Employers Holdings, Inc.
Form 10-Q
November 07, 2013

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM 10-Q

R QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the Quarterly Period Ended September 30, 2013

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from ____ to ____

Commission file number: 001-33245

EMPLOYERS HOLDINGS, INC.
(Exact name of registrant as specified in its charter)

Nevada	04-3850065
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)

10375 Professional Circle, Reno, Nevada 89521
(Address of principal executive offices and zip code)
(888) 682-6671
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes R 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 R 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 definitions of "large accelerated filer," "accelerated filer," "non-accelerated filer," and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer R	Accelerated filer o	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 R

Class	October 31, 2013
Common Stock, $0.01 par value per share	31,210,749 shares outstanding

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PART I – FINANCIAL INFORMATION
Item 1. Consolidated Financial Statements
Employers Holdings, Inc. and Subsidiaries
Consolidated Balance Sheets
(in thousands, except share data)

Assets	As of September 30, 2013 (unaudited)	As of December 31, 2012
Available for sale:		
Fixed maturity securities at fair value (amortized cost $2,022,240 at September 30, 2013 and $1,869,142 at December 31, 2012)	$2,101,357	$2,024,428
Equity securities at fair value (cost $86,384 at September 30, 2013 and $81,067 at December 31, 2012)	147,595	125,086
Total investments	2,248,952	2,149,514
Cash and cash equivalents	99,823	140,661
Restricted cash and cash equivalents	6,078	5,353
Accrued investment income	19,100	19,356
Premiums receivable (less bad debt allowance of $7,397 at September 30, 2013 and $5,957 at December 31, 2012)	282,940	223,011
Reinsurance recoverable for:		
Paid losses	8,946	9,467
Unpaid losses	779,842	805,386
Deferred policy acquisition costs	45,682	38,852
Deferred income taxes, net	52,356	26,231
Property and equipment, net	16,490	14,680
Intangible assets, net	9,881	10,558
Goodwill	36,192	36,192
Contingent commission receivable—LPT Agreement	21,388	19,141
Other assets	17,846	12,937
Total assets	$3,645,516	$3,511,339
Liabilities and stockholders' equity		
Claims and policy liabilities:		
Unpaid losses and loss adjustment expenses	$2,305,307	$2,231,540
Unearned premiums	318,983	265,149
Total claims and policy liabilities	2,624,290	2,496,689
Commissions and premium taxes payable	44,493	40,825
Accounts payable and accrued expenses	20,333	19,522
Deferred reinsurance gain—LPT Agreement	260,602	281,043
Notes payable	112,000	112,000
Other liabilities	27,269	21,879
Total liabilities	3,088,987	2,971,958
Commitments and contingencies		
Stockholders' equity:		
Common stock, $0.01 par value; 150,000,000 shares authorized; 54,579,523 and 54,144,453 shares issued and 31,206,549 and 30,771,479 shares outstanding at September 30, 2013 and December 31, 2012, respectively	546	541
Preferred stock, $0.01 par value; 25,000,000 shares authorized; none issued	—	—

Additional paid-in capital	337,403	325,991
Retained earnings	489,916	445,850
Accumulated other comprehensive income, net	91,214	129,549
Treasury stock, at cost (23,372,974 shares at September 30, 2013 and December 31, 2012)	(362,550)	(362,550)
Total stockholders’ equity	556,529	539,381
Total liabilities and stockholders’ equity	$3,645,516	$3,511,339

See accompanying unaudited notes to the consolidated financial statements.

