OneBeacon Insurance Group, Ltd.
Form 10-Q
October 30, 2009
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the period ended September 30, 2009

OR

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

For the transition period from to

Commission file number 1-33128

ONEBEACON INSURANCE GROUP, LTD.

(Exact name of Registrant as specified in its charter)

Bermuda (State or other jurisdiction of incorporation or organization)	**98-0503315** (I.R.S. Employer Identification No.)
601 Carlson Parkway **Minnetonka, Minnesota** (Address of principal executive offices)	**55305** (Zip Code)

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

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the preceding 12 months, and (2) has been subject to such filing requirements for the past 90 days. Yes x No o

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

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

Large accelerated filer o	Accelerated Filer x
Non-accelerated filer o	Smaller reporting company o

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

As of October 28, 2009, 23,366,312 Class A common shares, par value of $0.01 per share, and 71,754,738 Class B common shares, par value of $0.01 per share, were outstanding.

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ONEBEACON INSURANCE GROUP, LTD.

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PART 1. FINANCIAL INFORMATION

ITEM 1. Financial Statements

ONEBEACON INSURANCE GROUP, LTD.

CONSOLIDATED BALANCE SHEETS

	September 30, 2009 (Unaudited)	December 31, 2008
	(in millions, except share and per share amounts)	
Assets		
Investment Securities:		
Fixed maturity investments, at fair value (amortized cost $2,690.8 and $2,246.4)	$ 2,795.7	$ 2,134.8
Common equity securities, at fair value (cost $76.6 and $284.6)	81.2	276.7
Convertible bonds, at fair value (amortized cost $224.0 and $255.0)	244.0	241.2
Short-term investments, at amortized cost (which approximates fair value)	730.6	962.2
Other investments, at fair value (cost $145.2 and $178.6)	166.2	196.6
Total investments	4,017.7	3,811.5
Cash	53.0	53.0
Reinsurance recoverable on unpaid losses	686.2	859.4
Reinsurance recoverable on unpaid losses Berkshire Hathaway, Inc.	1,558.1	1,643.9
Reinsurance recoverable on paid losses	17.3	21.7
Premiums receivable	505.8	527.6
Securities lending collateral		100.7
Deferred acquisition costs	228.8	225.5
Net deferred tax asset	101.7	252.7
Investment income accrued	26.0	25.7
Ceded unearned premiums	59.1	66.5
Accounts receivable on unsettled investment sales	30.1	49.0
Other assets	290.7	303.6
Total assets	$ 7,574.5	$ 7,940.8
Liabilities		
Loss and LAE reserves	$ 4,029.6	$ 4,294.0
Unearned premiums	1,081.2	1,088.2
Debt	620.4	731.9
Securities lending payable	1.7	107.7
Ceded reinsurance payable	36.3	70.5
Accounts payable on unsettled investment purchases	29.3	6.8
Other liabilities	383.6	469.4
Total liabilities	6,182.1	6,768.5
Shareholders equity and noncontrolling interests		
OneBeacon s shareholders equity		
Common shares and paid-in surplus (par value $0.01; authorized, 200,000,000 shares; issued and outstanding, 95,121,050 and 95,094,199 shares)	1,017.9	1,016.7
Retained earnings	373.1	163.4
Accumulated other comprehensive loss, after tax:		
Net unrealized foreign currency translation losses	(0.6)	(0.6)
Other comprehensive loss items	(16.9)	(24.4)
Total OneBeacon s shareholders equity	1,373.5	1,155.1
Total noncontrolling interests	18.9	17.2
Total OneBeacon s shareholders equity and noncontrolling interests	1,392.4	1,172.3
Total liabilities, OneBeacon s shareholders equity and noncontrolling interests	$ 7,574.5	$ 7,940.8

See Notes to Consolidated Financial Statements

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ONEBEACON INSURANCE GROUP, LTD.

CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME (LOSS)

(Unaudited)

	Three months ended September 30, 2009	Three months ended September 30, 2008	Nine months ended September 30, 2009	Nine months ended September 30, 2008
	($ in millions, except per share amounts)			
Revenues				
Earned premiums	$ 492.8	$ 471.2	$ 1,470.8	$ 1,390.3
Net investment income	34.4	43.1	92.4	137.8
Net realized and unrealized investment gains (losses)	117.6	(355.9)	239.1	(413.9)
Net other revenues	5.7	4.4	16.2	10.6
Total revenues	650.5	162.8	1,818.5	1,124.8
Expenses				
Loss and LAE	298.2	303.4	861.9	878.7
Policy acquisition expenses	101.4	92.6	294.3	261.6
Other underwriting expenses	79.4	74.3	236.4	223.6
General and administrative expenses	6.9	7.1	18.9	14.5
Accretion of fair value adjustment to loss and LAE reserves	1.4	3.0	4.1	9.0
Interest expense on debt	9.1	11.0	30.1	33.9
Interest expense dividends on preferred stock subject to mandatory redemption				11.8
Interest expense accretion on preferred stock subject to mandatory redemption				21.6
Total expenses	496.4	491.4	1,445.7	1,454.7
Pre-tax income (loss)	154.1	(328.6)	372.8	(329.9)
Income tax (expense) benefit	(44.8)	117.7	(101.3)	120.6
Net income (loss) including noncontrolling interests	109.3	(210.9)	271.5	(209.3)
Less: Net (income) loss attributable to noncontrolling interests	(0.7)	0.6	(1.9)	(1.5)
Net income (loss) attributable to OneBeacon s shareholders	108.6	(210.3)	269.6	(210.8)
Change in foreign currency translation		0.3		0.3
Change in other comprehensive income and loss items	0.2	0.5	7.5	0.5
Comprehensive net income (loss) attributable to OneBeacon s shareholders	$ 108.8	$ (209.5)	$ 277.1	$ (210.0)
Basic and diluted earnings (loss) per share attributable to OneBeacon s shareholders				
Basic:				
Net income (loss) attributable to OneBeacon s shareholders	$ 1.14	$ (2.21)	$ 2.83	$ (2.19)
Diluted:				
Net income (loss) attributable to OneBeacon s shareholders	$ 1.14	$ (2.21)	$ 2.83	$ (2.19)
Dividends declared and paid per share	$ 0.21	$ 0.21	$ 0.63	$ 2.66

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ONEBEACON INSURANCE GROUP, LTD.

CONSOLIDATED STATEMENTS OF SHAREHOLDERS EQUITY

(Unaudited)

	OneBeacon s Shareholders Equity				
	Common shareholders equity	Common shares and paid-in surplus	Retained earnings ($ in millions)	Accum. other comprehensive (loss) income, after tax	Noncontrolling interests, after tax
Balances at January 1, 2009	$ 1,155.1	$ 1,016.7	$ 163.4	$ (25.0)	$ 17.2
Net income	269.6		269.6		1.9
Accrued option expense	0.9	0.9			
Issuance of common shares	0.3	0.3			0.3
Dividends	(59.9)		(59.9)		(0.6)
Contributions					5.1
Distributions					(5.0)
Other comprehensive income, after tax	7.5			7.5	
Balances at September 30, 2009	$ 1,373.5	$ 1,017.9	$ 373.1	$ (17.5)	$ 18.9

	OneBeacon s Shareholders Equity				
	Common shareholders equity	Common shares and paid-in surplus	Retained earnings ($ in millions)	Accum. other comprehensive income (loss), after tax	Noncontrolling interests, after tax
Balances at January 1, 2008	$ 1,906.5	$ 1,084.4	$ 641.0	$ 181.1	$ 21.3
Adjustment to adopt ASC 825, after tax			180.6	(180.6)	
Net (loss) income	(210.8)		(210.8)		1.5
Accrued option expense	1.2	1.2			
Issuance of common shares					0.3
Repurchases and retirements of common shares	(68.8)	(68.8)			
Dividends	(255.5)		(255.5)		(0.6)
Contributions					1.0
Distributions					(2.3)
Other comprehensive income, after tax	0.8			0.8	
Balances at September 30, 2008	$ 1,373.4	$ 1,016.8	$ 355.3	$ 1.3	$ 21.2

See Notes to Consolidated Financial Statements

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ONEBEACON INSURANCE GROUP, LTD.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

