OneBeacon Insurance Group, Ltd.
Form 10-K
February 28, 2013

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 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, 2012
OR

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

For the transition period from to
Commission file number 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
Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Class A Common Shares, par value $0.01 per share	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 Act. Yes o No x
Indicate by check mark if the Registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act. Yes o No 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 Exchange Act during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No o
Indicate by check mark whether the Registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months. Yes x No o
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. o
Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller

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

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

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

The aggregate market value of voting shares (based on the closing price of Class A common shares listed on the New York Stock Exchange and the consideration received for those shares not listed on a national or regional exchange) held by non-affiliates of the Registrant as of June 30, 2012, was $294,962,046.

As of February 25, 2013, 23,631,441 Class A common shares, par value $0.01 per share, and 71,754,738 Class B common shares, par value $0.01 per share, were outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Registrant's Definitive Proxy Statement to be filed with the Securities and Exchange Commission ("SEC") pursuant to Regulation 14A under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), relating to the Registrant's Annual General Meeting of Members scheduled to be held May 22, 2013 are incorporated by reference into Part III of this Form 10-K. With the exception of the portions of the Proxy Statement specifically incorporated herein by reference, the Proxy Statement is not deemed to be filed as part of this Form 10-K.

Table of Contents

Table of Contents

PART I

ITEM 1. BUSINESS

Overview

OneBeacon Insurance Group, Ltd. (the Company or the Registrant), an exempted Bermuda limited liability company, through its subsidiaries (collectively, OneBeacon, we, us, or our) is a specialty property and casualty insurance writer that offers a wide range of insurance products through independent agencies, regional and national brokers, wholesalers and managing general agencies. As a specialty underwriter, we believe that we will generate superior returns as compared to an underwriter that takes a more "generalist" underwriting approach and that our knowledge regarding specialized insurance products, targeted industries, classes of business, and risk characteristics provides us with a competitive edge when determining the terms and conditions on individual accounts. Our products relate to professional liability, marine, energy, entertainment, sports and leisure, excess property, environmental, group accident, property and inland marine, public entities, technology, surety, and tuition refund. Additionally, we wrote collector car and boat insurance through an exclusive underwriting agreement with Hagerty Insurance Agency (Hagerty) that was terminated effective January 1, 2013. See Collector Cars and Boats in "Insurance Operations—Specialty Products" below.

Our reportable segments are Specialty Products, Specialty Industries, and Investing, Financing and Corporate.

The Specialty Products segment is comprised of seven underwriting operating segments representing an aggregation based on those that offer distinct products and tailored coverages and services to a broad customer base across the United States. The Specialty Industries segment is comprised of six underwriting operating segments representing an aggregation based on those that focus on solving the unique needs of a particular customer or industry group. The Investing, Financing and Corporate segment includes the investing and financing activities for OneBeacon on a consolidated basis, and certain other activities conducted through the Company and our intermediate subsidiaries, as well as operations associated with personal lines business that we sold in 2010 (see Item 7—"Management's Discussion and Analysis of Financial Condition and Results of Operations—Significant Transactions").

Previously, we reported our insurance operations through a Specialty Insurance Operations segment and an Other Insurance Operations segment. The former Specialty Insurance Operations segment was comprised of twelve underwriting operating segments that were aggregated into a single reportable segment, with supplemental disclosures of three major underwriting units for financial reporting: MGA Business, Specialty Industries and Specialty Products. The former Other Insurance Operations segment consisted of substantially all operations classified as discontinued operations as of December 31, 2012, including AutoOne, other run-off business, and certain purchase accounting adjustments relating to the run-off business and the OneBeacon Acquisition (defined below). Prior periods have been reclassified to conform to the current presentation.

OneBeacon was acquired by White Mountains Insurance Group, Ltd. (White Mountains) from Aviva plc (Aviva) 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 our common shares in an initial public offering. Prior to the initial public offering, OneBeacon was a wholly-owned subsidiary of White Mountains. As of December 31, 2012, White Mountains owned 75.2% of our common shares.

Our headquarters are located at 14 Wesley Street, 5th Floor, Hamilton HM 11, Bermuda. Our U.S. corporate headquarters are located at 601 Carlson Parkway, Minnetonka, Minnesota 55305 and our registered office is located at Clarendon House, 2 Church Street, Hamilton HM 11, Bermuda.

