MOODY'S
INVESTORS SERVICE

CREDIT OPINION
10 July 2018

Update

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RATINGS

ProAssurance Corporation

Domicile	Birmingham, Alabama, United States
Long Term Rating	Baa2
Type	Senior Unsecured - Dom Curr
Outlook	Stable

Please see the ratings section at the end of this report for more information. The ratings and outlook shown reflect information as of the publication date.

Contacts

Jasper Cooper, CFA +1.212.553.1366
VP-Senior Analyst
jasper.cooper@moodys.com

Weigang Bo +1.212.553.4331
Associate Analyst
weigang.bo@moodys.com

Sarah Hibler +1.212.553.4912
Associate Managing Director
sarah.hibler@moodys.com

Marc R. Pinto, CFA +1.212.553.4352
MD-Financial Institutions
marc.pinto@moodys.com

ProAssurance Corporation

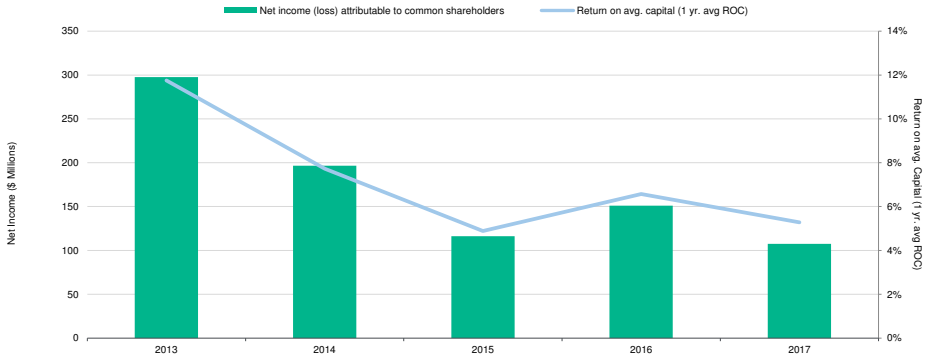
Semiannual update

Summary

Moody's A2 insurance financial strength (IFS) ratings on the ProAssurance Insurance Companies (PRA Group) and Baa2 senior unsecured rating of ProAssurance Corporation (ProAssurance, NYSE: PRA) are based primarily on the group's established track record and solid competitive market position as a specialist underwriter of healthcare (medical) professional liability (HCPL) insurance in the US along with its strong operating profitability and claim handling capabilities. The group maintains a conservative financial profile including low operational leverage, sound reserves and moderate financial leverage.

These strengths are tempered by the group's well above-average product risk given the company's primary focus on HCPL, which - despite strong performance in recent years - has over time exhibited among the highest levels of volatility in underwriting results and liability claim trends. The HCPL insurance industry faces a competitive pricing environment, loss costs are potentially rising particularly for large verdicts, and reserve redundancies have diminished. Through its Eastern Insurance Holding, Inc. (Eastern, rated A3 IFS) subsidiary, ProAssurance's second largest line of business is workers' compensation, which is also a long tail and historically volatile line. Given competitive pressures in the HCPL market, the company's net income has declined significantly over the past several years offset by a still strong capital position (Exhibit 1).

Exhibit 1
Net income and return on capital (1 yr. avg.)



Note: Adjusted net income for 2017 excludes a tax revenue of $6.5 million related to the new US tax law and recorded at the end of 2017
Source: Moody's Investors Service, Company Filings

Credit strengths

» Established track record and solid competitive market position as a specialist underwriter of HCPL and workers' compensation insurance in the US

» Solid capital adequacy, reflecting modest underwriting leverage and sound reserve position

» Relatively modest levels of goodwill and reinsurance recoverables

» Profitability track record and strong claim handling capabilities

» Good financial flexibility, reflecting moderate financial leverage

Credit challenges

» High product risk underwriting profile, given the group's primary focus in healthcare professional liability and workers' compensation

» Lack of significant product diversification

» Acquisition strategy involves execution and integration risks

» Shareholder dividends significantly in excess of net income in recent years

» Competition, given ProAssurance's emphasis on individual physicians and small groups, in the form of physicians moving into hospital captives and large clinic alternative risk transfer programs. The company is targeting the hospital HCPL market for growth, but this business tends to be less profitable than the company's traditional market

Rating outlook

The outlook for the ratings is stable, reflecting the group's market position as a specialist underwriter of HPCL in the US along with its strong operating profitability and claim handling capabilities.

