OneBeacon Insurance Group, Ltd.
Form 10-Q
August 03, 2016

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

FORM 10-Q

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

For the quarterly period ended June 30, 2016

OR

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

For the transition period from to

Commission file number 1-33128

ONEBEACON INSURANCE GROUP, LTD.
(Exact name of Registrant as specified in its charter)

Bermuda	98-0503315
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
605 North Highway 169 Plymouth, Minnesota (Address of principal executive offices)	55441 (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 x No o

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

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

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

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

As of August 1, 2016, 22,592,731 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.

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PART I. FINANCIAL INFORMATION
ITEM 1. FINANCIAL STATEMENTS

ONEBEACON INSURANCE GROUP, LTD.
CONSOLIDATED BALANCE SHEETS

($ in millions, except per share amounts)	June 30, 2016 (Unaudited)	December 31, 2015
Assets		
Investment Securities:		
Fixed maturity investments, at fair value (amortized cost: $2,090.6 in 2016 and $2,078.3 in 2015)	$ 2,119.8	$ 2,080.5
Short-term investments, at amortized cost (which approximates fair value)	114.5	69.2
Common equity securities, at fair value (amortized cost - $229.1 in 2016 and $295.0 in 2015)	237.1	298.7
Other investments, at fair value (amortized cost - $125.0 in 2016 and $135.6 in 2015)	147.2	143.0
Total investment securities	2,618.6	2,591.4
Cash	72.9	95.2
Reinsurance recoverables	183.5	193.5
Premiums receivable	238.9	219.0
Deferred acquisition costs	105.2	100.7
Ceded unearned premiums	34.5	29.5
Net deferred tax asset	122.2	140.2
Investment income accrued	9.4	10.1
Accounts receivable on unsettled investment sales	4.5	30.5
Other assets	181.1	192.5
Total assets	$ 3,570.8	$ 3,602.6
Liabilities		
Unpaid loss and loss adjustment expense reserves	$ 1,376.6	$ 1,389.8
Unearned premiums	556.4	560.3
Funds held under insurance contracts	140.9	137.7
Ceded reinsurance payable	23.9	29.8
Debt	273.0	272.9
Accounts payable on unsettled investment purchases	16.5	—
Other liabilities	157.6	207.6
Total liabilities	2,544.9	2,598.1
OneBeacon's common shareholders' equity and noncontrolling interests		
OneBeacon's common shareholders' equity		
Preference shares (Par value $0.01; 80,000,000 authorized shares; none issued or outstanding)	—	—
Common shares and paid-in surplus (Class A: par value $0.01; 200,000,000 authorized shares; 22,592,731 and 23,334,502 issued and outstanding)(Class B: par value $0.01; 200,000,000 authorized shares; 71,754,738 issued and outstanding for both periods)	1,011.8	1,022.0
Retained earnings (deficit)	15.4	(15.9)
Accumulated other comprehensive loss	(5.0)	(5.2)
Total OneBeacon's common shareholders' equity	1,022.2	1,000.9
Total noncontrolling interests	3.7	3.6
Total OneBeacon's common shareholders' equity and noncontrolling interests	1,025.9	1,004.5
Total liabilities, OneBeacon's common shareholders' equity and noncontrolling interests	$ 3,570.8	$ 3,602.6

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 June 30, 2016	Three months ended June 30, 2015	Six months ended June 30, 2016	Six months ended June 30, 2015
Revenues				
Earned premiums	$271.4	$319.3	$550.0	$605.9
Net investment income	12.1	10.1	26.5	20.6
Net realized and change in unrealized investment gains	24.7	(14.0)	41.3	0.2
Net other revenues (expenses)	0.8	(1.2)	1.7	(4.3)
Total revenues	309.0	314.2	619.5	622.4
Expenses				
Loss and loss adjustment expenses	179.7	194.5	338.5	360.4
Policy acquisition expenses	48.7	56.4	99.7	107.4
Other underwriting expenses	50.9	52.9	106.2	108.8
General and administrative expenses	3.5	4.2	7.4	8.3
Interest expense	3.2	3.3	6.5	6.5
Total expenses	286.0	311.3	558.3	591.4
Pre-tax income from continuing operations	23.0	2.9	61.2	31.0
Income tax benefit (expense)	2.0	0.9	10.7	(2.5)
Net income from continuing operations	25.0	3.8	71.9	28.5
Loss from discontinued operations, net of tax	—	(0.2)	—	(0.3)
Gain from sale of discontinued operations, net of tax	—	0.3	—	0.3
Net income, including noncontrolling interests	25.0	3.9	71.9	28.5
Less: Net income attributable to noncontrolling interests	(0.5)	(0.5)	(1.0)	(1.0)
Net income attributable to OneBeacon's common shareholders	24.5	3.4	70.9	27.5
Other comprehensive income, net of tax	0.2	0.2	0.2	0.4
Comprehensive income attributable to OneBeacon's common shareholders	$24.7	$3.6	$71.1	$27.9
Earnings per share attributable to OneBeacon's common shareholders—basic and diluted				
Net income from continuing operations, per share	$0.26	$0.03	$0.75	$0.29
Net income attributable to OneBeacon's common shareholders per share	$0.26	$0.03	$0.75	$0.29
Dividends declared and paid per OneBeacon's common share	$0.21	$0.21	$0.42	$0.42

See Notes to Consolidated Financial Statements.

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

	OneBeacon's Common Shareholders' Equity						Total OneBeacon's common shareholders' equity and noncontrolling interests
($ in millions)	Common shares outstanding	Common shares and paid-in surplus	Retained earnings	Accum. other comprehensive loss	Total OneBeacon common shareholders' equity	Noncontrolling interests, after tax	
Balances at January 1, 2016	95,089,240	$1,022.0	$(15.9)	$ (5.2)	$ 1,000.9	$ 3.6	$ 1,004.5
Comprehensive income:							
Net income	—	—	70.9	—	70.9	1.0	71.9
Other comprehensive income, net of tax	—	—	—	0.2	0.2	—	0.2
Total comprehensive income	—	—	70.9	0.2	71.1	1.0	72.1
Amortization of restricted share awards	—	1.3	—	—	1.3	—	1.3
Issuance of common shares	173,559	—	—	—	—	0.1	0.1
Repurchase and retirement of common shares	(915,330)	(11.5)	—	—	(11.5)	—	(11.5)
Dividends		—	(39.6)	—	(39.6)	(1.0)	(40.6)
Balances at June 30, 2016	94,347,469	$1,011.8	$ 15.4	$ (5.0)	$ 1,022.2	$ 3.7	$ 1,025.9