OneBeacon has assets, liabilities and capital related to non-specialty business that it no longer writes, principally non-specialty commercial lines and certain other run-off business, including nearly all of its asbestos and environmental reserves (Runoff Business). On October 17, 2012, OneBeacon entered into a definitive agreement to sell the Runoff Business, including various insurance subsidiaries holding runoff loss reserves for the Runoff Business (Runoff Subsidiaries), to Trebuchet U.S. Holdings, Inc. (Trebuchet), a wholly-owned subsidiary of Armour Group Holdings Limited (together with Trebuchet, Armour), to support the separation and transfer of the Runoff Business to Armour (the Runoff Transaction). Upon completion of the Runoff Transaction, which is expected to occur in the second half of 2013 subject to regulatory approval, OneBeacon will be focused exclusively on specialty business. See

Item 7—"Management's Discussion and Analysis of Financial Condition and Results of Operations—Significant Transactions" for a description of the Runoff Transaction.

At December 31, 2012 and 2011, OneBeacon had $5.4 billion and $5.8 billion of total assets and $1.0 billion and $1.1 billion of common shareholders' equity, respectively. OneBeacon wrote $1.2 billion, $1.1 billion and $1.2 billion in net written premiums in 2012, 2011 and 2010, respectively.

Table of Contents

The following table presents the financial strength ratings assigned to our principal insurance operating subsidiaries which support our ongoing specialty insurance operations (Ongoing Subsidiaries) as well as our Runoff Subsidiaries, as of February 28, 2013:

	A.M. Best[(1)]	Standard & Poor's[(2)]	Moody's[(3)]	Fitch[(4)]
Ongoing Subsidiaries:				
Ratings	"A" (Excellent)	"A-" (Strong)	"A2" (Good)	"A" (Strong)
Outlook	Stable	Stable	Stable	Stable
Runoff Subsidiaries:[(5)]				
Ratings	"A" (Excellent)	Unrated	"A2" (Good)	"A" (Strong)
Outlook	Under Review - Negative	N/A	Negative	Rating Watch - Negative

(1) "A" is the third highest of sixteen financial strength ratings assigned by A.M. Best Company (A.M. Best).

(2) "A-" is the seventh highest of twenty-one financial strength ratings assigned by Standard & Poor's Financial Services, LLC (Standard & Poor's).

(3) "A2" is the sixth highest of twenty-one financial strength ratings assigned by Moody's Investor Service (Moody's).

(4) "A" is the sixth highest of nineteen international financial strength ratings assigned by Fitch Ratings (Fitch).

(5) Following OneBeacon's announcement of the Runoff Transaction, A.M. Best, Fitch, Moody's and Standard & Poor's each issued a press release regarding the ratings implications. A.M. Best placed the Runoff Subsidiaries under review with negative implications; Fitch placed the Runoff Subsidiaries on credit watch negative; and Moody's assigned a negative outlook. Standard & Poor's downgraded and subsequently, at the request of OneBeacon, withdrew its rating on the Runoff Subsidiaries. All four ratings agencies affirmed the ratings of the Ongoing Subsidiaries with stable Outlook. The above table summarizes the ratings related to the entities supporting the Ongoing Subsidiaries and, separately the Runoff Subsidiaries.

Our Operating Principles

We strive to operate within the spirit of four operating principles. These are:

Underwriting Comes First. An insurance enterprise must respect the fundamentals of insurance. There must be a realistic expectation of underwriting profit on all business written, and demonstrated fulfillment of that expectation over time, with focused attention to the loss ratio and to all the professional insurance disciplines of pricing, underwriting and claims management.

Maintain a Disciplined Balance Sheet. The first concern here is that insurance liabilities must always be fully recognized. Loss reserves and expense reserves must be solid before any other aspect of the business can be solid. Pricing, marketing and underwriting all depend on informed judgment of ultimate loss costs and that can be managed effectively only with a disciplined balance sheet.

Invest for Total Return. Historical insurance accounting tends to hide unrealized gains and losses in the investment portfolio and over-reward reported investment income (interest and dividends). Regardless of the accounting, we must invest for the best growth in after tax value over time. In addition to investing our bond portfolios for total after tax return, that will also mean prudent investment in a balanced portfolio consistent with leverage and insurance risk considerations.

Think Like Owners. Thinking like owners has a value all its own. There are stakeholders in a business enterprise and doing good work requires more than this quarter's profit. But thinking like an owner embraces all that without losing the touchstone of a capitalist enterprise.