Employers Holdings, Inc. and Subsidiaries
Consolidated Statements of Comprehensive Income
(in thousands, except per share data)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
Revenues	(unaudited)		(unaudited)	
Net premiums earned	$164,429	$131,766	$472,357	$360,621
Net investment income	17,799	17,506	52,849	54,188
Realized gains on investments, net	1,075	1,838	5,735	4,561
Other income	29	30	276	225
Total revenues	183,332	151,140	531,217	419,595
Expenses				
Losses and loss adjustment expenses	105,767	96,823	326,677	265,150
Commission expense	19,946	16,681	58,466	47,118
Underwriting and other operating expenses	32,493	30,147	96,282	93,452
Interest expense	815	896	2,420	2,656
Total expenses	159,021	144,547	483,845	408,376
Net income before income taxes	24,311	6,593	47,372	11,219
Income tax benefit	(3,274)	(1,173)	(2,291)	(7,903)
Net income	$27,585	$7,766	$49,663	$19,122
Earnings per common share (Note 11):				
Basic	$0.88	$0.25	$1.60	$0.60
Diluted	$0.86	$0.25	$1.56	$0.60
Cash dividends declared per common share	$0.06	$0.06	$0.18	$0.18
Comprehensive income				
Unrealized gains (losses) during the period (net of tax expense (benefit) of $2,236 and $8,639 for the three months ended September 30, 2013 and 2012, respectively, and $(18,635) and $13,963 for the nine months ended September 30, 2013 and 2012, respectively)	$4,154	$16,045	$(34,607)	$25,933
Reclassification adjustment for realized gains in net income (net of taxes of $376 and $643 for the three months ended September 30, 2013 and 2012, respectively, and $2,007 and $1,596 for the nine months ended September 30, 2013 and 2012, respectively)	(699)	(1,195)	(3,728)	(2,966)
Other comprehensive income (loss), net of tax	3,455	14,850	(38,335)	22,967
Total comprehensive income	$31,040	$22,616	$11,328	$42,089
Realized gains on investments, net				
Net realized gains on investments before credit related impairments on fixed maturity securities	$1,075	$1,838	$5,803	$5,090
Other than temporary impairment, credit losses recognized in earnings	—	—	(68)	(529)
Realized gains on investments, net	$1,075	$1,838	$5,735	$4,561

See accompanying unaudited notes to the consolidated financial statements.

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Employers Holdings, Inc. and Subsidiaries
Consolidated Statements of Cash Flows
(in thousands)

	Nine Months Ended September 30,	
	2013	2012
Operating activities	(unaudited)	
Net income	$49,663	$19,122
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	4,324	4,193
Stock-based compensation	5,815	3,942
Amortization of premium on investments, net	6,574	5,342
Deferred income tax expense	(5,482)	(10,031)
Realized gains on investments, net	(5,735)	(4,561)
Excess tax benefits from stock-based compensation	(386)	—
Other	1,007	860
Change in operating assets and liabilities:		
Premiums receivable	(61,368)	(65,455)
Reinsurance recoverable for paid and unpaid losses	26,065	29,393
Federal income taxes	(925)	2,054
Unpaid losses and loss adjustment expenses	73,767	32,061
Unearned premiums	53,834	75,910
Accounts payable, accrued expenses and other liabilities	6,201	1,130
Deferred reinsurance gain—LPT Agreement	(20,441)	(11,501)
Contingent commission receivable—LPT Agreement	(2,247)	(2,450)
Other	(6,622)	10,584
Net cash provided by operating activities	124,044	90,593
Investing activities		
Purchase of fixed maturities	(340,343)	(260,797)
Purchase of equity securities	(22,058)	(28,336)
Proceeds from sale of fixed maturities	32,706	45,799
Proceeds from sale of equity securities	22,266	13,534
Proceeds from maturities and redemptions of investments	148,418	181,640
Proceeds from sale of fixed assets	285	107
Capital expenditures	(5,552)	(5,177)
Restricted cash and cash equivalents (used in) provided by investing activities	(725)	837
Net cash used in investing activities	(165,003)	(52,393)
Financing activities		
Acquisition of treasury stock	—	(41,385)
Cash transactions related to stock-based compensation	5,315	(209)
Dividends paid to stockholders	(5,580)	(5,664)
Excess tax benefits from stock-based compensation	386	—
Net cash provided by (used in) financing activities	121	(47,258)
Net decrease in cash and cash equivalents	(40,838)	(9,058)
Cash and cash equivalents at the beginning of the period	140,661	252,300
Cash and cash equivalents at the end of the period	$99,823	$243,242

See accompanying unaudited notes to the consolidated financial statements.

Employers Holdings, Inc. and Subsidiaries
Notes to Consolidated Financial Statements
(Unaudited)

1. Basis of Presentation and Summary of Operations

Employers Holdings, Inc. (EHI) is a Nevada holding company. Through its wholly owned insurance subsidiaries, Employers Insurance Company of Nevada (EICN), Employers Compensation Insurance Company (ECIC), Employers Preferred Insurance Company (EPIC), and Employers Assurance Company (EAC), EHI is engaged in the commercial property and casualty insurance industry, specializing in workers' compensation products and services. Unless otherwise indicated, all references to the "Company" refer to EHI, together with its subsidiaries.

The accompanying consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles (GAAP) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X of the Securities Exchange Act of 1934, as amended. Accordingly, they do not include all of the information and notes required by GAAP for complete financial statements. In the opinion of management, all adjustments (consisting of normal, recurring adjustments) necessary for a fair presentation of the Company's consolidated financial position and results of operations for the periods presented have been included. The results of operations for an interim period are not necessarily indicative of the results for an entire year. These financial statements have been prepared consistent with the accounting policies described in the Company's Annual Report on Form 10-K for the year ended December 31, 2012.

