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ProAssurance Corp.

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ProAssurance Corp.

Rationale

Business Risk Profile: Strong

- Top-five market share in the U.S. medical professional liability (MPL) market
- Successful track record of growth from acquisitions
- Good geographic diversification with a national footprint
- Improving product diversification from increasing workers' compensation (WC) and Lloyd's syndicate businesses
- Consistently outperforms the MPL and general insurance industry, but margins are shrinking

Financial Risk Profile: Extremely Strong

- Capital redundant at the 'AAA' level
- Conservative reserve position
- Adequate financial flexibility

Other Factors

- Highly experienced management team

Outlook: Stable

The stable outlook on ProAssurance Corp. (PRA) reflects Standard & Poor's Ratings Services' view that PRA's capital adequacy will remain redundant at the 'AAA' level over the next two years. We expect the company to maintain underwriting discipline and continue to outperform the industry. We also expect its combined ratio to be between 88%-92%, financial leverage to remain less than 15%, and coverage to be more than 6x for the next two years.

Downside scenario

We may lower the ratings if capital adequacy falls below the 'AAA' level due to either earnings weakening to substantially less than our base-case assumptions or non-accretive acquisitions. We may also lower the ratings if PRA's competitive position deteriorates as a result of industry trends.

Upside scenario

We are unlikely to raise the ratings during the next 24 months.

Base-Case Scenario

Macroeconomic Assumptions

- Continued slow growth for the U.S. economy, with GDP growth of 2.5% in 2015 and 2.8% in 2016
- Long-term trends in the health care industry continue, such as the movement toward integrated delivery systems (IDS) and hospitals purchasing doctors' practices
- No significant changes in the legal or legislative systems of the states where PRA has significant market share
- MPL market remains soft
- Labor market continues improving with expected unemployment dropping to 5.3% in 2015 and 4.9% in 2016

Company-Specific Assumptions

- PRA seeks strategic acquisitions and grows organically in markets that expand its geographic footprint
- Underwriting discipline continues outperforming the MPL and general insurance market by wide but shrinking margins
- Reserves remain adequate with continued reserve releases
- Capital at the 'AAA' level
- Financial leverage less than 15% with coverage of more than 6x

Key Metrics

	--Year ended Dec. 31--				
(Mil. $)	**2016***	**2015***	**2014**	**2013**	**2012**
Gross premiums written	>810	>800	779.6	567.5	536.4
P/C net combined ratio (%)	<92	<92	82.1	70.6	57.3
Net income	>140	>140	196.6	297.5	275.5
S&P capital adequacy/redundancy	AAA	AAA	AAA	AAA	AAA
Financial leverage (%)	<15	<15	11.0	9.7	5.7
Fixed-charge coverage (x)	>6	>6	20.6	126.2	146.0

*Forecast data reflect Standard & Poor's base-case assumptions.

Company Description

PRA is the fifth-largest MPL writer in the U.S., based on 2014 direct premiums written, with a 4.8% market share, and it is the largest independent publicly traded MPL writer. In 2014, the company increased its product diversification through the acquisition of Eastern Insurance Holdings Inc. (Eastern) and the creation of Syndicate 1729 at Lloyd's of London, of which it is the majority capital provider. The same year, PRA wrote $792 million of gross premiums written (GPW) with an equity base of $2.2 billion. As a result of the growth from Eastern and Syndicate 1729, GPW totaled about $421 million for first-half 2015.

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Business Risk Profile: Strong

We view PRA's business risk profile as strong, reflecting its intermediate industry and country risk and strong competitive position.

Insurance industry and country risk: Intermediate

PRA's insurance industry and country risk assessment (IICRA) is intermediate due to the very low country risk and an intermediate industry risk for its non-life insurance operations. The very low country risk reflects high income prospects based on GDP per capita and low risks in the political environment, financial system, payment culture, and rule of law in the U.S. We believe PRA's non-life operations are exposed to intermediate industry risks due to the inherent product risk and consequent susceptibility to reserve volatility. The litigious environment in the U.S. also affects claims amounts and payment patterns, but the stability of the U.S. insurance markets' profitability, growth prospects, and overall institutional framework offset these weaknesses.

