HANOVER INSURANCE GROUP, INC.
Form 10-K
February 25, 2014
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

FORM 10-K

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

For the fiscal year ended December 31, 2013

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: 1-13754

THE HANOVER INSURANCE GROUP, INC.

(Exact name of registrant as specified in its charter)

Delaware	**04-3263626**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**
440 Lincoln Street, Worcester, Massachusetts	**01653**
(Address of principal executive offices)	**(Zip Code)**

Registrant s telephone number, including area code:

(508) 855-1000

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

Title of each class	**Name of each exchange on which registered**
Common Stock, $.01 par value	**New York Stock Exchange**
7 5/8% Senior Debentures due 2025	**New York Stock Exchange**
6.35% Subordinated Debentures due 2053	**New York Stock Exchange**

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

NONE

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes x No ¨

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes ¨ No x

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 ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months. Yes x 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 the 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 the definitions of accelerated filer , large accelerated filer , and smaller reporting

company in Rule 12b-2 of the Exchange Act.

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

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

Based on the closing sales price of June 28, 2013, the aggregate market value of the voting and non-voting common stock held by non-affiliates of the registrant was $2,108,212,659.

The number of shares outstanding of the registrant s common stock, $0.01 par value, was 43,882,063 shares as of February 20, 2014.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of The Hanover Insurance Group, Inc. s Proxy Statement relating to the 2014 Annual Meeting of Shareholders to be held May 20, 2014 to be filed pursuant to Regulation 14A are incorporated by reference in Part III.

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THE HANOVER INSURANCE GROUP, INC.

ANNUAL REPORT ON FORM 10-K

FOR THE FISCAL YEAR ENDED DECEMBER 31, 2013

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PART I

ITEM 1 BUSINESS

ORGANIZATION

The Hanover Insurance Group, Inc. (THG) is a holding company organized as a Delaware corporation in 1995 and traces its roots to as early as 1852, when the Hanover Fire Insurance Company was founded. Our primary business operations are property and casualty insurance products and services. We market our domestic products and services through independent agents and brokers in the United States (U.S.) and conduct business internationally through a wholly-owned subsidiary, Chaucer Holdings plc (Chaucer), which operates through the Society and Corporation of Lloyd s (Lloyd s) and is domiciled in the United Kingdom (U.K.). Our consolidated financial statements include the accounts of THG; The Hanover Insurance Company (Hanover Insurance) and Citizens Insurance Company of America (Citizens), which are our principal U.S. domiciled property and casualty subsidiaries; Chaucer, which we acquired on July 1, 2011; and certain other insurance and non-insurance subsidiaries. Our results of operations also include the results of our discontinued operations, consisting primarily of our former life insurance businesses, our accident and health business and prior to April 30, 2012, our third party administration business.

FINANCIAL INFORMATION ABOUT OPERATING SEGMENTS

We conduct our business operations through four operating segments. These segments are Commercial Lines, Personal Lines, Chaucer and Other. We report interest expense related to our corporate debt separately from the earnings of our operating segments.

Information with respect to each of our segments is included in Results of Operations - Segments in Management s Discussion and Analysis of Financial Condition and Results of Operations and in Note 14 Segment Information in the Notes to the Consolidated Financial Statements included in Financial Statements and Supplementary Data of this Form 10-K.

Information with respect to geographic concentrations is included in the Description of Business by Segment in Part 1 Item 1 and in Note 14 Segment Information in the Notes to the Consolidated Financial Statements included in Financial Statements and Supplementary Data of this Form 10-K.

DESCRIPTION OF BUSINESS BY SEGMENT

Following is a discussion of each of our operating segments.

GENERAL

We manage our operations principally through four operating segments, including three in which we provide insurance products and services: Commercial Lines, Personal Lines, and Chaucer. We underwrite commercial and personal property and casualty insurance through Hanover Insurance, Citizens and other THG subsidiaries, through an independent agent and broker network concentrated in the Northeast, Midwest and Southeast U.S. We also continue to actively grow our Commercial Lines presence in the Western region of the U.S. Our Chaucer segment is a specialist insurance underwriting group which operates through Lloyd s and writes business internationally. Included in our fourth operating segment, Other, are Opus Investment Management, Inc. (Opus), a wholly-owned subsidiary of THG, which provides investment management services to our insurance and non-insurance companies, our institutions, pension funds and other organizations; earnings on holding company assets; and a run-off voluntary pools business.

Our business strategy focuses on providing our agents and customers stability and financial strength, while prudently growing and diversifying our product and geographical business mix. We conduct our business with an emphasis on agency relationships and active agency management, disciplined underwriting, pricing, quality claim handling, and customer service. Annually, we write over $4 billion in premiums, including over $3 billion domestically. Based on direct U.S. premiums written, we rank among the top 25 property and casualty insurers in the United States.

RISKS

The industry s profitability and cash flow can be, and historically has been, significantly affected by numerous factors, including price; competition; volatile and unpredictable developments such as extreme weather conditions, catastrophes and other disasters; legal and regulatory developments affecting pricing, underwriting, policy coverage and other aspects of doing business, as well as insurer and insureds liability; extra-contractual liability; size of jury awards; acts of terrorism; fluctuations in interest and currency rates or the value of investments; and other general economic conditions and trends, such as inflationary pressure or unemployment, that may affect the adequacy of reserves or the demand for insurance products. Our investment portfolio and its future returns may be further impacted by the capital markets and current economic conditions, which could affect our liquidity, the amount of realized losses and impairments that will be recognized, credit default levels, our ability to hold such investments until recovery and other

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factors. Additionally, the economic conditions in geographic locations where we conduct business, especially those locations where our business is concentrated, may affect the growth and profitability of our business. The regulatory environments in those locations, including any pricing, underwriting or product controls, shared market mechanisms or mandatory pooling arrangements, and other conditions, such as our agency relationships, affect the growth and profitability of our business. In addition, our loss and loss adjustment expense (LAE) reserves are based on our estimates, principally involving actuarial projections, at a given time, of what we expect the ultimate settlement and administration of claims will cost based on facts and circumstances then known, predictions of future events, estimates of future trends in claims frequency and severity and judicial theories of liability, costs of repairs and replacement, legislative activity and other factors. We expect to regularly reassess our estimate of loss reserves and LAE, both for current and past years, and any resulting changes will affect our reported profitability and financial position.

Reference is also made to Risk Factors in Part 1 Item 1A of this Form 10-K.

LINES OF BUSINESS

We underwrite commercial and personal property and casualty insurance coverage through our Commercial Lines, Personal Lines and Chaucer operating segments.

Commercial Lines

Our Commercial Lines segment generated $2.1 billion, or 44.3%, of consolidated operating revenues and $2.0 billion, or 44.1%, of net premiums written, for the year ended December 31, 2013.

The following table provides net premiums written by line of business for our Commercial Lines segment.

YEAR ENDED DECEMBER 31, 2013 ***(in millions, except ratios)***	**Net Premiums Written**	**% of Total**
Commercial multiple peril	**$ 651.7**	**32.5%**
Commercial automobile	**304.7**	**15.2**
Workers compensation	**229.6**	**11.4**
Other commercial lines:		
AIX program business	**253.0**	**12.6**
Inland marine	**197.6**	**9.8**
Management and professional liability	**116.0**	**5.8**
Surety	**68.7**	**3.4**
Other	**185.9**	**9.3**
Total	**$ 2,007.2**	**100.0%**

Our Commercial Lines product suite provides agents and customers with products designed for small, middle and specialized markets.

Commercial Lines coverages include:

Commercial multiple peril coverage insures businesses against third party general liability from accidents occurring on their premises or arising out of their operations, such as injuries sustained from products sold. It also insures business property for damage, such as that caused by fire, wind, hail, water damage (which may exclude flood), theft and vandalism.

Commercial automobile coverage insures businesses against losses incurred from personal bodily injury, bodily injury to third parties, property damage to an insured s vehicle and property damage to other vehicles and property.

Workers compensation coverage insures employers against employee medical and indemnity claims resulting from injuries related to work. Workers compensation policies are often written in conjunction with other commercial policies.

Other commercial lines is comprised of:

AIX program business provides coverage to under-served markets where there are specialty coverage or risk management needs, including commercial multiple peril, workers compensation, commercial automobile, general liability and other commercial coverages;

inland marine coverage insures businesses against physical losses to property, such as contractor s equipment, builders risk and goods in transit, and also covers jewelers block, fine art and other valuables;

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management and professional liability coverage provides protection for directors and officers of companies that may be sued in connection with their performance, errors and omissions protection to companies and individuals against negligence or bad faith, as well as protection for employment practices insurance and fidelity and crime.

surety provides businesses with contract surety coverage in the event of performance or non-payment claims, and commercial surety coverage related to fiduciary or regulatory obligations; and

other commercial lines coverages include umbrella, monoline general liability, specialty property, healthcare and miscellaneous commercial property.

Our strategy in Commercial Lines focuses on building deep relationships with partner agents through differentiated product offerings, industry segmentation, and franchise value through limited distribution. We have made a number of enhancements to our products and technology platforms that are intended to drive more total account placements in our small commercial and middle market business, while delivering enhanced margins in our specialty businesses. This aligns with our focus of improving and expanding our partnerships with a limited number of agents.

Our small commercial, middle market and specialty businesses constitute approximately 32%, 33% and 35% of our total Commercial Lines business, respectively. Small commercial offerings, which generally include premiums of $50,000 or less, deliver value through product expertise, local presence, and ease of doing business. Middle market accounts require greater claim and underwriting expertise, as well as a focus on industry segments where we can deliver differentiation in the market and value to agents and customers. Small and middle market accounts comprise $1.3 billion of the Commercial Lines. Our strategy is to continue to grow these businesses over time, even as we seek to reduce property exposures in certain geographic areas and manage our mix of business in the short term.

In our small commercial and middle market businesses, we have developed several niche insurance programs, including for schools, human services organizations, such as non-profit youth and community service organizations, and religious institutions. We have added additional segmentation to our core middle market commercial products, including real estate, hospitality and wholesale distributors and introduced products focused on management liability, specifically non-profit and private company directors and officers liability and employment practices liability.

Part of our strategy is to expand our specialty lines offerings in order to provide our agents and policyholders with a broader product portfolio and to increase our market penetration. Net premiums written in our specialty lines account for approximately one-third of our Commercial Lines net premiums written. As part of our strategy, we have over time acquired various specialized businesses aimed at further diversifying and growing our specialty lines. We used these acquisitions as platforms to expand our product offerings and grow through our existing agency and broker distribution network.

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

Personal Lines

Our Personal Lines segment generated $1.5 billion, or 32.4%, of consolidated operating revenues and $1.4 billion, or 31.4%, of net premiums written, for the year ended December 31, 2013.

The following table provides net premiums written by line of business for our Personal Lines segment.

YEAR ENDED DECEMBER 31, 2013 *(in millions, except ratios)*	**Net Premiums Written**	**% of Total**
Personal automobile	**$ 890.3**	**62.3%**
Homeowners	**496.7**	**34.8**
Other	**41.0**	**2.9**
Total	**$ 1,428.0**	**100.0%**

Personal Lines coverages include:

Personal automobile coverage insures individuals against losses incurred from personal bodily injury, bodily injury to third parties, property damage to an insured s vehicle, and property damage to other vehicles and other property.

Homeowners coverage insures individuals for losses to their residences and personal property, such as those caused by fire, wind, hail, water damage (except for flood), theft and vandalism, and against third party liability claims.

Other personal lines are comprised of personal inland marine (jewelry, art, etc.), umbrella, fire, personal watercraft, earthquake and other miscellaneous coverages.

Our strategy in Personal Lines is to build account oriented business through our partner agencies, with a focus on greater geographic diversification. The market for our Personal Lines business continues to be very competitive, with continued pressure on agents from direct writers, as well as from the increased usage of real time comparative rating tools and increasingly sophisticated rating and pricing tools. We maintain a focus on partnering with high quality, value added agencies that stress the importance of consultative selling and account rounding (the conversion of single policy customers to accounts with multiple policies and/or additional coverages). We are focused on making investments that are intended to help us maintain profitability, build a distinctive position in the market, and provide us with profitable growth opportunities. We continue to refine our products and to work closely with these high potential agents to increase the percentage of business they place with us and to ensure that it is consistent with our preferred mix of business. Additionally, we remain focused on further diversifying our state mix beyond the historical core states of Michigan, Massachusetts, New York and New Jersey, and on reducing property exposures in concentrated areas or where we have experienced persistent weather-related losses. We expect these efforts to decrease our risk concentrations and our dependency on these four states, as well as to contribute to improved profitability over time.

Chaucer

Our Chaucer segment generated $1.1 billion, or 23.1%, of consolidated operating revenues and $1.1 billion, or 24.5%, of net premiums written, for the year ended December 31, 2013.

The following table provides net premiums written by line of business for our Chaucer segment.

YEAR ENDED DECEMBER 31, 2013 *(in millions, except ratios)*	**Net Premiums Written**	**% of Total**
U.K. motor	**$ 300.5**	**26.9%**
Marine and aviation	**277.1**	**24.8**
Property	**191.9**	**17.2**
Energy	**174.2**	**15.6**
Casualty and other	**173.8**	**15.5**
Total	**$ 1,117.5**	**100.0%**

The Chaucer segment is comprised of international business written through Lloyd s, and includes:

Marine and aviation includes worldwide direct, facultative and treaty business. The marine account provides cover for hull, liability, war, terrorism, cargo, political risk, specie, fine art, satellite and ports and terminals. The aviation account insures airline hull and liability, general aviation, refuellers and aviation products.