The Company considers an operating segment to be any component of its business whose operating results are regularly reviewed by the Company's chief operating decision makers to make decisions about resources to be allocated to the segment and assess its performance based on discrete financial information. Currently, the Company has one operating segment, workers' compensation insurance and related services.

Use of Estimates

The preparation of the consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, and disclosure of contingent assets and liabilities, at the date of the consolidated financial statements, as well as the reported amounts of revenues and expenses during the reporting period. As a result, actual results could differ from these estimates. The most significant areas that require management judgment are the estimate of unpaid losses and loss adjustment expenses (LAE), evaluation of reinsurance recoverables, recognition of premium revenue, deferred income taxes, valuation of investments, and the valuation of goodwill and intangible assets.

Reclassifications

Certain prior period information has been reclassified to conform to the current period presentation.

2. Changes in Estimates

During the third quarter of 2013, the Company reduced its estimated reserves ceded under the Loss Portfolio Transfer Agreement (LPT Agreement) by $14.5 million. This change in estimate resulted in a $10.1 million cumulative adjustment to the deferred reinsurance gain–LPT Agreement (Deferred Gain), which was also recognized in losses and LAE in the consolidated statement of comprehensive income, so that the Deferred Gain reflects the balance that would have existed had the revised reserves been recognized at the inception of the LPT Agreement (LPT Reserve Adjustment). This change in estimate was the result of the determination in the third quarter of 2013 that an adjustment was necessary to reflect observed favorable paid loss trends. This change in estimate increased net income by $10.1 million, or $0.32 per basic and diluted share, for the three months ended September 30, 2013 and $0.33 and $0.32 per basic and diluted share, respectively, for the nine months ended September 30, 2013.

During the third quarter of 2013, the Company reallocated $24.3 million in reserves from non-taxable periods prior to January 1, 2000 to taxable years, which reduced our effective tax rate by 10.5 percentage points for the nine months ended September 30, 2013. This change in estimate was the result of the determination in the third quarter of 2013 that a reallocation of reserves among accident years was appropriate to address a continuation of observed loss trends. The income tax impact of this change in estimate increased net income by $5.0 million, or $0.16 per basic and diluted share for the three and nine months ended September 30, 2013.

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3. New Accounting Standards

In February 2013, the Financial Accounting Standards Board issued Accounting Standards Update Number 2013-02, Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income (Topic 220). This update requires companies to report the effect of significant reclassifications out of accumulated other comprehensive income on the respective line items in net income if the amount being reclassified is required under GAAP to be reclassified in its entirety to net income. For other amounts that are not required under GAAP to be reclassified in their entirety to net income in the same reporting period, an entity is required to cross-reference other disclosures required under GAAP that provide additional detail about those amounts. This update became effective prospectively for reporting periods beginning after December 15, 2012. The Company adopted this update beginning in the first quarter of 2013. The adoption of this new guidance did not have a material impact on the Company's consolidated financial condition or results of operations.

4. Fair Value of Financial Instruments

The carrying value and the estimated fair value of the Company’s financial instruments were as follows:

	September 30, 2013		December 31, 2012	
	Carrying Value	Estimated Fair Value	Carrying Value	Estimated Fair Value
	(in thousands)			
Financial assets				
Investments	$2,248,952	$2,248,952	$2,149,514	$2,149,514
Cash and cash equivalents	99,823	99,823	140,661	140,661
Restricted cash and cash equivalents	6,078	6,078	5,353	5,353
Financial liabilities				
Notes payable	112,000	114,501	112,000	118,207

The Company's estimates of fair value for financial liabilities are based on a combination of the variable interest rates for the Company's existing line of credit and other notes with similar durations to discount the projection of future payments on notes payable, and have been determined to be Level 2 fair value measurements, as defined below.

Assets and liabilities recorded at fair value on the consolidated balance sheets are categorized based upon the levels of judgment associated with the inputs used to measure their fair value. Level inputs are defined as follows:

- Level 1 - Inputs are unadjusted quoted market prices for identical assets or liabilities in active markets at the measurement date.
- Level 2 - Inputs other than Level 1 prices that are observable for similar assets or liabilities through corroboration with market data at the measurement date.
- Level 3 - Inputs that are unobservable that reflect management's best estimate of what market participants would use in pricing the assets or liabilities at the measurement date.