Factors that could lead to an upgrade

» Strong results through the HCPL and WC underwriting cycles

» Increased product diversification through measured growth

» Financial leverage below 10%, combined with strong capital adequacy (e.g. gross underwriting leverage at 1.0x or below) and solid reserve position

» Sustained interest and shareholder dividend coverage in excess of 8x

Factors that could lead to a downgrade

» A sizeable expansion into a product or geographical area outside of the company's core strengths

» Material negative developments in the healthcare professional liability environment or legislation that could increase loss cost trends or reduce profitability and/or franchise strength

» Adjusted financial leverage in excess of 25%, together with interest and preferred dividend earnings and cash-flow coverage below 6x and 5x, respectively

» Annual adverse reserve development in excess of 3%

» Gross underwriting leverage at 3.0x or greater

Key indicators

Exhibit 2

ProAssurance Corporation [1][2]	2017	2016	2015	2014	2013
As Reported (U.S. Dollar Millions)					
Total Assets	4,929	5,065	4,906	5,169	5,151
Total Shareholders' Equity	1,595	1,799	1,958	2,158	2,394
Net income (loss) attributable to common shareholders	107	151	116	197	298
Gross Premiums Written	875	835	812	780	568
Net Premiums Written	764	739	709	702	525
Moody's Adjusted Ratios					
High Risk Assets % Shareholders' Equity	70.5%	58.0%	48.5%	43.6%	33.1%
Reinsurance Recoverable % Shareholders' Equity	24.0%	17.7%	14.9%	12.8%	11.4%
Goodwill & Intangibles % Shareholders' Equity	21.6%	19.0%	17.7%	16.2%	10.1%
Gross Underwriting Leverage	2.0x	1.7x	1.5x	1.4x	1.2x
Return on avg. capital (1 yr. avg ROC)	5.3%	6.6%	4.9%	7.7%	11.8%
Sharpe Ratio of ROC (5 yr. avg)	262.7%	272.8%	276.0%	503.9%	NA
Adv./(Fav.) Loss Dev. % Beg. Reserves (1 yr. avg)	-7.8%	-8.2%	-8.9%	-10.0%	-12.0%
Financial Leverage	21.6%	20.8%	15.8%	11.2%	9.9%
Total Leverage	21.6%	20.8%	15.8%	11.2%	9.9%
Earnings Coverage (1 yr.)	8.8x	12.1x	9.4x	18.9x	122.4x
Cash Flow Coverage (1 yr.)	8.3x	11.6x	11.3x	16.3x	88.5x

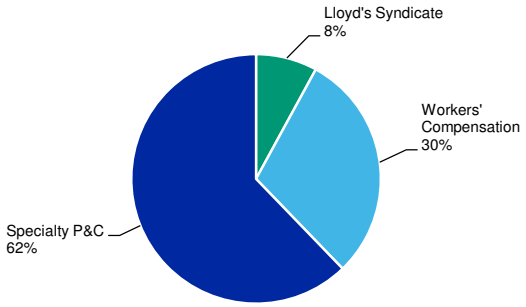
[1] Information based on US GAAP financial statements as of Fiscal YE December 31.
[2] Certain items may have been relabeled and/or reclassified for global consistency.
Source: Moody's Investors Service, Company Filings

Profile

ProAssurance Corporation, based in Birmingham, Alabama, offers professional liability insurance products in the US, primarily to physicians, dentists and other health care providers, but also to health care facilities, through its various subsidiaries. The company also writes product liability coverage for medical technology and life science companies, and engages in the legal professional liability business. Furthermore, it offers workers' compensation insurance and other property and casualty insurance and reinsurance. ProAssurance's insurance operating companies do not participate in any pooling arrangements, except for three Eastern subsidiaries - Eastern Alliance Insurance Company, Allied Eastern Indemnity Company, and Eastern Advantage Assurance Company - which have an intercompany pooling agreement.