Energy encompasses exploration and production, construction, downstream, operational power and renewables, insuring against physical damage, business interruption, control of well, seepage and pollution and liabilities. Energy also includes a nuclear account, which provides coverage across the nuclear fuel cycle from raw uranium and nuclear fuel to the shipment and storage of waste, with the majority of the exposure relating to power generation at nuclear power stations. In addition to providing coverage for physical damage to civil nuclear power stations, nuclear also provides limited liability coverage.

Property includes treaty business, as well as direct and facultative coverage for commercial and industrial risks against physical damage and business interruption. The treaty account covers cedants on a global basis, predominantly on an excess of loss basis for both per risk and catastrophe coverage, with a limited amount of proportional treaty and reinsurance assumed business.

U.K. motor provides primary insurance coverage to U.K. motor policyholders. Chaucer writes personal automobile, commercial and fleet polices, as well as specialist classes, including motorcycles, motor trade, and classic and specialist vehicles. In addition, the U.K. motor line includes a small amount of commercial property damage and liability polices protecting small/medium-sized enterprises.

Casualty and other provides liability coverage for professional and commercial risks on a direct and treaty basis, crime and professional liability coverage for financial institutions, medical malpractice and excess workers compensation. Other lines also encompass liabilities arising from previous participations on third party Lloyd s syndicates, principally from Syndicate 4000, which provides liability coverage to financial institutions.

Chaucer is a specialist insurance underwriting group that participates in the Lloyd s market through the provision of capital to support the underwriting activities of syndicates at Lloyd s and the ownership of Chaucer Syndicates Limited (CSL), a managing agent. CSL manages two syndicates currently underwriting at Lloyd s.

Chaucer provides capital to Syndicate 1084, which underwrites a range of property, marine, aviation, casualty and energy products for commercial clients worldwide and motor business for personal and commercial clients in the U.K.; and Syndicate 1176, which primarily provides protection against physical damage and limited liability exposures from power generation at nuclear power stations. The energy line of business includes $19.9 million of net premiums written from Syndicate 1176.

We will have an economic interest in Syndicate 1084 of 100% for 2014, increasing from 98% in 2013. Our economic interest in Syndicate 1176 will also increase to 57% in 2014 from 56% in 2013.

Previously, Chaucer managed and participated in Syndicate 4000, which continues to have exposure to potential claims arising from difficulties within the financial and professional liability markets, primarily during 2007 and 2008. Chaucer sold its right to participate in Syndicate 4000 for the 2009 year of account and after.

Chaucer has broad underwriting expertise to support its diversified underwriting portfolio that, we believe, provides many benefits, including capital diversification, volatility management and long-term protection of our underwriting capabilities. We actively manage our portfolio, transferring underwriting capital to increase premium volumes during periods of increased rates, while remaining selective or reducing our capital and premium volumes in those lines where rates are under pressure.

Overall, we believe that the strength and depth of our underwriting teams, together with the broad diversity of our underwriting portfolio and our membership of the Lloyd s market, underpin our ability to manage both the scale and composition of our business. Moreover, these strengths, combined with our continued active management of our portfolio and the underwriting opportunities available, provide a sound basis for the profitable development of the Chaucer business.

Other

The Other segment consists of: Opus, which provides investment advisory services to affiliates and also manages approximately $1.4 billion of assets for unaffiliated institutions such as insurance companies, retirement plans and foundations; earnings on holding company assets; and voluntary pools business, which is in run-off.

MARKETING AND DISTRIBUTION

We serve a variety of standard, specialty and niche markets. Consistent with our objective to diversify our underwriting risks on a geographic and line of business basis, we currently have a distribution split of approximately one-third each of domestic standard Commercial Lines, international and domestic specialty lines, and domestic standard Personal Lines. Our Commercial and Personal Lines segments, comprising our principal domestic U.S. subsidiaries, distribute our products primarily through an independent agent network. Our Chaucer segment, comprising our international business, distributes primarily through insurance brokers in the Lloyd s market, as well as

through comparative website aggregators with respect to the U.K. motor business.

Commercial and Personal Lines

Our Commercial and Personal Lines agency distribution strategy and field structure are designed to maintain a strong focus on local markets and the flexibility to respond to specific market conditions. During 2013, we wrote 21.5% of our Commercial and Personal Lines business in Michigan and 9.5% in Massachusetts. Our structure is a key factor in the establishment and maintenance of productive, long-term relationships with mid-sized, well-established independent agencies. We maintain 41 local offices across 29 states. The majority of processing support for these locations is provided from Worcester, Massachusetts; Howell, Michigan; Salem, Virginia; and Windsor, Connecticut.

Independent agents account for substantially all of the sales of our Commercial and Personal Lines property and casualty products. Agencies are appointed based on profitability, track record, financial stability, professionalism, and business strategy. Once appointed, we monitor their performance and, subject to legal and regulatory requirements, may take actions as necessary to change these business relationships, such as discontinuing the authority of the agent to underwrite certain products or revising commissions or bonus opportunities. We compensate agents primarily through base commissions and bonus plans that are tied to an agency s written premium, growth and profitability.

We are licensed to sell property and casualty insurance in all fifty states in the U.S., as well as in the District of Columbia. We actively market Commercial Lines policies throughout the U.S. in 36 states and Personal Lines policies in 18 states.

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The following table provides our top Commercial and Personal Lines geographical markets based on total net premiums written in the state in 2013.

YEAR ENDED DECEMBER 31, 2013	Commercial Lines		Personal Lines		Total Commercial and Personal Lines	
(in millions, except ratios)	Net Premiums Written	% of Total	Net Premiums Written	% of Total	Net Premiums Written	% of Total
Michigan	$ 140.5	7.0%	$ 596.4	41.8%	$ 736.9	21.5%
Massachusetts	145.4	7.2	181.2	12.7	326.6	9.5
New York	220.5	11.0	95.3	6.7	315.8	9.2
California	241.7	12.0	0.3		242.0	7.0
New Jersey	111.6	5.6	73.4	5.1	185.0	5.4
Illinois	90.3	4.5	68.8	4.8	159.1	4.6
Texas	142.6	7.1			142.6	4.2
Connecticut	49.2	2.5	56.1	3.9	105.3	3.1
Virginia	56.6	2.8	35.3	2.5	91.9	2.7
Maine	57.6	2.9	33.2	2.3	90.8	2.6
Georgia	53.0	2.6	32.3	2.3	85.3	2.5
New Hampshire	39.4	2.0	36.6	2.6	76.0	2.2
Florida	69.5	3.5	5.1	0.4	74.6	2.2
Indiana	37.2	1.9	37.1	2.6	74.3	2.2
Louisiana	32.4	1.6	35.3	2.5	67.7	2.0
Tennessee	30.9	1.5	29.2	2.0	60.1	1.8
Ohio	25.2	1.3	32.8	2.3	58.0	1.7
Wisconsin	30.5	1.5	26.3	1.8	56.8	1.7
Oklahoma	29.6	1.5	22.3	1.6	51.9	1.5
Other	403.5	20.0	31.0	2.1	434.5	12.4
Total	$ 2,007.2	100.0%	$ 1,428.0	100.0%	$ 3,435.2	100.0%

We manage our Commercial Lines portfolio, which includes our core and specialty businesses, with a focus on growth from the most profitable industry segments within our underwriting expertise. Our core business is generally comprised of several coordinated commercial lines of business, including small and middle market accounts, which include segmented businesses and niches. Core Commercial Lines direct premium written is comprised of small and mid-sized accounts; such business is split between small accounts generally having less than $50,000 in premium and middle market accounts, those with premium over $50,000, with most accounts having less than $250,000 of premium. Additionally, we have multiple specialty lines of business, which include program business, inland marine, management and professional liability, surety, specialty property and healthcare. The Commercial Lines segment seeks to maintain strong agency relationships as a strategy to secure and retain our agents best business. We monitor quality of business written through an ongoing quality review program, accountability for which is shared at the local, regional and corporate levels.

We manage Personal Lines business with a focus on acquiring and retaining quality accounts. Currently, approximately 75% of our policies in force are account business. Approximately 55% of our Personal Lines net premium written is generated in the combined states of Michigan and Massachusetts. In Michigan, based upon direct premiums written for 2012, we underwrite approximately 8% of the state s total market.

Approximately 64% of our Michigan Personal Lines business is in the personal automobile line and 34% is in the homeowners line. Michigan business represents approximately 43% of our total personal automobile net premiums written and 41% our total homeowners net premiums written. In Michigan, we are a principal market for many of our appointed agencies with approximately $1.5 million of total direct premiums written per agency in 2013.

Approximately 70% of our Massachusetts Personal Lines business is in the personal automobile line and 26% is in the homeowners line. Massachusetts business represents approximately 14% of our total personal automobile net premiums written and approximately 10% of our total homeowners net premiums written.

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We sponsor local and national agent advisory councils to gain the benefit of our agents insight and enhance our relationships. These councils provide feedback, input on the development of products and services, guidance on marketing efforts, support for our strategies, and assist us in enhancing our local market presence.

Chaucer

Chaucer underwrites business from two main sources: approximately 77% from Lloyd s brokers and underwriting agencies, placed in the open market, and 23% from retail brokers and comparative website aggregators for U.K. motor business. We primarily compensate brokers, underwriting agencies and aggregators through commission payments.

In the Lloyd s open market, brokers approach Chaucer with individual insurance and reinsurance risk opportunities for underwriter consideration. Brokers also gain access to Chaucer s products through selected underwriting agencies (also referred to as coverholders), to which Chaucer has granted limited authority to make underwriting decisions on individual risks. In general, risks written through underwriting agencies are smaller in terms of both exposure and premium. Risks are placed in Lloyd s through a subscription placement process whereby generally several syndicates take a share of a contract rather than one insurer taking 100% on a direct basis. This facilitates the spreading of large and complex risks across a number of insurers, while limiting the counterparty risk of each insurer.

We have an international network of offices to improve our access to high quality risks worldwide. This is expected to improve the diversification of our underwriting and our ability to manage our portfolio. We have offices in Singapore; Copenhagen, Denmark; and Buenos Aires, Argentina to capitalize upon specific class of business opportunities in these regions. We also have offices in Houston, Texas, to extend our energy network to North America, and Oslo, Norway, to provide access to the Norwegian and regional North Sea energy sector.

The following table provides a geographical breakdown of Chaucer s total gross premiums written (GPW) based on the location of risk:

YEAR ENDED DECEMBER 31, 2013	% of Total GPW in Chaucer Segment
United Kingdom[1]	24.0%
United States	14.9
Americas, excluding the United States	11.1
Asia Pacific	5.4
Middle East and Africa	5.2
Europe	3.1
Worldwide and other[2]	36.3
Total	100.0%

(1) Primarily U.K. motor.
(2) Worldwide and other comprises insured risks that move across multiple geographic areas due to their mobile nature or insured risks that are fixed in locations that span more than one geographic area. These contracts include, for example, marine and aviation hull, satellite and offshore energy exploration and production risks that

can move across multiple geographic areas and assumed risks where the cedant insures risks in two or more geographic zones.

Other

With respect to our Other segment business, we market our investment advisory services directly through Opus.

PRICING AND COMPETITION

The property and casualty industry is a very competitive market. Our competitors include national, international, regional and local companies that sell insurance through various distribution channels, including independent agencies, captive agency forces, brokers and direct to consumers through the internet or otherwise. They also include mutual insurance companies, reciprocals and exchanges. In the Commercial and Personal Lines segments, we market through independent agents and brokers and compete for business on the basis of product, price, agency and customer service, local relationships, ratings, and effective claims handling, among other things. We believe that an emphasis on maintaining strong agency relationships and a local presence in our markets, coupled with investments in products, operating efficiency, technology and effective claims handling, will enable us to compete effectively. Our broad product offerings in Commercial Lines and total account strategy in Personal Lines are instrumental to our strategy to capitalize on these relationships and improve profitability.

We seek to achieve targeted combined ratios in each of our product lines. Targets vary by product and geography and change with market conditions. The targeted combined ratios reflect competitive market conditions, investment yield expectations, our loss payout patterns, and target returns on equity. This strategy is intended to enable us to achieve measured growth and consistent profitability.

For all major product lines, we employ pricing teams which produce exposure and experience-based rating models to support underwriting decisions. In addition, in the Commercial and Personal Lines segments, we seek to utilize our understanding of local markets to achieve superior underwriting results. We rely on market information provided by our local agents and on the knowledge of staff in the local branch offices. Since we maintain a strong regional focus and a significant market share in a number of states, we can better apply our knowledge and experience in making underwriting and rate setting decisions. Also, we seek to gather objective and verifiable information at a policy level during the underwriting process, such as loss histories, past driving records and, where permitted, credit histories.

The Commercial and Personal Lines segments are not dependent on a single customer or even a few customers, for which the loss of any one or more would have an adverse effect upon the insurance operations for these segments.

Although we conduct some business on a direct basis through the Chaucer segment, we market the majority of Chaucer product offerings through insurance brokers in the Lloyd s specialty and the U.K. motor markets, which provide access to business from clients and coverholders. We are able to attract business through our recognized capability to serve as the lead underwriter in most classes we write, particularly in classes where such lead ability is sought by clients and recognized by following markets. This requires significant underwriting and claims handling expertise in very specialized lines of business. Our competitors include large international insurance companies and other Lloyd s managing underwriters. In the U.K. motor lines, our competitors include large U.K. personal lines insurers. Broker relationships that are ten percent or more of total Chaucer 2013 gross premiums written are with Marsh & McLennan Companies (14%) and Aon Benfield (14%).

CLAIMS MANAGEMENT

Claims management includes the receipt of initial loss notifications, generation of appropriate responses to claim reports, loss appraisals, identification and handling of coverage issues, determination of whether further investigation is required, retention of legal representation where appropriate, establishment of case reserves, approval of loss payments and notification to reinsurers. Part of our strategy focuses on efficient, timely, and fair claim settlements to meet customer service expectations and maintain valuable independent agent relationships. Additionally, effective claims management is important to our business as claim payments and related loss adjustment expenses are our single largest expenditures.