	OneBeacon's Common Shareholders' Equity						Total OneBeacon's common shareholders' equity and noncontrolling interests
($ in millions)	Common shares outstanding	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, 2015	95,296,387	$1,023.7	$ 27.3	$ (5.2)	$ 1,045.8	$ 3.5	$ 1,049.3
Comprehensive income:							
Net income	—	—	27.5	—	27.5	1.0	28.5
Other comprehensive income, net of tax	—	—	—	0.4	0.4	—	0.4
Total comprehensive income	—	—	27.5	0.4	27.9	1.0	28.9
Amortization of restricted share awards	—	1.1	—	—	1.1	—	1.1
Issuance of common shares	81,000	—	—	—	—	0.1	0.1
Repurchase and retirement of common shares	(113,551)	(1.6)	—	—	(1.6)	—	(1.6)
Dividends		—	(40.0)	—	(40.0)	(1.1)	(41.1)
Balances at June 30, 2015	95,263,836	$1,023.2	$ 14.8	$ (4.8)	$ 1,033.2	$ 3.5	$ 1,036.7

See Notes to Consolidated Financial Statements.

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

	Six months ended June 30,	
($ in millions)	2016	2015
Cash flows from operations:		
Net income including noncontrolling interests	$71.9	$28.5
Charges (credits) to reconcile net income to cash flows provided from operations:		
Net loss from discontinued operations	—	0.3
Net gain from sale of discontinued operations	—	(0.3)
Net realized and change in unrealized investment gains	(41.3)	(0.2)
Net adjustment to gain on sale of business	—	3.7
Deferred income tax expense (benefit)	19.2	(3.8)
Other operating items:		
Net change in loss and LAE reserves	(13.2)	8.6
Net change in unearned premiums	(3.9)	27.9
Net change in ceded unearned premium	(5.0)	(25.4)
Net change in premiums receivable	(19.9)	(50.7)
Net change in reinsurance recoverables on paid and unpaid losses	10.0	5.8
Net change in funds held under reinsurance contracts	—	(12.2)
Net change in funds held under insurance contracts	3.2	21.6
Net change in ceded reinsurance payable	(5.9)	35.4
Net change in other assets and liabilities	(32.4)	3.6
Net cash provided from (used for) operations—continuing operations	(17.3)	42.8
Net cash used for operations—discontinued operations	—	(0.3)
Net cash provided from (used for) operations	(17.3)	42.5
Cash flows from investing activities:		
Net maturities, purchases and sales of short-term investments	(45.4)	44.3
Maturities of fixed maturity investments	229.5	115.8
Sales of fixed maturity investments	200.5	450.0
Sales of common equity securities	174.4	268.1
Return of capital and distributions of other investments	7.0	28.2
Purchases of fixed maturity investments	(449.4)	(714.1)
Purchases of common equity securities	(109.5)	(248.7)
Contributions for other investments	(0.4)	(3.3)
Net change in unsettled investment purchases and sales	42.5	25.8
Proceeds from sale of property and equipment	—	56.8
Net acquisitions of property and equipment	(2.1)	(1.8)
Net cash used for investing activities	47.1	21.1
Cash flows from financing activities:		
Cash dividends paid to common shareholders	(39.6)	(40.0)
Repurchases and retirements of common stock	(11.5)	(1.6)
Payments on capital lease obligation	(1.0)	(2.8)
Net cash used for financing activities	(52.1)	(44.4)
Net (decrease) increase in cash during period	(22.3)	19.2
Cash balance at beginning of period	95.2	87.0

Cash balance at end of period	$72.9	$106.2

See Notes to Consolidated Financial Statements.

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"). 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 76.1% 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 26 Reid Street, Hamilton HM 11, Bermuda. The Company's U.S. corporate headquarters are located at 605 North Highway 169, Plymouth, Minnesota 55441 and its registered office is located at Clarendon House, 2 Church Street, Hamilton HM 11, Bermuda.

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 as well as the vast majority of asbestos and environmental reserves (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 for the three and six months ended June 30, 2016 and 2015 and in the consolidated statement of cash flows for the six months ended June 30, 2016 and 2015.

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. The Specialty Industries segment is comprised of six 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 holding company 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 2015 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 2015 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

Business Combinations - Measurement Period Adjustments

Effective January 1, 2016, OneBeacon adopted ASU 2015-16, Simplifying the Accounting for Measurement-Period Adjustments, which requires adjustments to provisional amounts recorded in connection with a business combination that are identified during the measurement period to be recorded in the reporting period in which the adjustment amounts are determined, rather than as retroactive adjustments to prior periods. OneBeacon has not recognized any adjustments to estimated purchase accounting amounts for the year to date period ended June 30, 2016 and accordingly, there was no effect to OneBeacon's financial statements upon adoption.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
NOTE 1. Nature of Operations and Summary of Significant Accounting Policies