The following methods and assumptions were used to determine the fair value of each class of assets and liabilities recorded at fair value in the consolidated balance sheets.

Fair value of available-for-sale fixed maturity and equity securities is based on quoted market prices, where available, and is obtained primarily from third party pricing services, which generally use Level 1 or Level 2 inputs. The Company obtains a quoted price for each security from third party pricing services. The quoted prices are derived through recently reported trades for identical or similar securities. For securities not actively traded, the third party pricing services may use quoted market prices of similar instruments or discounted cash flow analyses, incorporating inputs that are currently observable in the markets for similar securities. Inputs that are often used in the valuation methodologies include, but are not limited to, broker quotes, benchmark yields, credit spreads, default rates, and prepayment speeds. The Company also performs a quarterly analysis on the prices received from third party pricing services to determine whether the prices are reasonable estimates of fair value, including confirming the fair values of these securities through observable market prices using an alternative pricing source. If differences are noted in this review, the Company may obtain additional information from other pricing services to validate the quoted price. There were no adjustments to prices obtained from third party pricing services as of September 30, 2013 or December 31, 2012 that were material to the consolidated financial statements.

If quoted market prices and an estimate determined by using objectively verifiable information are unavailable, the Company produces an estimate of fair value based on internally developed valuation techniques, which, depending on the level of observable market inputs, will render the fair value estimate as Level 2 or Level 3. The Company bases all of its estimates of fair value for assets on the bid price as it represents what a third party market participant would be willing to pay in an arm's length transaction.

These methods of valuation will only produce an estimate of fair value if there is objectively verifiable information to produce a valuation. If objectively verifiable information is not available, the Company would be required to produce an estimate of fair value using some of the same methodologies, making assumptions for market-based inputs that are unavailable.

Estimates of fair value for fixed maturity securities are based on estimates using objectively verifiable information and are included in the amount disclosed in Level 2 of the hierarchy. The Level 3 fair value estimates include the Company's assumptions about risk assessments and market participant assumptions based on the best information available, including quotes from market makers and other broker/dealers recognized as market participants, using standard or trade derived inputs, new issue data, monthly payment information, cash flow generation, prepayment speeds, spread adjustments, or rating updates.

The following table presents the items on the accompanying consolidated balance sheets that are stated at fair value and the fair value measurements.

	September 30, 2013			December 31, 2012		
	Level 1	Level 2	Level 3	Level 1	Level 2	Level 3
	(in thousands)					
Fixed maturity securities						
U.S. Treasuries	$—	$159,293	$—	$—	$152,490	$—
U.S. Agencies	—	74,623	—	—	93,967	—
States and municipalities	—	761,801	—	—	758,516	—
Corporate securities	—	754,226	—	—	676,243	—
Residential mortgage-backed securities	—	258,851	—	—	252,852	—
Commercial mortgage-backed securities	—	51,269	—	—	56,120	—
Asset-backed securities	—	41,294	—	—	34,240	—
Total fixed maturity securities	—	2,101,357	—	—	2,024,428	—
Equity securities	$147,595	$—	$—	$125,086	$—	$—

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5. Investments

The cost or amortized cost, gross unrealized gains, gross unrealized losses, and estimated fair value of the Company's investments were as follows:

	Cost or Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
	(in thousands)			
At September 30, 2013				
Fixed maturity securities				
U.S. Treasuries	$150,708	$8,598	$(13)	$159,293
U.S. Agencies	71,058	3,565	—	74,623
States and municipalities	721,713	43,616	(3,528)	761,801
Corporate securities	732,309	30,528	(8,611)	754,226
Residential mortgage-backed securities	252,022	9,574	(2,745)	258,851
Commercial mortgage-backed securities	53,044	361	(2,136)	51,269
Asset-backed securities	41,386	76	(168)	41,294
Total fixed maturity securities	2,022,240	96,318	(17,201)	2,101,357
Equity securities	86,384	61,617	(406)	147,595
Total investments	$2,108,624	$157,935	$(17,607)	$2,248,952
At December 31, 2012				
Fixed maturity securities				
U.S. Treasuries	$138,839	$13,651	$—	$152,490
U.S. Agencies	88,202	5,765	—	93,967
States and municipalities	689,776	68,740	—	758,516
Corporate securities	627,047	49,461	(265)	676,243
Residential mortgage-backed securities	236,461	16,488	(97)	252,852
Commercial mortgage-backed securities	54,755	1,410	(45)	56,120
Asset-backed securities	34,062	211	(33)	34,240
Total fixed maturity securities	1,869,142	155,726	(440)	2,024,428
Equity securities	81,067	45,399	(1,380)	125,086
Total investments	$1,950,209	$201,125	$(1,820)	$2,149,514