Table 1

Industry And Country Risk		
Insurance sector	**IICRA**	**Business mix (%)**
U.S. P/C	Intermediate risk	100

Competitive position: Strong with improving diversification

We view PRA's competitive position as strong, which its national footprint and strong operating performance primarily support. PRA is the fifth-largest MPL writer in the U.S. and has significant presence in the Mid-Atlantic, Midwest, and Southeast regions.

Our positive view of PRA's operating performance reflects its track record of consistently outperforming the industry. The company's average combined ratio for 2010–2014 was 66.3% compared to 101% for the property and casualty (P/C) industry overall. PRA's skills in underwriting and handling claims are among the best in the industry and help differentiate the company from its peers in terms of operating performance. The company's average annual loss ratio has benefited from approximately 44% of reserve releases, primarily as a result of frequency reduction in the accident years 2004 to 2009. However, after years of healthy underwriting profits, pricing pressure in the broader market is beginning to affect the MPL industry. Furthermore, PRA's largest MPL policyholder base, sole physician or small physician practices, is gradually declining as more doctors are choosing to work for larger groups or become directly employed by hospitals or other health care delivery systems.

In an effort to enhance the scope of coverages, PRA could offer the increasingly complex health care delivery system. PRA expanded into WC insurance in 2014 with its acquisition of Eastern. This acquisition had the additional effect of diversifying the company's premium base, and Eastern now contributes approximately one-third of PRA's overall premium volume. Although underwriting performance in the WC space has historically not been as profitable as in the MPL space, Eastern's performance has been stronger than its peers', with an average five-year statutory combined ratio of 92%. PRA has also branched out by offering other products, such as through its Lloyd's syndicate that launched in 2014. However, we don't expect the Lloyd's syndicate to contribute meaningful profits during the next 24 months.

Because of PRA's change in business mix and slowing of its overall reserve releases, we expect the company to lower its expectations for its 2015 and 2016 combined ratio. However, we expect the company's operating performance to remain better than the overall P/C industry.

Table 2

Competitive Position							
	--As of Sept. 30--		--Year ended Dec. 31--				
(Mil. $)	**2015**	**2014**	**2014**	**2013**	**2012**	**2011**	**2010**
Gross premiums written	651.3	632.0	779.6	567.5	536.4	565.9	533.2
Change in gross premiums written (%)	3.1	39.9	37.4	5.8	(5.2)	6.1	(3.7)
Net premiums earned	529.3	525.1	699.7	527.9	550.7	565.4	519.1
P/C: reinsurance utilization - premiums written (%)	10.7	10.0	10.0	7.5	1.5	1.3	5.2

Financial Risk Profile: Extremely Strong

We view PRA's financial risk profile as extremely strong, reflecting its extremely strong capital and earnings, intermediate risk position, and strong financial flexibility.

Capital and earnings: Extremely strong

We consider PRA's capital and earnings extremely strong, which its capital redundancies at the 'AAA' level and strong earnings support. In our base-case forecast, we expect capital to remain redundant at the 'AAA' level because the company has consistently managed it at this level for the past few years. During the past three years and through third-quarter 2015, the company has used over $1 billion of capital to create value via dividends, share repurchases, and strategic acquisitions. Despite the magnitude of capital that the company has deployed, the management team is committed to maintaining 'AAA' capital adequacy. We believe strong earnings and management's commitment will support PRA's capital at the 'AAA' level.

