4	
General and administrative expenses	4.1	3.3	
Interest expense	3.2	3.2	
Total expenses	280.1	252.0	
Pre-tax income from continuing operations	28.1	54.8	
Income tax expense	(3.4	) (7.1	)
Net income from continuing operations	24.7	47.7	
Loss from discontinued operations, net of tax	(0.1	) (0.5	)
Net income, including noncontrolling interests	24.6	47.2	
Less: Net income attributable to noncontrolling interests	(0.5	) (0.4	)
Net income attributable to OneBeacon's common shareholders	24.1	46.8	
Other comprehensive income, net of tax	0.2	—	
Comprehensive income attributable to OneBeacon's common shareholders	\$24.3	\$46.8	
Earnings per share attributable to OneBeacon's common shareholders—basic and diluted			
Net income from continuing operations, per share	\$0.25	\$0.50	
Loss from discontinued operations, net of tax, per share	—	(0.01	)
Net income attributable to OneBeacon's common shareholders per share	\$0.25	\$0.49	
Dividends declared and paid per OneBeacon's common share	\$0.21	\$0.21	

See Notes to Consolidated Financial Statements.

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ONEBEACON INSURANCE GROUP, LTD.  
CONSOLIDATED STATEMENTS OF COMMON SHAREHOLDERS' EQUITY  
(Unaudited)

(\$ in millions)	OneBeacon's Common Shareholders' Equity					Total OneBeacon's common shareholders' equity and noncontrolling interests
	Common shares and paid-in surplus	Retained earnings	Accum. other comprehensive income	Total OneBeacon common shareholders' equity	Noncontrolling interests, after tax	
Balances at January 1, 2015	\$1,023.7	\$ 27.3	\$ (5.2 )	\$ 1,045.8	\$ 3.5	\$ 1,049.3
Comprehensive income:						
Net income	—	24.1	—	24.1	0.5	24.6
Other comprehensive income, net of tax	—	—	0.2	0.2	—	0.2
Total comprehensive income	—	24.1	0.2	24.3	0.5	24.8
Amortization of restricted share awards	0.6	—	—	0.6	—	0.6
Issuance of common shares	—	—	—	—	0.1	0.1
Repurchase and retirement of common shares	(1.6 )	—	—	(1.6 )	—	(1.6 )
Dividends	—	(20.0 )	—	(20.0 )	(1.1 )	(21.1 )
Balances at March 31, 2015	\$1,022.7	\$ 31.4	\$ (5.0 )	\$ 1,049.1	\$ 3.0	\$ 1,052.1

(\$ in millions)	OneBeacon's Common Shareholders' Equity					Total OneBeacon's common shareholders' equity and noncontrolling interests
	Common shares and paid-in surplus	Retained earnings	Accum. other comprehensive income (loss)	Total OneBeacon common shareholders' equity	Noncontrolling interests, after tax	
Balances at January 1, 2014	\$1,022.5	\$ 74.4	\$ 6.8	\$ 1,103.7	\$ 3.1	\$ 1,106.8
Comprehensive income:						
Net income	—	46.8	—	46.8	0.4	47.2
Total comprehensive income	—	46.8	—	46.8	0.4	47.2
Amortization of restricted share awards	0.8	—	—	0.8	—	0.8
Issuance of common shares	—	—	—	—	0.2	0.2
Repurchase and retirement of common shares	(1.8 )	—	—	(1.8 )	—	(1.8 )
Dividends	—	(20.0 )	—	(20.0 )	(0.9 )	(20.9 )
Balances at March 31, 2014	\$1,021.5	\$ 101.2	\$ 6.8	\$ 1,129.5	\$ 2.8	\$ 1,132.3

See Notes to Consolidated Financial Statements.