The amortized cost and estimated fair value of fixed maturity securities at September 30, 2013, by contractual maturity, are shown below. Expected maturities differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	Amortized Cost	Estimated Fair Value
	(in thousands)	
Due in one year or less	$141,285	$143,450
Due after one year through five years	786,373	822,971
Due after five years through ten years	571,472	598,132
Due after ten years	176,658	185,390
Mortgage and asset-backed securities	346,452	351,414
Total	$2,022,240	$2,101,357

The following is a summary of investments that have been in a continuous unrealized loss position for less than 12 months and those that have been in a continuous unrealized loss position for 12 months or greater as of September 30, 2013 and December 31, 2012.

	September 30, 2013			December 31, 2012		
	Estimated Fair Value	Gross Unrealized Losses	Number of Issues	Estimated Fair Value	Gross Unrealized Losses	Number of Issues
	(dollars in thousands)					
Less than 12 months:						
Fixed maturity securities						
U.S. Treasuries	$4,440	$(13)	2	$—	$—	—
States and municipalities	101,983	(3,528)	27	—	—	—
Corporate securities	257,784	(8,453)	94	36,338	(265)	12
Residential mortgage-backed securities	78,234	(2,739)	36	14,629	(28)	6
Commercial mortgage-backed securities	33,681	(2,136)	10	10,432	(45)	4
Asset-backed securities	30,490	(168)	14	16,714	(33)	5
Total fixed maturity securities	506,612	(17,037)	183	78,113	(371)	27
Equity securities	7,852	(329)	24	11,645	(1,207)	35
Total less than 12 months	$514,464	$(17,366)	207	$89,758	$(1,578)	62
12 months or greater:						
Fixed maturity securities						
Corporate securities	$2,426	$(158)	1	$—	$—	—
Residential mortgage-backed securities	498	(6)	16	2,341	(69)	17
Total fixed maturity securities	2,924	(164)	17	2,341	(69)	17
Equity securities	617	(77)	1	456	(173)	4
Total 12 months or greater	$3,541	$(241)	18	$2,797	$(242)	21
Total available-for-sale:						
Fixed maturity securities						
U.S. Treasuries	$4,440	$(13)	2	$—	$—	—
States and municipalities	101,983	(3,528)	27	—	—	—
Corporate securities	260,210	(8,611)	95	36,338	(265)	12
Residential mortgage-backed securities	78,732	(2,745)	52	16,970	(97)	23
Commercial mortgage-backed securities	33,681	(2,136)	10	10,432	(45)	4
Asset-backed securities	30,490	(168)	14	16,714	(33)	5
Total fixed maturity securities	509,536	(17,201)	200	80,454	(440)	44
Equity securities	8,469	(406)	25	12,101	(1,380)	39
Total available-for-sale	$518,005	$(17,607)	225	$92,555	$(1,820)	83

Based on reviews of the fixed maturity securities, the Company determined that unrealized losses for the nine months ended September 30, 2013 were primarily the result of changes in prevailing interest rates and not the credit quality of the issuers. The fixed maturity securities whose total fair value was less than amortized cost were not determined to be other-than-temporarily impaired given the severity and duration of the impairment, the credit quality of the issuers, the Company's intent to not sell the securities, and a determination that it is not more likely than not that the Company will be required to sell the securities until fair value recovers to above cost, or maturity.

Based on reviews of the equity securities, the Company recognized an impairment of $0.1 million in the fair value of one equity security for the nine months ended September 30, 2013 as a result of the severity and duration of the change in fair value of that security.

Realized gains on investments, net, and the change in unrealized gains (losses) on fixed maturity and equity securities are determined on a specific-identification basis and were as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
	(in thousands)			
Realized gains on investments, net				
Fixed maturity securities				
Gross gains	$215	$1,138	$216	$3,433
Gross losses	(7)	—	(7)	(5)
Realized gains on fixed maturity securities, net	$208	$1,138	$209	$3,428
Equity securities				
Gross gains	$868	$731	$5,845	$1,891
Gross losses	(1)	(31)	(319)	(758)
Realized gains on equity securities, net	$867	$700	$5,526	$1,133
Total	$1,075	$1,838	$5,735	$4,561
Change in unrealized gains (losses)				
Fixed maturity securities	$(1,086)	$17,600	$(76,168)	$21,158
Equity securities	6,401	5,246	17,191	14,177
Total	$5,315	$22,846	$(58,977)	$35,335