	Nine months ended September 30, 2009	2008
	($ in millions)	
Cash flows from operations:		
Net income (loss) including noncontrolling interests	$ 271.5	$ (209.3)
Charges (credits) to reconcile net income (loss) to cash flows used for operations:		
Net realized and unrealized investment (gains) losses	(239.1)	413.9
Net realized gains from sale of common stock of subsidiary		(1.0)
Net realized loss on settlement of interest rate swap	7.4	
Net other realized gains	(5.4)	
Dividends paid on mandatorily redeemable preferred stock of subsidiary		11.8
Deferred income tax expense (benefit)	147.0	(149.1)
Other operating items:		
Net change in loss and LAE reserves	(264.4)	(72.3)
Net change in unearned premiums	(7.0)	102.5
Net change in ceded reinsurance payable	(34.2)	(5.2)
Net change in premiums receivable	21.8	(51.5)
Net change in reinsurance recoverable on paid and unpaid losses	263.4	87.1
Net change in other assets and liabilities	(47.4)	(115.7)
Net cash provided from operations	113.6	11.2
Cash flows from investing activities:		
Net maturities, purchases and sales of short-term investments	233.6	(203.3)
Purchases of short-term held-to-maturity investments		(7.1)
Maturities of fixed maturity investments	389.5	929.6
Maturities of fixed maturity investments held-to-maturity		312.6
Sales of fixed maturity investments	528.9	558.8
Sales of common equity securities	214.3	179.9
Sales of convertible bonds	123.5	188.7
Distributions and redemptions of other investments	44.7	20.7
Purchases of fixed maturity investments	(1,380.2)	(956.7)
Purchases of common equity securities	(37.8)	(95.7)
Purchases of convertible bonds	(89.9)	(320.0)
Contributions for other investments	(6.5)	(22.5)
Sale of common stock of subsidiary, net of sales costs		4.2
Purchase of subsidiary		(7.3)
Net change in unsettled investment purchases and sales	41.4	64.1
Net acquisitions of property and equipment	(1.8)	(0.6)
Net cash provided from investing activities	59.7	645.4
Cash flows from financing activities:		
Repayment of debt	(42.8)	(2.0)
Settlement of interest rate swap	(7.4)	
Repurchases of Senior Notes	(63.2)	(22.3)
Cash dividends paid to common shareholders	(59.9)	(255.5)
Repurchases and retirements of Class A common shares		(68.8)
Redemption of mandatorily redeemable preferred stock of subsidiary		(300.0)

Dividends paid on mandatorily redeemable preferred stock of subsidiary				(11.8)
Net cash used for financing activities		(173.3)		(660.4)
Net change in cash during period				(3.8)
Cash balance at beginning of period		53.0		49.4
Cash balance at end of period	$	53.0	$	45.6
Supplemental cash flows information:				
Interest paid	$	21.6	$	23.1
Net tax (refunds) payments to national governments		(1.9)		60.8

See Notes to Consolidated Financial Statements

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

Basis of presentation

These interim consolidated financial statements include the accounts of OneBeacon Insurance Group, Ltd. (the Company or the Registrant) and its subsidiaries (collectively, OneBeacon) and have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP). The OneBeacon operating companies are U.S.-based property and casualty insurance writers, most of which operate in a multi-company pool. OneBeacon offers a wide range of specialty, commercial and personal products and services sold primarily through select independent agencies, brokers and managing general agencies.

OneBeacon was acquired by White Mountains Insurance Group, Ltd. (White Mountains) from Aviva plc (Aviva , formerly CGNU) in 2001 (the OneBeacon Acquisition). White Mountains is a holding company whose businesses provide property and casualty insurance, reinsurance and certain other products. During the fourth quarter of 2006, White Mountains sold 27.6 million or 27.6% of the Company s common shares in an initial public offering. Prior to the initial public offering, OneBeacon was a wholly-owned subsidiary of White Mountains. As of September 30, 2009 and December 31, 2008, White Mountains owned 75.4% and 75.5%, respectively, of the Company s common shares. Within this report, the term OneBeacon is used to refer to one or more entities within the consolidated organization, as the context requires. The Company is a Bermuda exempted limited company with its headquarters located at 14 Wesley Street, 5th Floor, Hamilton HM 11, Bermuda. The Company s principal executive office is located at 601 Carlson Parkway, Minnetonka, Minnesota 55305, its U.S. headquarters are located at 1 Beacon Lane, Canton, Massachusetts 02021 and its registered office is located at Clarendon House, 2 Church Street, Hamilton HM 11, Bermuda. OneBeacon s reportable segments are Insurance Operations and Other Operations, as defined below.