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ONEBEACON INSURANCE GROUP, LTD.  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
(Unaudited)

(\$ in millions)	Three months ended March 31,	
	2015	2014
Cash flows from operations:		
Net income including noncontrolling interests	\$24.6	\$47.2
Charges (credits) to reconcile net income to cash flows provided from operations:		
Net loss from discontinued operations	0.1	0.5
Net realized and change in unrealized investment gains	(14.2	) (18.9
Net adjustment to gain on sale of business	3.7	—
Deferred income tax expense	0.5	10.9
Other operating items:		
Net change in loss and LAE reserves	(38.2	) 15.5
Net change in unearned premiums	2.0	37.3
Net change in premiums receivable	(16.6	) (21.0
Net change in reinsurance recoverables on paid and unpaid losses	14.0	6.8
Net change in funds held under reinsurance contracts	19.7	(12.1
Net change in funds held under insurance contracts	12.0	1.0
Net change in other assets and liabilities	15.8	(48.2
Net cash provided from operations—continuing operations	23.4	19.0
Net cash used for operations—discontinued operations	(0.1	) (14.6
Net cash provided from operations	23.3	4.4
Cash flows from investing activities:		
Net maturities, purchases and sales of short-term investments	8.0	4.3
Maturities of fixed maturity investments	32.9	115.7
Sales of fixed maturity investments	177.6	324.6
Sales of common equity securities	39.6	24.3
Sales of convertible fixed maturity investments	0.7	6.8
Return of capital and distributions of other investments	3.0	1.6
Purchases of fixed maturity investments	(273.0	) (466.0
Purchases of common equity securities	(26.2	) (26.0
Purchases of convertible fixed maturity investments	(0.5	) (3.8
Contributions for other investments	(1.4	) (2.3
Net change in unsettled investment purchases and sales	40.3	10.6
Net acquisitions of property and equipment	(0.4	) (0.6
Net cash provided from (used for) investing activities	0.6	(10.8
Cash flows from financing activities:		
Cash dividends paid to common shareholders	(20.0	) (20.0
Repurchases and retirements of common stock	(1.6	) (1.8
Payments on capital lease obligation	(1.4	) (1.3
Net cash used for financing activities	(23.0	) (23.1
Net increase (decrease) in cash during period	0.9	(29.5
Cash balance at beginning of period	87.0	168.1
Cash balance at end of period	\$87.9	\$138.6

See Notes to Consolidated Financial Statements.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

Basis of presentation

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

OneBeacon is 75.3% owned by White Mountains Insurance Group, Ltd. ("White Mountains"), a holding company whose businesses provide property and casualty insurance, reinsurance and certain other products. The Company's headquarters are located at 14 Wesley Street, 5th Floor, Hamilton HM 11, Bermuda. The Company's U.S. corporate headquarters are located at 601 Carlson Parkway, Minnetonka, Minnesota 55305 and its registered office is located at Clarendon House, 2 Church Street, Hamilton HM 11, Bermuda. OneBeacon has entered into an agreement to sell its building in Canton, Massachusetts, which is presented as held for sale in the March 31, 2015 and December 31, 2014 consolidated balance sheets.

On December 23, 2014, OneBeacon completed the sale of its run-off business to a subsidiary of Armour Group Holdings Limited ("Armour"). See Note 2—"Acquisitions and Dispositions" and Note 15—"Discontinued Operations." The run-off business included the results of OneBeacon's non-specialty commercial lines business and certain other run-off business, including the vast majority of asbestos and environmental reserves, as well as certain purchase accounting adjustments related to the run-off business (the "Runoff Business," the sale of which is referred to as the "Runoff Transaction"). The Runoff Business has been presented as discontinued operations in the consolidated statements of operations and cash flows for the three months ended March 31, 2015 and 2014. The Runoff Business disposal group excludes investing and financing activities from amounts classified as discontinued operations. OneBeacon's investing and financing operations are conducted on an overall consolidated level and, accordingly, there are no separately identifiable investing or financing cash flows associated with the Runoff Business. The legal entities included in the sale held an agreed upon level of invested assets and capital at closing.

OneBeacon's reportable segments are Specialty Products, Specialty Industries and Investing, Financing and Corporate. The Specialty Products segment is comprised of ten active underwriting operating segments, representing an aggregation based on those that offer distinct products and tailored coverages and services to a broad customer base across the United States. During the three months ended March 31, 2015, the Company restructured its former Professional Insurance underwriting operating segment into four separate underwriting operating segments: Healthcare, Management Liability, Financial Services and Other Professional Lines.