Fair Value Measurements
Effective January 1, 2016, OneBeacon adopted ASU 2015-07, Fair Value Measurement - Disclosures for Investments in Certain Entities that Calculate Net Asset Value per Share (or Its Equivalent) (ASC 820) which eliminates the requirement to disclose the fair value hierarchy level for investments for which fair value is measured at net asset value ("NAV") using the practical expedient in ASC 820. OneBeacon measures the fair value of its investments in hedge funds and private equity funds using this practical expedient. Upon adoption, these fair value measurements are no longer classified within the fair value hierarchy. Prior year amounts have been modified to conform to the current year's disclosures.
Amendments to Consolidation Analysis
On January 1, 2016, OneBeacon adopted 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. Adoption of ASU 2015-02 did not affect the consolidation analysis for any of OneBeacon's investments.
Share-Based Compensation Awards
On January 1, 2016, OneBeacon adopted 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 (ASC 718). The new 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 is to be recognized in the period when it becomes probable the performance target will be achieved in an amount equal to the compensation cost attributable to the periods for which service has been rendered. There was no effect to OneBeacon's financial statements upon adoption.
Debt Issuance Costs
Effective January 1, 2016, OneBeacon adopted ASU 2015-03, Imputation of Interest (ASC 835) which requires debt issuance costs to be presented as a deduction from the carrying amount of the related debt, consistent with the treatment required for debt discounts. The new guidance requires amortization of debt issuance costs to be classified within interest expense and also requires disclosure of the debt's effective interest rate. OneBeacon has applied the guidance retrospectively and as a result has reclassified $1.9 million of debt issuance costs from other assets, reflecting these amounts as reduction from the related debt and has modified its disclosures to include the required effective interest rate on its debt. Adoption of ASU 2015-03 did not have a material impact on OneBeacon's financial position, results of operations, or cash flows. In addition, effective January 1, 2016, OneBeacon adopted ASU 2015-15, Imputation of Interest (ASC 835), which addresses the presentation and subsequent measurement of debt issuance costs related to line-of-credit arrangements. Adoption of ASU 2015-15 did not have a significant effect on OneBeacon's financial position, results of operations, cash flows, presentation or disclosures.
Recently Issued Accounting Pronouncements
Credit Losses
In June 2016, the FASB issued ASU 2016-13, Measurement of Credit Losses on Financial Instruments (ASC 326), which establishes new guidance for the recognition of credit losses for financial assets measured at amortized cost. The new ASU, which applies to financial assets that have the contractual right to receive cash, including reinsurance receivables, requires reporting entities to estimate the credit losses expected over the life of a credit exposure using historical information, current information and reasonable and supportable forecasts that affect the collectability of the financial asset. ASU 2016-13 is effective for annual periods beginning after January 1, 2020, including interim periods. OneBeacon is evaluating the expected impact of this new guidance.

Stock Compensation

On March 30, 2016, the Board issued ASU 2016-09, Improvements to Employee Share-Based Payment Accounting (ASC 718) which is intended to simplify certain aspects of the accounting for share-based compensation. The new guidance provides an accounting policy election to account for forfeitures by either applying an assumption, as required under existing guidance, or by recognizing forfeitures when they actually occur. The new guidance is effective for annual periods beginning after December 15, 2016, and interim periods within those annual periods with early adoption permitted. OneBeacon does not expect a significant effect upon adoption.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
NOTE 1. Nature of Operations and Summary of Significant Accounting Policies

Leases
On February 25, 2016, the FASB issued ASU 2016-02, Leases (ASC 842). The new guidance requires lessees to recognize lease assets and liabilities on the balance sheet for both operating and financing leases, with the exception of leases with an original term of 12 months or less. Under existing guidance recognition of lease assets and liabilities is not required for operating leases. The lease assets and liabilities to be recognized are both measured initially based on the present value of the lease payments. Under the new guidance, a sale-leaseback transaction must meet the recognition criteria under ASC 606, Revenues in order to be accounted for as sale. The new guidance is effective for OneBeacon for years beginning after December 15, 2018, including interim periods therein. OneBeacon is evaluating the expected impact of this new guidance and available adoption methods.
Financial Instruments - Recognition and Measurement
On January 5, 2016, the FASB issued ASU 2016-01, Recognition and Measurement of Financial Assets and Financial Liabilities (ASC 825-10). The new guidance requires all equity securities with readily determinable fair values to be measured at fair value with changes therein recognized through current period earnings. In addition, the new ASU simplifies the impairment assessment of equity investments without readily determinable fair values by requiring a qualitative assessment to identify impairment, and for impaired equity security investments to be measured at fair value. ASU 2016-01 is effective for fiscal years beginning after December 15, 2017, with early adoption permitted. OneBeacon has taken the fair value election for its portfolio of equity security investments and accordingly, does not expect the adoption of ASU 2016-01 to have a significant impact on its financial statements.
Insurance Contracts
In May 2015, the FASB issued ASU 2015-09, Disclosures about Short Duration Contracts (ASC 944) which requires expanded footnote disclosures about loss and loss adjustment expense ("LAE") reserves. Under the new guidance, some disclosures currently presented outside of OneBeacon’s financial statements, such as loss development tables and a reconciliation of loss development data to the loss and LAE reserves reflected on the balance sheet, will become part of the financial statement footnotes. In addition, the loss development tables required to be presented under the new ASU must be presented on a disaggregated basis by accident year rather than by reporting year as currently presented. Some of the expanded disclosures are new requirements, such as the disclosure of reserves for losses incurred but not reported ("IBNR") plus expected development on reported claims, which must be presented by accident year on a disaggregated basis. The new guidance also requires new disclosures about claim frequency data together with descriptions of the approach used to measure that data. Qualitative descriptions of methodologies and assumptions used to develop IBNR estimates must be presented together with the disaggregated amounts of IBNR to which they relate, along with a discussion of any significant changes in methodology and assumptions and the related effect upon the loss reserves. The new guidance will be effective for annual periods beginning after December 15, 2015 and interim periods within annual periods beginning after December 15, 2016 with retrospective restatement of prior periods required. OneBeacon will modify its financial statement footnote disclosures to conform to the requirements of ASU 2015-09 upon adoption, including revisions to prior year’s 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. In August 2015, the FASB issued ASU 2015-14, Revenue from Contracts with Customers (ASC 606), which delayed the effective date of ASU 2014-09 by one year. As a result, the standard is effective for annual and interim periods beginning after December 15, 2017. 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.
NOTE 2. Acquisitions and Dispositions
Crop Business

On July 31, 2015, Monsanto Company sold Climate Crop Insurance Agency ("CCIA"), the third party agency with which OneBeacon previously had an exclusive managing general agency agreement, to an affiliate of AmTrust Financial Services, Inc. ("AmTrust"). As a result of the sale, the Company exited the multiple peril crop insurance ("MPCI") business and its related crop-hail business (collectively, "Crop Business"). As a result of the transaction, OneBeacon and CCIA agreed to an early termination of the existing five year agreement. In connection with the termination of the agreement, OneBeacon received a payment of $3.0 million. Also related to the transaction, OneBeacon withdrew its 2016 Plan of Operations, which previously

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
NOTE 2. Acquisitions and Dispositions

authorized it to write MPCI for the 2016 Reinsurance Year, and affiliates of AmTrust agreed to reinsure the Company's remaining net Crop Business exposure for the 2015 Reinsurance Year under a related 100% quota share reinsurance agreement which, coupled with other transfer and assignment agreements as well as communications with policyholders and agents, had the effect of assumption reinsurance. As a result of this transaction, the Company has no material net exposure related to the Crop Business.