Table 3

Capitalization Statistics							
	--As of Sept. 30--		--Year ended Dec. 31--				
(Mil. $)	**2015**	**2014**	**2014**	**2013**	**2012**	**2011**	**2010**
Common shareholders' equity	2,006.8	2,321.2	2,157.9	2,394.4	2,270.6	2,164.5	1,855.9
Change in common shareholders' equity (%)	(13.5)	(2.2)	(9.9)	5.5	4.9	16.6	8.9
Total reported capital	2,356.8	2,571.2	2,407.9	2,644.4	2,395.6	2,214.1	1,907.0
Change in total capital (reported) (%)	(8.3)	8.3	(8.9)	10.4	8.2	16.1	8.7

Table 4

Earnings Statistics							
	--As of Sept. 30--		--Year ended Dec. 31--				
(Mil. $)	**2015**	**2014**	**2014**	**2013**	**2012**	**2011**	**2010**
Total revenue	621.8	626.7	837.7	672.3	687.0	710.8	674.7
EBIT adjusted	145.1	178.5	262.5	332.3	369.9	413.1	318.6
EBITDA adjusted	173.4	214.8	312.9	378.2	407.5	448.8	345.3

Table 4

Earnings Statistics (cont.)							
Net income (attributable to all shareholders)	81.2	131.5	196.6	297.5	275.5	287.1	231.6
Return on revenue (%)	23.3	28.5	31.3	49.4	53.8	58.1	47.2
Return on shareholders' equity (reported) (%)	5.0	7.5	8.6	12.8	12.4	14.3	13.0
P/C: Net expense ratio (%)	29.8	30.3	30.2	28.0	24.6	24.1	26.0
P/C: Net loss ratio (%)	60.1	54.8	51.9	42.6	32.7	28.7	42.6
P/C: Net combined ratio (%)	89.9	85.0	82.1	70.6	57.3	52.8	68.6

Risk position: Well-diversified and high-quality investment portfolio

PRA's risk position reflects intermediate risk, which its conservative investment portfolio supports. As of June 30, 2015, the investment portfolio comprised 77% fixed-income securities, 8% equities, 4% cash and short-term investments, and 11% in alternative and other investments. Most of the fixed-income portfolio (93%) is investment grade, with an average credit rating of 'A+'. PRA's investment strategy is to provide adequate liquidity, preserve capital, and minimize volatility while generating income.

Table 5

Risk Position							
	--As of Sept. 30--		**--Year ended Dec. 31--**				
(Mil. $)	**2015**	**2014**	**2014**	**2013**	**2012**	**2011**	**2010**
Total invested assets	3,988.7	4,339.4	4,246.5	4,189.4	4,087.0	4,261.4	4,085.2
Net investment income	82.2	92.8	125.6	129.3	136.1	141.0	146.4
Net investment yield (%)	2.6	2.9	3.0	3.1	3.3	3.4	3.7
Net investment yield including realized capital gains/(losses) (%)	3.1	3.7	3.7	4.8	4.0	3.5	4.1
Portfolio composition (% of general account invested assets)							
Cash and short-term investments (%)	9.0	7.9	7.7	9.0	4.7	5.9	5.4
Bonds (%)	70.9	74.8	74.1	74.4	84.4	86.0	88.2
Equity investments (%)	11.9	9.8	10.8	7.8	5.8	3.4	2.4
Real estate (%)	1.0	0.9	0.9	1.0	1.0	0.9	1.1
Investments in affiliates (%)	3.5	3.2	3.1	3.4	2.1	2.1	1.6
Other investments (%)	3.7	3.4	3.4	4.4	2.0	1.8	1.4

Financial flexibility: Strong, reflecting capital market access

PRA has strong financial flexibility, in our view, with broad access to capital markets as a publicly traded company. In November 2013, it issued $250 million 10-year senior notes due in 2023 for general corporate purposes. We expect its financial leverage to be less than 15% and its fixed-charge coverage to be more than 6x over the next two years.