Property and Casualty Insurance Overview

Generally, property and casualty insurance companies write insurance policies in exchange for premiums paid by their customers (the insured). An insurance policy is a contract between the insurance company and the insured where the insurance company agrees to pay for losses suffered by the insured that are covered under the contract. Such contracts

often are subject to subsequent legal interpretation by courts, legislative action and arbitration.
We write both property insurance and casualty insurance. Property insurance generally covers the financial consequences of accidental losses to the insured's property, such as a business's building, inventory and equipment or personal property.

Table of Contents

Casualty insurance (often referred to as liability insurance) generally covers the financial consequences of a legal liability of an individual or an organization resulting from negligent acts and omissions causing bodily injury and/or property damage to a third party. Premiums from ocean and inland marine, private passenger auto, fire and allied lines, and certain commercial multiple peril policies generally represent our property lines of business, and claims from such business are typically reported and settled in a relatively short period of time. Premiums from general liability, commercial and personal auto liability and certain commercial multiple peril policies generally represent our casualty lines of business, and claims from such business can take years, even decades, to settle. Our Specialty Products and Specialty Industries segments each write business in both the property and casualty lines, as well as other lines of business such as credit and accident insurance.

We believe that our various lines of business generally fall into three major categories, which are reflective of how we view the primary risk classification associated with each line: property lines, casualty lines, and other lines. Net written premiums by line of business for the years ended December 31, 2012, 2011 and 2010 consist of the following:

	Year ended December 31,		
	2012	2011	2010[1]
Insurance operations by line of business	($ in millions)		
Property Lines:			
Ocean and Inland Marine	$214.2	$210.7	$208.6
Private Passenger Auto	99.7	92.8	87.1
Commercial Multiple Peril and Auto	52.7	39.7	31.5
Fire and Allied	50.5	57.7	57.4
Total Property Lines	417.1	400.9	384.6
Casualty Lines:			
General Liability	418.1	372.7	356.6
Automobile Liability	74.8	63.9	55.0
Workers Compensation	71.9	50.8	42.4
Other Casualty	38.2	30.7	25.4
Total Casualty Lines	603.0	518.1	479.4
Other Lines[2]	159.1	143.7	124.0
Total insurance operations line of business	$1,179.2	$1,062.7	$988.0

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(1) Excludes $179.7 million in net written premiums associated with personal lines that were sold in 2010, which are included in the Investing, Financing and Corporate segment.

(2) Includes Group Accident & Health and Credit insurance products.

We derive substantially all of our revenues from earned premiums, investment income, and net realized and unrealized investment gains and losses on investment securities. Earned premiums represent premiums received from insureds, which are recognized as revenue over the period of time that insurance coverage is provided (i.e., ratably over the life of the policy). A significant period of time normally elapses between the receipt of insurance premiums and the payment of insurance claims. During this time, we invest the premiums, earn investment income, and generate net realized and unrealized gains and losses on investment activities.

Insurance companies incur a significant amount of their total expenses from policyholder losses, which are commonly referred to as claims. In settling policyholder losses, various loss adjustment expenses (LAE) are incurred such as insurance adjusters' fees and litigation expenses. Loss and LAE are categorized by the year in which the claim is incurred, or “accident year.” In the following calendar years, as we increase or decrease our estimate for the ultimate loss and LAE for claims incurred in prior accident years, we will record favorable or adverse “loss reserve development” which is recorded in the current period. In addition, insurance companies incur policy acquisition expenses, such as commissions paid to agents and premium taxes, and other expenses related to the underwriting process, including their employees' compensation and benefits. The key measure of relative underwriting performance for an insurance company is the combined ratio. An insurance company's combined ratio, under accounting principles generally accepted in the United States (GAAP), is calculated by adding the ratio of incurred loss and LAE to earned premiums (the loss and LAE ratio) and the ratio of policy acquisition and other underwriting expenses to earned premiums (the expense ratio). A combined ratio under 100% indicates that an insurance company is generating an underwriting profit. However, when considering investment income and investment gains or losses, insurance companies operating at a combined ratio of greater than 100% can be profitable.

Table of Contents

Insurance Business

Our reportable segments are Specialty Products, Specialty Industries, and Investing, Financing and Corporate.