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. OneBeacon provided financing in the form of surplus notes issued by Bedivere Insurance Company ("Bedivere"), one of the legal entities transferred as part of the transaction, having a par value of $101.0 million, which had a fair value of $64.9 million on the date of sale. See Note 15—"Discontinued Operations" for further information.

Essentia Insurance Company

Effective January 1, 2013, OneBeacon completed the sale of Essentia Insurance Company ("Essentia"), which wrote the collector cars and boats business, to Markel Corporation. During the first quarter of 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 payable to Markel Corporation pursuant to the indemnification provisions in the stock purchase agreement governing the sale of Essentia.

Except as described above, during the three and six months ended June 30, 2016 and 2015, there were no significant acquisitions or dispositions.

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 and six months ended June 30, 2016 and 2015:

	Three months ended June 30,		Six months ended June 30,	
($ in millions)	2016	2015	2016	2015
Gross beginning balance	$1,343.8	$1,304.0	$1,389.8	$1,342.2
Less beginning reinsurance recoverables on unpaid losses	(150.4)	(141.6)	(186.0)	(161.6)
Net beginning loss and LAE reserves	1,193.4	1,162.4	1,203.8	1,180.6
Loss and LAE incurred relating to:				
Current year losses	164.3	194.5	323.1	362.2
Prior year losses	15.4	—	15.4	(1.8)
Total incurred loss and LAE	179.7	194.5	338.5	360.4
Loss and LAE paid relating to:				
Current year losses	(37.1)	(42.7)	(59.1)	(64.8)
Prior year losses	(122.2)	(110.5)	(269.4)	(272.5)
Total loss and LAE payments	(159.3)	(153.2)	(328.5)	(337.3)
Net ending loss and LAE reserves	1,213.8	1,203.7	1,213.8	1,203.7
Plus ending reinsurance recoverables on unpaid losses	162.8	147.1	162.8	147.1
Gross ending loss and LAE reserves	$1,376.6	$1,350.8	$1,376.6	$1,350.8

Loss and LAE development

Loss and LAE development—2016

During both the three and six months ended June 30, 2016, OneBeacon experienced $15.4 million net unfavorable loss and LAE reserve development on prior accident year reserves. During the three months ended June 30, 2016, the Healthcare operating segment recorded $20.0 million of net unfavorable loss reserve development as a result of increasing claim frequency, as well as higher than expected paid and case activity, most notably within the senior living sub-line, which provides medical

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
NOTE 3. Unpaid Loss and Loss Adjustment Expense (LAE) Reserves

malpractice and general liability insurance for extended care facilities, including assisted living, memory care and continuing care facilities. As a result of the continuing loss activity experienced in this sub-line, an in-depth claim file review was performed which confirmed that the increased case incurred was driven by frequency, especially in the more recent prior accident years, as opposed to other potential considerations such as changes in claims-handling practices. In addition, a thorough actuarial review was completed, including analysis of the results of enhancements made to the predictive model deployed in the senior living sub-line. Adverse financial results were primarily observed in high-risk categories of business and in difficult geographic venues identified by the predictive model data. As a result of these analyses, management increased its best estimate of prior accident year losses, and increased its loss provisions for the current accident year based on the updated actuarial indications. In addition, also within the Healthcare operating segment, there were two large claims within the managed care errors and omissions sub-line related to unexpected outcomes from mediation and extended costs associated with claim defense, which contributed to the unfavorable development in prior accident years. In the six months ended June 30, 2016, Healthcare has recorded $30.0 million of adverse prior year development, which included prior year loss activity recorded in the first quarter of 2016 in the complex risk sub-line, which provides professional liability coverage to hospitals, physicians, and physician groups as well as physicians' extended reporting period coverage.

In addition to Healthcare, but to a lesser extent, Programs also experienced unfavorable development during the three months ended June 30, 2016 primarily as a result of two larger auto-related programs; the total unfavorable development in Healthcare and Programs, along with a few other businesses, was partially offset by favorable development in Financial Services and several other businesses.

During the six months ended June 30, 2016, net unfavorable development was driven by Healthcare. In addition, to a lesser extent, unfavorable development in Programs and a few other businesses, was partially offset by favorable development in Technology, Financial Services and Accident, as well as other businesses.

Loss and LAE development—2015

During the three months ended June 30, 2015, OneBeacon experienced no net loss and LAE reserve development on prior accident year reserves, as favorable development from several businesses, most notably Specialty Property and Surety, was offset by unfavorable development primarily due to a large claim in Entertainment and an increase in the frequency of small to medium losses in the Ocean Marine business.

During the six months ended June 30, 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 Technology, Specialty Property, Government Risks, and Surety. This favorable development was mostly offset by unfavorable development in Entertainment driven by several large losses and small to mid-sized claims and by losses within the Inland Marine business resulting from a few large claims and, to a lesser extent, from Tuition Reimbursement.

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 reinsurance coverage is discussed in Note 4—"Reinsurance" in the Company's 2015 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 2015 Annual Report on Form 10-K.

The Company entered into a 50% quota share reinsurance agreement related to its Financial Institutions business.

Effective May 1, 2016, OneBeacon renewed its property catastrophe reinsurance program through April 30, 2017. The program provides coverage for OneBeacon's property business as well as certain acts of terrorism. Under the program, the first $20.0 million of losses resulting from any single catastrophe are retained, with 100% of the next $110.0 million of losses resulting from the catastrophe being reinsured. Any part of a catastrophe loss in excess of $130.0

million would be retained in full. In the event of a catastrophe, OneBeacon's property catastrophe reinsurance program is reinstated for the remainder of the original contract term by paying a reinstatement premium that is based on the percentage of coverage reinstated and the original property catastrophe coverage premium.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
NOTE 4. Reinsurance

Reinsurance Recoverables
As of June 30, 2016, OneBeacon had reinsurance recoverables on paid losses of $20.7 million and reinsurance recoverables on unpaid losses of $162.8 million. As reinsurance contracts do not relieve OneBeacon of its obligations, collectability 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, excluding industry pools and associations, based upon reinsurance recoverable amounts on paid and unpaid losses and LAE:

Standard & Poor's Rating[(1)]:	Balance at June 30, 2016 ($ in millions)	% of total
AA	$ 47.4	26 %
A	112.4	61 %
BBB, Not Rated and Other[(2)]	23.7	13 %
Total reinsurance recoverables	$ 183.5	100%

[(1)] Standard & Poor's ratings as detailed above are "AA" (Very strong), "A" (Strong) and "BBB" (Adequate).
[(2)]Includes reinsurance recoverable on unpaid losses from Bedivere of $18.2 million.