Commercial and Personal Lines

We utilize experienced claims adjusters, appraisers, medical specialists, managers and attorneys to manage our claims. Our U.S. property and casualty operations have field claims adjusters located throughout the states and regions in which we do business. Claims field staff members work closely with the independent agents who bound the policies under which coverage is claimed. Claims office adjusting staff is supported by general adjusters for large property and large casualty losses, by automobile and heavy equipment damage appraisers for automobile material damage losses, and by medical specialists whose principal concentration is on workers compensation and automobile injury cases. Additionally, the claims offices are supported by staff attorneys, both in the home office and in regional locations, who specialize in litigation defense and claim settlements. We have a catastrophe response team to assist policyholders impacted by severe weather events. This team mobilizes quickly to impacted regions, often in advance for a large tracked storm, to support our local claims adjusters and facilitate a timely response to resulting claims. We

also maintain a special unit that investigates suspected insurance fraud and abuse. We utilize claims processing technology which allows most of the smaller and more routine Personal Lines claims to be processed at centralized locations.

Chaucer

For international risks, the Chaucer claims team generally is responsible for establishing case reserves, loss and LAE cost management, exposure mitigation and litigation management. Chaucer has engaged a third party administrator to handle aviation claims and authorizes selected agencies to manage claims under risks which they have bound on Chaucer s behalf.

For claims under our direct claims team management, where Chaucer is the lead syndicate or designated claims manager, our appointed claims adjusters work with the broker representing the insured. This may involve appointing attorneys, loss adjusters or other third party experts. Where Chaucer is not the lead underwriter or designated claims manager, the lead underwriter and designated claims manager together establish case reserves in conjunction with professional third party adjusters, and then advise all

other syndicates participating on the risk of the loss reserve requirements. In such cases, the Chaucer claims team review material claims and developments. Chaucer also engages automobile body and repair shops to assist in managing claims for its U.K. motor business.

CATASTROPHES

We are subject to claims arising out of catastrophes, which historically have had a significant impact on our results of operations and financial condition. Coverage for such events is a core part of our business and we expect to experience catastrophe losses in the future, which could have a material adverse impact on us. Catastrophes can be caused by various events, including snow, ice storm, hurricane, earthquake, tornado, wind, hail, flood, drought, terrorism, fire, explosion, or other extraordinary events. The incidence and severity of catastrophes are inherently unpredictable.

Commercial and Personal Lines

We endeavor to manage our catastrophe risks through underwriting procedures, including the use of deductibles and specific exclusions for floods and earthquakes, subject to regulatory restrictions, and through geographic exposure management and reinsurance. The catastrophe reinsurance program is structured to protect us on a per-occurrence basis. We monitor geographic location and coverage concentrations in order to manage corporate exposure to catastrophic events. Although catastrophes can cause losses in a variety of property and casualty lines, commercial multiple peril and homeowners property coverages have, in the past, generated the majority of catastrophe-related claims.

Chaucer

Individual commercial and industrial risks within our property, marine and aviation, and energy lines include protection against natural or man-made catastrophes worldwide. We accept these risks on direct, facultative and proportional and excess of loss treaty bases. Such risks are managed through limiting the proportion of any individual risk or class of risk we assume, managing geographic concentration and through the purchase of reinsurance.

We purchase reinsurance to limit our exposure to individual risks and catastrophic events. This includes facultative reinsurance, to limit the exposure on a specified risk; specific excess and proportional treaty, to limit exposure to individual contracts or risks within specified classes of business; and catastrophe excess of loss reinsurance, to limit exposure to any one event that might affect more than one individual contract.

The level of reinsurance that Chaucer purchases is dependent on a number of factors, including our underwriting risk appetite for catastrophe risk, the specific risks inherent in each line or class of business risk written and the pricing, coverage and terms and conditions available from the reinsurance market.

TERRORISM

As a result of the tragic events of September 11, 2001, the insurance industry has had heightened concern about the potential for losses caused by terrorist acts. These losses may encompass people, property and business operations covered under workers compensation, commercial multiple peril and other Commercial Lines policies. In certain cases, we are not able to exclude coverage for these losses, either because of regulatory requirements or competitive pressures. We continually evaluate the potential effect of these low frequency, but potentially high severity events in our overall pricing and underwriting plans, especially for policies written in major metropolitan areas.

Private sector catastrophe reinsurance is limited and generally unavailable for losses attributed to acts of terrorism, particularly those involving nuclear, biological, chemical and/or radiological events. As a result, the industry s primary reinsurance protection against large-scale terrorist attacks in the U.S. is provided through a Federal program that provides compensation for insured losses resulting from acts of terrorism. Additionally, certain terrorism-related risks embedded in our Commercial and Personal Lines are covered under the existing Catastrophe, Property per Risk and Casualty Excess of Loss corporate reinsurance treaties (see Reinsurance for additional information).

The Terrorism Risk Insurance Act of 2002 established the Terrorism Risk Insurance Program (the U.S. Program). Coverage under the U.S. Program applies to workers compensation, commercial multiple peril and certain other Commercial Lines policies for U.S. direct written policies. The Terrorism Risk Insurance Program Reauthorization Act of 2007 (TRIPRA) extended the U.S. Program through December 31, 2014. All commercial property and casualty insurers licensed in the U.S. participate in the program. Under the program, a participating issuer, in exchange for making terrorism insurance available, is entitled to be reimbursed by the Federal Government for 85% of subject losses, after an insurer deductible, subject to an annual industry-wide cap of $100 billion. The U.S. Program does not cover losses in surety, Personal Lines or certain other lines of insurance. Losses caused by terrorist acts are not excluded from homeowners or personal automobile policies.

Efforts are underway to extend the U.S. Program beyond 2014, although there can be no assurance that such legislation will pass or be similar to the existing U.S. Program. Accordingly, there is additional uncertainty regarding our exposure with respect to terrorism coverage after December 31, 2014, and this uncertainty extends to any policies issued or renewed in 2014, since such policy terms will extend into the 2015 calendar year.

As an admitted carrier, we are regulated by state laws that specifically prohibit the industry s ability to exclude terrorism losses from workers compensation coverage in addition to requiring the industry to offer terrorism coverage for virtually all commercial property and casualty products. The expiration of the U.S. Program has prompted consideration by the industry of conditional renewal provisions . Such provisions would automatically exclude losses caused by terrorism if the U.S. Program is not extended. At this time, we have elected not to take this approach, consistent with most of the industry, because of our expectation that the U.S. Program will be extended. We continue to review our approach to this matter as we monitor the progress of pending legislation and other market considerations. See Risk Factors for additional information.

As required by the current U.S. Program, we offer policyholders in specific lines of insurance the option to elect terrorism coverage. In order for a loss to be covered under the U.S. Program, the loss must meet aggregate industry loss minimums and must be the result of an act of terrorism as certified by the Secretary of the Treasury in concurrence with the Secretary of State and the U.S. Attorney General. Losses from acts which do not qualify or are not so certified will not receive the benefit of the U.S. Program and in fact, may be deemed covered losses whether or not terrorism coverage was purchased. The current U.S. Program requires insurance carriers to retain 15% of any claims from a certified terrorist event in excess of the federally mandated deductible. The deductible represents 20% of direct earned premium for the covered lines of business of the prior year. In 2013, our deductible was $322.7 million, which represents 21.2% of year-end 2012 statutory policyholder surplus of our U.S. domestic insurers, and is estimated to be $350.4 million in 2014, representing 19.1% of 2013 year-end statutory policyholder surplus.

Given the unpredictable nature of the frequency and severity of terrorism losses, future losses from acts of terrorism could be material to our operating results, financial position, and/or liquidity. We attempt to manage our exposures on an individual line of business basis and in the aggregate by one-half square mile grids.

Chaucer s direct written U.S. policies are also covered under the provisions of TRIPRA. A limited portion of Chaucer s business outside of the U.S. is exposed to terrorism with respect to certain commercial property classes that are written on a standalone basis. We manage this exposure through policy limits, monitoring of risk aggregation and reinsurance. Generally, terrorism coverage is excluded from most commercial property classes and coverages that Chaucer writes. For our nuclear energy business, most of our liability coverage does not exclude losses resulting from acts of terrorism, although such policies are generally subject to a sub-limit of 50% of full policy limits.

REGULATION

Commercial and Personal Lines

Our U.S. property and casualty insurance subsidiaries are subject to extensive regulation in the various states in which they transact business and are supervised by the individual state insurance departments. Numerous aspects of our business are subject to regulation, including premium rates, mandatory covered risks, limitations on the ability to non-renew or reject business, prohibited exclusions, licensing of agents, investments, restrictions on the size of risks that may be insured under a single policy, reserves and provisions for unearned premiums, losses and other obligations, deposits of securities for the benefit of policyholders, investments and capital, policy forms and coverages, advertising, and other conduct, including restrictions on the use of credit information and other factors in underwriting, as well as other underwriting and claims practices. States also regulate various aspects of the contractual relationships between insurers and independent agents.

Such laws, rules and regulations are usually overseen and enforced by the various state insurance departments, as well as through private rights of action and increasingly, by state attorneys general. Such regulations or enforcement actions are often responsive to current consumer and political sensitivities such as automobile and homeowners insurance rates and coverage forms, or which may arise after a major event such as Superstorm Sandy. Such rules and regulations may result in rate suppression, and limit our ability to manage our exposure to unprofitable or volatile risks or other adverse consequences. The federal government also may regulate aspects of our businesses such as the use of insurance (credit) scores in underwriting and the protection of confidential information.

In addition, as a condition to writing business in certain states, insurers are required to participate in various pools or risk sharing mechanisms or to accept certain classes of risk, regardless of whether such risks meet its underwriting requirements for voluntary business. Some states also limit or impose restrictions on the ability of an insurer to withdraw from certain classes of business. For example, Massachusetts, New Jersey, New York, and California each

impose material restrictions on a company s ability to materially reduce its exposures or to withdraw from certain lines of business in their respective states. The state insurance departments can impose significant charges on an insurer in connection with a market withdrawal or refuse to approve withdrawal plans on the grounds that they could lead to market disruption. Laws and regulations that limit cancellation and non-renewal of policies or that subject withdrawal plans to prior approval requirements may significantly restrict our ability to exit unprofitable markets.

Over the past several years, other state-sponsored insurers, reinsurers or involuntary pools have increased, particularly those states which have Atlantic or Gulf Coast storm exposures. As a result, the potential assessment exposure of insurers doing business in such states and the attendant collection risks have increased. Such actions and related regulatory restrictions may limit our ability to reduce our potential exposure to hurricane-related losses.

The insurance laws of many states subject property and casualty insurers doing business in those states to statutory property and casualty guaranty fund assessments. The purpose of a guaranty fund is to protect policyholders by requiring that solvent property and casualty insurers pay insurance claims of insolvent insurers. These guaranty associations generally pay these claims by assessing solvent insurers proportionately based on the insurer s share of voluntary premiums written in the state. While most guaranty associations provide for recovery of assessments through subsequent rate increases, surcharges or premium tax credits, there is no assurance that insurers will ultimately recover these assessments, which could be material, particularly following a large catastrophe or in markets which become disrupted.

We are subject to periodic financial and market conduct examinations conducted by state insurance departments. We are also required to file annual and other reports with state insurance departments relating to the financial condition of our insurance subsidiaries and other matters.

From time to time, proposals have been made to establish a federal based insurance regulatory system and to allow insurers to elect either federal or state-based regulation (optional federal chartering). In light of the recent challenging economic environment, the focus on increased regulatory controls and the creation of a Federal Insurance Office, there has been renewed interest in such proposals.

Chaucer

Chaucer is regulated by the Prudential Regulation Authority (PRA) and the Financial Conduct Authority (FCA), which replaced the Financial Services Authority in April 2013, who together have responsibility for the financial services industry, including insurers, insurance intermediaries and Lloyd s in the U.K, and is supervised by the Council of Lloyd s, which is the franchisor for all Lloyd s operations.

The PRA (which is part of The Bank of England) and FCA are given statutory powers by the Financial Services Act of 2012. The PRA is responsible for the prudential supervision of, among other financial institutions, Lloyd s insurers, with a particular focus on financial stability. The FCA focuses on conduct of business issues, with a particular focus on consumer protection and market integrity.

The PRA, FCA and Council of Lloyd s have common objectives in ensuring the appropriate regulation of the Lloyd s market and, to minimize duplication, the PRA and FCA have arrangements with Lloyd s for co-operation on supervision and enforcement. Lloyd s, which is regulated by both the PRA and FCA, has responsibility under the Lloyd s Act 1982 (the Lloyd s Act) for the implementation of certain PRA and FCA prescribed rules relating to the operation of the Lloyd s market. Lloyd s prescribes, in respect of its managing agents and corporate members, certain minimum standards relating to their management and control, solvency and various other requirements. The PRA and FCA directly monitor the compliance of Lloyd s managing agents with the systems and controls that Lloyd s prescribes.

The Council of Lloyd s has wide discretionary powers to regulate Lloyd s underwriting. For example, it may change the basis of allocation for syndicate expenses or the capital requirements for syndicate participations. Exercising any of these powers might affect the return on an investment of the corporate member in a given underwriting year. In addition, the annual business plans of each syndicate are subject to the review and approval of the Lloyd s Franchise Board, which is responsible for business planning and monitoring for all syndicates.

