

Employers Holdings, Inc.
Form 10-K
March 01, 2013

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM 10-K

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

For the fiscal year ended December 31, 2012

OR

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

For the transition period from ____ to ____

Commission file number: 001-33245

EMPLOYERS HOLDINGS, INC.

(Exact name of registrant as specified in its charter)

Nevada

(State or other jurisdiction

of incorporation or organization)

10375 Professional Circle, Reno, Nevada 89521

(Address of principal executive offices and zip code)

(888) 682-6671

(Registrant's telephone number, including area code)

04-3850065

(I.R.S. Employer

Identification Number)

Securities registered pursuant to Section 12(b) of the Act:

Title of each class

Common Stock, \$0.01 par value per share

Securities registered pursuant to Section 12(g) of the Act: None

Name of each exchange on which registered

New York Stock Exchange

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes o No R

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act.

Yes o No R

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 R 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

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to submit and post such files). Yes No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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 definitions of "large accelerated filer," "accelerated filer," "non-accelerated filer," and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company

The aggregate market value of the voting and non-voting common equity held by non-affiliates of the registrant as of June 30, 2012 was \$558,293,802.

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

| | |
|--|-------------------------------|
| Class | February 21, 2013 |
| Common Stock, \$0.01 par value per share | 30,775,229 shares outstanding |

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's Definitive Proxy Statement relating to the 2013 Annual Meeting of Stockholders are incorporated by reference in Items 10, 11, 12, 13 and 14 of Part III of this report.

EXPLANATORY NOTE

We are revising our consolidated financial statements for the fiscal years ended December 31, 2011 and 2010, and our selected financial data for the fiscal years ended December 31, 2011, 2010, 2009, and 2008 in this Annual Report on Form 10-K for the fiscal year ended December 31, 2012. These revisions are the result of the need to correct the manner in which we account for the contingent profit commission to which we are entitled under the Loss Portfolio Transfer Agreement (LPT Agreement). We assessed the impact of these revisions and concluded that they were not material to any of our financial statements for the each of the three quarters within the nine months ended September 30, 2012, or fiscal years ended December 31, 2011, 2010, 2009, or 2008. As a result, we have not filed amendments to any of our previously filed Annual Reports on Form 10-K or Quarterly Reports on Form 10-Q. We have revised these historical financial results in this Annual Report on Form 10-K. Although the effect of these revisions was not material to those previously issued financial statements, the cumulative effect of reflecting these revisions in the current year would have been material for the fiscal year ended December 31, 2012. Since these revisions are treated as corrections to our prior period financial results, the revisions are considered to be a restatement under U.S. generally accepted accounting principles (GAAP). Accordingly, the revised financial information included in this Annual Report on Form 10-K has been identified as “restated.”

In 1999, the Nevada State Industrial Insurance System (the Fund) entered into a retroactive 100% quota share reinsurance agreement through a loss portfolio transfer transaction with third party reinsurers. On January 1, 2000, one of our insurance subsidiaries, Employers Insurance Company of Nevada, assumed all of the assets, liabilities and operations of the Fund, including the Fund's rights and obligations associated with the LPT Agreement. The LPT Agreement was a non-recurring transaction which does not affect our ongoing operations. In the quarter ended December 31, 2012, we concluded that a modification was necessary in order to properly apply reinsurance accounting principles to the contingent profit commission under the LPT Agreement. This modification resulted in a change in the manner in which we record the estimate of contingent commission receivable–LPT Agreement, which impacts the amortization of the deferred reinsurance gain–LPT Agreement and is reflected in losses and loss adjustment expense (LAE) incurred in our consolidated statements of income and comprehensive income. The effect of the revisions to the previously issued consolidated statements of income and comprehensive income for the years ended December 31, 2011 and 2010 was to increase the commission expense and decrease the losses and LAE, with the net effect of increasing net income and earnings per share. Additionally, total stockholders' equity at December 31, 2011 decreased and there was an increase to the contingent commission receivable–LPT Agreement and the deferred reinsurance gain–LPT Agreement on the consolidated balance sheets as of December 31, 2011. Note 2 to the consolidated financial statements included in this Annual Report on Form 10-K contains tabular disclosures that set forth certain restated financial information.

For more information regarding the impact on our financial results, please refer to Part II, Item 6, “Selected Financial Data,” and Item 7, “Management's Discussion and Analysis of Financial Condition and Results of Operations,” and to our Consolidated Financial Statements included in Part II, Item 8, including Note 2, “Revision of Previously Issued Consolidated Financial Statements,” and Note 21, “Selected Quarterly Financial Data (Unaudited).”