The Specialty Products segment is comprised of seven underwriting operating segments representing an aggregation based on those that offer distinct products and tailored coverages and services to a broad customer base across the United States. The Specialty Industries segment is comprised of six underwriting operating segments representing an aggregation based on those that focus on solving the unique needs of a particular customer or industry group. The Investing, Financing and Corporate segment includes the investing and financing activities for OneBeacon on a consolidated basis, and certain other activities conducted through the Company and our intermediate subsidiaries, as well as operations associated with personal lines business that we sold in 2010 (see Item 7—"Management's Discussion and Analysis of Financial Condition and Results of Operations—Significant Transactions"). See Note 12—"Segment Information" in the accompanying consolidated financial statements.

Our net written premiums by segment for the years ended December 31, 2012, 2011 and 2010 consist of the following:

	Year ended December 31,		
	2012	2011	2010[1]
	($ in millions)		
Specialty Products	$630.9	$571.2	$556.8
Specialty Industries	548.3	491.5	431.2
Total	$1,179.2	$1,062.7	$988.0

[1] Excludes $179.7 million in net written premiums associated with personal lines that were sold in 2010, which are included in the Investing, Financing and Corporate segment.

Specialty Products

For the years ended December 31, 2012, 2011 and 2010, our Specialty Products segments net written premiums by underwriting operating segment were as follows:

	Year ended December 31,		
	2012	2011	2010
	($ in millions)		
Professional Insurance	$340.7	$314.9	$320.7
Collector Cars and Boats	179.7	166.6	153.3
Tuition Reimbursement	65.1	60.6	59.7
Other Specialty Products	45.4	29.1	23.1
Total Specialty Products	$630.9	$571.2	$556.8

A description of business written by each underwriting operating segment in the Specialty Products segment follows:

OneBeacon Professional Insurance (Professional Insurance)

Professional Insurance specializes in professional liability product solutions for a specialized customer base, including hospitals, managed care organizations, long-term care facilities, medical facilities, physician groups, media organizations, lawyers, design professionals, financial services and technology providers. Additionally, Professional Insurance provides employment practices liability, management liability and other tailored products for complex organizations including health care provider excess insurance and HMO reinsurance. General liability, property and workers compensation coverages are also available for financial institutions. Professional Insurance policies are primarily issued on a "claims made" basis, which generally covers claims that are made against an insured during the time period when a liability policy is in effect, regardless of when the event causing the loss occurred. This coverage differs from "claims occurrence" basis policies, which generally cover losses on events that occur during a period specified in the policy, regardless of when the claim is reported.

Collector Cars and Boats

Through our exclusive partnership with Hagerty, we offered tailored coverages for collectible vehicles and wooden boats, automotive museums and restoration shops. Notable features included agreed value for the insured vehicle or boat, flexible

4

Table of Contents

usage, and overseas shipping/foreign touring coverage—supported by in-house claims expertise. In January 2013, OneBeacon and Hagerty terminated their relationship and we sold to Markel Corporation, Essentia Insurance Company ("Essentia"), an indirect wholly-owned subsidiary that wrote the Hagerty collector car and boat business. We anticipate recognizing a pre-tax gain on sale of approximately $23.0 million ($15.0 million after tax) in the first quarter of 2013. For the years ended December 31, 2012, 2011 and 2010, business written through Hagerty generated net written premiums of approximately 15%, 16% and 13%, respectively, of our consolidated net written premiums.

Tuition Reimbursement

A.W.G. Dewar, Inc. (Dewar) has been a leading provider of tuition reimbursement insurance since 1930. Dewar's product, classified as credit insurance, protects both schools and parents from the financial consequences of a student's withdrawal or dismissal from school. We own approximately 82% of Dewar.

Other Specialty Products

OneBeacon Specialty Property (Specialty Property)

Specialty Property provides excess property and inland marine solutions that augment primary policies or provide coverage in excess of self-insured retentions. Target classes of business include apartments and condominiums, commercial real estate, small-to-medium manufacturing, retail/wholesale, education and public entities. Specialty Property products are provided primarily through surplus lines wholesalers.

OneBeacon Excess and Surplus (Excess and Surplus)

Excess and Surplus was established in July 2010 to support our current businesses and write selectively in the excess and surplus market. Excess and Surplus includes OneBeacon Environmental, which specializes in environmental risk solutions designed to address a variety of exposures for a broad range of businesses, including multiline casualty placements for the environmental industry. The product suite includes commercial general liability, contractors environmental liability, professional services liability, environmental premises liability, products pollution liability, follow-form excess and commercial auto.