We participate in the Lloyd s market through our ownership of Chaucer Syndicates Limited, which we refer to as CSL, a managing agent with responsibility for the management of Syndicates 1084 and 1176, for which we provide capital to support their underwriting activities. Our membership in Lloyd s requires us to comply with its bylaws and regulations, the Lloyd s Act and the applicable provisions of the Financial Services and Markets Act. These include the requirement to provide capital (referred to as Funds at Lloyd s) in the form of cash, securities or letters of credit in an amount agreed with by Lloyd s under the capital setting regime of the PRA. The completion of an annual capital adequacy exercise enables each corporate member to calculate the capital required. These requirements allow Lloyd s to evaluate whether each corporate member has sufficient assets to meet its underwriting liabilities plus a required solvency margin.

If a corporate member of Lloyd s is unable to meets its policyholder obligations, such obligations may be payable by the Lloyd s Central Fund, which acts similar to a state guaranty fund in the U.S. If Lloyd s determines that the Central Fund needs to be increased, it has the power to assess premium levies on all current Lloyd s members. The Council of

Lloyd s has discretion to call or assess up to 3% of a member s underwriting capacity in 2014 as a Central Fund contribution.

Solvency II

In 2009, the European Union (E.U.) adopted a directive covering capital requirements, risk management and regulatory reporting for insurance organizations. The directive, known as Solvency II, imposes economic risk-based solvency requirements across all E.U. member states that comprise three pillars. First, there are quantitative capital requirements, based on a valuation of the entire balance sheet of an insurance organization. Second, Solvency II requires insurance organizations to undertake a qualitative regulatory review, including governance, internal controls, enterprise risk management and the supervisory review process. Third, to enhance market discipline, insurance organizations must report their financial conditions to regulators. Final E.U. approval of Solvency II is

currently due in the first half of 2014, with an anticipated commencement date for the new regulatory regime of January 1, 2016. Chaucer continues to work to ensure compliance with the requirements in accordance with the timetable set out by Lloyd s.

Other

In addition to the U.K. and European regulations, the Chaucer segment is subject to regulation in the U.S through the Lloyd s market. The Lloyd s market has licenses to engage in insurance business in Illinois, Kentucky and the U.S. Virgin Islands and operates as an eligible excess and surplus lines insurer in all other states and territories. Lloyd s is also an accredited reinsurer in all states and territories. Lloyd s maintains various trust funds in the state of New York to protect its U.S. business and is subject to regulation by the New York Insurance Department, which acts as the domiciliary department for Lloyd s U.S. trust funds. There are also deposit trust funds in other U.S. states to support Lloyd s excess and surplus lines insurance and reinsurance business.

See also to Note 18 Commitments and Contingencies in the Notes to Consolidated Financial Statements included in Financial Statements and Supplementary Data of this Form 10-K.

INVOLUNTARY RESIDUAL MARKETS

As a condition of our license to write business in various domestic states and international jurisdictions, we are required to participate in mandatory property and casualty residual market mechanisms which provide various insurance coverages where such coverage may not otherwise be available at rates deemed reasonable. Such mechanisms provide coverage primarily for personal and commercial property, personal and commercial automobile, and workers compensation, and include assigned risk plans, reinsurance facilities and involuntary pools, joint underwriting associations, fair access to insurance requirements (FAIR) plans, and commercial automobile insurance plans.

For example, since most states compel the purchase of a minimal level of automobile liability insurance, states have developed shared market mechanisms to provide the required coverages and in many cases, optional coverages, to those drivers who, because of their driving records or other factors, cannot find insurers who will insure them voluntarily. Also, FAIR plans and other similar property insurance shared market mechanisms increase the availability of property insurance in circumstances where homeowners are unable to obtain insurance at rates deemed reasonable, such as in coastal areas or in areas subject to other hazards. Licensed insurers writing business in such states are often required to pay assessments to cover reserve deficiencies generated by such plans.

With respect to FAIR plans and other similar property insurance shared market mechanisms that have significant exposures, it is difficult to accurately estimate our potential financial exposure for future events. Assessments following a large coastal event, particularly affecting Massachusetts, Florida, New York or New Jersey, could be material to our results of operations. Our participation in such shared markets or pooling mechanisms is generally proportional to our direct writings for the type of coverage written by the specific pooling mechanism in the applicable state or other jurisdiction. For example, we are subject to mandatory participation in the Michigan Assigned Claims (MAC) facility. MAC is an assigned claim plan covering people injured in uninsured motor vehicle accidents. Our participation in the MAC facility is based on our share of personal and commercial automobile direct written premium in the state and resulted in underwriting losses of $15.0 million in 2013 and 2012 and $11.1 million in 2011. Additionally, Chaucer s U.K. motor line is subject to similar mandatory assessments from the U.K. Motor Insurance Bureau (MIB) and these assessments were $4.3 million in 2013 and not significant to our results of operations in 2012 and 2011. Included in other expenses in 2011 was a $4.3 million charge related to a write-off of our equity interest in the accumulated surplus of the North Carolina Beach Plan (NCBP), a mandatory reinsurance

facility, as a result of state legislation intended to reform the funding mechanism of the NCBP. There were no other mandatory residual market mechanisms that were significant to our 2013, 2012 or 2011 results of operations.

RESERVE FOR UNPAID LOSSES AND LOSS ADJUSTMENT EXPENSES

Reference is made to Results of Operations - Segments Reserve for Losses and Loss Adjustment Expenses of Management s Discussion and Analysis of Financial Condition and Results of Operations of this Form 10-K.

The following table reconciles reserves determined in accordance with accounting principles and practices prescribed or permitted by U.S. insurance statutory authorities (U.S. Statutory) and the U.K. financial services regulatory authority (U.K. Statutory) for our domestic and Chaucer operations, respectively, to reserves determined in accordance with generally accepted accounting principles in the United States of America (U.S. GAAP). The primary difference between the U.S. Statutory reserves and our U.S. GAAP reserves is the requirement, on a U.S. GAAP basis, to present reinsurance recoverables as an asset, whereas U.S. Statutory guidance

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provides that reserves are reflected net of the corresponding reinsurance recoverables. There are no significant differences between U.K. Statutory reserves and our U.S. GAAP reserves. We do not use discounting techniques in establishing U.S. GAAP reserves for losses and LAE, nor have we participated in any loss portfolio transfers or other similar transactions.

DECEMBER 31	**2013**	**2012**	**2011**
(in millions)			
U.S. Statutory reserve for losses and LAE	**$ 2,725.0**	$ 2,646.7	$ 2,350.7
U.K. Statutory reserve for losses and LAE	**2,373.9**	2,397.7	2,319.8
Total Statutory reserve for losses and LAE	**5,098.9**	5,044.4	4,670.5
U.S. GAAP adjustments:			
Reinsurance recoverables on unpaid losses of our U.S. insurance subsidiaries	**1,242.2**	1,265.0	1,198.5
Reserves for discontinued operations	**(121.3)**	(126.8)	(124.6)
Other	**11.7**	14.4	15.9
U.S. GAAP reserve for losses and LAE	**$ 6,231.5**	$ 6,197.0	$ 5,760.3

Reserves for discontinued operations of our U.S. insurance subsidiaries are included in liabilities of discontinued operations for U.S. GAAP and loss and loss adjustment expenses for Statutory reporting.

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ANALYSIS OF LOSS AND LOSS ADJUSTMENT EXPENSE RESERVE DEVELOPMENT

The following table sets forth the development of our U.S. GAAP reserves (net of reinsurance recoverables) for unpaid losses and LAE from 2003 through 2013. This table includes our Chaucer segment U.S. GAAP reserves beginning December 31, 2011. Conditions and trends that have affected reserve development in the past will not necessarily recur in the future. It is not appropriate to extrapolate future favorable or unfavorable development based on amounts experienced in prior periods.

EMBER 31	**2013**	**2012**	**2011**	**2010**	**2009**	**2008**	**2007**	**2006**	**2005**	**2004**	**200**
illions)											
eserve for s and LAE	$ 4,201.1	$ 4,122.7	$ 3,828.5	$ 2,162.2	$ 2,093.7	$ 2,214.9	$ 2,227.2	$ 2,276.5	$ 2,354.1	$ 2,166.3	$ 2,08
ulative nt paid as											
year later		1,469.8	1,396.5	840.7	738.6	788.5	711.1	689.9	729.5	622.0	65
years later			2,172.6	1,277.9	1,120.3	1,126.8	1,050.5	1,061.8	1,121.9	967.0	99
e years later				1,543.6	1,355.8	1,362.8	1,222.7	1,268.4	1,368.3	1,175.4	1,21
years later					1,487.2	1,500.5	1,346.8	1,364.7	1,499.6	1,312.9	1,35
years later						1,577.6	1,426.6	1,438.8	1,555.7	1,384.4	1,43
ears later							1,473.9	1,493.9	1,606.3	1,416.2	1,48
n years later								1,527.5	1,647.8	1,456.3	1,50
years later									1,676.7	1,489.9	1,54
years later										1,515.3	1,57
vears later											1,59
eserve timated as											
of year	4,201.1	4,122.7	3,828.5	2,162.2	2,093.7	2,214.9	2,227.2	2,276.5	2,354.1	2,166.3	2,08
year later		4,052.0	3,841.6	2,094.4	1,982.6	2,059.6	2,075.6	2,140.1	2,274.1	2,086.8	2,07
years later			3,843.2	2,090.5	1,916.4	1,973.3	1,865.7	2,011.0	2,158.8	1,994.4	2,02
e years later				2,124.2	1,902.7	1,930.8	1,793.7	1,852.7	2,075.0	1,904.4	1,97
years later					1,923.4	1,922.6	1,770.6	1,810.9	1,965.3	1,858.0	1,92
years later						1,939.7	1,773.2	1,793.9	1,936.4	1,780.8	1,90
ears later							1,779.4	1,798.0	1,922.4	1,761.2	1,83
n years later								1,802.4	1,924.6	1,749.0	1,82
years later									1,929.1	1,749.0	1,80
years later										1,754.7	1,81
vears later											1,81
ulative net ndancy ciency) (4)	$	$ 70.7	$ (14.7)	$ 38.0	$ 170.3	$ 275.2	$ 447.8	$ 474.1	$ 425.0	$ 411.6	$ 26
stment for gn currency		5.6	33.0								

ange[3]

ulative net ndancy ciency) ding foreign ncy ange[3]	$	$ 76.3	$ 18.3	$ 38.0	$ 170.3	$ 275.2	$ 447.8	$ 474.1	$ 425.0	$ 411.6	$ 26
s reserve for s and LAE	$ 6,231.5	$ 6,197.0	$ 5,760.3	$ 3,277.7	$ 3,153.9	$ 3,203.1	$ 3,167.7	$ 3,166.0	$ 3,461.7	$ 3,073.4	$ 3,02
surance erables	2,030.4	2,074.3	1,931.8	1,115.5	1,060.2	988.2	940.5	889.5	1,107.6	907.1	94
iability	4,201.1	4,122.7	3,828.5	2,162.2	2,093.7	2,214.9	2,227.2	2,276.5	2,354.1	2,166.3	2,08
stimated reserve for s and LAE		6,065.1	5,756.3	3,374.6	3,213.1	3,211.8	3,052.7	3,063.5	3,452.3	3,080.8	3,13
stimated urance erables		2,013.1	1,913.1	1,250.4	1,289.7	1,272.1	1,273.3	1,261.1	1,523.2	1,326.1	1,32
stimated net ity		4,052.0	3,843.2	2,124.2	1,923.4	1,939.7	1,779.4	1,802.4	1,929.1	1,754.7	1,81
ulative gross ndancy ciency) [4]	$	$ 131.9	$ 4.0	$ (96.9)	$ (59.2)	$ (8.7)	$ 115.0	$ 102.5	$ 9.4	$ (7.4)	$ (11

(1) Sets forth the estimated net liability for unpaid losses and LAE recorded at the balance sheet date at the end of each of the indicated years; represents the estimated amount of net losses and LAE for claims arising in the current and all prior years that are unpaid at the balance sheet date, including incurred but not reported (IBNR) reserves.

(2) Cumulative loss and LAE payments made in succeeding years for losses incurred prior to the balance sheet date. Chaucer claims payments denominated in foreign currencies are converted to U.S. dollars at the average foreign exchange rates during the year of payment and are not revalued at the current year foreign exchange rates. Because claims paid in prior years are not revalued at the current year s foreign exchange rates, the difference between the cumulative claims paid at the end of any given year and the immediately previous year represents the claims paid during the year.

(3) Re-estimated amount of the previously recorded liability based on experience for each succeeding year; increased or decreased as payments are made and more information becomes known about the severity of remaining unpaid claims. Chaucer unpaid losses and LAE denominated in foreign currencies are re-estimated using the foreign exchange rates in effect as of December 31, 2013 and the resulting cumulative foreign exchange translation effect is shown as an adjustment to the cumulative net redundancy (deficiency).

(4) Cumulative redundancy or deficiency at December 31, 2013 of the net and gross reserve amounts shown in the corresponding column. A redundancy in reserves means the reserves established in prior years exceeded actual losses and LAE or were re-evaluated at less than the original reserved amount. A deficiency in reserves means the reserves established in prior years were less than actual losses and LAE or were re-evaluated at more than the original reserved amount.

REINSURANCE

Reinsurance Program Overview

We maintain ceded reinsurance programs designed to protect against large or unusual loss and LAE activity. We utilize a variety of reinsurance agreements, which are intended to control our individual policy and aggregate exposure to large property and casualty losses, stabilize earnings and protect capital resources. These programs include facultative reinsurance (to limit exposure on a specified policy); specific excess and proportional treaty reinsurance (to limit exposure on individual policies or risks within specified classes of business); and catastrophe excess of loss reinsurance (to limit exposure to any one event that might impact more than one individual contract). Catastrophe reinsurance protects us, as the ceding insurer, from significant losses arising from a single event such as snow, ice storm, hurricane, earthquake, tornado, wind, hail, terrorism, fire, explosion or other extraordinary events. We determine the appropriate amount of reinsurance based upon our evaluation of the risks insured, exposure analyses prepared by consultants, our risk appetite and on market conditions, including the availability and pricing of reinsurance.