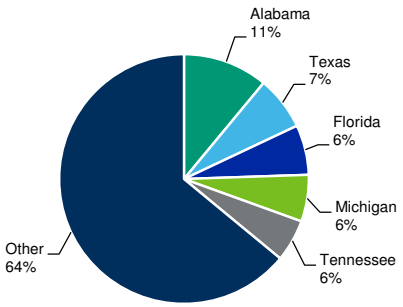
ProAssurance is the majority capital provider of Lloyd's Syndicate 1729 (62% participation), which provides a range of P&C insurance and reinsurance in both the U.S. and international markets. As of January 1, 2018, the company became the sole capital provider for the newly formed Syndicate 6131, focusing on contingency and specialty property business, and will also serve as a quota share reinsurer to Syndicate 1729.

Exhibit 3
Gross premiums written by business lines
(in %, consolidated, for 2017)



Source: Company GAAP filings

Exhibit 4
Direct premiums written by geography
(in %, consolidated, for 2017)



Source: Company combined Statutory filings

Detailed credit considerations

Moody's rates ProAssurance's core insurance affiliates (including ProAssurance Indemnity Company, Inc., ProAssurance Casualty Company, and Podiatry Insurance Company of America) A2 for insurance financial strength, which is in line with the adjusted aggregate profile indicated by the Moody's IFS rating scorecard (Exhibit 4).

INSURANCE FINANCIAL STRENGTH RATING

The key factors currently influencing the rating and outlook are as follows:

Market position, brand and distribution: Strong market position in a fragmented market

ProAssurance ranks among the five leading insurers of healthcare professional liability insurance in the US, with a market share of about 5%, based on 2017 direct premiums written. Its principal competitors include both physician owned insurers, as well as diversified national commercial insurers for whom HCPL tends to be a relatively small component of their total operations.

ProAssurance's core individual physicians franchise is impacted by structural changes occurring within the healthcare industry as doctors move from individual practices and small doctor groups to hospitals and larger physician groups, which account for a smaller share of the company's premium. The company is targeting the hospital HCPL market for growth, which may be a difficult strategy given the lower margins of this business relative to the company's core individual physicians and small physician groups.

ProAssurance distributes its products primarily through specialty independent agents (approximately 65% in 2017), but also on a direct basis (35%) in certain states and to podiatrists through its PICA subsidiary, while Eastern distributes its products primarily through a limited number of independent agents. The group's underwriting expense profile, in the low 30% range is competitive for the segment, and reflective of its established underwriting franchise.

Through Eastern, ProAssurance writes workers' compensation (WC) insurance and specialty WC reinsurance for small and middle-sized companies in low or middle-hazard industries such as clerical office, light manufacturing, healthcare, auto dealers, and other industries. Eastern allows ProAssurance to offer multiple products to medical facilities, which make up a growing share of the HCPL market. ProAssurance participates in a Lloyd's syndicate that underwrites a wide range of P&C insurance and reinsurance lines of business. Overall, given ProAssurance's strong market position within the HCPL market and its competitive expense profile, we view the group's market position as being in line with Baa-rated insurers rather than the unadjusted Ba level in the scorecard.

Product risk and diversification: Volatile lines of business with low product diversification

Moody's considers ProAssurance's product risk profile to be high, given that HCPL has historically been one of the most volatile segments of the P&C insurance sector, and subject to significant swings in underwriting profitability, reserve adequacy and claims

frequency and severity, largely reflecting litigation trends and state-specific considerations. Through Eastern, the company writes workers' compensation, which is also a long tail and historically volatile line, although ProAssurance has a lower average claim duration compared to most WC insurers given an underwriting strategy focused on smaller, less risky employers and a claims mitigation strategy focused on quickly returning injured workers to work. Although ProAssurance also underwrites a limited amount of medical technology and life sciences product liability coverage (including medical devices, biotechnology and pharmaceuticals) as well as lawyers professional liability insurance, the company lacks meaningful product diversification beyond HCPL and WC.