The Specialty Industries segment is comprised of five active underwriting operating segments, representing an aggregation based on those that focus on solving the unique needs of a particular customer or industry group. The Investing, Financing and Corporate segment includes the investing and financing activities for OneBeacon on a consolidated basis, and certain other activities conducted through the Company and its intermediate subsidiaries. All significant intercompany transactions have been eliminated in consolidation. These interim financial statements include all adjustments considered necessary by management to fairly state the financial position, results of operations and cash flows of OneBeacon. These interim financial statements may not be indicative of financial results for the full year and should be read in conjunction with the Company's 2014 Annual Report on Form 10-K. The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Refer to the Company's 2014 Annual Report on Form 10-K for a complete discussion regarding OneBeacon's significant accounting policies. Certain amounts in the prior period financial statements have been reclassified to conform to the current presentation.

Recently Adopted Changes in Accounting Principles

Qualified Affordable Housing Projects

Effective January 1, 2015, OneBeacon adopted ASU 2014-01, Accounting for Investments in Qualified Affordable Housing Projects ("QAHP") (ASC 323). ASU 2014-01 allows investors in QAHP to make a policy election to use the proportional amortization method. Under the proportional amortization method, the investor amortizes the initial cost of the investment in proportion to the tax credits and other tax benefits received and recognizes the investment results, net of the

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

related tax benefits, as a component of income tax expense. Prior to adoption, OneBeacon accounted for its QAHP investment under the equity method and recognized its share of its QAHP investment's losses in investment income. OneBeacon made the policy election to account for its QAHP investment using the proportional amortization method, applied retrospectively. Under the proportional amortization method, the cumulative loss recognized through December 31, 2014 increased by \$1.2 million. As a result of the retrospective adoption, OneBeacon's common shareholders equity has been reduced by \$0.6 million as of January 1, 2014. In addition, the retrospective adoption resulted in an increase of \$0.4 million to net investment income and a net increase of \$0.6 million to income tax expense for the three months ended March 31, 2014. Footnote disclosures for prior year amounts have been amended to be consistent with the restated amounts described above.

Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity

In April 2014, the Financial Accounting Standard Board ("FASB") issued ASU 2014-08, Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity (ASC 205 and ASC 360) to reduce diversity in practice for reporting discontinued operations. ASU 2014-08 limits discontinued operations treatment to disposals that represent a strategic shift and that have a major effect on a reporting entity's operations and financial results to be reported as discontinued operations. The revised guidance also requires expanded disclosure in the financial statements for discontinued operations as well as for disposals of significant components of an entity that do not qualify for discontinued operations presentation. OneBeacon has not had any transactions that occurred since ASU 2014-08 became effective on December 15, 2014.

Pushdown Accounting

ASU 2014-17, Pushdown Accounting, a consensus of the FASB Emerging Issues Task Force (ASC 805) became effective upon its issuance on November 18, 2014. The new guidance, which is applicable prospectively, gives an acquired non-public company the option to apply pushdown accounting in its separate company financial statements in the period in which it is acquired in a change of control transaction. Once pushdown accounting has been applied, the election is irreversible. Acquired entities that chose not to apply pushdown accounting at the time of acquisition, may apply pushdown accounting in a subsequent period as a change in accounting principle under ASC 250, Accounting Changes and Error Corrections. OneBeacon has not had any acquisitions since AUS 2014-17 became effective.

Unrecognized Tax Benefits

Effective January 1, 2014, OneBeacon adopted ASU 2013-11, Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists. The new ASU generally requires balance sheet presentation of an unrecognized tax benefit as a reduction of a deferred tax asset for a net operating loss ("NOL") carryforward or tax credit carryforward rather than as a liability. This adoption did not have any impact on the Company's financial position, results of operations, cash flows or financial statement presentation.

Recently Issued Accounting Pronouncements

Debt Issuance Costs

In April 2015, the FASB issued ASU 2015-03, Imputation of Interest (ASC 835) which requires debt issuance costs related to a recognized debt liability to be presented as a deduction from the carrying amount of the related debt, consistent with the treatment required for debt discounts. ASU 2015-03 is effective for annual and interim reporting periods beginning after December 15, 2015. OneBeacon does not expect ASU 2015-03 to impact its financial position, results of operations, cash flows, presentation and disclosures.

Amendments to Consolidation Analysis

In February 2015, the FASB issued ASU 2015-02, Amendments to the Consolidation Analysis (ASC 810) which amends the guidance for determining whether an entity is a variable interest entity ("VIE"). ASU 2015-02 eliminates the separate consolidation guidance for limited partnerships and with it, the presumption that a general partner should consolidate a limited partnership. In addition, ASU 2015-02 changes the guidance for determining if fee arrangements qualify as variable interests and the effect fee arrangements have on the determination of the primary beneficiary.