Net investment income was as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
	(in thousands)			
Fixed maturity securities	$17,465	$17,161	$51,991	$53,261
Equity securities	950	856	2,733	2,280
Cash equivalents and restricted cash	19	134	82	546
	18,434	18,151	54,806	56,087
Investment expenses	(635)	(645)	(1,957)	(1,899)
Net investment income	$17,799	$17,506	$52,849	$54,188

The Company is required by various state laws and regulations to keep securities or letters of credit in depository accounts with certain states in which it does business. As of September 30, 2013 and December 31, 2012, securities having a fair value of $603.4 million and $530.6 million, respectively, were on deposit. These laws and regulations govern not only the amount, but also the types of securities that are eligible for deposit. The deposits are limited to fixed maturity securities in all states. Additionally, certain reinsurance contracts require Company funds to be held in trust for the benefit of the ceding reinsurer to secure the outstanding liabilities assumed by the Company. The fair value of fixed maturity securities held in trust for the benefit of ceding reinsurers at September 30, 2013 and December 31, 2012 was $32.1 million and $35.0 million, respectively. Pursuant to the Amended Credit Facility, a portion of the Company's debt was secured by fixed maturity securities and restricted cash and cash equivalents that had a fair value of $100.6 million and $110.4 million at September 30, 2013 and December 31, 2012, respectively.

6. Income Taxes

Income tax expense for interim periods is measured using an estimated effective tax rate for the annual period. The following is a reconciliation of the federal statutory income tax rate to the Company's effective tax rates for the periods presented.

	Nine Months Ended September 30,	
	2013	2012
Expense computed at statutory rate	35.0 %	35.0 %
Dividends received deduction and tax-exempt interest	(15.0)	(65.3)
LPT deferred gain amortization	(9.3)	(44.7)
LPT Reserve Adjustment	(6.0)	—
Pre-privatization reserve adjustment, excluding LPT	(10.5)	—
Other	1.0	4.6
Effective tax rate	(4.8)%	(70.4)%

7. Liability for Unpaid Losses and Loss Adjustment Expenses

The following table represents a reconciliation of changes in the liability for unpaid losses and LAE.

	Nine Months Ended September 30,	
	2013	2012
	(in thousands)	
Unpaid losses and LAE, gross of reinsurance, at beginning of period	$2,231,540	$2,272,363
Less reinsurance recoverables for unpaid losses and LAE	805,386	940,840
Net unpaid losses and LAE at beginning of period	1,426,154	1,331,523
Losses and LAE, net of reinsurance, related to:		
Current period	347,568	277,821
Prior periods	1,797	1,281
Total net losses and LAE incurred during the period	349,365	279,102
Deduct payments for losses and LAE, net of reinsurance, related to:		
Current period	46,347	40,991
Prior periods	203,707	178,087
Total net payments for losses and LAE during the period	250,054	219,078
Ending unpaid losses and LAE, net of reinsurance	1,525,465	1,391,547
Reinsurance recoverable for unpaid losses and LAE	779,842	912,877
Unpaid losses and LAE, gross of reinsurance, at end of period	$2,305,307	$2,304,424

Total net losses and LAE included in the above table excludes the impact of the amortization of the deferred reinsurance gain—LPT Agreement (Note 8).

The increase in the estimates of incurred losses and LAE attributable to insured events for prior periods was primarily related to the Company's assigned risk business.

8. LPT Agreement

The Company is party to a 100% quota share retroactive reinsurance agreement (LPT Agreement) under which $1.5 billion in liabilities for losses and LAE related to claims incurred by EICN prior to July 1, 1995 were reinsured for consideration of $775.0 million. The LPT Agreement provides coverage up to $2.0 billion. The initial Deferred Gain resulting from the LPT Agreement was recorded as a liability in the accompanying consolidated balance sheets as Deferred reinsurance gain–LPT Agreement. The Company is also entitled to receive a contingent profit commission under the LPT Agreement. The contingent profit commission is an amount based on the favorable difference between actual paid losses and LAE and expected paid losses and LAE as established in the LPT Agreement. The Company records its estimate of contingent profit commission in the accompanying consolidated balance sheets as Contingent commission receivable–LPT Agreement and a corresponding liability is recorded on the accompanying consolidated balance sheets in Deferred reinsurance gain–LPT Agreement. The Deferred Gain is being amortized using the recovery method. Amortization is determined by the proportion of actual reinsurance recoveries to total estimated recoveries over the life of the LPT Agreement, except for the contingent profit commission, which is amortized through June 30, 2024. The amortization is recorded in losses and LAE incurred in the accompanying consolidated statements of comprehensive income. Any adjustments to the Deferred Gain are recorded in losses and LAE incurred in the accompanying consolidated statements of comprehensive income.