Through its participation in Lloyd's syndicate 1729, ProAssurance writes a range of P&C insurance and reinsurance in both the U.S. and international markets. As of January 1, 2018, the company became the sole capital provider for the newly formed Syndicate 6131, focusing on contingency and specialty property business, and will also serve as a quota share reinsurer to Syndicate 1729. ProAssurance's Lloyd's syndicate segment accounted for almost 8% of the company's 2017 net premiums earned and consists of casualty (41% of 2017 GPW), property (37%), catastrophe (15%), and property reinsurance (7%) lines of business.

Whereas many of ProAssurance's multiline competitors focus on HCPL coverages for institutional healthcare providers, ProAssurance focuses on the individual physicians and other professionals, and therefore has a more granular risk profile. With Eastern, ProAssurance is targeting institutional healthcare providers by offering multiple liability coverages. ProAssurance underwrites in all 50 states and the District of Columbia, with the company's six largest states account for about 46% of total premium volume (including Eastern) on a combined statutory basis. It is the leading HCPL underwriter in several states with HCPL market shares in excess of 30% (including Alabama, where it has about 48% market share), and ranks among the top four HCPL underwriters in about a dozen other states. ProAssurance's knowledge of local/state-specific territories is a key factor to controlling its product risk and claims and underwriting performance, given the very different medical/legal liability climate in each state. Overall, given ProAssurance's concentration in two historically volatile and long-tail lines of business, we view the group's product risk and diversification as being in line with the Ba-rated insurers rather than the unadjusted Baa level in the scorecard.

Asset quality: High quality investment portfolio with modest reinsurance recoverables

ProAssurance's asset quality is good overall with a predominant percentage of its investment portfolio in well diversified, high-quality and liquid fixed income securities. As of March 31, 2018, fixed income and short-term securities account for approximately 72% of the investment portfolio, with approximately 94% investment grade and an effective duration of 3.4 years. ProAssurance has significantly increased its allocation to equities and alternative investments in recent years, resulting in a high-risk assets to shareholders' equity ratio of about 72.5% as of March 31, 2018. ProAssurance uses reinsurance as an important component of its risk management process, but it maintains a high overall retention level (about 87% for 2017) and reinsurance recoverables are therefore moderate at about 24.4% of shareholders' equity as of March 31, 2018. The group has maintained a relatively stable panel of quality international reinsurers. Goodwill and other intangibles also remain modest relative to capital, given the company's focus on smaller business acquisitions, which often have lower price/book ratios and the use of portfolio transfer/renewal rights transactions in some of its other business acquisitions.

Capital adequacy: Strong capital adequacy but low product diversification

ProAssurance's strong capital adequacy is reflected in its moderate gross underwriting leverage (about 2.0x as of year-end 2017), which in turn reflects the group's good earnings generation as well as its moderate premium and reinsurance leverage. Moody's considers the group's capital adequacy profile to be more conservative than average for US commercial and specialty lines insurers. However, in light of the enterprise's high product risk, low product diversification and high underwriting cyclicality of the HCPL and WC sectors, we see this conservative posture as an important component of the group's core credit profile supporting its rating, and therefore consider capital adequacy to be in line with expectations for Aa-rated insurers rather than the unadjusted Aaa metric in the scorecard.

Profitability: Profitability impacted by competitive pricing environment

ProAssurance has historically maintained excellent profitability, but results have declined significantly in recent years. While the group's five-year average return on capital is 7.2%, yearly returns on capital have generally declined to 5.3% for 2017, compared to a five-year high of 11.8% for 2013. For 2017, the combined ratio was 95.4% compared to 91.4% during the prior year. The increase is primarily due to losses from Hurricanes Harvey, Irma and Maria, which caused higher current accident year net loss ratios particularly in the Lloyd's

Syndicate segment. The combined ratio in Q1 2018 increased to 99.9% from 96.3% in the prior year quarter, primarily driven by lower favorable reserve development in the Specialty P&C segment as well as a competitive pricing environment.

Contributing to underwriting profitability in recent years has been significant reserve releases on business written in prior years. Moody's expects that pricing pressures for HCPL together with potentially rising loss costs particularly for large verdicts and a likely tapering of reserve margins will continue to exert downward pressure on operating margins in the coming years. The company continues to write business at a high current accident year loss ratio (81.5% for Q1 2018), offset by 12.2 points of favorable reserve development, leading to a combined ratio of 99.9% for the quarter.