ASU 2015-02 is effective for annual and interim reporting periods beginning after December 15, 2015 and must be applied retrospectively. OneBeacon does not expect ASU 2015-02 to affect the consolidation analysis for any of its existing investments.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

Share-Based Compensation Awards

In June 2014, the FASB issued ASU 2014-12, Share-Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved after the Requisite Service Period. The new guidance is intended to eliminate diversity in practice for employee share-based awards containing performance targets that could be achieved after the requisite service period. Some reporting entities account for performance targets that can be achieved after the requisite service period as performance conditions that affect the vesting of the award while other reporting entities treat those performance targets as non-vesting conditions that affect the grant-date fair value of the award. The updated guidance requires that a performance target that affects vesting and that can be achieved after the requisite service period be treated as a performance condition. Compensation cost should be recognized in the period it becomes probable that the performance target will be achieved and should represent the compensation cost attributable to the periods for which service has been rendered. The new guidance is effective for annual and interim reporting periods beginning after December 15, 2015. OneBeacon does not expect adoption to have a significant impact on its financial position, results of operations, cash flows, presentation or disclosures.

Revenue Recognition

In May 2014, the FASB issued ASU 2014-09, Revenue from Contracts with Customers (ASC 606), which modifies the guidance for revenue recognition. The scope of the new ASU excludes insurance contracts but is applicable to certain fee arrangements, such as investment management fees. The Company is in the process of evaluating the new guidance and has not yet determined the potential effect of adoption on its financial position, results of operations, or cash flows. ASU 2014-09 is effective for annual and interim reporting periods beginning after December 15, 2016.

NOTE 2. Acquisitions and Dispositions

Runoff Business

As described in Note 1—"Nature of Operations and Summary of Significant Accounting Policies," on December 23, 2014, OneBeacon completed the sale of its Runoff Business to Armour. Prior to the closing of the Runoff Transaction, OneBeacon Insurance Company, one of the entities that was sold upon the closing of the Runoff Transaction and which has since been renamed Bedivere Insurance Company ("Bedivere"), distributed Atlantic Specialty Insurance Company ("ASIC") to its immediate parent, as well as cash and investments such that Bedivere contained the minimum capital on the date of sale pursuant to the stock purchase agreement. In conjunction with the Runoff Transaction, OneBeacon provided financing in the form of surplus notes having a par value of \$101.0 million, which had a fair value of \$64.9 million on the date of sale. As part of the Runoff Transaction, OneBeacon and Armour entered into a limited Transition Services Agreement ("TSA"), pursuant to which OneBeacon is providing certain transition services to Armour during the term of the TSA, which has an initial term of one year. See Note 15—"Discontinued Operations" for further information regarding activity reported as discontinued operations during the three months ended March 31, 2015 and 2014.

Essentia Insurance Company

Effective January 1, 2013, OneBeacon completed the sale of Essentia Insurance Company ("Essentia"), an indirect wholly-owned subsidiary which wrote the collector cars and boats business, to Markel Corporation and recognized a pre-tax gain on sale of \$23.0 million (\$15.0 million after tax) in the first quarter of 2013. During the three months ended March 31, 2015, the Company recognized in net other revenues (expenses) a \$3.7 million negative adjustment to the pre-tax gain on sale of Essentia in connection with an assessment from the Michigan Catastrophic Claims Association (MCCA) payable to Markel Corporation pursuant to the indemnification provisions in the stock purchase agreement governing the sale of Essentia. As a result of this adjustment, the revised pre-tax gain on sale of Essentia was \$19.3 million (\$12.5 million after tax).

Except as described above, during the three months ended March 31, 2015 and 2014, there were no significant acquisitions or dispositions.