The following tables present the summary impacts of the restatement adjustments on our previously reported consolidated retained earnings at December 31, 2009 and consolidated net income and earnings per share for the years ended December 31, 2011 and 2010 (in thousands, except per share data):

| | | |
|--|--------------|-----------|
| Retained earnings at December 31, 2009 (previously reported) | | \$266,491 |
| LPT Contingent Commission Adjustment | | (13,183) |
| Retained earnings at December 31, 2009 (as restated) | | \$253,308 |
| | December 31, | |
| | 2011 | 2010 |
| Net income (previously reported) | \$48,313 | \$62,799 |
| Adjustment | 310 | 670 |
| Net income (as restated) | \$48,623 | \$63,469 |

Earnings per common share:

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| | | |
|-------------------------------|---------|---------|
| Basic (previously reported) | \$ 1.30 | \$ 1.52 |
| Adjustment | — | 0.01 |
| Basic (as restated) | \$ 1.30 | \$ 1.53 |
| | | |
| Diluted (previously reported) | \$ 1.29 | \$ 1.51 |
| Adjustment | 0.01 | 0.02 |
| Diluted (as restated) | \$ 1.30 | \$ 1.53 |

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FORWARD-LOOKING STATEMENTS

The Private Securities Litigation Reform Act of 1995 provides a safe harbor for forward-looking statements if accompanied by meaningful cautionary statements identifying important factors that could cause actual results to differ materially from those discussed. You should not place undue reliance on these statements, which speak only as of the date of this report. Forward-looking statements include those related to our expected financial position, business, financing plans, litigation, future premiums, revenues, earnings, pricing, investments, business relationships, expected losses, loss reserves, acquisitions, competition, and rate increases with respect to our business and the insurance industry in general. Statements including words such as “expect,” “intend,” “plan,” “believe,” “estimate,” “may,” “anticipate,” “will” or similar statements of a future or forward-looking nature identify forward-looking statements. We undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise, except as required by law. All forward-looking statements address matters that involve risks and uncertainties that could cause actual results to differ materially from historical or anticipated results, depending on a number of factors. These risks and uncertainties include, but are not limited to, those set forth in Item 1A, “Risk Factors” and the other documents that we have filed with the Securities and Exchange Commission.

NOTE REGARDING RELIANCE ON STATEMENTS IN OUR CONTRACTS

The agreements included or incorporated by reference as exhibits to this Annual Report on Form 10-K may contain representations and warranties by each of the parties to the applicable agreement. These representations and warranties were made solely for the benefit of the other parties to the applicable agreement and:

- were not intended to be treated as categorical statements of fact, but rather as a way of allocating the risk to one of the parties if those statements prove to be inaccurate;
- may have been qualified in such agreement by disclosures that were made to the other party in connection with the negotiation of the applicable agreement;
- may apply contract standards of “materiality” that are different from “materiality” under the applicable securities laws; and
- were made only as of the date of the applicable agreement or such other date or dates as may be specified in the agreement.

Notwithstanding the inclusion of the foregoing cautionary statements, we acknowledge that we are responsible for considering whether additional specific disclosures of material information regarding material contractual provisions are required to make the statements in this report not misleading.

PART I

Item 1. Business

General

Employers Holdings, Inc. (EHI) is a holding company incorporated in Nevada in 2005. Unless otherwise indicated, all references to “we,” “us,” “our,” the “Company” or similar terms refer to EHI together with its subsidiaries. We had 667 full-time employees at December 31, 2012 and our principal executive offices are located at 10375 Professional Circle in Reno, Nevada.

Our insurance subsidiaries have each been assigned an A.M. Best Company (A.M. Best) rating of “A-” (Excellent), with a “negative” financial outlook.

Our Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, amendments to those reports, and Proxy Statement for our Annual Meeting of Stockholders are available free of charge on our website at www.employers.com as soon as reasonably practicable after they are electronically filed with or furnished to the Securities and Exchange Commission (SEC). Our website also provides access to reports filed by our Directors, executive officers and certain significant stockholders pursuant to Section 16 of the Securities Exchange Act of 1934. In addition, our Corporate Governance Guidelines, Code of Business Conduct and Ethics, Code of Ethics for Senior Financial Officers, and charters for the standing committees of our Board of Directors are available on our website. Copies of these documents may also be obtained free of charge by written request to Investor Relations, 10375 Professional Circle, Reno, Nevada 89521-4802. The SEC also maintains a website at www.sec.gov that contains the information that we file electronically with the SEC.