However, we also believe that ProAssurance's discipline with respect to underwriting, actuarial and claims settlement functions, together with its improved geographic spread of risk, should continue to provide it with flexibility to focus its underwriting on states and regions with better pricing, underwriting and claims environments, and to de-emphasize those with more difficult operating environments. Despite combined ratios that are historically higher than ProAssurance's HCPL business, ProAssurance's WC business adds to diversification of earnings but also exposes the company to additional underwriting and reserving risks.

Reserve adequacy: Strong reserve adequacy with a conservative reserving philosophy

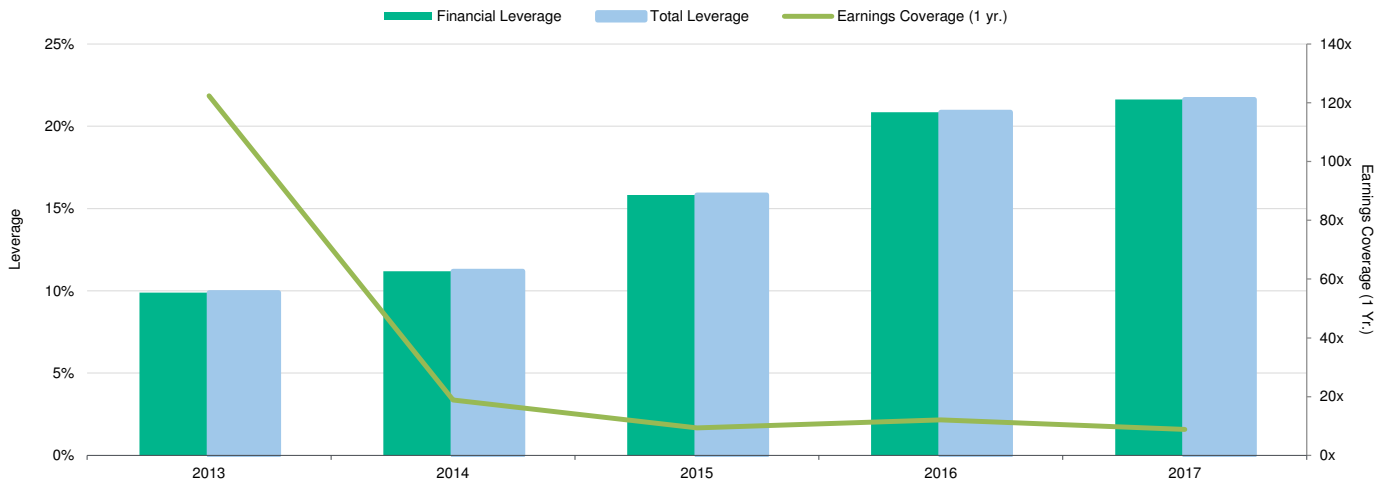
ProAssurance's historical reserve releases have been sound and notably well above peers. Although we estimate that the group's year-end 2017 reserves continue to be redundant, we believe the margin has trended down over the last few years. For 2017, ProAssurance reported $134.4 million of the favorable development compared to $143.8 million for 2016. For Q1 2018, the company reported $22.8 million of favorable development, compared to $28.8 million in the prior year quarter. We believe that reserve releases will likely continue to decline over the medium term as accident year loss ratios increase, pricing remains competitive, and loss cost trends revert to historical levels. The WC business also exposes the company to reserve risk given historic industry reserve volatility for the line of business; therefore, Moody's views the company's reserve adequacy more in line with Aa-rated insurers rather than the unadjusted Aaa metric in the scorecard.

Financial flexibility: Moderate financial leverage consistent with primary focus in two volatile market segments

ProAssurance's use of debt in its capital structure has historically been low, and Moody's expects that adjusted leverage will remain in the low 20% range, a level that we consider to be appropriate for an insurer primarily focused in potentially high volatility segments such as HCPL and workers' compensation. The company's adjusted debt to capital was 20.3% as of March 31, 2018, while both earnings and cashflow coverage of interest remain strong. As a publicly traded holding company, ProAssurance has demonstrated access to both equity and debt capital markets, which we view positively. However, we note that the company's specialty focus and relatively small profile in capital markets could reduce its ability to raise additional capital quickly in a stress scenario, and, as a result, somewhat tempers its financial flexibility.