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## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

## NOTE 3. Unpaid Loss and Loss Adjustment Expense (LAE) Reserves

## Loss and LAE reserve summary

The following table summarizes the loss and LAE reserve activities of OneBeacon's insurance subsidiaries for the three months ended March 31, 2015 and 2014:

(\$ in millions)	Three months ended	
	March 31,	
	2015	2014
Gross beginning balance	\$1,342.2	\$1,054.3
Less beginning reinsurance recoverables on unpaid losses	(161.6 )	(80.2 )
Net beginning loss and LAE reserves	1,180.6	974.1
Loss and LAE incurred relating to:		
Current year losses	167.7	150.8
Prior year losses	(1.8 )	(1.4 )
Total incurred loss and LAE from continuing operations	165.9	149.4
Loss and LAE paid relating to:		
Current year losses	(22.1 )	(18.3 )
Prior year losses	(162.0 )	(115.5 )
Total loss and LAE payments from continuing operations	(184.1 )	(133.8 )
Net ending loss and LAE reserves	1,162.4	989.7
Plus ending reinsurance recoverables on unpaid losses	141.6	80.1
Gross ending loss and LAE reserves	\$1,304.0	\$1,069.8

## Loss and LAE development

## Loss and LAE development—2015

During the three months ended March 31, 2015, OneBeacon experienced \$1.8 million of net favorable loss and LAE reserve development on prior accident year reserves, primarily attributable to favorable development from Crop resulting from the 2014 crop year and favorable development in several other businesses, most notably the ocean marine business within International Marine Underwriters (IMU), Technology, Government Risks, Surety and Specialty Property. This favorable development was mostly offset by unfavorable development in Entertainment driven by several large and small to mid-sized claims and by losses within the Company's inland marine business within IMU resulting from a few large claims.

## Loss and LAE development—2014

During the three months ended March 31, 2014, OneBeacon experienced \$1.4 million of favorable net loss and LAE reserve development on prior accident year reserves. The development primarily related to the ocean marine business within the IMU underwriting operating segment and the Technology underwriting operating segment.

See Note 15—"Discontinued Operations" for a discussion of impacts to reserves for unpaid losses and LAE related to discontinued operations.

## NOTE 4. Reinsurance

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

## Reinsurance Treaties

The Company's catastrophe reinsurance coverage is discussed in Note 4—"Reinsurance" in the Company's 2014 Annual Report on Form 10-K. Except as discussed below, there have been no material changes to the Company's reinsurance coverage from that reported in the 2014 Annual Report on Form 10-K.





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## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

## NOTE 4. Reinsurance

Effective January 1, 2015, OneBeacon purchased an aggregate stop loss on its multi-peril crop insurance ("MPCI") portfolio for the 2015 crop year, providing 52.0% of coverage in excess of a 98.0% loss ratio on premiums covered by the contract and a separate aggregate stop loss providing 80.0% of coverage in excess of a 100.0% loss ratio on its crop-hail portfolio. OneBeacon also purchased a new quota share reinsurance contract on 30.0% of its MPCI portfolio.

## Reinsurance Recoverables

As of March 31, 2015, OneBeacon had reinsurance recoverables on paid losses of \$18.2 million and reinsurance recoverables on unpaid losses of \$141.6 million. As reinsurance contracts do not relieve OneBeacon of its obligations, collectibility of balances due from reinsurers is critical to OneBeacon's financial strength. The following table summarizes Standard & Poor's Financial Services, LLC ("Standard & Poor's") ratings for OneBeacon's reinsurers for its continuing insurance operations, excluding industry pools and associations, based upon reinsurance recoverable amounts on paid and unpaid losses and LAE:

(\$ in millions)	Balance at		
Standard & Poor's Rating <sup>(1)</sup> :	March 31,	%	
	2015		
AA	\$57.6	36	%
A	79.0	49	%
BBB, Not Rated and Other	23.2	15	%
Total reinsurance recoverables	\$159.8	100	%

<sup>(1)</sup> Standard & Poor's ratings as detailed above are "AA" (Very strong), "A" (Strong) and "BBB" (Adequate).

## NOTE 5. Investment Securities

OneBeacon's invested assets are comprised of securities and other investments held for general investment purposes. Refer to the Company's 2014 Annual Report on Form 10-K for a complete discussion.

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

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

Other investments primarily include surplus notes, private equity funds and hedge funds. OneBeacon measures its investments in private equity funds and hedge funds at fair value with changes therein reported in total revenues as net realized and change in unrealized investment gains. Surplus notes provided in conjunction with the financing of the Runoff Transaction are measured at their estimated fair value based on discounted expected cash flows, with changes in fair value reported in total revenues as net realized and change in unrealized investment gains. Other investments also include an investment in a community reinvestment vehicle which is accounted for at fair value and a tax advantaged federal affordable housing development fund which is accounted for under the proportional amortization method.