We cede to reinsurers a portion of our risk based upon insurance policies subject to such reinsurance. Reinsurance contracts do not relieve us from our obligations to policyholders. Failure of reinsurers to honor their obligations could result in losses to us. We believe that the terms of our reinsurance contracts are consistent with industry practice in that they contain standard terms with respect to lines of business covered, limit and retention, arbitration and occurrence. We believe our reinsurers are financially sound, based upon our ongoing review of their financial statements, financial strength ratings assigned to them by rating agencies, their reputations in the reinsurance marketplace, our collections history, advice from third parties, and the analysis and guidance of our reinsurance advisors.

Although we exclude coverage of nuclear, chemical or biological events from the Personal Lines and Commercial Lines policies we write in the U.S., we are statutorily required to provide this coverage in our workers compensation policies. We have workers compensation reinsurance coverage under our casualty reinsurance treaty of approximately $10 million for losses that result from nuclear, chemical or biological events and approximately $45 million for terrorism losses excluding those that result from nuclear, chemical or biological events. All other U.S.-based exposure or treaties exclude such coverage. Further, under TRIPRA, our retention of U.S. domestic losses in 2014 from such events, if deemed certified terrorist events, is limited to 15% of losses in excess of an approximate $350 million deductible, up to a combined annual aggregate limit for the federal government and all insurers of $100 billion. Such events could be material to our financial position or results of operations. See Terrorism for additional information.

Reference is made to Note 16 Reinsurance in the Notes to Consolidated Financial Statements included in Financial Statements and Supplementary Data of this Form 10-K. Reference is also made to Involuntary Residual Markets .

Commercial and Personal Lines

Our 2014 reinsurance program for our Commercial Lines and Personal Lines segments is substantially consistent with our 2013 program design. In light of the favorable reinsurance market conditions at January 1, 2014, we expanded our reinsurance coverage in some treaties and increased our limit in others. The following discussion summarizes both our 2013 and 2014 reinsurance programs for our Commercial Lines and Personal Lines segments (excluding coverage available under the U.S. federal terrorism program which is described under Terrorism), but does not purport to be a complete description of the program or the various restrictions or limitations which may apply:

Our Commercial Lines and Personal Lines segments were primarily protected by a property catastrophe occurrence treaty, a property per risk excess of loss treaty, as well as a casualty excess of loss treaty, with retentions of $200 million, $2 million, and $2 million, respectively.

The property catastrophe occurrence treaty provides coverage, on an occurrence basis, up to $700 million (up to $1.1 billion in the Northeast), less a $200 million retention, with no co-participation, for all defined perils. The $700 million to $1.1 billion layer has been renewed effective July 1, 2014 and will reinsure all catastrophe occurrences nationwide. For 2013 and 2014, the property per risk excess of loss treaty provides coverage, on a per risk basis, up to $100 million, less a $2 million retention, with co-participations for 2013 and 2014 ranging from 10% to 12.75% for reinsurance placed in the $2 million to $3 million layer and zero to 10% for reinsurance placed in the $3 million to $10 million layer.

The casualty excess of loss treaty provides coverage, on a per occurrence basis for each loss, up to $50 million less a $2 million retention, with no co-participation. For both years, umbrella lines share coverage with casualty lines at the $2 million to $10 million layer, with the maximum umbrella limit of $5 million subject to the casualty treaty. There is also separate umbrella only coverage that provides protection in both 2013 and 2014 for the $5 million to $25 million layer. Professional liability and management liability risks formerly covered in a separate treaty are covered in the casualty excess of loss treaty effective January 1, 2014, which now includes a $1 million to $2 million layer only for these risks.

For 2013 and 2014, Commercial Lines segments are further protected by excess of loss treaty agreements for specific lines of business such as surety and fidelity bond liability, and healthcare liability. Surety and fidelity bond excess of loss treaty provides coverage, on a per principal basis, up to $35 million, less a $5 million retention, with co-participations ranging from 5% to 15% for individual layers placed within the treaty.

In addition to certain layers of coverage from our Commercial and Personal Lines segment reinsurance program as described above, the Commercial Lines AIX program business also includes surplus share, quota share, excess of loss, facultative and other forms of reinsurance that cover the writings from AIX specialty and proprietary programs. There are approximately 45 different AIX programs, and the reinsurance structure is customized to fit the exposure profile for each program.

Our intention is to renew the surety and fidelity bond treaty, and the property per risk excess of loss treaty in July 2014 with the same or similar terms and conditions, but there can be no assurance that we will be able to maintain our current levels of reinsurance, pricing and terms and conditions. For our 2014 reinsurance program, all other treaties described above were effective January 1, 2014 for a twelve month period.

Chaucer

Chaucer s 2014 reinsurance program is substantially consistent with the 2013 program design. The 2013 and 2014 Chaucer reinsurance programs contain a combination of reinsurance treaties that either provide coverage across several lines or are specific to individual lines of business or classes of business within certain lines. Generally, for each line or class of Chaucer s business, there are a variety of proportional, excess of loss (occurrence and aggregate basis), facultative and other treaty forms, which work in conjunction to provide coverage limits. For 2013, Chaucer increased its net retentions for certain lines and classes predominantly through various co-participation levels within certain treaty layers. For 2014, Chaucer s net retentions are generally consistent with the 2013 levels.

The Chaucer programs described below are substantially in place as of February 1, 2014 and we expect to implement throughout the year any remaining parts of the program as described; however, there can be no assurances that we will be successful in placing reinsurance for each line as planned. The following discussion summarizes both our 2013 and 2014 reinsurance programs for the Chaucer segment, but does not purport to be a complete description of the program or the various restrictions or limitations which may apply. The limit figures below are presented net of treaty co-participation.

We purchase proportional and non-proportional reinsurance which is intended to provide sufficient underwriting capacity to effectively conduct business in the Lloyd s market and to protect against frequency and severity of losses.

For the property lines reinsurance coverage in 2013 and 2014:

The direct property catastrophe occurrence reinsurance for selected international territories provides coverage up to approximately $46 million and $38 million, less retentions of approximately $15 million and $10 million, respectively.

The assumed property catastrophe reinsurance for selected international territories provides coverage up to approximately $93 million and $115 million, less retentions of approximately $20 million and $24 million, respectively. Additionally, the assumed property catastrophe occurrence reinsurance for the United States and the Caribbean provides coverage up to approximately $112 million and $133 million, less retentions of approximately $29 million and $30 million, respectively. For 2014 reinsurance programs, our assumed property catastrophe coverage is placed partially on an occurrence, and partially on an aggregate basis.

The direct property per risk excess of loss reinsurance provides coverage up to approximately $17 million and $18 million, less retentions of approximately $6 million and $8 million, respectively.

For the energy, marine and aviation lines reinsurance coverage in 2013 and 2014:

The nuclear energy lines occurrence reinsurance provides coverage up to approximately $163 million and $165 million, less retentions of approximately $54 million and $55 million, respectively.

The non-nuclear energy lines occurrence reinsurance provides coverage up to approximately $158 million and $154 million, respectively, less retentions of approximately $17 million and $20 million, respectively.

The marine lines excess of loss reinsurance provides coverage, on a per occurrence basis, up to approximately $56 million and $60 million, respectively, less retentions of approximately $5 million for both years.

The aviation lines reinsurance provides coverage, on a per occurrence basis, up to approximately $51 million and $52 million respectively, less retentions of approximately $2 million and $3million, respectively.

The U.K. motor line has protection from a reinsurance program placed on a losses occurring basis, which is unlimited in excess of $1.6 million, both in terms of the amount and the number of losses sustained. For 2012, 2013 and 2014, there is co-participation on the $1.6 million in excess of $1.6 million layer of 30%, 30% and 15% for each year, respectively.

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Reinsurance Recoverables

Other than our investment portfolio, the single largest asset class is our reinsurance receivables, which consist of our estimate of amounts recoverable from reinsurers with respect to losses incurred to date (including losses incurred but not reported) and unearned premiums, net of amounts estimated to be uncollectible. This estimate depends upon a number of factors, including an estimate of the amount of reserves attributable to business written in various lines and in various years. This estimate is expected to be revised at each reporting period and such revisions, which could be material, affect our results of operations and financial position. Reinsurance recoverables include amounts due from both United States and state mandatory reinsurance or other risk sharing mechanisms, and private reinsurers to whom we have voluntarily ceded business.

We are subject to concentration of risk with respect to reinsurance ceded to various mandatory residual markets, facilities and pooling mechanisms. As a condition to conduct business in various states, we are required to participate in residual market mechanisms, facilities and pooling arrangements which usually are designed to provide insurance coverages to individuals or other entities that are otherwise unable to purchase such coverage voluntarily or at rates deemed reasonable. These market mechanisms, facilities and pooling arrangements comprise $887.6 million of our total reinsurance recoverables on paid and unpaid losses and unearned premiums at December 31, 2013 and include, among others, the Michigan Catastrophic Claims Association (MCCA).

The MCCA is a mandatory reinsurance association which reinsures claims under Michigan s unlimited personal injury protection coverage which is required under all Michigan automobile insurance policies. The MCCA reinsures all such claims in excess of a statutorily established company retention, currently $530,000. Funding for MCCA comes from assessments against automobile insurers based upon their share of insured automobiles in the state. Insurers are allowed to pass along this cost to Michigan automobile policyholders. This recoverable accounted for 61% of our total personal automobile gross reserves at December 31, 2013 and 2012. Reinsurance recoverables related to MCCA were $867.0 million and $856.3 million at December 31, 2013 and 2012, respectively. Because the MCCA is supported by assessments permitted by statute, and there have been no significant uncollectible balances from MCCA identified during the three years ending December 31, 2013, we believe that we have no significant exposure to uncollectible reinsurance balances from this entity.

In addition to the reinsurance ceded to various residual market mechanisms, facilities and pooling arrangements and the former capital provision reinsurance treaty with Flagstone Re, as described below, we have $1,315.9 million of reinsurance assets due from traditional reinsurers. These amounts are due principally from highly-rated reinsurers, defined as rated A- or higher by A.M. Best Rating Agency or other equivalent rating. The following table displays balances recoverable from our ten largest reinsurance groups at December 31, 2013, along with the group s rating from the indicated rating agency. The contractual obligations under reinsurance agreements are typically with individual subsidiaries of the group or syndicates at Lloyd s and are not typically guaranteed by other group members or syndicates at Lloyd s. Reinsurance recoverables are comprised of paid losses recoverable, outstanding losses recoverable, incurred but not reported losses recoverable, and ceded unearned premium.

REINSURERS	**A.M. Best Rating**	**Reinsurance Recoverable**
(in millions)		
Lloyd s Syndicates	A	$ 271.0
Munich Reinsurance Companies	A+	156.5
HDI Group	A	119.9

Partner Re Ltd. Companies	A+	91.9
Alleghany Corporation	A	77.3
Swiss Re Ltd.	A+	52.0
XL Group PLC	A	47.4
Toa Reinsurance Company Ltd.	A+	44.4
Aspen Insurance Holdings Ltd.	A	30.4
Everest Re Group Ltd.	A+	28.5
Subtotal		919.3
All other reinsurers		396.6
Residual markets, facilities and pooling arrangements		887.6
Flagstone Re (capital provision reinsurance)		131.5
Total		$ 2,335.0

Reinsurance recoverable balances in the table above are shown before consideration of balances owed to reinsurers and any potential rights of offset, including collateral held by us and, are net of an allowance for uncollectible recoverables. Reinsurance treaties are generally purchased on an annual basis. Treaties typically contain provisions that allow us to demand that a reinsurer post letters of credit or assets as security if a reinsurer is an unauthorized reinsurer under applicable regulations or if its rating falls below a

predetermined contractual level. In regards to reinsurance recoverables due from Lloyd s Syndicates, as part of the Lloyd s chain of security afforded to all of its policyholders, recourse is available to the Lloyd s Central Fund in the event of the failure of an individual syndicate and its capital providers. In accordance with the terms of a capital provision reinsurance treaty with Flagstone Re, which was in place for underwriting years 2009 through 2012, Flagstone Re provided additional gross underwriting capacity to Syndicate 1084. Under this agreement, Flagstone Re is obligated to provide Funds at Lloyd s and is subject to offsetting funds withheld balances with Chaucer. As a result, in the event of a default, we have access to collateral to pay losses reinsured by Flagstone Re on policies written through the end of 2012.

Although reinsurance makes the reinsurer liable to us to the extent the risk is transferred or ceded to the reinsurer, ceded reinsurance arrangements do not eliminate our obligation to pay claims to our policyholders. Accordingly, we bear credit risk with respect to our reinsurers. Specifically, our reinsurers may not pay claims made by us on a timely basis, or they may not pay some or all of these claims. In addition, from time to time insurers and reinsurers may disagree on the scope of the reinsurance or on the underlying insured risks. Any of these events would increase our costs and could have a material adverse effect on our business.

We have established a reserve for uncollectible reinsurance of $20.7 million as of December 31, 2013, which was determined by considering reinsurer specific default risk on paid and unpaid recoverables as indicated by their financial strength ratings, any current risk of dispute on paid recoverables, our collection experience and the development of our ceded loss reserves. There have been no significant balances determined to be uncollectible, and thus no significant charges recorded during 2013 for uncollectible reinsurance recoverables.