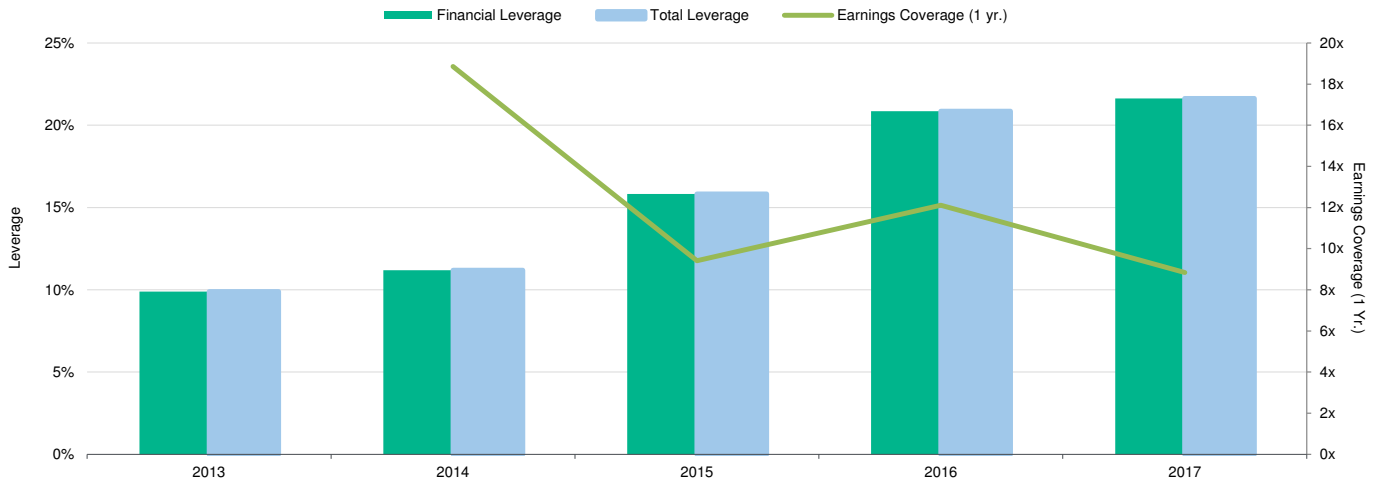
The company did not repurchase common stock during 2017 or Q1 2018. ProAssurance announced a special dividend of about $250 million during Q4 of 2017, which was paid in January 2018. Shareholder dividends including special dividends have exceeded net income in recent years, amounting to 295%, 209% and 103% of net income for 2017, 2016, and 2015 respectively. As of March 31, 2018, the board authorization of share repurchases or debt retirement totaled $109.6 million. We expect that future dividend and repurchase activity will be executed so as not to materially weaken the group's fundamentally strong capital position and financial flexibility.

Exhibit 5
Financial flexibility



Source: Moody's Investors Service, Company Filings

Exhibit 6
Financial flexibility



Note: 2013 Earnings Coverage was 122.4x
Source: Moody's Investors Service, Company Filings

Liquidity analysis

As of March 31, 2018, the holding company's cash and short-term investments totaled approximately $103 million, which more than covers interest expense and common stock dividends totaling approximately $85 million per year. During 2017, ProAssurance's insurance subsidiaries sent about $360 million in dividends to the holding company which included $200 million of extraordinary dividends. The company also has access to a $200 million revolving credit facility ($83 million drawn as of March 31, 2018), which also has an available $50 million accordion feature. The facility is due June 2020. The company also has $250 million of senior notes due in 2023.

Given the company's well above-average product risk and limited product diversification, we view some of the holding company capital as supportive of the insurance operations in the stress scenario. As such, we view the company's financial flexibility in line with A-rated insurers rather than the unadjusted Aa metric in the scorecard.