Description of Business

We are a specialty provider of workers' compensation insurance focused on select small businesses in low to medium hazard industries. We employ a disciplined, conservative underwriting approach designed to individually select specific types of businesses, predominantly those in the lowest four of the seven workers' compensation insurance industry defined hazard groups, that we believe will have fewer and less costly claims relative to other businesses in the same hazard groups. Workers' compensation is provided for under a statutory system wherein most employers are required to provide coverage for their employees' medical, disability, vocational rehabilitation, and/or death benefit costs for work-related injuries or illnesses. We operate as a single reportable segment and conduct operations in 31 states and the District of Columbia, with a concentration in California, where over one-half of our business is generated. We had total assets of \$3.5 billion at December 31, 2012 and 2011. The following table highlights key results of our operations for the last three years.

| For the Years Ended | Net Premiums Written (in thousands, except ratios) | Total Revenue | Net Income | Statutory Combined Ratio ⁽¹⁾ | |
|---------------------------------|--|---------------|------------|--|---|
| December 31, 2012 | \$569,676 | \$579,182 | \$106,891 | 85.8 | % |
| December 31, 2011 (As Restated) | 410,038 | 464,154 | 48,623 | 112.1 | |
| December 31, 2010 (As Restated) | 313,098 | 415,604 | 63,469 | 109.8 | |

Our combined ratio on a statutory basis is a measure of underwriting profitability. Elsewhere in this report, unless (1) otherwise stated, the term “combined ratio” refers to a calculation based on U.S. generally accepted accounting principles (GAAP).

The statutory combined ratio for the year ended December 31, 2012 includes the impact of a \$100.0 million favorable adjustment to the ceded reserves under the Loss Portfolio Transfer Agreement. See Note 3 in the Notes to our Consolidated Financial Statements.

Our statutory combined ratio for the five years ended December 31, 2011 was 99.5%, compared to the industry composite statutory combined ratio of 115.2% for the same five-year period (calculated by A.M. Best for individual companies that have more than 50% of their business in workers' compensation).

Our insurance subsidiaries are domiciled in the following states:

State of Domicile

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Employers Insurance Company of Nevada (EICN)
Employers Compensation Insurance Company (ECIC)
Employers Preferred Insurance Company (EPIC)
Employers Assurance Company (EAC)
Products and Services

Nevada
California
Florida
Florida

Workers' compensation provides insurance coverage for the statutorily prescribed benefits that employers are required to provide to their employees who may be injured or suffer illness in the course of employment. The level of benefits varies by state, the

nature and severity of the injury or disease, and the wages of the injured worker. Each state has a statutory, regulatory, and adjudicatory system that sets the amount of wage replacement to be paid, determines the level of medical care required to be provided, establishes the degree of permanent impairment, and specifies the options in selecting healthcare providers. These state laws generally require two types of benefits for injured employees: (a) medical benefits, including expenses related to the diagnosis and treatment of an injury, disease, or both, as well as any required rehabilitation, and (b) indemnity payments, which consist of temporary wage replacement, permanent disability payments, and death benefits to surviving family members.

Disciplined Underwriting

Our strategy is to focus on disciplined underwriting and continue to pursue profitable growth opportunities across market cycles. We carefully monitor market trends to assess new business opportunities that we expect will meet our pricing and risk standards. We price our policies based on the specific risks associated with each potential insured rather than solely on the industry class in which a potential insured is classified. Our disciplined underwriting approach is a critical element of our culture and we believe that it has allowed us to offer competitive prices, diversify our risks, and out-perform the industry.

The following table compares our statutory loss and loss adjustment expense (LAE) ratio, a measure which relates inversely to our underwriting profitability, to the statutory industry composite loss and LAE ratio reported by A.M. Best (calculated for U.S. insurance companies having more than 50% of their premiums generated by workers' compensation insurance products).

| Year | Statutory Loss and LAE Ratio | | |
|------|------------------------------|--------------------|---|
| | EHI ⁽¹⁾ | A.M. Best | |
| 2007 | 46.4 | % 77.7 | % |
| 2008 | 51.4 | 78.6 | |
| 2009 | 57.5 | 86.1 | |
| 2010 | 66.2 | 87.4 | |
| 2011 | 77.6 | 89.6 | |
| 2012 | 57.4 | N/A ⁽²⁾ | |

(1) Our statutory loss and LAE ratio includes changes to reserves for losses and LAE established for prior periods.

(2) As of the date of this report, statutory industry composite loss and LAE ratio data was not available for 2012.

We execute our underwriting processes through automated systems and experienced underwriters with specific knowledge of local markets. We have developed automated underwriting templates for specific classes of business that produce faster quotes when certain underwriting criteria are met. Our underwriting guidelines consider many factors, such as type of business, nature of operations, and risk exposures, and are designed to minimize or prevent underwriting of certain undesirable classes of business.

Loss Control

Our loss control professionals provide consultation to policyholders to assist them in preventing losses and containing costs once claims occur. They also assist our underwriting personnel in evaluating potential and current policyholders and are an important part of our underwriting discipline.

Premium Audit

We conduct premium audits on substantially all of our policyholders annually upon the policy expiration. Premium audits allow us to comply with applicable state and reporting bureau requirements and to verify that policyholders have accurately reported their payroll and employee job classifications. We also selectively perform interim audits on certain classes of business or if unusual claims are filed or concerns are raised regarding projected annual payrolls, which could result in substantial variances at final audit.