OneBeacon s Insurance Operations segment, formerly known as Primary Insurance Operations, includes the results of its insurance operations. OneBeacon s Other Operations segment consists of the Company and its intermediate holding companies which include OneBeacon U.S. Enterprises Holdings, Inc. and OneBeacon U.S. Holdings, Inc. (OBH), both U.S.-domiciled companies, as well as various intermediate holding companies domiciled in the United States, Gibraltar, Luxembourg and Bermuda.

All significant intercompany transactions have been eliminated in consolidation. These interim financial statements include all adjustments, consisting of a normal recurring nature, considered necessary by management to fairly present the financial position, results of operations and cash flows of OneBeacon. These interim financial statements may not be indicative of financial results for the full year and should be read in conjunction with the Company s 2008 Annual Report on Form 10-K. The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Refer to the Company s 2008 Annual Report on Form 10-K for a complete discussion regarding OneBeacon s significant accounting policies. Certain amounts in the prior period financial statements have been reclassified to conform to the current presentation.

Recently Adopted Changes in Accounting Principles

Accounting Standards Codification

In June 2009, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 168, The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles which establishes the FASB Accounting Standards Codification (Codification or ASC) as the source of authoritative accounting principles to be applied in the preparation of financial statements in conformity with GAAP. Subsequently codified as ASC 105, the standard is effective for interim and annual periods ending after September 15, 2009. All existing non-Securities and Exchange Commission (SEC) accounting and reporting were superseded by the Codification. OneBeacon adopted the Codification for the interim period ending September 30, 2009. Adoption had no effect on OneBeacon s accounting policies or financial statement presentation. The Codification did change the basis for reference to authoritative GAAP guidance, and, accordingly, OneBeacon s note disclosures reflect the references under Codification.

Business Combinations and Noncontrolling Interests

On January 1, 2009, OneBeacon adopted SFAS No. 141 (Revised 2007), Business Combinations A Replacement of FASB Statement No. 141 , subsequently codified as ASC 805, and SFAS No. 160, Noncontrolling Interests an amendment to ARB 51 , subsequently codified within ASC 810.

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ASC 805 requires the acquiring company to recognize the fair value of all assets acquired and liabilities assumed at their fair values at the acquisition date, with certain exceptions including income taxes which will continue to be accounted for under SFAS No. 109, Accounting for Income Taxes , subsequently codified as ASC 740. This represents a basic change in approach from the old cost allocation method used prior to the revision. In addition, ASC 805 changes the accounting for step acquisitions since it requires recognition of all assets acquired and liabilities assumed, regardless of the acquirer s percentage of ownership in the acquiree. This means that the acquirer will measure and recognize all of the assets, liabilities and goodwill, not just the acquirer s share. Assets and liabilities arising from contractual contingencies are to be recognized at the acquisition date, at fair value. Non-contractual contingencies are to be recognized when it is more likely than not that they meet the Statement of Financial Accounting Concepts No. 6, Elements of Financial Statements (A Replacement of FASB Concepts Statement No. 3 Incorporating an Amendment of FASB Concepts Statement No. 2) criteria for an asset or liability. Previously, recognition of preacquisition contingencies was deferred until the criteria in SFAS No. 5, Accounting for Contingencies , subsequently codified as ASC 450, had been met. Changes in the amount of deferred taxes arising from a business combination are to be recognized in either income or through a change in contributed capital, depending on the circumstances. Previously under ASC 740, such changes were recognized through goodwill. Acquisition related costs, such as legal fees and due diligence costs would be expensed and would not be recognized as part of goodwill. The classification of insurance and reinsurance contracts is re-evaluated at the acquisition date only if their terms were changed in connection with the acquisition. ASC 805 applies prospectively to business combinations effective January 1, 2009. ASC 805 did not impact OneBeacon s previous transactions involving purchase accounting.