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 2015 Annual Report on Form 10-K for a complete discussion.

OneBeacon classifies its portfolio of fixed maturity investments and common equity securities 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, on a pre-tax basis, in total revenues as net realized and change in unrealized investment gains.

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, with changes in fair value reported in total revenues as net realized and change in unrealized investment gains and a tax advantaged federal affordable housing development fund which is accounted for under the proportional amortization method.

Prospector Partners, LLC (“Prospector”), was previously the primary manager of OneBeacon's publicly-traded common equity securities portfolio. The Prospector-managed separate accounts were liquidated during the second quarter of 2015, and a Prospector-managed hedge fund was redeemed. As the separate accounts were liquidated, OneBeacon reinvested the majority of the proceeds into exchange traded funds ("ETFs") that seek to provide investment results that, before expenses, generally correspond to the performance of the S&P 500, Russell 1000, and Russell 1000 Value indices.

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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 and dividend income from its equity investments.
Net investment income for the three and six months ended June 30, 2016 and 2015 consisted of the following:

	Three months ended June 30,		Six months ended June 30,	
($ in millions)	2016	2015	2016	2015
Fixed maturity investments	$12.2	$10.3	$24.3	$20.5
Short-term investments	0.1	—	0.1	—
Common equity securities	0.5	1.5	1.5	3.1
Other investments[(1)]	0.5	(0.1)	3.0	—
Gross investment income	13.3	11.7	28.9	23.6
Less external investment expenses	(1.2)	(1.6)	(2.4)	(3.0)
Net investment income, pre-tax	$12.1	$10.1	$26.5	$20.6

[(1)] Includes an interest payment on the surplus notes of $2.4 million received in the six months ended June 30, 2016.

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

	Three months ended June 30,		Six months ended June 30,	
($ in millions)	2016	2015	2016	2015
Fixed maturity investments	$0.4	$1.2	$(1.0)	$1.9
Common equity securities	3.7	24.6	(1.0)	34.4
Other investments	(3.0)	9.4	(2.8)	8.4
Net realized investment gains (losses), pre-tax	$1.1	$35.2	$(4.8)	$44.7

The net changes in net unrealized gains for the three and six months ended June 30, 2016 and 2015 are as follows:

	Three months ended June 30, 2016			Six months ended June 30, 2016		
($ in millions)	Changes in net unrealized investment gains	Changes in net foreign currency gains (losses)	Total net changes in unrealized gains reflected in revenues	Changes in net unrealized investment gains	Changes in net foreign currency gains (losses)	Total net changes in fair value reflected in revenues
Fixed maturity investments	$12.0	$ —	$ 12.0	$27.0	$ —	$ 27.0
Common equity securities	(5.4)	—	(5.4)	4.3	—	4.3
Other investments	17.0	—	17.0	14.8	—	14.8
Net change, pre-tax	$23.6	$ —	$ 23.6	$46.1	$ —	$ 46.1

	Three months ended June 30, 2015			Six months ended June 30, 2015		
($ in millions)	Changes in net	Changes in net	Total net changes	Changes in net	Changes in net	Total net changes

	unrealized investment gains	foreign currency gains (losses)	in unrealized gains reflected in revenues	unrealized investment gains	foreign currency gains (losses)	in fair value reflected in revenues
Fixed maturity investments	$(9.1)	$ —	$ (9.1)	$(2.5)	$ —	$ (2.5)
Common equity securities	(26.5)	0.3	(26.2)	(30.9)	0.2	(30.7)
Other investments	(13.9)	—	(13.9)	(11.3)	—	(11.3)
Net change, pre-tax	$(49.5)	$ 0.3	$ (49.2)	$(44.7)	$ 0.2	$ (44.5)

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
NOTE 5. Investment Securities

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 June 30, 2016 and December 31, 2015 were as follows:

($ in millions)	June 30, 2016	December 31, 2015
Investment securities:		
Gross unrealized investment gains	$ 70.0	$ 46.5
Gross unrealized investment losses	(10.6)	(33.2)
Total net unrealized investment gains, pre-tax	59.4	13.3
Income taxes	(19.5)	(6.5)
Total net unrealized investment gains, after-tax	$ 39.9	$ 6.8

The cost or amortized cost, gross unrealized pre-tax investment gains and losses, net foreign currency gains and losses and carrying values of OneBeacon's fixed maturity investments as of June 30, 2016 and December 31, 2015 were as follows:

	June 30, 2016				
($ in millions)	Cost or amortized cost	Gross unrealized gains	Gross unrealized losses	Net unrealized foreign currency gains (losses)	Carrying value
U.S. Government and agency obligations	$53.5	$ 0.3	$ —	$ —	$53.8
Debt securities issued by corporations	699.4	15.3	(0.1)	—	714.6
Municipal obligations	67.4	2.8	(0.1)	—	70.1
Mortgage and asset-backed securities	1,191.0	5.8	(1.4)	—	1,195.4
Foreign government obligations	1.0	0.2	—	—	1.2
Preferred stocks	78.3	6.4	—	—	84.7
Total fixed maturity investments	$2,090.6	$ 30.8	$ (1.6)	$ —	$2,119.8

	December 31, 2015				
($ in millions)	Cost or amortized cost	Gross unrealized gains	Gross unrealized losses	Net unrealized foreign currency gains (losses)	Carrying value
U.S. Government and agency obligations	$85.4	$ —	$ (0.1)	$ —	$85.3
Debt securities issued by corporations	810.8	4.1	(4.5)	—	810.4
Municipal obligations	67.7	1.5	(0.2)	—	69.0
Mortgage and asset-backed securities	1,035.1	1.3	(4.5)	—	1,031.9
Foreign government obligations	1.0	0.2	—	—	1.2
Preferred stocks	78.3	4.4	—	—	82.7
Total fixed maturity investments	$2,078.3	$ 11.5	$ (9.3)	$ —	$2,080.5

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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 unrealized pre-tax foreign currency gains and losses and carrying values of common equity securities and other investments as of June 30, 2016 and December 31, 2015 were as follows:

($ in millions)	June 30, 2016 Cost or amortized cost	Gross unrealized gains	Gross unrealized losses	Net unrealized foreign currency gains (losses)	Carrying value
Common equity securities	$229.1	$ 13.8	$ (5.8)	$ —	$ 237.1
Other investments	125.0	25.4	(3.2)	—	147.2
Total common equity securities and other investments	$354.1	$ 39.2	$ (9.0)	$ —	$ 384.3

($ in millions)	December 31, 2015 Cost or amortized cost	Gross unrealized gains	Gross unrealized losses	Net unrealized foreign currency gains (losses)	Carrying value
Common equity securities	$295.0	$ 12.7	$ (9.0)	$ —	$ 298.7
Other investments	135.6	22.3	(14.9)	—	143.0
Total common equity securities and other investments	$430.6	$ 35.0	$ (23.9)	$ —	$ 441.7

As of June 30, 2016 and December 31, 2015, the Company held unrestricted collateral from its customers, primarily relating to its surety business, of $140.9 million and $137.7 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.