Table 6

Financial Flexibility							
	--As of Sept. 30--		**--Year ended Dec. 31--**				
(Mil. $)	**2015**	**2014**	**2014**	**2013**	**2012**	**2011**	**2010**
EBITDA fixed-charge coverage including realized and unrealized gains/(losses) (x)	11.8	19.4	21.5	148.8	156.1	100.9	110.1
EBITDA fixed-charge coverage (x)	15.0	18.8	20.6	126.2	146.0	99.8	104.9
Financial leverage including pension deficit as debt (%)	15.5	10.2	11.0	9.7	5.7	2.8	3.2

Other Assessments

We view PRA's enterprise risk management (ERM) as adequate and its management and governance practices as satisfactory, supporting the rating.

Enterprise risk management: Adequate

We regard PRA's ERM framework as adequate because the company has proven mechanisms to identify, measure, and manage risk exposures and losses within chosen risk tolerances. We consider ERM of low importance to PRA based on its excess capital relative to its risk profile and because the company's profile is low complexity.

We assess PRA's risk management culture as neutral because it has a well-defined committee structure with clearly defined risk owners and frequent reporting, which result in effective risk management. Overall, PRA's risk controls are strong, primarily because the focus of its underwriting is on profitability, it manages reserves prudently, and it uses both internal and external monitoring. In addition, the company's claims management culture is strong; it aggressively defends claims that it sees as having no merit, which a committee, led by the CEO and chief medical officer, identifies every two weeks. PRA's close ties to medical communities help it understand critical underwriting issues and prepare for emerging trends.

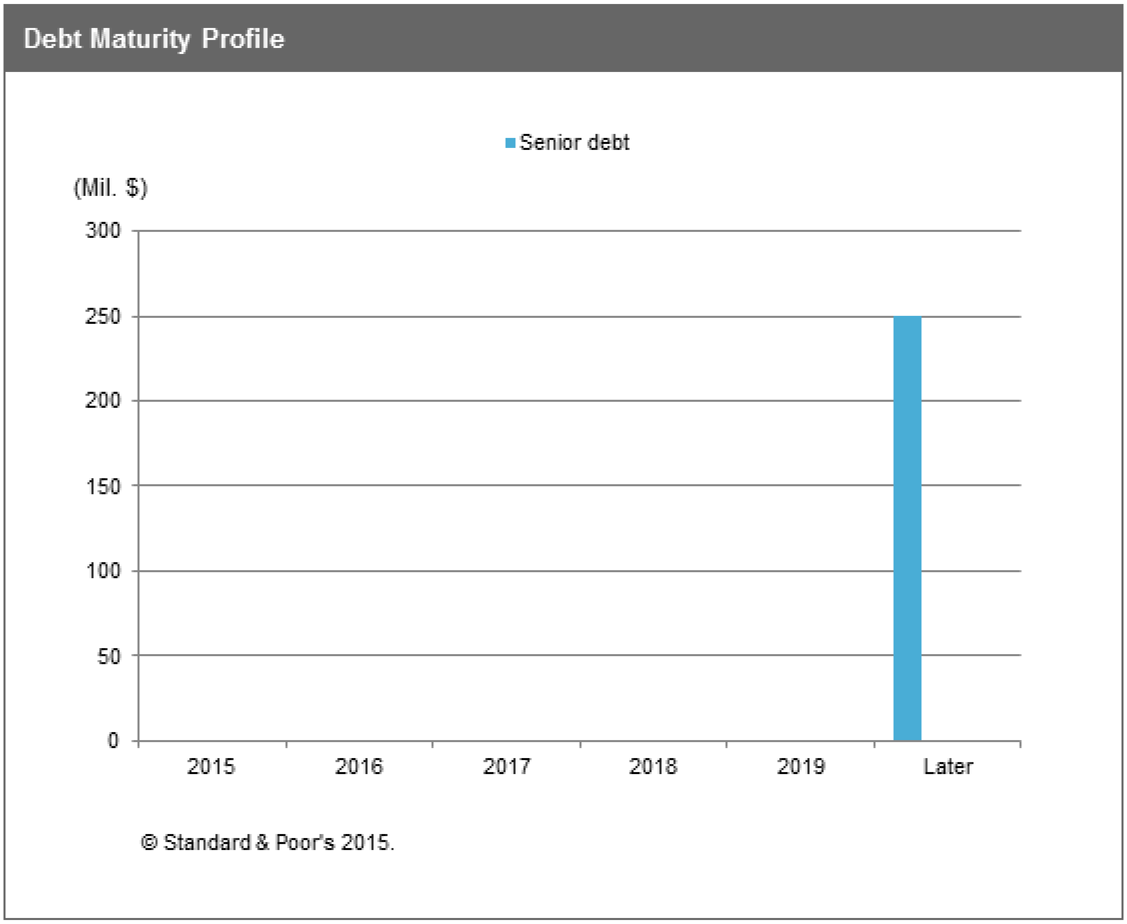
Management and governance: Well-experienced team