ASC 810 requires all companies to account for noncontrolling interests (formerly referred to as minority interests) in subsidiaries as equity, clearly identified and presented separately from parent company equity. Once a controlling interest has been acquired, any subsequent acquisitions or dispositions of noncontrolling interests that do not result in a change of control are to be accounted for as equity transactions. Assets and liabilities acquired are measured at fair value only once; at the original acquisition date, i.e., the date at which the acquirer gained control. When a subsidiary is deconsolidated, any retained noncontrolling equity investment is to be measured at fair value with the gain or loss on the deconsolidation being measured using fair value rather than the carrying amount of the retained ownership interest. The recognition and measurement requirements of ASC 810 apply prospectively upon adoption; the presentation and disclosure requirements must be retrospectively applied. Accordingly, upon adoption of ASC 810, OneBeacon has changed the presentation of its financial statements for prior periods to conform to the required presentation as follows: noncontrolling interests are presented on the balance sheets within equity, separate from OneBeacon s shareholders equity; the portion of net income and comprehensive income attributable to OneBeacon s common shareholders and the noncontrolling interests are presented separately on the consolidated statements of operations and comprehensive income (loss); and the consolidated statements of shareholders equity include a reconciliation of the noncontrolling interests from the beginning to the end of each reporting period.

Derivatives and Hedging Activities

On January 1, 2009, OneBeacon adopted SFAS No. 161, Disclosures about Derivative Instruments and Hedging Activities an Amendment of FASB Statement No. 133 , subsequently codified within ASC 815. Under ASC 815, companies that use derivatives must disclose the following: objectives and strategies for using derivative instruments in terms of underlying risk and accounting designation; the fair values of derivative instruments and their gains and losses in a tabular format; and information about credit-risk-related contingent features. The adoption had no impact on OneBeacon s financial position or results of operations. See Note 6 for disclosures related to OneBeacon s interest rate swap.

Participating Securities Granted in Share-Based Payment Transactions

On January 1, 2009, OneBeacon adopted FASB Staff Position (FSP) EITF 03-6-1, Determining Whether Instruments Granted in Share-Based Transactions are Participating Securities , subsequently codified within ASC 260, which addresses whether instruments granted in share-based payment transactions should be considered participating securities prior to vesting. Under ASC 260, instruments that hold unforfeitable rights to dividends or dividend equivalents, regardless of whether paid or unpaid, should be considered participating securities and accordingly should be included in the calculation of earnings per share under the two-class method instead of the treasury stock method. Unvested restricted stock issued under employee incentive compensation plans containing such dividend participation features would be considered participating securities. None of OneBeacon s share-based payment transactions include participating securities. The adoption did not impact OneBeacon s earnings per share calculation. See Note 12 for the calculation of earnings per share.

Fair Value Measurements

On January 1, 2009, OneBeacon adopted FSP FAS 157-2, Effective Date of FASB Statement No. 157 , subsequently codified within ASC 820. Fair value measurement under ASC 820 was delayed for nonfinancial assets and nonfinancial liabilities to fiscal years beginning after November 15, 2008. OneBeacon adopted ASC 820 for items that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually) as of January 1, 2008 with respect to its investments securities. Refer

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to Note 5 for the required disclosures related to investment securities. The adoption of ASC 820 with regard to nonfinancial assets and nonfinancial liabilities had no impact on OneBeacon s financial position or results of operations.

Other-Than-Temporary Impairments

On June 30, 2009, OneBeacon adopted FSP FAS 115-2 and FAS 124-2, Recognition and Presentation of Other-Than-Temporary Impairments , subsequently codified within ASC 320, which amends the guidance for other-than temporary impairments for debt securities classified as held-to-maturity or available-for-sale. ASC 320 requires that in evaluating if an impairment of a debt security is other-than-temporary, the entity is to assess whether it has the intent to sell the security or if it is more likely than not that it will be required to sell the security before the recovery of its amortized cost basis. If the present value of cash flows expected to be collected is less than the amortized cost of the security, a credit loss is deemed to exist and the security is considered to be impaired. The portion of the impairment loss related to a credit loss is to be recognized in earnings. The portion of the impairment loss related to factors other than credit loss is recognized in other comprehensive income. Upon adoption, a cumulative effect adjustment to the opening balance of retained earnings shall be recorded with a corresponding adjustment to accumulated other comprehensive income.