OneBeacon Program Group (Programs)

Formed in 2012, Programs provides a full range of multi-line package insurance solutions for select specialty programs overseen by dedicated agencies that perform all policy administration functions. Products are available on an admitted and nonadmitted basis. Programs works primarily with managing general agents and managing general underwriters, commonly referred to as program administrators.

OneBeacon Surety Group (Surety)

Formed in 2012, Surety offers a broad range of commercial, custom and miscellaneous surety bonds targeting middle-market, Fortune 2500 companies written through a network of independent agencies, brokers and wholesalers. Business is serviced through eight regions throughout the United States.

Specialty Industries

For the years ended December 31, 2012, 2011 and 2010, our Specialty Industries segment's net written premiums by underwriting operating segment were as follows:

	Year ended December 31,		
	2012	2011	2010
	($ in millions)		
International Marine Underwriters	$160.1	$180.0	$188.9
Technology	121.0	94.3	75.3
Accident	102.0	86.8	66.9
Entertainment	71.4	61.2	56.2
Other Specialty Industries	93.8	69.2	43.9
Total Specialty Industries	$548.3	$491.5	$431.2

Table of Contents

A description of business written by each underwriting operating segment in OneBeacon's Specialty Industries segment follows:

International Marine Underwriters (IMU)

IMU traces its roots to the early 1900s, and offers a full range of ocean and inland marine insurance solutions. Ocean marine products include, but are not limited to, commercial hull and marine liabilities at both the primary and excess levels; ocean and air cargo with coverage extensions such as inland transit, warehousing and processing; yachts; and several marine “package” products with comprehensive property, auto and liability coverage. Inland marine solutions include builders' risks, contractors' equipment, energy, installation floaters, fine arts, motor truck cargo, transportation, miscellaneous articles floaters, warehousemen's legal liability and other inland marine opportunities. During 2012, we merged the Property Inland Marine underwriting unit into our IMU underwriting segment.

OneBeacon Technology Insurance (Technology)

Our Technology underwriting operating segment provides insurance solutions for specific technology industries including: infotech, medtech, telecommunications, electronic manufacturing, integration contractors, instrument manufacturers and clean tech/solar. Tailored products and coverages include property, general liability, business auto, commercial umbrella, workers compensation, international, technology errors or omissions, data privacy and communications liability. Specialized technology insurance expertise, innovation and service are delivered through dedicated underwriting, risk control and claims staff.

OneBeacon Accident Group (Accident)

Our Accident underwriting operating segment focuses on analyzing and developing unique accident solutions for the transportation industry and corporate accident marketplace, while also developing specialized accident insurance programs. Our Accident product suite includes accidental death and dismemberment, occupational accident, sports accident, non-truckers liability, vehicle physical damage and other accident coverages. Accident also provides employers and affinity groups with access to services including a discounted prescription drug program, identity theft management services and travel assistance services.

Other Specialty Industries

OneBeacon Entertainment (Entertainment)

Entertainment provides specialized commercial insurance, including professional liability protection, for the entertainment, sports and leisure industries. Coverages include film and television portfolio, producers portfolio, theatrical package, event cancellation, premises liability, event liability and participant liability.

OneBeacon Government Risks (Government Risks)

Government Risks provides solutions for mid-sized municipalities and counties, special districts including water and sanitation, non-rail transit authorities and other publicly funded agencies. Government Risks products cover property and casualty risks, employment practices liability and professional liability for law enforcement and public officials. Government Risks products are offered on a fully insured, deductible, self-insured retention or assumed reinsurance basis.

OneBeacon Energy Group (Energy)

Energy, a business we decided to exit (except for certain inland marine accounts that will be transferred into our IMU underwriting operating segment) commencing in the fourth quarter of 2012, focused on middle-market upstream and midstream conventional energy businesses, alternative and renewable energy producers, alternative fuel producers and related service and manufacturing enterprises. Energy offered a full array of property, inland marine and casualty insurance, including property damage, boiler and machinery breakdown, general liability, auto liability and umbrella liability. Energy did not offer offshore energy products.