Prospector Partners LLC ("Prospector") is currently the primary manager of OneBeacon's publicly-traded common equity and convertible securities portfolio pursuant to an investment management agreement dated February 25, 2015. The investment management agreements with Prospector will terminate during 2015. As a result, OneBeacon intends to liquidate the Prospector portfolios and redeem the Prospector managed hedge fund during 2015. In the near term, OneBeacon expects to invest the majority of the proceeds in passive equity vehicles.



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## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

## NOTE 5. Investment Securities

OneBeacon's net investment income is comprised primarily of interest income associated with fixed maturity investments, dividend income from its equity investments, and interest income from its short-term investments. Net investment income for the three months ended March 31, 2015 and 2014 consisted of the following:

(\$ in millions)	Three months ended	
	March 31,	
	2015	2014
Fixed maturity investments	\$10.2	\$10.3
Common equity securities	1.6	1.7
Convertible fixed maturity investments	—	—
Other investments	0.1	0.1
Gross investment income	11.9	12.1
Less investment expenses	(1.4	) (1.7
Net investment income, pre-tax	\$10.5	\$10.4

The composition of net realized investment gains consisted of the following:

(\$ in millions)	Three months ended	
	March 31,	
	2015	2014
Fixed maturity investments	\$0.7	\$0.8
Common equity securities	9.8	5.4
Convertible fixed maturity investments	—	1.1
Other investments	(1.0	) —
Net realized investment gains, pre-tax	\$9.5	\$7.3

As of March 31, 2015 and December 31, 2014, OneBeacon reported \$39.1 million and \$0.5 million, respectively, in accounts payable on unsettled investment purchases and \$5.5 million and \$7.2 million, respectively, in accounts receivable on unsettled investment sales.

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## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

## NOTE 5. Investment Securities

The net changes in fair value for the three months ended March 31, 2015 and 2014 are as follows:

(\$ in millions)	Three months ended March 31, 2015		
	Changes in net unrealized investment gains	Changes in net foreign currency translation gains (losses)	Total net changes in fair value reflected in revenues
Fixed maturity investments	\$6.6	\$—	\$6.6
Common equity securities	(4.4	) (0.1	) (4.5
Convertible fixed maturity investments	0.4	—	0.4
Other investments	2.2	—	2.2
Net change, pre-tax	\$4.8	\$(0.1	) \$4.7
(\$ in millions)	Three months ended March 31, 2014		
	Changes in net unrealized investment gains	Changes in net foreign currency translation gains (losses)	Total net changes in fair value reflected in revenues
Fixed maturity investments	\$4.7	\$—	\$4.7
Common equity securities	3.1	—	3.1
Convertible fixed maturity investments	0.7	—	0.7
Other investments	3.1	—	3.1
Net change, pre-tax	\$11.6	\$—	\$11.6

The components of OneBeacon's ending net unrealized investment gains and losses, excluding the impact of net unrealized foreign currency translation gains and losses, on its investment portfolio as of March 31, 2015 and December 31, 2014 were as follows:

(\$ in millions)	March 31, 2015	December 31, 2014
Investment securities:		
Gross unrealized investment gains	\$109.4	\$104.7
Gross unrealized investment losses	(8.8	) (8.9
Total net unrealized investment gains, pre-tax	100.6	95.8
Income taxes	(28.3	) (26.9
Total net unrealized investment gains, after tax	\$72.3	\$68.9

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## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

## NOTE 5. Investment Securities

The cost or amortized cost, gross unrealized pre-tax investment gains and losses, net foreign currency losses and carrying values of OneBeacon's fixed maturity investments as of March 31, 2015 and December 31, 2014 were as follows:

(\$ in millions)	March 31, 2015				
	Cost or amortized cost	Gross unrealized gains	Gross unrealized losses	Net unrealized foreign currency gains (losses)	Carrying value
U.S. Government and agency obligations	\$38.7	\$0.1	\$—	\$—	\$38.8
Debt securities issued by industrial corporations	762.2	14.7	(0.1	) —	776.8
Municipal obligations	64.7	1.5	(0.2	) —	66.0
Asset-backed securities	897.4	3.2	(1.1	) —	899.5
Foreign government obligations	1.0	0.3	—	—	1.3
Preferred stocks	78.3	6.1	—	—	84.4
Total fixed maturity investments	\$1,842.3	\$25.9	\$(1.4	) \$—	\$1,866.8
(\$ in millions)	December 31, 2014				
	Cost or amortized cost	Gross unrealized gains	Gross unrealized losses	Net unrealized foreign currency gains (losses)	Carrying value
U.S. Government and agency obligations	\$38.0	\$—	\$—	\$—	\$38.0
Debt securities issued by industrial corporations	787.7	11.5	(1.0	) —	798.2
Municipal obligations	62.4	1.4	(0.1	) —	63.7
Asset-backed securities	814.4	1.5	(1.5	) —	814.4
Foreign government obligations	1.0	0.3	—	—	1.3
Preferred stocks	78.3	5.9	—	—	84.2
Total fixed maturity investments	\$1,781.8	\$20.6	\$(2.6	) \$—	\$1,799.8

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## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

## NOTE 5. Investment Securities

The cost or amortized cost, gross unrealized pre-tax investment gains and losses, net foreign currency losses and carrying values of common equity securities, convertible fixed maturity investments and other investments as of March 31, 2015 and December 31, 2014 were as follows:

March 31, 2015					
(\$ in millions)	Cost or amortized cost	Gross unrealized gains	Gross unrealized losses	Net unrealized foreign currency translation gains (losses)	Carrying value
Common equity securities	\$279.7	\$37.3	\$(4.7)	) \$(0.3	) \$312.0
Convertible fixed maturity investments	4.9	0.4	(0.2)	) —	5.1
Other investments	154.5	45.8	(2.5)	) —	197.8
Total common equity securities, convertible fixed maturity investments and other investments	\$439.1	\$83.5	\$(7.4)	) \$(0.3	) \$514.9
December 31, 2014					
(\$ in millions)	Cost or amortized cost	Gross unrealized gains	Gross unrealized losses	Net unrealized foreign currency translation gains (losses)	Carrying value
Common equity securities	\$283.2	\$39.3	\$(2.4)	) \$(0.1	) \$320.0
Convertible fixed maturity investments	5.2	—	(0.2)	) —	5.0
Other investments	157.7	44.8	(3.7)	) —	198.8
Total common equity securities, convertible fixed maturity investments and other investments	\$446.1	\$84.1	\$(6.3)	) \$(0.1	) \$523.8

As of March 31, 2015 and December 31, 2014, the Company held unrestricted collateral from its customers, primarily relating to its surety business, of \$93.0 million and \$81.0 million, respectively, which is included in cash and invested assets. The obligation to return these funds is classified as funds held under insurance contracts in the consolidated balance sheets.

## Fair value measurements

As of March 31, 2015 and December 31, 2014, approximately 89% and 90%, respectively, of the investment portfolio recorded at fair value was priced based upon observable inputs.

The fair values of OneBeacon's investments in hedge funds and private equity funds have been classified as Level 3 under the fair value hierarchy since the fund managers do not provide sufficient information to independently evaluate the pricing inputs and methods for each underlying investment, and therefore the inputs are considered to be unobservable. As of March 31, 2015 and December 31, 2014, OneBeacon did not record a liquidity adjustment to the net asset value related to its investments in hedge funds or private equity funds. Also classified as Level 3 under the fair value hierarchy are surplus notes which are measured at their estimated fair value based on discounted expected cash flows, with changes in fair value reported in total revenues as net realized and change in unrealized investment gains.



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## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

## NOTE 5. Investment Securities

As of both March 31, 2015 and December 31, 2014, other investments reported at fair value represented approximately 7% of the total investment portfolio and consisted of the following as of March 31, 2015 and December 31, 2014:

(\$ in millions)	March 31, 2015	December 31, 2014
Hedge funds <sup>(1)</sup>	\$42.9	\$42.3
Private equity funds <sup>(2)</sup>	56.1	60.1
Total hedge funds and private equity funds	99.0	102.4
Surplus notes (par value \$101.0) <sup>(3)</sup>	68.1	65.1
Investment in community reinvestment vehicle	14.4	14.3
Trust certificates	0.1	0.2
Total other investments <sup>(4)</sup>	\$181.6	\$182.0

<sup>(1)</sup> Consists of 7 hedge funds as of both March 31, 2015 and December 31, 2014.