OneBeacon accounts for its investments in debt securities under SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities , subsequently codified as ASC 825, and accordingly, all changes in the fair value of its debt securities are recognized in revenues regardless of whether or not such changes in fair value represent a temporary or other-than-temporary decline in value. Accordingly, the adoption of ASC 320 had no effect on OneBeacon s method of accounting for its portfolio of investment securities.

Determining Fair Values in an Inactive Market and Distressed Transactions

On June 30, 2009, OneBeacon adopted FSP FAS 157-4, Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly , subsequently codified within ASC 820. ASC 820 provides guidance for estimating fair value when the volume and level of activity for the asset or liability have significantly decreased and on identifying circumstances that indicate a transaction is not orderly. Factors to consider include few recent transactions, price quotations that are not based on current information or which vary substantially over time or among market makers, a significant increase in implied liquidity risk premiums, yields, or performance indicators, a wide bid-ask spread, a significant decline or absence of a market for new issuances or limited information released publicly. A reporting entity should evaluate whether there has been a significant decrease in the volume and level of activity for the asset or liability when compared with normal activity for the asset or liability or similar assets or liabilities. If the reporting entity concludes that there has been a significant decrease in the volume and level of activity, transactions or quoted prices may not be determinative of fair value. Further analysis of the transactions or quoted prices is needed, and a significant adjustment to the transactions or quoted prices may be necessary to estimate fair value which is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction. In addition, ASC 820 expands interim disclosures to require a description of the inputs and valuation techniques used to estimate fair value and a discussion of changes during the period. The adoption of ASC 820 had no material impact on OneBeacon s financial position or results of operations.

Interim Fair Value Disclosures

On June 30, 2009, OneBeacon adopted FSP FAS 107-1 and APB 28-1, Interim Disclosures about Fair Value of Financial Instruments (FSP FAS 107-1 and APB 28-1), subsequently codified within ASC 825, which amends SFAS No. 107, Disclosures about Fair Value of Financial Instruments (SFAS 107), subsequently codified within ASC 820, and Accounting Principles Board Opinion (APB) No. 28, Interim Financial Reporting , subsequently codified as ASC 270. Under ASC 825, a publicly traded company shall disclose in the body or the accompanying notes of its summarized financial information for interim reporting periods and in its financial statements for its annual reporting periods the fair value of all financial instruments for which it is practicable to estimate that value. An entity shall also disclose the method(s) and significant assumptions used to estimate the fair value of the financial instruments and any changes in the method(s) and significant assumptions, if any, during the period. OneBeacon carries its financial instruments on its balance sheet at fair value with the exception of its fixed-rated, long-term indebtedness. See Note 11 for required disclosures.

Subsequent Events

On June 30, 2009, OneBeacon adopted SFAS No. 165, Subsequent Events , subsequently codified within ASC 855, which establishes principles and requirements for subsequent events. ASC 855 establishes the period after the balance sheet date during which management shall evaluate events or transactions that may occur for potential recognition or disclosure in the financial statements; the circumstances under which an entity shall recognize events or transactions occurring after the balance sheet date in its financial statements; and the disclosures that an entity shall make about events or transactions that occurred after the balance sheet date. Subsequent events that provide additional evidence about conditions that existed at the balance sheet date are to be recognized in the financial statements. Subsequent events that are conditions that arose after the balance sheet date but prior to the issuance of the financial statements are not recognized in the financial statements, but should be disclosed if failure to do so would render the

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financial statements misleading. ASC 855 requires disclosure of the date through which subsequent events have been evaluated. For subsequent events not recognized, disclosures should include a description of the nature of the event and either an estimate of its financial effect or a statement that such an estimate cannot be made. The adoption of ASC 855 had no impact on the recognition or disclosure of subsequent events. OneBeacon evaluates subsequent events through the date it files its Quarterly Report on Form 10-Q with the SEC. For the period ended September 30, 2009, this date was October 30, 2009.