PRA's management and governance practices are satisfactory, in our opinion. The management team, which has an average tenure of 15 years, is well experienced and has extensive knowledge of the MPL industry. Further strengthening its management, PRA has retained senior executives with considerable product expertise from the entities it has acquired. PRA's claims management is one of its primary competitive advantages. It tries more claims than its peers, and it's willing to defend its clients' claims to the extent permitted under the laws and legal system of each state. This not only leads to a lower loss ratio for PRA, but it also helps retain clients, and it prevents its products from becoming commodities. The company's strong and exclusive relationship with various legal firms makes it difficult for other companies to enter states in which PRA already holds a dominant market position.

Liquidity: Exceptional

We view PRA's liquidity as exceptional, which a liquid investment portfolio with no upcoming debt maturities supports. We don't expect PRA to have liquidity constraints in meeting its obligations in the next two years because of the cash flow from its underwriting and investment activities. We also expect its liquidity resources to cover funds for acquisitions.

Chart 1



Factors Specific To The Holding Company

PRA largely relies on its regulated insurance operating units to meet its potential debt obligations and other cash requirements, including interest and principal payment on debt, shareholder dividends, and other expenses. The holding company has access to a revolving credit facility of $250 million. In 2014, the parent received a total of $285 million in dividends, including $56 million in extraordinary dividends, from its insurance subsidiaries. The subsidiaries may pay the parent up to $149 million in ordinary dividends by year-end 2015 without prior regulatory approval.

Accounting Considerations

PRA is a publicly traded insurance holding company and prepares consolidated financial statements quarterly on a U.S. generally accepted accounting principles basis and files them with the Securities and Exchange Commission. The domestic insurance subsidiaries file financial statements with state insurance regulators, which are prepared in accordance with statutory accounting principles. PRA has filed its reports on time, and we are unaware of any adverse opinion from the auditor. We analyze both PRA's audited and unaudited financial reports.

Related Criteria And Research

- Group Rating Methodology, Nov. 19, 2013
- Insurers: Rating Methodology, May 7, 2013
- Enterprise Risk Management, May 7, 2013
- Methodology For Linking Short-Term And Long-Term Ratings For Corporate, Insurance, And Sovereign Issuers, May 7, 2013
- Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- Principles Of Credit Ratings, Feb. 16, 2011
- Refined Methodology And Assumptions For Analyzing Insurer Capital Adequacy Using The Risk-Based Insurance Capital Model, June 7, 2010
- Use Of CreditWatch And Outlooks, Sept. 14, 2009
- Hybrid Capital Handbook: September 2008 Edition, Sept. 15, 2008

Ratings Detail (As Of December 14, 2015)	
Operating Company Covered By This Report	
ProAssurance Corp.	
Counterparty Credit Rating	
Local Currency	BBB+/Stable/--
Senior Unsecured	BBB+

*Unless otherwise noted, all ratings in this report are global scale ratings. Standard & Poor's credit ratings on the global scale are comparable across countries. Standard & Poor's credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.