<sup>(2)</sup> Consists of 17 private equity funds as of both March 31, 2015 and December 31, 2014.

<sup>(3)</sup> The change in the fair value of the surplus notes during the first quarter of 2015 was due to accretion of the discount and changes in credit spreads and U.S. Treasury rates.

Excludes the carrying value of \$16.2 million and \$16.8 million as of March 31, 2015 and December 31, 2014, respectively, associated with a tax advantaged federal affordable housing development fund accounted for using the proportional amortization method.

The largest investment in a single hedge fund or private equity fund was \$15.7 million and \$15.8 million as of March 31, 2015 and December 31, 2014, respectively.

As of March 31, 2015 and December 31, 2014, OneBeacon held one private preferred stock that represented approximately 85% and 84%, respectively, of its preferred stock portfolio. OneBeacon used quoted market prices for similar securities that were adjusted to reflect management's best estimate of fair value; this security is classified as a Level 3 measurement.



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## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

## NOTE 5. Investment Securities

The following tables summarize the Company's fair value measurements for investments as of March 31, 2015 and December 31, 2014 by level:

(\$ in millions)	Fair value at March 31, 2015	Level 1	Level 2	Level 3
Fixed maturity investments:				
U.S. Government and agency obligations	\$38.8	\$38.8	\$—	\$—
Debt securities issued by corporations:				
Consumer	328.1	—	328.1	—
Financial	129.8	—	129.8	—
Industrial	86.2	—	86.2	—
Communications	56.8	—	56.8	—
Energy	54.6	—	54.6	—
Utilities	44.0	—	44.0	—
Basic materials	39.3	—	39.3	—
Technology	38.0	—	38.0	—
Debt securities issued by corporations	776.8	—	776.8	—
Asset-backed securities	899.5	—	871.1	28.4
Preferred stocks	84.4	—	13.0	71.4
Municipal obligations	66.0	—	66.0	—
Foreign government obligations	1.3	0.6	0.7	—
Fixed maturity investments	1,866.8	39.4	1,727.6	99.8
Short-term investments	194.2	193.7	0.5	—
Common equity securities:				
Consumer	129.8	129.8	—	—
Financials	73.9	73.9	—	—
Energy	13.3	13.3	—	—
Basic Materials	9.8	9.8	—	—
Utilities	3.6	3.6	—	—
Other	81.6	81.6	—	—
Common equity securities	312.0	312.0	—	—
Convertible fixed maturity investments	5.1	—	5.1	—
Other investments <sup>(1)</sup>	181.6	—	—	181.6
Total <sup>(1)</sup>	\$2,559.7	\$545.1	\$1,733.2	\$281.4

<sup>(1)</sup> Excludes the carrying value of \$16.2 million associated with a tax advantaged federal affordable housing development fund accounted for using the proportional amortization method as of March 31, 2015.

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## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

## NOTE 5. Investment Securities

(\$ in millions)	Fair value at December 31, 2014	Level 1	Level 2	Level 3
Fixed maturity investments:				
U.S. Government and agency obligations	\$38.0	\$38.0	\$—	\$—
Debt securities issued by corporations:				
Consumer	286.8	—	286.8	—
Financial	148.6	—	148.6	—
Industrial	104.8	—	104.8	—
Communications	74.9	—	74.9	—
Basic materials	56.4	—	53.5	2.9
Energy	53.5	—	53.5	—
Utilities	44.2	—	44.2	—
Technology	29.0	—	29.0	—
Debt securities issued by corporations	798.2	—	795.3	2.9
Asset-backed securities	814.4	—	814.4	—
Preferred stocks	84.2	—	13.1	71.1
Municipal obligations	63.7	—	63.7	—
Foreign government obligations	1.3	0.7	0.6	—
Fixed maturity investments	1,799.8	38.7	1,687.1	74.0
Short-term investments	202.2	201.7	0.5	—
Common equity securities:				
Consumer	121.7	121.7	—	—
Financials	72.4	72.4	—	—
Energy	15.6	15.6	—	—
Basic Materials	9.9	—	—	—