Our exposure to credit risk from any one reinsurer is managed through diversification by reinsuring with a number of different reinsurers, principally in the United States and European reinsurance markets. When reinsurance for our Commercial and Personal Lines segments is placed, our standards of acceptability generally require that a reinsurer must have a minimum policyholder surplus of $500 million, a rating from A.M. Best and/or S&P of A or better, or an equivalent financial strength if not rated. Similarly, the Chaucer segment generally requires all reinsurers to have a rating from S&P of A- or better and minimum level of net assets of $500 million. In addition, for lower rated reinsurers, certain reinsurers for our United States insurance operations that have not been granted authorized status by an insurance company s state of domicile, and in certain other circumstances deemed appropriate by Chaucer s security committee, reinsurers must generally provide collateral equal to 100% of estimated reinsurance recoverables. The collateral can serve to mitigate credit risk.

DISCONTINUED OPERATIONS

Discontinued operations primarily include our former life insurance businesses, which were sold prior to 2009, our Discontinued Accident and Health Business and our former third party administration business, which was sold in 2012.

The Discontinued Accident and Health Business includes interests in 25 accident and health reinsurance pools and arrangements that we retained subsequent to the sale of First Allmerica Financial Life Insurance Company (FAFLIC); all of which were assumed by Hanover Insurance. We ceased writing new premiums in this business in 1999, subject to certain contractual obligations. The reinsurance pool business consists primarily of the medical and disability portions of workers compensation risks, long-term care, assumed personal accident, individual medical, long-term disability, and special risk business. This business includes residual health insurance policies. Total claim reserves for the assumed accident and health business were $120.4 million at December 31, 2013. The total amount recoverable from third party reinsurers was $2.0 million at December 31, 2013. Total net reserves were $118.4 million at December 31, 2013. We will continue to account for this business as discontinued operations. Assets and liabilities

related to the Discontinued Accident and Health Business are reflected as assets and liabilities of discontinued operations.

Loss estimates associated with substantially all of the Discontinued Accident and Health Business are provided by managers of each pool. We adopt reserve estimates for this business that consider this information, expected returns on assets assigned to this business and other facts. We update these reserves as new information becomes available and further events occur that may affect the ultimate resolution of unsettled claims. We believe that the reserves recorded related to this business are adequate. However, since reserve and loss cost estimates related to the Discontinued Accident and Health Business are dependent on several assumptions, including, but not limited to, future health care costs, persistency of medical care inflation, investment performance, claims, particularly in the long-term care business, morbidity and mortality assumptions, and these assumptions can be impacted by technical developments and advancements in the medical field and other factors, there can be no assurance that the reserves established for this business will prove sufficient. Revisions to these reserves could have a material adverse effect on our results of operations for a particular quarterly or annual period or on our financial position.

Discontinued operations, in total, generated a net gain of $5.3 million during 2013 and primarily related to our former life insurance business. Reference is made to Discontinued Operations in Management s Discussion and Analysis of Financial Condition and Results of Operations of this Form 10-K.

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INVESTMENT PORTFOLIO

We held $8.1 billion of investment assets, including cash and cash equivalents, at December 31, 2013. Approximately 86% of our investment assets were comprised of fixed maturities, which included both investment grade and below investment grade public and private debt securities; 6% were comprised of cash and cash equivalents; 5% consisted of equity securities; and the remaining 3% included overseas deposits and other investments. These investments are generally of high quality and our fixed maturities are broadly diversified across sectors of the fixed income market.

Our investment portfolio is managed by Opus Investment Management Inc., a wholly-owned subsidiary of THG, including the selection and monitoring of external asset managers primarily for our non-U.S. dollar portfolios. Our overall investment strategy is intended to balance investment income with credit and interest rate risk, while maintaining sufficient liquidity and the opportunity for capital growth. The asset allocation process takes into consideration the types of business written and the level of surplus required to support our different businesses and the risk return profiles of the underlying asset classes. We look to balance the goals of capital preservation, net investment income stability, liquidity and total return. For certain portfolios in which fixed maturities are primarily denominated in U.K. pound sterling and Euro, we employ two external asset managers with international market expertise to manage these portfolios, totaling approximately $823 million. We select and monitor managers based on investment style, performance and corporate governance.

The majority of our assets are invested in the fixed income markets. Through fundamental research and credit analysis, with a focus on value investing, we seek to identify a portfolio of stable income-producing higher quality U.S. government, foreign government, municipal, corporate, residential and commercial mortgage-backed securities and asset-backed securities. We have a general policy of diversifying investments both within and across major investment and industry sectors to mitigate credit and interest rate risk. We monitor the credit quality of our investments and our exposure to individual markets, borrowers, industries, sectors and, in the case of direct commercial mortgages and commercial mortgage-backed securities, property types and geographic locations.

Investments held by our insurance subsidiaries are subject to diversification requirements under state insurance laws and other regulatory requirements. The investment portfolio duration is approximately 4.1 years and is generally maintained in the range of 1 to 2 times the duration of our insurance liabilities. We seek to maintain sufficient liquidity to support our cash flow requirements by monitoring the cash requirements associated with our insurance and corporate liabilities, laddering the maturities within the portfolio, closely monitoring our investment durations, holding high quality liquid public securities and managing the purchases and sales of assets.

Reference is made to Investments in Management s Discussion and Analysis of the Financial Condition and Results of Operations of this Form 10-K.

RATING AGENCIES

Insurance companies are rated by rating agencies to provide both industry participants and insurance consumers information on specific insurance companies. Higher ratings generally indicate the rating agencies opinion regarding financial stability and a stronger ability to pay claims.

We believe that strong ratings are important factors in marketing our products to our agents and customers, since rating information is broadly disseminated and generally used throughout the industry. We believe that a rating of A- or higher from A.M. Best Co. is particularly important for our business. Insurance company financial strength ratings are assigned to an insurer based upon factors deemed by the rating agencies to be relevant to policyholders and are not directed toward protection of investors. Such ratings are neither a rating of securities nor a recommendation to buy,

hold or sell any security.

EMPLOYEES

As of December 31, 2013, we have approximately 5,100 employees, with approximately 4,300 located in the United States, and 800 internationally, almost all of whom are located in the United Kingdom. We believe our relations with employees are good.

EXECUTIVE OFFICERS OF THE REGISTRANT

Reference is made to Directors and Executive Officers of the Registrant in Part III - Item 10 of this Form 10-K.

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AVAILABLE INFORMATION

We file our annual report on Form 10-K, quarterly reports on Form 10-Q, periodic information on Form 8-K, our proxy statement, and other required information with the Securities Exchange Commission (SEC). Shareholders may read and copy any materials on file with the SEC at the SEC s Public Reference Room at 100 F Street, NE, Washington, DC 20549. Shareholders may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. In addition, the SEC maintains an Internet website, http://www.sec.gov, which contains reports, proxy and information statements and other information with respect to our filings.

Our website address is http://www.hanover.com. We make available free of charge on or through our website, our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to those reports filed or furnished pursuant to Sections 13(a) or 15(d) of the Securities Exchange Act of 1934, as soon as reasonably practicable after we electronically file such material with, or furnish it to, the SEC. Additionally, our Code of Conduct is available, free of charge, on our website. Our Corporate Governance Guidelines and the charters of our Audit Committee, Compensation Committee, Committee of Independent Directors and Nominating and Corporate Governance Committee, are available on our website. All documents are also available in print to any shareholder who requests them.

ITEM 1A RISK FACTORS

RISK FACTORS AND FORWARD LOOKING STATEMENTS

We wish to caution readers that the following important factors, among others, in some cases have affected, and in the future could affect, our actual results and could cause our actual results to differ materially from historical results and from those expressed in any forward-looking statements made from time to time by us on the basis of our then-current expectations. When used in this Form 10-K, the words believes , anticipates , expects , projections , outlook , should , could , plan , guidance , likely , on track to , targeted and similar expressions are intended to identify forward-looking statements. Our businesses are in rapidly changing and competitive markets and involve a high degree of risk and unpredictability. Forward-looking projections are subject to these risks and unpredictability.

Our results may fluctuate as a result of cyclical or non-cyclical changes in the property and casualty insurance industry.

The property and casualty insurance industry historically has been subject to significant fluctuations and uncertainties. Our profitability is affected significantly by the following items:

- increases in costs, particularly those occurring after the time our insurance products are priced and including construction, automobile repair, and medical and rehabilitation costs. This includes cost shifting from health insurers to casualty and liability insurers (whether as a result of an increasing number of injured parties without health insurance, coverage changes in health policies to make such coverage secondary to casualty policies, the implementation of national healthcare legislation, lower reimbursement rates for the same procedure by health insurers or government-sponsored insurance, or the implementation of the Medicare Secondary Payer Act, which imposes reporting and other requirements with respect to medical and related claims paid for Medicare eligible individuals). As it relates to construction, there are often temporary increases in the cost of building supplies and construction labor after a significant event (for example, so

called demand surge that causes the cost of labor, construction materials and other items to increase in a geographic area affected by a catastrophe). In addition, we are limited in our ability to negotiate and manage reimbursable expenses incurred by our policyholders;

competitive and regulatory pressures, which affect the prices of our products and the nature of the risks covered;

volatile and unpredictable developments, including severe weather, catastrophes and terrorist actions;

legal, regulatory and socio-economic developments, such as new theories of insured and insurer liability and related claims and extra-contractual awards such as punitive damages, and increases in the size of jury awards or changes in applicable laws and regulations (such as changes in the thresholds affecting no fault liability or when non-economic damages are recoverable for bodily injury claims or coverage requirements);

fluctuations in interest rates, inflationary pressures, default rates and other factors that affect investment returns; and

other general economic conditions and trends that may affect the adequacy of reserves.

The demand for property and casualty insurance can also vary significantly based on general economic conditions (either nationally or regionally and, with respect to our Chaucer segment, internationally), rising as the overall level of economic activity increases and falling as such activity decreases. Loss patterns also tend to vary inversely with local economic conditions, increasing during difficult economic times and moderating during economic upswings or periods of stability. The fluctuations in demand and competition could produce unpredictable underwriting results.

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Actual losses from claims against our property and casualty insurance subsidiaries may exceed their reserves for claims.

Our property and casualty insurance subsidiaries maintain reserves to cover their estimated ultimate liability for losses and loss adjustment expenses with respect to reported and unreported claims incurred as of the end of each accounting period. Reserves do not represent an exact calculation of liability. Rather, reserves represent estimates, involving actuarial projections and judgments at a given time, of what we expect the ultimate settlement and administration of incurred claims will cost based on facts and circumstances then known, predictions of future events, estimates of future trends in claims frequency and severity and judicial theories of liability, costs of repair and replacement, legislative activity and myriad other factors.

The inherent uncertainties of estimating reserves are greater for certain types of property and casualty insurance lines. These include automobile bodily injury, personal automobile personal injury protection, and workers compensation, where a longer period of time may elapse before a definitive determination of ultimate liability may be made, environmental liability, where the technological, judicial and political climates involving these types of claims are continuously evolving, and casualty coverages such as professional liability. There is also greater uncertainty in establishing reserves with respect to new business, particularly new business that is generated with respect to newly introduced product lines, such as our professional liability and healthcare lines, by newly appointed agents or in geographies where we have less experience in conducting business. In these cases, there is less historical experience or knowledge and less data upon which the actuaries can rely. Estimating reserves is further complicated by unexpected claims or unintended coverage that emerge due to changing conditions. These emerging issues may increase the size or number of claims beyond our underwriting intent and may not become apparent for many years after a contract is issued.

Additionally, the introduction of new Commercial Lines products, including through several acquired subsidiaries, the development of new niche and specialty lines and the introduction of new lines of business at Chaucer, present new risks. Certain new specialty products, such as the human services program, non-profit directors and officers liability and employment practices liability policies, lawyers and other professional liability policies, healthcare lines and private company directors and officers coverage may also require a longer period of time (the so-called tail) to determine the ultimate liability associated with the claims and may produce more volatility in our results and less certainty in our accident year reserves. Some lines of business, such as commercial surety, are less susceptible to establishing reserves based on actuarial or historical experience and losses may be episodic, depending on economic and other factors.

We regularly review our reserving techniques, reinsurance and the overall adequacy of our reserves based upon, among other things:

- our review of historical data, legislative enactments, judicial decisions, legal developments in imposition of damages, changes in political attitudes and trends in general economic conditions;
- our review of per claim information;
- historical loss experience of our property and casualty insurance subsidiaries and the industry as a whole; and

the terms of our property and casualty insurance policies.

Underwriting results and operating income could be adversely affected by further changes in our net loss and LAE estimates related to significant events or emerging risks, such as risks related to breaches of computer network systems (cyber-risks), privacy regulations or disruptions caused by solar flares.

Estimating losses following any major catastrophe or with respect to emerging claims is an inherently uncertain process. Factors that add to the complexity in these events include the legal and regulatory uncertainty, the complexity of factors contributing to the losses, delays in claim reporting and with respect to areas with significant property damage, the impact of demand surge and a slower pace of recovery resulting from the extent of damage sustained in the affected areas due, in part, to the availability and cost of resources to effect repairs. Emerging claims issues may involve complex coverage, liability and other costs which could significantly affect LAE. As a result, there can be no assurance that our ultimate costs associated with these events or issues will not be substantially different from current estimates (for example, actual losses arising from an event like Superstorm Sandy may vary widely depending on the interpretation of various policy provisions). Investors should consider the risks and uncertainties in our business that may affect net loss and LAE reserve estimates and future performance, including the difficulties in arriving at such estimates.

Anticipated losses associated with business interruption exposure, the impact of wind versus water as the cause of loss, supplemental payments on previously closed claims caused by the development of latent damages or new theories of liability and inflationary pressures could have a negative impact on future loss reserve development.