Table of Contents

Geographic Concentrations

Substantially all of our net written premiums are derived from business produced in the United States. For the years ended December 31, 2012, 2011 and 2010, business was produced in the following states:

	Year ended December 31,					
	2012		2011		2010(2)	
California	15.9	%	13.9	%	13.4	%
New York	9.4		9.3		8.8	
Texas	7.3		6.8		6.7	
Florida	5.1		5.0		5.6	
District of Columbia	4.6		3.8		2.4	
Massachusetts	3.7		4.5		5.0	
Other(1)	54.0		56.7		58.1	
Total	100.0	%	100.0	%	100.0	%

(1) No other individual state is greater than 5% of net written premiums for the years ended December 31, 2012, 2011 and 2010.

(2) Excludes net written premiums associated with personal lines that were sold in 2010.

Marketing and Distribution

We offer our products through a network of independent agents, regional and national brokers and wholesalers. Overall, we have approximately 2,700 distribution relationships across the country. In recent years, we have expanded our distribution channels to include select managing general agencies (MGAs), either through acquisitions or exclusive relationships. These MGAs focus on a particular customer group with tailored products and services, and related expertise.

We protect the integrity of our franchise value by selectively appointing distribution partners that demonstrate business and industry knowledge and geographic profiles that align with our target markets and specialized capabilities. We believe in the added value provided by independent distribution partners as they conduct more complete assessments of their clients' needs, which result in more appropriate coverages and prudent risk management. We also believe that independent insurance agencies and brokers will continue to be a significant force in overall industry premium production.

Underwriting and Pricing

We believe there must be a realistic expectation of attaining an underwriting profit on all the business we write, as well as a demonstrated fulfillment of that expectation over time. Consistent with our "Underwriting Comes First" operating principle, adequate pricing is a critical component for achieving an underwriting profit. We underwrite our book with a disciplined approach towards pricing our insurance products and are willing to forgo a business opportunity if we believe it is not priced appropriately to the exposure.

We actively monitor pricing activity and measure usage of tiers, credits, debits and limits. In addition, we regularly update base rates to achieve targeted returns on capital and attempt to shift writings away from lines and classes where pricing is inadequate. To the extent changes in premium rates, policy forms or other matters are subject to regulatory approval (see "Regulatory Matters—General" and "Risk Factors—Regulation may restrict our ability to operate"), we proactively monitor our pending regulatory filings to facilitate, to the extent possible, their prompt processing and approval. Lastly, we expend considerable effort to measure and verify exposures and insured values.

Competition

Property and casualty insurance is highly competitive. Our businesses each compete against a different subset of companies. In general terms, we compete in one or more of our businesses with most of the large multi-line insurance companies, such as ACE, AIG, Chubb Group, CNA, Liberty Mutual, Travelers and Zurich Insurance Group. We also compete with most of the specialty companies, such as Allied World Assurance Company, HCC Insurance Holdings, Inc., Ironshore Inc., Markel Corporation, RLI Corp. and W.R. Berkley Corporation. Lastly, we compete in certain of our businesses with various local and regional insurance companies.

7

Table of Contents

The more significant competitive factors for most insurance products we offer are price, product terms and conditions, agency and broker relationships, and claims service. Our underwriting principles and dedication to independent distribution partners are unlikely to make us the low-cost provider in most markets. While it is often difficult for insurance companies to differentiate their products, we believe that providing superior specialty products to satisfy market needs and relying on agents and brokers who value our targeted expertise, superior claims service, and disciplined underwriting, establishes a competitive advantage. The continued existence of carriers operating with lower cost structures places ongoing pressure on our pricing and terms and conditions, which may impact our ability to compete.

Claims Management

Effective claims management is a critical factor in achieving satisfactory underwriting results. We maintain an experienced staff of appraisers, medical specialists, managers and field adjusters strategically located throughout our operating territories. We also maintain a special investigative unit designed to detect insurance fraud and abuse and support efforts by regulatory bodies and trade associations to curtail fraud.

Claims operations are organized into ongoing claims and run-off claims, with specific claims resources supporting the respective operations. This approach allows us to better identify and manage claims handling costs. In addition, a shared claims service unit manages costs related to all claims staff and vendors. We have adopted a total claims cost management approach that gives equal importance to controlling claims handling expenses, legal expenses and claims payments, enabling us to lower the sum of the three. This approach requires the utilization of a considerable number of conventional metrics to monitor the effectiveness of various programs implemented to lower total loss costs. We utilize the metrics to guard against implementation of expense containment programs that will cost us more than we expect to save.

Our claims department utilizes a claims workstation to record reserves, payments and adjuster activity and, with support from expert tools, assists each claim handler in identifying recovery potential, estimating property damage, evaluating claims and identifying fraud. Our commitment and performance in fighting insurance fraud has reduced claim costs and aided law enforcement investigations.