The following table summarizes the ratings of the debt securities issued by corporations owned by OneBeacon as of June 30, 2016 and December 31, 2015:

($ in millions)	at Fair value June 30, 2016	December 31, 2015
AA[1]	$64.5	$ 42.7
A[1]	235.0	265.4
BBB[1]	415.1	502.3
Debt securities issued by corporations	$714.6	$ 810.4

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[1] Credit ratings are assigned based on the following hierarchy: 1) Standard and Poor’s Financial Services LLC (“Standard and Poor’s”) and 2) Moody’s Investor Service (“Moody’s”).

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
NOTE 5. Investment Securities

Fair value measurements
Fair value measurements are categorized into a hierarchy that distinguishes between inputs based on market data from independent sources ("observable inputs") and a reporting entity's internal assumptions based upon the best information available when external market data is limited or unavailable ("unobservable inputs"). Quoted prices in active markets for identical assets or liabilities have the highest priority ("Level 1"), followed by observable inputs other than quoted prices, including prices for similar but not identical assets or liabilities ("Level 2") and unobservable inputs, including the reporting entity's estimates of the assumptions that market participants would use, having the lowest priority ("Level 3"). As of both June 30, 2016 and December 31, 2015, approximately 92% of the investment portfolio recorded at fair value was priced based upon observable inputs.

Investments valued using Level 1 inputs include fixed maturity investments, primarily investments in U.S. Treasuries, common equity securities and short-term investments, which include U.S. Treasury Bills. Investments valued using Level 2 inputs comprise fixed maturity investments, which have been disaggregated into classes, including debt securities issued by corporations, municipal obligations, mortgage and asset-backed securities, foreign government obligations and preferred stocks. Investments valued using Level 2 inputs also include certain ETFs that track US stock indices such as the S&P 500 but are traded on foreign exchanges and that management values using the fund's published NAV to account for the difference in market close times. Fair value estimates for investments that trade infrequently and have few or no observable market prices are classified as Level 3 measurements. Level 3 fair value estimates based upon unobservable inputs include OneBeacon's investments in surplus notes which are measured at their estimated fair value based on discounted expected cash flows using information as of the measurement date, as well as certain investments in fixed maturity investments, common equity securities and other investments, where quoted market prices are unavailable or are not considered reasonable. OneBeacon determines when transfers between levels have occurred as of the beginning of the period.

OneBeacon uses brokers and outside pricing services to assist in determining fair values. For investments in active markets, OneBeacon uses the quoted market prices provided by outside pricing services to determine fair value. The outside pricing services OneBeacon uses have indicated that they will only provide prices where observable inputs are available. In circumstances where quoted market prices are unavailable or are not considered reasonable, OneBeacon estimates the fair value using industry standard pricing methodologies and observable inputs such as benchmark yields, reported trades, broker-dealer quotes, issuer spreads, benchmark securities, bids, offers, credit ratings, prepayment speeds, reference data including research publications and other relevant inputs. Given that many fixed maturity investments do not trade on a daily basis, the outside pricing services evaluate a wide range of fixed maturity investments by regularly drawing parallels from recent trades and quotes of comparable securities with similar features. The characteristics used to identify comparable fixed maturity investments vary by asset type and take into account market convention.

OneBeacon's process to assess the reasonableness of the market prices obtained from the outside pricing sources covers substantially all of its fixed maturity investments and includes, but is not limited to, evaluation of pricing methodologies, review of the pricing services' quality control processes and procedures on at least an annual basis, comparison of market prices to prices obtained from alternate independent pricing vendors on at least a semi-annual basis, monthly analytical reviews of certain prices and review of assumptions utilized by the pricing service for selected measurements on an ad hoc basis throughout the year. OneBeacon also performs back-testing of selected purchases and sales activity to determine whether there are any significant differences between the market price used to value the security prior to purchase or sale and the actual purchase or sale price on an ad-hoc basis throughout the year. Prices provided by the pricing services that vary by more than 5% and $1.0 million from the expected price based on these procedures are considered outliers. Also considered outliers are prices that haven’t changed from period to period and prices that have trended unusually compared to market conditions. In circumstances where the results of OneBeacon's review process does not appear to support the market price provided by the pricing services, OneBeacon challenges the price. If OneBeacon cannot gain satisfactory evidence to support the challenged price, it relies upon its own pricing methodologies to estimate the fair value of the security in question.

The valuation process above is generally applicable to all of OneBeacon’s fixed maturity investments. The techniques and inputs specific to asset classes within OneBeacon's fixed maturity investments for Level 2 securities that use observable inputs are as follows:

Debt securities issued by corporations: The fair value of debt securities issued by corporations is determined from an evaluated pricing model that uses information from market sources and integrates relative credit information, observed market movements, and sector news. Key inputs include benchmark yields, reported trades, broker-dealer quotes, issuer spreads, two-