Because of the inherent uncertainties involved in setting reserves and establishing current and prior-year loss picks , including those related to catastrophes, we cannot provide assurance that the existing reserves or future reserves established by our property and casualty insurance subsidiaries will prove adequate in light of subsequent events. Our results of operations and financial condition could therefore be materially affected by adverse loss development for events that we insured in prior periods.

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Due to geographical concentration in our U.S. property and casualty business, changes in economic, regulatory and other conditions in the regions where we operate could have a significant negative impact on our business as a whole. Geographic concentrations also expose us to losses that are potentially disproportionate to our market share in the event of natural or other catastrophes.

We generate a significant portion of our U.S. property and casualty insurance net premiums written and earnings in Michigan, Massachusetts and other states in the Northeast, including New Jersey and New York. For the year ended December 31, 2013, approximately 22% and 10% of our net premiums written in our U.S. property and casualty business were generated in the states of Michigan and Massachusetts, respectively. Many states in which we do business impose significant rate control and residual market charges, and restrict an insurer s ability to exit such markets. The revenues and profitability of our property and casualty insurance subsidiaries are subject to prevailing economic, regulatory, demographic and other conditions, including adverse weather in Michigan and the Northeast. Because of our geographic concentration in certain regions, our business as a whole could be significantly affected by changes in the economic, regulatory and other conditions in such areas.

Further, certain new catastrophe models assume an increase in frequency and severity of certain weather events, whether as a result of potential global climate change or otherwise. Financial strength rating agencies are placing increased emphasis on capital and reinsurance adequacy for insurers with certain geographic concentrations of risk which may be subject to disproportionate risk of loss. These factors also may result in insurers seeking to diversify their geographic exposure, which could result in increased regulatory restrictions in those markets where insurers seek to exit or reduce coverage, as well as an increase in competitive pressures in less weather-exposed markets.

Our profitability may be adversely affected if our pricing models differ materially from actual results.

The profitability of our business depends on the extent to which our actual claims experience is consistent with the assumptions we use in pricing our policies. We price our business in a manner that is intended to be consistent, over time, with actual results and return objectives. Our estimates and models, and/or the assumptions behind them, may differ materially from actual results.

If we fail to appropriately price the risks we insure, or fail to change our pricing model to appropriately reflect our current experience, or if our claims experience is more frequent or severe than our underlying risk assumptions, our profit margins may be negatively affected. If we underestimate the frequency and/or severity of extreme adverse events occurring, our financial condition may be adversely affected. If we overestimate the risks we are exposed to, we may overprice our products, and new business growth and retention of our existing business may be adversely affected.

Limitations on the ability to predict the potential impact of weather events and catastrophes may impact our future profits and cash flows.

Our business is subject to claims arising out of catastrophes that may have a significant impact on our results of operations and financial condition. We may experience catastrophe losses that could have a material adverse impact on our business. Catastrophes can be caused by various events, including hurricanes, floods, earthquakes, tornadoes, wind, hail, fires, drought, severe winter weather, sabotage, terrorist actions, explosions, nuclear accidents, solar flares, and power outages. The frequency and severity of catastrophes are inherently unpredictable.

The extent of gross losses from a catastrophe is a function of the total amount of insured exposure in the area affected by the event and the severity of the event. The extent of net losses depends on the amount and collectability of reinsurance.

Additionally, the severity of certain catastrophes could be so significant that it impacts the ability of certain locations to recover their economic viability in the near-term, which could also have a significant negative impact on our business.

Although catastrophes can cause losses in a variety of property and casualty lines, homeowners and commercial multiple peril property insurance have, in the past, generated the vast majority of our catastrophe-related claims. Our catastrophe losses have historically been principally weather-related, particularly from hurricanes, as well as snow and ice damage from winter storms. However, with the acquisition of Chaucer, we are subject to greater diversity in the types and geographic distribution of potential catastrophe losses. For example, Chaucer incurred catastrophe losses in 2013 from floods in Europe and hurricanes in Mexico, in 2012 from the earthquake in Italy and both the drought and Superstorm Sandy in the U.S., and in 2011 from the earthquake and ensuing tsunami in Japan, the earthquakes in New Zealand, and flooding in Australia and Thailand.

Although the insurance industry and rating agencies have developed various models intended to help estimate potential insured losses under thousands of scenarios, there is no reliable way of predicting the probability of such events or the magnitude of such losses before a specific event occurs. We utilize various models and other techniques in an attempt to measure and manage potential catastrophe losses within various income and capital risk appetites. However, such models and techniques have many limitations. In addition, due to historical concentrations of business, regulatory restrictions and other factors, particularly in the Northeast and in the state of Michigan, our ability to manage such concentrations is limited.

We purchase catastrophe reinsurance as protection against catastrophe losses. Based upon an ongoing review of our reinsurers financial statements, financial strength ratings assigned to them by rating agencies, their reputations in the reinsurance marketplace, our collections history with them and the analysis and guidance of our reinsurance advisors, we believe that the financial condition of our reinsurers is sound. However, reinsurance is subject to counterparty risks, including those resulting from over-concentration of exposures within the industry. In setting our retention levels and coverage limits, we also consider our level of statutory surplus and exposures, as well as the current reinsurance pricing environment. There can be no assurance that our reinsurance program will provide adequate coverage levels should we experience losses from one significant or several large catastrophes.

Our business is dependent on our ability to manage risk, and the failure of the risk mitigation strategies we utilize could have a material adverse effect on our financial condition or results of operations.

Our business performance is highly dependent on our ability to manage operational risks that arise from a large number of day-to-day business activities, including insurance underwriting, claims processing, servicing, investment, financial and tax reporting, compliance with regulatory requirements and other activities. We utilize a number of strategies to mitigate our insurance risk exposure, including: engaging in thorough underwriting, utilizing limits, deductibles and exclusions to mitigate policy risk, reviewing the terms and conditions of our policies, focusing on our risk aggregation by product line, geography, industry type, credit exposure and other bases, and ceding insurance risk. We seek to monitor and control our exposure to risks arising out of these activities through an enterprise-wide risk management framework. However, there are inherent limitations in all of these tactics and no assurance can be given that these processes and procedures will effectively control all known risks or effectively identify unforeseen risks or that an event or series of events will not result in loss levels in excess of our probable maximum loss models, which could have a material adverse effect on our financial condition or results of operations. It is also possible that losses could manifest themselves in ways that we do not anticipate and that our risk mitigation strategies are not designed to address. Such a manifestation of losses could have a material adverse effect on our financial condition or results of operations. These risks may be heightened during challenging economic conditions such as those recently experienced in the U.S. and elsewhere.

We cannot guarantee the adequacy of or ability to maintain our current level of reinsurance coverage.

Similar to insurance companies, reinsurance companies can also be adversely impacted when catastrophes occur. There can be no assurance that we will be able to maintain our current levels of reinsurance coverage. In particular, and as discussed under Reinsurance Program Overview of this Form 10-K, not all of our 2014 reinsurance programs for the Commercial and Personal Lines and Chaucer business are fully placed. Future catastrophic events and other changes in the reinsurance marketplace, including as a result of investment losses or disruptions due to challenges in the financial markets that have occurred or could occur in the future, may adversely affect our ability to obtain such coverages, as well as adversely affect the cost of obtaining that coverage.

Additionally, the availability, scope of coverage, cost, and creditworthiness of reinsurance could continue to be adversely affected as a result of not only new catastrophes, but also terrorist attacks and the perceived risks associated with future terrorist activities, global conflicts, and the changing legal and regulatory environment (including changes which could create new insured risks).

Federal terrorism coverage under TRIPRA is due to expire by its terms on December 31, 2014, and there have been proposals to scale back coverage under TRIPRA. We are unable to predict the likelihood that TRIPRA will be extended or of adoption of any proposals to reduce coverage; however, failure to timely reauthorize TRIPRA or a reduction in TRIPRA coverage would change our risk profile, and could have an adverse effect on our results of operations and financial position, because among other things, we may deem it prudent to reduce coverage in certain

lines of business, such as workers compensation, or limit our exposure concentrations in certain geographic areas or to purchase additional reinsurance. Reinsurance may not be available at reasonable rates.

Although we monitor their financial soundness, we cannot be sure that our reinsurers will pay in a timely fashion, if at all.

We purchase reinsurance by transferring part of the risk that we have assumed (known as ceding) to reinsurance companies in exchange for part of the premium we receive in connection with the risk. As of December 31, 2013, our reinsurance receivable (including from the MCCA) amounted to approximately $2.3 billion. Although reinsurance makes the reinsurer liable to us to the extent the risk is transferred or ceded to the reinsurer, it does not relieve us (the reinsured) of our liability to our policyholders or, in cases where we are a reinsurer, to our reinsureds. Accordingly, we bear counterparty risk with respect to our reinsurers. Although we monitor the credit quality of our reinsurers, we cannot be sure that they will pay the reinsurance recoverables owed to us currently or in the future or that they will pay such recoverables on a timely basis.

Climate change may adversely impact our results of operations.

There are concerns that the higher level of weather-related catastrophes and other losses incurred by the industry in recent years is indicative of changing weather patterns, whether as a result of changing climate (global climate change) or otherwise, which could cause such events to persist. This would lead to higher overall losses which we may not be able to recoup, particularly in the current economic and competitive environment, and higher reinsurance costs. As noted above, certain catastrophe models assume an increase in frequency and severity of certain weather events which could result in a disproportionate impact on insurers with certain geographic concentrations of risk. This would also likely increase the risks of writing property insurance in coastal areas, particularly in jurisdictions which restrict pricing and underwriting flexibility.

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In addition, global climate change could have an impact on assets in which we invest, resulting in realized and unrealized losses in future periods which could have a material adverse impact on our results of operations and/or financial position. It is not possible to foresee which, if any, assets, industries or markets will be materially and adversely affected, nor is it possible to foresee the magnitude of such effect.

We may incur financial losses resulting from our participation in shared market mechanisms, mandatory reinsurance programs and mandatory and voluntary pooling arrangements.

In most of the jurisdictions in which we operate, our property and casualty insurance subsidiaries are required to participate in mandatory property and casualty shared market mechanisms, government-sponsored reinsurance programs or pooling arrangements. These arrangements are designed to provide various insurance coverages to individuals or other entities that otherwise are unable to purchase such coverage or to support the costs of uninsured motorist claims in a particular state or region. We cannot predict whether our participation in these shared market mechanisms or pooling arrangements will provide underwriting profits or losses to us. For the year ended December 31, 2013, we experienced an underwriting loss of $14.5 million from participation in these mechanisms and pooling arrangements, compared to underwriting losses of $15.3 million and $13.1 million in 2012 and 2011, respectively. We may face similar or even more dramatic earnings fluctuations in the future.

Additionally, increases in the number of participants or insureds in state-sponsored reinsurance pools, FAIR Plans or other residual market mechanisms, particularly in the states of Louisiana, Massachusetts and Florida, combined with regulatory restrictions on the ability to adequately price, underwrite, or non-renew business, as well as new legislation, or changes in existing case law, could expose us to significant exposures and risks of increased assessments from these residual market mechanisms. There could also be significant adverse impact as a result of losses incurred in those states due to hurricane exposure, as well as the declining number of carriers providing coverage in those regions. We are unable to predict the likelihood or impact of such potential assessments or other actions.

We also have credit risk associated with certain mandatory reinsurance programs such as the Michigan Catastrophic Claims Association. The MCCA was created to fund Michigan s unique unlimited personal injury protection benefit. As of December 31, 2013, our estimated reinsurance recoverable from the MCCA was $867.0 million. The MCCA operates with a deficit which may fluctuate significantly based on investment returns, discount rates, incurred claims, annual assessments and other factors.

In addition, we may be adversely affected by liabilities resulting from our previous participation in certain voluntary property and casualty assumed reinsurance pools. We have terminated participation in virtually all property and casualty voluntary pools, but remain subject to claims related to periods in which we participated. The property and casualty assumed reinsurance businesses have suffered substantial losses during the past several years, particularly related to environmental and asbestos exposure for property and casualty coverages, in some cases resulting from incidents alleged to have occurred decades ago. Due to the inherent volatility in these businesses, possible issues related to the enforceability of reinsurance treaties in the industry and the recent history of increased losses, we cannot provide assurance that our current reserves are adequate or that we will not incur losses in the future. Although we have discontinued participation in these reinsurance pools, we are subject to claims related to prior years or from pools we could not exit entirely. Our operating results and financial position may be adversely affected by liabilities resulting from any such claims in excess of our loss estimates. As of December 31, 2013, our reserves for these pools totaled $37.1 million.

Our businesses are heavily regulated and changes in regulation may reduce our profitability.

Our U.S. insurance businesses are subject to supervision and regulation by the state insurance authority in each state in which we transact business. This system of supervision and regulation relates to numerous aspects of an insurance company s business and financial condition, including limitations on the authorization of lines of business, underwriting limitations, the ability to utilize credit-based insurance scores in underwriting, the ability to terminate agents, supervisory and liability responsibilities for agents, the setting of premium rates, the requirement to write certain classes of business which we might otherwise avoid or charge different premium rates, restrictions on the ability to withdraw from certain lines of business, the establishment of standards of solvency, the licensing of insurers and agents, compensation of agents, concentration of investments, levels of reserves, the payment of dividends, transactions with affiliates, changes of control, protection of private information of our agents, policyholders, claimants and others (which may include highly sensitive financial or medical information or other private information such as social security numbers, driving records, drivers license numbers, etc.) and the approval of policy forms. From time to time, various states and Congress have proposed to prohibit or otherwise restrict the use of credit-based insurance scores in underwriting or rating our Personal Lines business. The elimination of the use of credit-based insurance scores could cause significant disruption to our business and our confidence in our pricing and underwriting. Most insurance regulations are designed to protect the interests of policyholders rather than stockholders and other investors.