Catastrophe Risk Management and Reinsurance Protection

In the normal course of our business, we purchase reinsurance from high-quality, highly rated, third-party reinsurers in order to minimize loss from large losses or catastrophic events.

The timing and size of catastrophe losses are unpredictable and the level of losses experienced in any year could be material to our operating results and financial position. Examples of catastrophes include losses caused by earthquakes, wildfires, hurricanes and other types of storms and terrorist acts. The extent of losses caused by catastrophes is a function of the amount and type of insured exposure in the area affected by the event as well as the severity of the event. We use models (primarily AIR Worldwide (AIR) version 12) to estimate the probability of the occurrence of a catastrophic event as well as potential losses under various scenarios. We use this model output in conjunction with other data to manage our exposure to catastrophe losses through individual risk selection and by limiting our concentration of insurance written in catastrophe-prone areas such as coastal regions. In addition, we impose wind deductibles on existing coastal windstorm exposures.

We seek to further reduce our potential loss from catastrophe exposures through the purchase of catastrophe reinsurance. Effective May 1, 2012, we renewed our property catastrophe reinsurance program through April 30, 2013. The program provides coverage for our property business as well as certain acts of terrorism. Under the program, the first $25.0 million of losses resulting from any single catastrophe are retained and the next $155.0 million of losses resulting from the catastrophe are reinsured in three layers, although we retain a co-participation of 55% of losses from $25.0 million to $40.0 million, 15% of losses from $40.0 million to $80.0 million, and 10% of losses from $80.0 million to $180.0 million. Any loss above $180.0 million would be retained in full. In the event of a catastrophe, our property catastrophe reinsurance program is reinstated for the remainder of the original contract term by paying a reinstatement premium that is based on the percentage of coverage reinstated and the original property catastrophe coverage premium. We anticipate that the $180.0 million limit is sufficient to cover Northeast windstorm losses with a modeled 0.4% probability of occurrence (1-in-250-year event). This $180.0 million limit was reduced from the $225.0 million limit that our previous catastrophe reinsurance program provided, as a result of lower

catastrophe exposure as a specialty-focused company.
In addition to the corporate catastrophe reinsurance protection that we secure, we may also purchase dedicated reinsurance protection for specific businesses. In 2012, we purchased insurance to protect our collector car and boat business from catastrophic losses. This treaty covered losses in excess of $2.5 million up to $25 million in two layers. The first layer, $2.5 million in excess of $2.5 million carried a 5% co-participation. The company held a 20% co-participation on the second

Table of Contents

layer, $20 million in excess of $5 million. Catastrophe losses above $25 million are retained by the company in full. Reinstatement premiums are paid if the coverage is attached.

We also purchase a per occurrence treaty for IMU that protects against large occurrences, whether a single large claim or a catastrophe. The IMU treaty attaches at $2 million per occurrence. Coverage is provided up to $60 million. The first layer of the marine treaty is $5 million in excess of $2 million, with an annual aggregate deductible of $1.5 million for large losses and $5 million for catastrophes losses. For losses in the layer $10 million excess of $50 million, the company retains half of the loss. The portion of loss above $60 million is retained in full by the company. Reinstatement premiums are paid in full or in part depending on the layer and the occurrence if the coverage is attached. Losses retained under both the collector car and marine reinsurance treaties are subject to the corporate catastrophe treaty.

We also purchase property-per-risk reinsurance coverage to reduce large loss volatility. The property-per-risk reinsurance program reinsures losses in excess of $10.0 million up to $100.0 million. Individual risk facultative reinsurance may be purchased above $100.0 million where we deem it appropriate. Under the property-per-risk program, we retain a co-participation of 10% for losses in excess of $20.0 million up to $50.0 million and a co-participation of 20% for losses in excess of $50.0 million. The property-per-risk program also provides one limit of reinsurance protection for losses in excess of $10.0 million up to $100.0 million on an individual risk basis for foreign terrorism losses. However, any nuclear events, or biological, chemical or radiological terrorist attacks are not covered.

We also maintain a casualty reinsurance program that provides protection for individual policies involving general liability, automobile liability, professional liability or umbrella liability. Our healthcare professional liability treaty covers losses in excess of $5.0 million up to $20.0 million in two layers. The first layer, $5.0 million excess of