Other Considerations

Eastern Alliance Insurance Company and Allied Eastern Indemnity Company, the lead operating companies of Eastern, are rated A3 for financial strength with a stable outlook which reflects its market position as a monoline workers' compensation writer, a high quality investment portfolio, a strong reinsurance program, and implicit support from ProAssurance. The company generally focuses on lower hazard classes of business and has good record of profitability. These strengths are tempered by Eastern's modest size compared to competitors, its concentrated product risk in a historically volatile line of business, and low geographic diversification with more than half of its business in Pennsylvania. This business concentration accentuates the company's exposure to changes in the legal environment, competition and regulation. Eastern has a weaker standalone credit profile but benefits from implicit support from ProAssurance.

Factors that could result in a ratings upgrade of Eastern include: an upgrade of PRA Group's IFS ratings; and, stronger explicit support from ProAssurance. Conversely, factors that could result in a downgrade include: a downgrade of PRA Group's IFS ratings; a reduction in implicit support from ProAssurance; gross underwriting leverage above 4.5x; erosion of capital and surplus in excess of 10%; or combined ratios consistently above 105%.

Support and structural considerations

The three notch spread between ProAssurance's Baa2 senior debt rating and the A2 IFS ratings of its subsidiaries is consistent with Moody's typical notching practices for US insurance holding company structures.

Methodology and scorecard

Exhibit 7

Scorecard

Financial Strength Rating Scorecard [1][2]	Aaa	Aa	A	Baa	Ba	B	Caa	Score	Adj Score
Business Profile								Ba	Baa
Market Position and Brand (25%)								Ba	Baa
- Relative Market Share Ratio						X			
- Underwriting Expense Ratio % Net Premiums Written				31.9%					
Product Focus and Diversification (10%)								Baa	Ba
- Product Risk					X				
- P&C Insurance Product Diversification				X					
- Geographic Diversification		X							
Financial Profile								Aa	Aa
Asset Quality (10%)								Aa	Aa
- High Risk Assets % Shareholders' Equity			70.5%						
- Reinsurance Recoverable % Shareholders' Equity	24.0%								
- Goodwill & Intangibles % Shareholders' Equity		21.6%							
Capital Adequacy (15%)								Aaa	Aa
- Gross Underwriting Leverage	2.0x								
Profitability (15%)								A	A
- Return on Capital (5 yr. avg)			7.2%						
- Sharpe Ratio of ROC (5 yr. avg)			262.7%						
Reserve Adequacy (10%)								Aaa	Aa
- Adv./(Fav.) Loss Dev. % Beg. Reserves (5 yr. wtd avg)	-8.7%								
Financial Flexibility (15%)								Aa	A
- Financial Leverage		21.6%							
- Total Leverage		21.6%							
- Earnings Coverage (5 yr. avg)	34.3x								
- Cash Flow Coverage (5 yr. avg)	27.2x								
Operating Environment								Aaa - A	Aaa - A
Aggregate Profile								A2	A2

[1] Information based on US GAAP financial statements as of Fiscal YE December 31.

[2] The Scorecard rating is an important component of the company's published rating, reflecting the stand-alone financial strength before other considerations (discussed above) are incorporated into the analysis.

Source: Moody's Investors Service, Company Filings

Ratings

Exhibit 8

Category	Moody's Rating
PROASSURANCE CORPORATION	
Rating Outlook	STA
Senior Unsecured	Baa2
PROASSURANCE CASUALTY COMPANY	
Rating Outlook	STA
Insurance Financial Strength	A2
PROASSURANCE INDEMNITY COMPANY, INC.	
Rating Outlook	STA
Insurance Financial Strength	A2
PODIATRY INSURANCE COMPANY OF AMERICA	
Rating Outlook	STA
Insurance Financial Strength	A2
EASTERN ALLIANCE INSURANCE COMPANY	
Rating Outlook	STA
Insurance Financial Strength	A3
ALLIED EASTERN INDEMNITY COMPANY	
Rating Outlook	STA
Insurance Financial Strength	A3

Source: Moody's Investors Service

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Contacts

Jasper Cooper, CFA +1.212.553.1366
VP-Senior Analyst
jasper.cooper@moodys.com

Marc R. Pinto, CFA +1.212.553.4352
MD-Financial Institutions
marc.pinto@moodys.com

CLIENT SERVICES

Americas	1-212-553-1653
Asia Pacific	852-3551-3077
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