Legislative and regulatory restrictions are constantly evolving and are subject to then current political pressures. For example, following Superstorm Sandy, the states of New Jersey and New York are considering proposals such as homeowners Bill of Rights , restrictions on storm deductibles and additional mandatory claim handling guidelines. Such actions also occur at the federal level, such as the U. S. Department of Housing and Urban Development s proposal that may increase the legal risk of providing homeowners and commercial residential property insurance by imposing liability for discrimination on the basis of a disparate-impact theory even without any evidence of discriminatory intent. Some states are also considering mandating owners of firearms to purchase liability insurance.

In addition, in July 2010, in response to the global financial crisis, The Dodd-Frank Wall Street Reform and Consumer Protection Act was enacted. This legislation provides for enhanced regulation for the financial services industry through initiatives including, but not limited to, the creation of a Federal Insurance Office and several federal oversight agencies, the requiring of more transparency, accountability and focus in protecting investors and businesses, input of shareholders regarding executive compensation, and enhanced empowerment of regulators to pursue those who engage in financial fraud and unethical business practices. The Securities and Exchange Commission adopted regulations designed to encourage, reward, and protect whistleblowers , whether or not they first report the potential infraction to the company for correction or remedial action.

Also, beginning in 2011, the federal Medicare, Medicaid and SCHIP Extension Act mandates reporting and other requirements applicable to property and casualty insurance companies which make payments to or on behalf of claimants who are eligible for Medicare benefits. These requirements have made bodily injury claim resolutions more difficult, particularly for complex matters or for injuries requiring treatment over an extended period, and impose significant penalties for non-compliance and reporting errors. These new requirements also have increased the circumstances under which the federal government may seek to recover from insurers amounts paid to claimants in circumstances where the government had previously paid benefits. In January 2013, the Strengthening Medicare and Repaying Taxpayers Act was signed into law. We are not yet certain of the effect of this law on our ability to settle cases or exposure to federal recoupment claims.

With respect to our U.S. insurance business, state regulatory oversight and various proposals at the federal level may in the future adversely affect our ability to sustain adequate returns in certain lines of business or in some cases, operate the line profitably. In recent years, the state insurance regulatory framework has come under increased federal scrutiny, and certain state legislatures have considered or enacted laws that alter and, in many cases, increase state authority to regulate insurance companies and insurance holding company systems.

Our business could be negatively impacted by adverse state, federal and foreign legislation or regulation, including those resulting in:

- decreases in rates;
- limitations on premium levels;
- coverage and benefit mandates;
- limitations on the ability to manage care and utilization or other claim costs;

- requirements to write certain classes of business or in certain geographies;
- restrictions on underwriting, on methods of compensating independent producers, or on our ability to cancel or renew certain business (which negatively affects our ability to reduce concentrations of property risks);
- higher liability exposures for our insureds;
- increased assessments or higher premium or other taxes; and
- enhanced ability to pierce no fault thresholds or recover non-economic damages (such as pain and suffering).

These regulations serve to protect the customers and other third parties who deal with us and are heavily influenced by the then current political environment. If we are found to have violated an applicable regulation, administrative or judicial proceedings may be initiated against us which could result in censures, fines, civil penalties (including punitive damages), the issuance of cease-and-desist orders, premium refunds or the reopening of closed claim files, among other consequences. These actions could have a material adverse effect on our financial position and results of operations.

Congress, as well as state, local and foreign governments, also consider from time to time legislation that could increase our tax costs. If such legislation is adopted, our consolidated net income could decline.

In addition, we are reliant upon independent agents and brokers to market our products. Changes in regulations related to insurance agents and brokers that materially impact the profitability of the agent and broker business or that restrict the ability of agents and brokers to market and sell insurance products would have a material adverse effect on our business.

With respect to our U.K. insurance business, Chaucer s regulated subsidiaries are subject to the U.K. s Prudential Regulation Authority (PRA) and the Financial Conduct Authority (FCA) regulations, which replaced the Financial Services Authority in April 2013, and are subject to limitations and approval requirements with respect to payments of dividends, return of capital and becoming a borrower, guarantor or provider of security interest on any financial obligations and other aspects of its operations.

The PRA and FCA have substantial powers of intervention in relation to the Lloyd s managing agents, such as Chaucer, which they regulate, including the power to remove their authorization to manage Lloyd s syndicates. In addition, each year the PRA requires Lloyd s to satisfy an annual solvency test that measures whether Lloyd s has sufficient assets in the aggregate to meet all outstanding liabilities of its members, both current and run-off. If Lloyd s fails this test, the PRA may require Lloyd s to cease trading and/or its members to cease or reduce underwriting. The FCA focuses on conduct of business issues with a particular focus on consumer protection and market integrity. Future regulatory changes or rulings by the PRA and FCA could interfere with our business strategy or financial assumptions, possibly resulting in a material adverse effect on our profitability.

There are a number of regulatory and legal changes that are aimed at reducing the cost of motor insurance to consumers which will have an impact on Chaucer s U.K. Division, including the Legal Aid and Sentencing of Offenders Act (LASPO) 2012, the Competition Commission inquiry in the U.K. Private Motor Insurance market and the Department for Transport consultation on whiplash claims. Of these three initiatives only LASPO is currently in effect and the U.K. Division has completed all necessary steps to ensure that compliance with the requirements of the Act is achieved without any commercial disadvantages to the division. We do not yet know the impact of the Competition Commission inquiry in the U.K. Private Motor Insurance market and the Department for Transport consultation on whiplash claims on Chaucer s business operations or the U.K. insurance industry.

Additionally, the Lloyd s worldwide insurance and reinsurance business is subject to various regulations, laws, treaties and other applicable policies of the European Union, as well as each nation, state and locality in which it operates. Material changes in governmental requirements and laws could have an adverse effect on Lloyd s and its member companies, including Chaucer.

The European Union (E.U.) is phasing in a new composite E.U. directive (known as Solvency II) covering the prudential supervision of all insurance and reinsurance companies that is being developed to replace the existing life insurance, non-life insurance and reinsurance directives that govern the insurance business in the U.K. (among various other obligations, Solvency II will impose new capital requirements on Chaucer). It is estimated that the implementation of Solvency II will take effect during 2016, but it is possible some rules will come into force earlier. We could be impacted by the implementation of Solvency II, depending on the costs associated with implementation by each E.U. country, any increased capital requirements applicable to us, and any costs associated with adjustments to our operations. We are also subject to risks and uncertainties relating to changes to the regulatory framework in the U.K. with the recent introduction of the PRA and FCA. We anticipate new conduct requirements to develop over the next twelve months.

From time to time, we are also involved in investigations and proceedings by U.S., U.K., state and other governmental and self-regulatory agencies. We cannot provide assurance that these investigations, proceedings and inquiries will not result in actions that would adversely affect our results of operations or financial condition.

As a specialist in Lloyd s insurance group, Chaucer is subject to a number of risks which could materially and adversely affect us.

As a specialist in Lloyd s insurance group, Chaucer is subject to a number of specific risk factors and uncertainties, including without limitation:

- its reliance on insurance and reinsurance brokers and distribution channels to distribute and market its products (so called coverholders);

its obligations to maintain funds at Lloyd s to support its underwriting activities; its risk-based capital requirement being assessed periodically by Lloyd s and being subject to variation;

its reliance on ongoing approvals from Lloyd s, the PRA and FCA and other regulators to conduct its business, including a requirement that its Annual Business Plan be approved by Lloyd s before the start of underwriting for each account year;

its obligations to contribute to the Lloyd s Central Fund and pay levies to Lloyd s;

its financial strength rating is derived from the rating assigned to Lloyd s, and Chaucer has very limited ability to directly affect the overall Lloyd s rating;

its ongoing ability to utilize Lloyd s trading licenses in order to underwrite business outside the United Kingdom;

its ongoing exposure to levies and charges in order to underwrite at Lloyd s; and

the requirement to maintain deposits in the United States for U.S. site risks it underwrites.

Whenever a member of Lloyd s is unable to pay its policyholder obligations, such obligations may be payable by the Lloyd s Central Fund. If Lloyd s determines that the Central Fund needs to be increased, it has the power to assess premium levies on current Lloyd s

members up to 3% of a member s underwriting capacity in any one year. We do not believe that any assessment is likely in the foreseeable future and have not provided allowance for such an assessment. However, based on our 2014 estimated underwriting capacity at Lloyd s of £878.0 million, the December 31, 2013 exchange rate of 1.66 dollars per GBP and assuming the maximum 3% assessment, we could be assessed up to approximately $43.6 million in 2014.

We are subject to litigation risks, including risks relating to the application and interpretation of contracts, and adverse outcomes in litigation and legal proceedings could adversely affect our results of operations and financial condition.

We are subject to litigation risks, including risks relating to the application and interpretation of insurance and reinsurance contracts, and are routinely involved in litigation that challenges specific terms and language incorporated into property and casualty contracts, such as claims reimbursements, covered perils and exclusion clauses, among others, or the interpretation or administration of such contracts. We are also involved in legal actions that do not arise in the ordinary course of business, some of which assert claims for substantial amounts. Adverse outcomes, including with respect to the matter captioned Durand Litigation under Commitments and Contingencies Legal Proceedings in Note 18 in the Notes to the Consolidated Financial Statements included in Financial Statements and Supplementary Data of this Form 10-K, could materially affect our results of operations and financial condition.

We are subject to mandatory assessments by state guaranty funds; an increase in these assessments could adversely affect our results of operations and financial condition.

All fifty states of the United States and the District of Columbia have insurance guaranty fund laws requiring property and casualty insurance companies doing business within the state to participate in guaranty associations. These associations are organized to pay contractual obligations under insurance policies issued by impaired or insolvent insurance companies. The associations levy assessments, up to prescribed limits, on all member insurers in a particular state on the basis of the proportionate share of the premiums written by member insurers in the lines of business in which the impaired or insolvent insurer is engaged. Although mandatory assessments by state guaranty funds that are used to cover losses to policyholders of insolvent or rehabilitated companies can be substantially recovered through policyholder surcharges or a reduction in future premium taxes in many states (provided the collecting insurer continues to write business in such state), there can be no assurance that all funds will be recoupable in the future. During 2013, we had a total assessment of $6.0 million levied against us, with refunds of $0.4 million received in 2013 for a total net assessment of $5.6 million. As of December 31, 2013, we have $0.7 million of reserves related to guaranty fund assessments. In the future, these assessments may increase above levels experienced in the current and prior years. Future increases in these assessments depend upon the rate of insolvencies of insurance companies. An increase in assessments could adversely affect our results of operations and financial condition.

If we are unable to attract and retain qualified personnel, or if we experience the loss or retirement of key executives or other key employees, we may not be able to compete effectively and our operations could be impacted significantly.

Our future success will be affected by our continued ability to attract and retain qualified executives and other key employees, particularly those experienced in the property and casualty industry and the Lloyd s market.

Our profitability could be adversely affected by periodic changes to our relationships with our agencies.

We periodically review agencies, including managing general agencies, with which we do business to identify those that do not meet our profitability standards or are not strategically aligned with our business. Following these periodic reviews, we may restrict such agencies access to certain types of policies or terminate our relationship with them,

subject to applicable contractual and regulatory requirements which limit our ability to terminate agents or which require us to renew policies. We may not achieve the desired results from these measures, and our failure to do so could negatively affect our operating results and financial position.

We may be affected by disruptions caused by the introduction of new products, related technology changes, and new operating models in Commercial Lines, Personal Lines and Chaucer businesses and recent or future acquisitions, and expansion into new geographic areas. We could also be affected by an inability to retain profitable policies in force and attract profitable policies in our Commercial Lines, Personal Lines and Chaucer segments, particularly in light of a competitive product pricing environment and the adoption by competitors of strategies to increase agency appointments and commissions and increased advertising.

There are increased underwriting risks associated with premium growth and the introduction of new products or programs in our Commercial Lines, Personal Lines and Chaucer businesses. Additionally, we have increased underwriting risks associated with the appointment of new agencies and managing general agencies and with the expansion into new geographical areas, including international expansion.

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The introduction of new Commercial Lines products, including through our acquired subsidiaries and the development of new niche and specialty lines, presents new risks. Certain new specialty products may present longer tail risks and increased volatility in profitability. Our expansion into western states, including California, presents additional underwriting risks since the regulatory, geographic, natural risk, legal environment, demographic, business, economic and other characteristics of these states present challenges different from those in the states in which we historically have conducted business.

Our Personal Lines production and earnings may be unfavorably affected by the continued introduction of new products and our focus on account business (i.e., policyholders who have both automobile and homeowner insurance with us) which we believe, despite pricing discounts, will ultimately be more profitable business. We may also experience adverse selection, which occurs when insureds with larger risks purchase our products because of favorable pricing, under-pricing, operational difficulties or implementation impediments with independent agents or the inability to grow new markets after the introduction of new products or the appointment of new agents.

There can be no assurance that as we enter new states or regions or grow business in our identified growth states, we won t experience higher loss trends than anticipated.

Integration of acquired businesses involves a number of risks and there can be no assurance that we will be successful integrating recent and future acquisitions.

There can be no assurance that we will be able to successfully integrate recent and any future acquisitions or that we will not assume unknown liabilities and reserve deficiencies in connection with such acquisitions. If we are unable to successfully integrate new businesses, then we could be impeded from realizing the benefits of an acquisition. The integration process could disrupt our business and a failure to successfully integrate newer businesses could have a material adverse effect on our business, financial condition and results of operations. The difficulties of integrating an acquisition and risks to our business include, among others:

- unanticipated issues in integrating information, communications and other systems;
- unanticipated incompatibility of logistics, marketing and administration methods;