The Company amortized $22.7 million and $14.0 million of the Deferred Gain for the nine months ended September 30, 2013 and 2012, respectively. Additionally, the Deferred Gain was reduced by $10.1 million in September 2013 due to the favorable LPT Reserve Adjustment (Note 2). The remaining Deferred Gain was $260.6 million and $281.0 million as of September 30, 2013 and December 31, 2012, respectively. The estimated remaining liabilities subject to the LPT Agreement were $633.0 million and $672.3 million as of September 30, 2013 and December 31, 2012, respectively. Losses and LAE paid with respect to the LPT Agreement totaled $630.0 million and $605.1 million through September 30, 2013 and December 31, 2012, respectively.

9. Accumulated Other Comprehensive Income, net

Accumulated other comprehensive income, net, is comprised of unrealized gains on investments classified as available-for-sale, net of deferred tax expense. The following table summarizes the components of accumulated other comprehensive income, net:

	September 30, 2013	December 31, 2012
	(in thousands)	
Net unrealized gain on investments, before taxes	$140,328	$199,305
Deferred tax expense on net unrealized gains	(49,114)	(69,756)
Total accumulated other comprehensive income, net	$91,214	$129,549

10. Stock-Based Compensation

The Company awarded stock options, restricted stock units (RSUs) and performance share units (PSUs) to certain officers and Directors of the Company as follows:

	Number Awarded	Weighted Average Fair Value on Date of Grant	Weighted Average Exercise Price	Aggregate Fair Value on Date of Grant (in millions)
March 2013				
Stock options[1]	162,800	$7.04	$22.24	$1.1
RSUs[1]	73,894	22.24	—	1.6
PSUs[2]	147,440	22.24	—	3.3
May 2013				
RSUs[1]	14,550	24.74	—	0.4
September 2013				
RSUs[1]	2,704	29.58	—	0.1

(1) The stock options and RSUs awarded in March 2013 were awarded to certain officers of the Company and vest 25% on March 19, 2014, and each of the subsequent three anniversaries of that date. The stock options and RSUs are subject to accelerated vesting in certain circumstances, such as: death or disability, or in connection with change of control of the Company. The stock options expire seven years from the date of grant.

The RSUs awarded in May and September 2013 were granted to non-employee Directors of the Company and vest on May, 23, 2014.

(2) The PSUs have a performance period of three years and are subject to certain performance goals, based on the Company's statutory combined ratio, with payouts that range from 0% to 200% of the target awards. The values shown in the table represent the target number of PSUs awarded.

A total of 344,105 and 101,261 stock options were exercised during the nine months ended September 30, 2013 and the year ended December 31, 2012, respectively.

11. Earnings Per Share

Basic earnings per share includes no dilution and is computed by dividing income applicable to stockholders by the weighted average number of shares outstanding for the period. Diluted earnings per share reflects the potential dilutive impact of all convertible securities on earnings per share. Diluted earnings per share includes shares assumed issued under the "treasury stock method," which reflects the potential dilution that would occur if outstanding options were to be exercised. The following table presents the net income and the weighted average shares outstanding used in the earnings per common share calculations.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
	(in thousands, except share data)			
Net income available to stockholders—basic and diluted	$27,585	$7,766	$49,663	$19,122
Weighted average number of shares outstanding—basic	31,214,230	30,891,648	31,070,571	31,689,844
Effect of dilutive securities:				
PSUs	284,217	23,842	211,347	6,329
Stock options	457,909	109,152	382,871	93,975
RSUs	77,320	52,736	136,581	128,472
Dilutive potential shares	819,446	185,730	730,799	228,776
Weighted average number of shares outstanding—diluted	32,033,676	31,077,378	31,801,370	31,918,620

Diluted earnings per share excludes outstanding options and other common stock equivalents in periods where the inclusion of such options and common stock equivalents would be anti-dilutive. The following table presents options and RSUs that were excluded from diluted earnings per share.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
Options excluded as the exercise price was greater than the average market price	—	934,597	—	934,597
Options and RSUs excluded under the treasury method as the potential proceeds on settlement or exercise price was greater than the value of shares acquired	165,504	242,300	165,504	556,212

Item 2. Management's Discussion and Analysis of Consolidated Financial Condition and Results of Operations

You should read the following discussion and analysis in conjunction with our consolidated financial statements and the related notes thereto included in Item 1 of Part I. Unless otherwise indicated, all references to "we," "us," "our," "the Company," or similar terms refer to Employers Holdings, Inc. (EHI), together with its subsidiaries. The information contained in this quarterly report is not a complete description of our business or the risks associated with an investment in our common stock. We urge you to carefully review and consider the various disclosures made by us in this quarterly report and in our other reports filed with the Securities and Exchange Commission (SEC), including our Annual Report on Form 10-K for the year ended December 31, 2012 (Annual Report).