Recent Accounting Pronouncements

Disclosures about Postretirement Benefit Plan Assets

In December 2008, the FASB issued FSP FAS 132(R)-1, Employers Disclosures about Postretirement Benefit Plan Assets , subsequently codified within ASC 715, which requires additional disclosures regarding plan assets of a defined benefit pension or other postretirement plan. The disclosures are to provide users of financial statements with an understanding of how investment allocation decisions are made, the major categories of plan assets, the inputs and valuation techniques used to measure the fair value of plan assets, the effect of fair value measurements using significant unobservable inputs on changes in plan assets for the period and significant concentrations of risk within plan assets. This requirement is effective for fiscal years ending after December 15, 2009 with earlier adoption permitted. OneBeacon is currently evaluating the potential impact of adoption.

Transfers of Financial Assets and Amendments to FIN 46R

In June 2009, the FASB issued SFAS No. 166, Accounting for Transfers of Financial Assets (SFAS 166) and SFAS No. 167, Amendments to FIN46(R) (SFAS 167). SFAS 166 eliminates the concept of a qualifying special-purpose entity (QSPE) and accordingly, any existing QSPE must be evaluated for consolidation upon adoption of SFAS 166. Under SFAS 166, the appropriateness of derecognition is evaluated based on whether or not the transferor has surrendered control of the transferred assets. The evaluation must consider any continuing involvement by the transferor. SFAS 167 amends FASB Interpretation No. 46(R), Consolidation of Variable Interest Entities , subsequently codified as ASC 810, to clarify the application of consolidation accounting for entities for which the controlling financial interest might not be solely identified through voting rights. The guidance under SFAS 167 still requires a reporting entity to perform an analysis to determine if its variable interests give it a controlling financial interest in a variable interest entity (VIE). The analysis required identifies the primary beneficiary of a VIE as the entity having both of the following:

- The power to direct the activities of a variable interest entity that most significantly impact the entity s economic performance; and
- The obligation to absorb losses of the entity that could potentially be significant to the VIE or the right to receive benefits from the entity that could potentially be significant to the VIE.

In addition, a reporting entity must assess whether it has an implicit financial responsibility to ensure that a VIE operates as designed when determining if it has the power to direct the activities of the VIE that most significantly affect the entity s economic performance. The concept of a reconsideration event is retained and an ongoing reassessment of whether a reporting entity is the primary beneficiary of a VIE is required. Specifically, the list of reconsideration events includes a change in facts and circumstances where the holders of an equity investment at risk as a group lose the power from voting or similar rights to direct the activities of the entity that most significantly affect the entity s economic performance. In addition, a troubled debt-restructuring is now defined as a reconsideration event. Both statements expand required disclosures and are effective as of the beginning of the first annual reporting period that begins after November 15, 2009. OneBeacon is currently evaluating the potential impact of adoption.

Measuring Liabilities at Fair Value

On August 29, 2009 the FASB issued Accounting Standards Update (ASU) 2009-05, Measuring Liabilities at Fair Value which amends the guidance for measuring the fair value for liabilities (ASC 820). The ASU provides additional guidance for circumstances where a quoted price in an active market for an identical liability is not available and permits use of the quoted price for an identical liability when traded as an asset or quoted prices for similar liabilities when traded as an asset. The ASU also notes that valuation techniques consistent with the fair value principles of ASC 820 may be used, including a present value technique or market approach based on the amount that the reporting entity would pay to transfer the identical liability or would receive to enter into an identical liability at the measurement date. The guidance in the ASU is effective for the first interim reporting period beginning after issuance, which would be the reporting period ending December 31, 2009 for OneBeacon. OneBeacon has liabilities recorded at fair value in accordance with ASC 820 and included in other liabilities. These liabilities relate to securities that have been sold short by a limited partnership that OneBeacon invests in and is required to consolidate in accordance with GAAP. OneBeacon is currently studying the guidance in the ASU to evaluate the expected effect of adoption.