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
NOTE 5. Investment Securities

sided markets, benchmark securities, bids, offers, and reference data including sector, coupon, quality ratings, duration, credit enhancements, early redemption features and market research publications.
Municipal obligations: The fair value of municipal obligations is determined from an evaluated pricing model that uses information from market makers, broker-dealers, buy-side firms, and analysts along with general market information. Key inputs include benchmark yields, reported trades, issuer financial statements, material event notices and new issue data, as well as broker-dealer quotes, issuer spreads, two-sided markets, benchmark securities, bids, offers, and reference data including type, coupon, credit quality ratings, duration, credit enhancements, geographic location and market research publications.
Mortgage and asset-backed securities: The fair value of mortgage and asset backed securities is determined from an evaluated pricing model that uses information from market sources and leveraging similar securities. Key inputs include benchmark yields, reported trades, underlying tranche cash flow data, collateral performance, plus new issue data, as well as broker-dealer quotes, issuer spreads, two-sided markets, benchmark securities, bids, offers, and reference data including issuer, vintage, loan type, collateral attributes, prepayment speeds, default rates, recovery rates, cash flow stress testing, credit quality ratings and market research publications.
Foreign government obligations: The fair value of foreign government obligations is determined from an evaluated pricing model that uses feeds from data sources in each respective country, including active market makers and inter-dealer brokers. Key inputs include benchmark yields, reported trades, broker-dealer quotes, two-sided markets, benchmark securities, bids, offers, local exchange prices, foreign exchange rates and reference data including coupon, credit quality ratings, duration and market research publications.
Preferred stocks: The fair value of preferred stocks is determined from an evaluated pricing model that calculates the appropriate spread over a comparable security for each issue. Key inputs include exchange prices (underlying and common stock of same issuer), benchmark yields, reported trades, broker-dealer quotes, issuer spreads, two-sided markets, benchmark securities, bids, offers, and reference data including sector, coupon, credit quality ratings, duration, credit enhancements, early redemption features and market research publications.
Level 3 valuations are generated from techniques that use assumptions not observable in the market. These unobservable assumptions reflect OneBeacon's assumptions that market participants would use in valuing the investment. Generally, certain securities may start out as Level 3 when they are originally issued but as observable inputs become available in the market, they may be reclassified to Level 2.
The fair values of OneBeacon's investments in hedge funds and private equity funds have been classified as net asset value as prescribed by ASU 2015-07. As of June 30, 2016 and December 31, 2015, OneBeacon did not record a liquidity adjustment to the net asset value related to its investments in hedge funds or private equity funds.
As of both June 30, 2016 and December 31, 2015, other investments reported at fair value represented approximately 5% of the total investment portfolio and consisted of the following:

($ in millions)	June 30, 2016	December 31, 2015
Hedge funds[(1)]	$ 17.2	$ 16.4
Private equity funds[(2)]	39.5	46.1
Total hedge funds and private equity funds	56.7	62.5
Surplus notes (par value $101.0)[(3)]	62.8	51.5
Investment in community reinvestment vehicle	14.3	14.3
Total other investments[(4)]	$ 133.8	$ 128.3

(1) Consists of 4 hedge funds as of both June 30, 2016 and December 31, 2015.
(2) Consists of 18 private equity funds as of June 30, 2016 and 17 private equity funds as of December 31, 2015.
(3) The increase in the fair value of the surplus notes during the six months ended June 30, 2016 was driven primarily by the narrowing of non-investment grade credit spreads as well as the time value of money benefit generated by

moving six months closer to modeled cash receipts, partially offset by the impact of an interest payment received in the first quarter of 2016.

(4) Excludes the carrying value of $13.4 million and $14.7 million as of June 30, 2016 and December 31, 2015, 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 $13.6 million and $12.9 million as of June 30, 2016 and December 31, 2015, respectively.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
NOTE 5. Investment Securities

As of June 30, 2016 and December 31, 2015, OneBeacon held one private preferred stock that represented approximately 84% and 85%, 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.

Surplus Notes

In the fourth quarter of 2014, in conjunction with the Runoff Transaction, OneBeacon provided financing in the form of surplus notes, which had a fair value of $62.8 million and $51.5 million as of June 30, 2016 and December 31, 2015, respectively. The surplus notes, issued by one of the transferred entities, Bedivere (“Issuer”), were in the form of both seller priority and pari passu notes.

The internal valuation model used to estimate the fair value is based on discounted expected cash flows using information as of the measurement date. The estimated fair value of the surplus notes is sensitive to changes in U.S. treasury rates and public corporate debt credit spreads, as well as changes in estimates with respect to other variables including a discount to reflect the private nature of the notes (and the related lack of liquidity), the credit quality of the notes – based on the financial performance of the Issuer relative to expectations, and the timing, amount, and likelihood of interest and principal payments on the notes, which are subject to regulatory approval and therefore may vary from the contractual terms. An interest payment of $2.4 million was received in the six months ended June 30, 2016. The Company has assumed for estimating value purposes that subsequent interest payouts will begin in year five (2020) and principal repayments begin on a graduating basis in year ten (2025) for the seller priority note and year fifteen (2030) for the pari passu note. Although these variables involve considerable judgment, the Company does not currently expect any resulting changes in the estimated value of the surplus notes to be material to its financial position.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
NOTE 5. Investment Securities

Below is a table illustrating the valuation adjustments taken to arrive at estimated fair value of the surplus notes as of June 30, 2016 and December 31, 2015:

	Type of Surplus Note		Total as of June 30, 2016
	Seller Priority	Pari Passu	
	(in millions)		
Par value	$57.9	$43.1	$101.0
Fair value adjustments to reflect:			
Current market rates on public debt and contract-based repayments[1]	2.7	(8.4)	(5.7)
Regulatory approval[2]	(7.4)	(12.5)	(19.9)
Liquidity adjustment[3]	(9.0)	(3.6)	(12.6)
Total	(13.7)	(24.5)	(38.2)
Fair value[4]	$44.2	$18.6	$62.8

	Type of Surplus Note		Total as of December 31, 2015
	Seller Priority	Pari Passu	
	(in millions)		
Par value	$57.9	$43.1	$ 101.0
Fair value adjustments to reflect:			
Current market rates on public debt and contract-based repayments[1]	(0.4)	(14.7)	(15.1)
Regulatory approval[2]	(11.7)	(12.5)	(24.2)
Liquidity adjustment[3]	(7.8)	(2.4)	(10.2)
Total	(19.9)	(29.6)	(49.5)
Fair value	$38.0	$13.5	$ 51.5

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(1) Represents the value of the surplus notes, at current market yields on comparable publicly traded debt, and assuming issuer is allowed to make principal and interest payments when its financial capacity is available, as measured by statutory capital in excess of a 250% score under the National Association of Insurance Commissioners' risk-based capital standards for property and casualty companies.

(2) Represents anticipated delay in securing regulatory approvals of interest and principal payments to reflect graduated changes in Issuer's statutory surplus. The monetary impact of the anticipated delay is measured based on credit spreads of publicly traded debt with roughly equivalent percentages of discounted payments missed.

(3) Represents impact of liquidity spread to account for OneBeacon's sole ownership of the notes, lack of a trading market, and ongoing regulatory approval risk.

(4) The increase in the fair value of the surplus notes during the six months ended June 30, 2016 was driven primarily by the narrowing of non-investment grade credit spreads as well as the time value of money benefit generated by moving six months closer to modeled cash receipts, partially offset by the impact of an interest payment received in the first quarter of 2016.

Fair value measurements by level

The following tables summarize the Company's fair value measurements for investments as of June 30, 2016 and December 31, 2015 by level. The major security types were based on the legal form of the securities. OneBeacon has disaggregated its fixed maturity investments based on the issuing entity type, which impacts credit quality, with debt securities issued by U.S. government entities carrying minimal credit risk, while the credit and other risks associated with other issuers, such as corporations, foreign governments, municipalities or entities issuing asset-backed securities vary depending on the nature of the issuing entity type. OneBeacon further disaggregates debt securities issued by corporations and common equity securities by industry sector because investors often reference commonly used benchmarks and their subsectors to monitor risk and performance. Accordingly, OneBeacon has further disaggregated these asset classes into subclasses based on the similar sectors and industry classifications the Company uses to evaluate investment risk and performance against commonly used benchmarks, such as the Barclays U.S. Intermediate Aggregate and S&P 500 indices.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
NOTE 5. Investment Securities

($ in millions)	Fair value at June 30, 2016	Level 1	Level 2	Level 3
Fixed maturity investments:				
U.S. Government and agency obligations	$53.8	$53.8	$—	$—
Debt securities issued by corporations:				
Consumer	207.6	—	207.6	—
Industrial	123.3	—	123.3	—
Healthcare	105.2	—	105.2	—
Financials	92.1	—	92.1	—
Energy	54.8	—	54.8	—
Utilities	41.9	—	41.9	—
Communications	40.1	—	40.1	—
Technology	29.1	—	29.1	—
Basic materials	20.5	—	20.5	—
Debt securities issued by corporations	714.6	—	714.6	—
Municipal obligations	70.1	—	70.1	—
Mortgage and asset-backed securities	1,195.4	—	1,181.5	13.9
Foreign government obligations	1.2	0.6	0.6	—
Preferred stocks	84.7	—	13.5	71.2
Fixed maturity investments	2,119.8	54.4	1,980.3	85.1
Short-term investments	114.5	114.5	—	—
Common equity securities:				
Exchange traded funds(1)	87.5	65.6	21.9	—
Consumer	37.9	37.9	—	—
Healthcare	30.5	30.5	—	—
Technology	24.0	24.0	—	—
Communications	19.6	19.6	—	—
Industrial	17.3	17.3	—	—
Financials	12.5	12.5	—	—
Energy	7.8	7.8	—	—
Common equity securities	237.1	215.2	21.9	—
Other investments(2)(3)	133.8	—	—	77.1
Total(1)(2)	$2,605.2	$384.1	$2,002.2	$162.2

(1) ETFs traded on foreign exchanges are priced using the fund's published NAV to account for the difference in market close times and are therefore designated as level 2 measurements.

(2) Excludes the carrying value of $13.4 million associated with a tax advantaged federal affordable housing development fund accounted for using the proportional amortization method as of June 30, 2016.

(3) As described in Note 1—"Nature of Operations and Summary of Significant Accounting Policies" investments in hedge funds and private equity funds of $56.7 million measured at fair value for which NAV is the practical expedient are no longer classified within the fair value hierarchy.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
NOTE 5. Investment Securities

($ in millions)	Fair value at December 31, 2015	Level 1	Level 2	Level 3
Fixed maturity investments:				
U.S. Government and agency obligations	$ 85.3	$ 85.3	$—	$—
Debt securities issued by corporations:				
Consumer	218.3	—	218.3	—
Healthcare	136.2	—	136.2	—
Industrial	121.8	—	121.8	—
Financials	116.0	—	116.0	—
Energy	75.2	—	75.2	—
Communications	46.0	—	46.0	—
Utilities	42.2	—	42.2	—
Technology	28.9	—	28.9	—
Basic materials	25.8	—	25.8	—
Debt securities issued by corporations	810.4	—	810.4	—
Municipal obligations	69.0	—	69.0	—
Mortgage and asset-backed securities	1,031.9	—	1,031.9	—
Foreign government obligations	1.2	0.6	0.6	—
Preferred stocks	82.7	—	12.7	70.0
Fixed maturity investments	2,080.5	85.9	1,924.6	70.0
Short-term investments	69.2	69.2	—	—
Common equity securities:				
Exchange traded funds(1)	183.3	162.0	21.3	—
Consumer	38.2	38.2	—	—
Communications	23.9	23.9	—	—
Healthcare	19.6	19.6	—	—
Technology	14.7	14.7	—	—
Industrial	14.5	14.5	—	—
Financials	4.5	4.5	—	—
Common equity securities	298.7	277.4	21.3	—
Other investments(2)(3)	128.3	—	—	65.8
Total(1)(2)(3)	$ 2,576.7	$ 432.5	$ 1,945.9	$ 135.8

(1) ETFs traded on foreign exchanges are priced using the fund's published NAV to account for the difference in market close times and are therefore designated as level 2 measurements.

(2) Excludes the carrying value of $14.7 million associated with a tax advantaged federal affordable housing development fund accounted for using the proportional amortization method as of December 31, 2015.

(3) As described in Note 1—"Nature of Operations and Summary of Significant Accounting Policies" investments in hedge funds and private equity funds of $62.5 million measured at fair value for which NAV is the practical expedient are no longer classified within the fair value hierarchy.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
NOTE 5. Investment Securities

Rollforwards of Fair Value Measurements by Level
The following tables summarize the changes in OneBeacon's fair value measurements by level for the three and six months ended June 30, 2016 and 2015:

($ in millions)	Level 1 Investments	Level 2 Investments	Level 3 Investments Fixed maturity investments	Other investments(1)	NAV investments(2)	Total(1)(2)(3)
Balance at January 1, 2016	$ 363.3	$ 1,945.9	$ 70.0	$ 65.8	$ 62.5	$ 2,507.5
Amortization/accretion	—	(3.2)	—	—	—	(3.2)
Net realized and unrealized gains	5.6	12.5	0.5	0.4		