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Alternative Investments

On September 30, 2009 the FASB issued ASU 2009-12, Investments in Certain Entities that Calculate Net Asset Value per Share (or Its Equivalent), the final standard amending ASC 820 with respect to alternative investments. Alternative investments include ownership interests in hedge funds and private equity funds, which OneBeacon includes in other investments. Under the ASU, the fair value of an alternative investment may be estimated based on net asset value per share (NAV) as reported by the investee, subject to certain requirements. The investee must calculate its NAV in accordance with the measurement principles of ASC 946 (U.S. GAAP for Investment Companies), meaning that the investee s underlying investments have been measured at fair value. In addition, in circumstances where the investor intends to sell the investment for an amount that differs from the NAV, NAV may not be used to estimate fair value. The ASU also expands required disclosures, including requiring the amount of unfunded commitments, a description of the terms and conditions upon which the investor may redeem investments, the circumstances in which an otherwise redeemable investment might not be redeemable (for instance, investment subject to a lockup period) as well as an estimate of when the restriction will lapse and, in circumstances where the investment cannot be redeemed but the investor receives distributions through the liquidation of the underlying assets, an estimate of the period of time over which the underlying assets are expected to be liquidated. The ASU is effective for interim and annual periods ending after December 15, 2009 and may be adopted early. OneBeacon expects to adopt the ASU as of December 31, 2009 and is currently evaluating the expected effect of adoption.

NOTE 2. Acquisitions and Dispositions

During the first nine months of 2009, there were no acquisitions or dispositions.

During the third quarter of 2008, OneBeacon acquired Entertainment Brokers International Insurance Services (EBI), an insurance agency specializing in the entertainment, sports and leisure industries, for $8.0 million. OneBeacon paid $7.3 million in cash as of September 30, 2008 with the remaining $0.7 million paid in cash in October 2008. In connection with the purchase of EBI, which was accounted for as an acquisition under the purchase method of accounting in accordance with GAAP at the time of the acquisition, OneBeacon recorded the identifiable assets and liabilities of EBI at their fair value at acquisition date. Significant assets and liabilities acquired include premiums and commissions receivable of $16.6 million and premiums and commissions payable of $16.1 million. After allocating the purchase price to identifiable tangible assets and liabilities, OneBeacon also recorded an adjustment to allocate the remaining acquisition cost to an intangible asset of $9.5 million which represents the value of business in force at the acquisition date. The amortization associated with the intangible asset will be amortized over a 10-year period in proportion to the timing of the discounted cash flows used to value the business.

During the first quarter of 2008, OneBeacon sold one of its inactive licensed subsidiaries, Midwestern Insurance Company, to National Guaranty Insurance Company for $4.2 million in cash and recorded a pre-tax gain of $1.0 million through net other revenues.

NOTE 3. Reserves for Unpaid Loss and LAE

The following table summarizes the loss and LAE reserve activities of OneBeacon s insurance subsidiaries for the three and nine months ended September 30, 2009 and 2008:

	Three months ended September 30, 2009	Three months ended September 30, 2008	Nine months ended September 30, 2009	Nine months ended September 30, 2008
	($ in millions)			
Gross beginning balance	$ 4,060.5	$ 4,425.5	$ 4,294.0	$ 4,480.3
Less beginning reinsurance recoverable on unpaid losses	(2,301.2)	(2,571.9)	(2,503.3)	(2,629.5)
Net loss and LAE reserves	1,759.3	1,853.6	1,790.7	1,850.8
Loss and LAE incurred relating to:				
Current year losses	318.9	324.2	915.2	911.7
Prior year losses	(20.7)	(20.8)	(53.3)	(33.0)
Total incurred loss and LAE	298.2	303.4	861.9	878.7
Accretion of fair value adjustment to net loss and LAE reserves	1.4	3.0	4.1	9.0
Loss and LAE paid relating to:				
Current year losses	(138.6)	(133.5)	(327.9)	(319.5)
Prior year losses	(135.0)	(163.4)	(543.5)	(555.9)
Total loss and LAE payments	(273.6)	(296.9)	(871.4)	(875.4)