The Private Securities Litigation Reform Act of 1995 provides a safe harbor for forward-looking statements if accompanied by meaningful cautionary statements identifying important factors that could cause actual results to differ materially from those discussed. You should not place undue reliance on these statements, which speak only as of the date of this report. Forward-looking statements include those related to our expected financial position, business, financing plans, litigation, future premiums, revenues, earnings, pricing, investments, business relationships, expected losses, loss experience, loss reserves, acquisitions, competition, the impact of changes in interest rates, rate increases with respect to our business, and the insurance industry in general. Statements including words such as "expect," "intend," "plan," "believe," "estimate," "may," "anticipate," "will" or similar statements of a future or forward-looki identify forward-looking statements.

We undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events, or otherwise, except as required by law. All forward-looking statements address matters that involve risks and uncertainties that could cause actual results to differ materially from historical or anticipated results, depending on a number of factors. These risks and uncertainties include, but are not limited to, those described in our Annual Report and other documents that we have filed with the SEC.

Overview

We are a Nevada holding company. Through our insurance subsidiaries, we provide workers' compensation insurance coverage to select, small businesses in low to medium hazard industries. Workers' compensation insurance is provided under a statutory system wherein most employers are required to provide coverage for their employees' medical, disability, vocational rehabilitation, and/or death benefit costs for work-related injuries or illnesses. We provide workers' compensation insurance in 31 states and the District of Columbia, with a concentration in California, where over one-half of our business is generated. Our revenues are primarily comprised of net premiums earned, net investment income, and net realized gains on investments.

We target small businesses, as we believe that this market is traditionally characterized by fewer competitors, more attractive pricing, and stronger persistency when compared to the U.S. workers' compensation insurance industry in general. We believe we are able to price our policies at levels that are competitive and profitable over the long-term. Our underwriting approach is to consistently underwrite small business accounts at appropriate and competitive prices without sacrificing long-term profitability and stability for short-term top-line revenue growth.

Our goal is to maintain our focus on disciplined underwriting and to continue to pursue profitable growth opportunities across market cycles; however, we continue to be affected by persistently low investment yields and continuing high levels of unemployment nationally. We believe overall economic conditions will remain uncertain in the near-term.

We market and sell our workers' compensation insurance products through independent local, regional, and national agents and brokers; through our strategic partnerships and alliances, including our principal partners ADP, Inc. and Anthem Blue Cross of California; and through relationships with national, regional, and local trade groups and associations.

Results of Operations

Overall, net income was $27.6 million and $49.7 million for the three and nine months ended September 30, 2013, respectively, compared to $7.8 million and $19.1 million for the corresponding periods of 2012. We recognized underwriting income (losses) of $6.2 million and $(9.1) million for the three and nine months ended September 30, 2013, respectively, compared to underwriting losses of $11.9 million and $45.1 million for the same periods of 2012. Underwriting income or loss is determined by deducting losses and LAE, commission expense, and underwriting and other operating expenses from net premiums earned. Key factors that affected our financial performance during the three and nine months ended September 30, 2013, compared to the same periods of 2012, include:

- Gross premiums written increased 14.6% and 20.5%;
- Net premiums earned increased 24.8% and 31.0%;
- Losses and LAE increased 9.2% and 23.2%;

- Underwriting and other operating expenses increased 7.8% and 3.0%; and
- Income tax benefit increased $2.1million and decreased $5.6 million.

Our results of operations were also impacted by: (1) favorable development in the estimated reserves ceded under the LPT Agreement. This adjustment to the estimated reserves ceded resulted in a $10.1 million cumulative adjustment to the Deferred Gain, which reduced our losses and LAE by the same amount during the third quarter of 2013 (LPT Reserve Adjustment); and (2) a reallocation of reserves from non-taxable periods prior to January 1, 2000, which reduced our effective tax rate by 10.5 percentage points for the nine months ended September 30, 2013.

A primary measure of our performance is our ability to increase stockholders’ equity, including the impact of the Deferred reinsurance gain–LPT Agreement (Deferred Gain), over the long-term; however, during periods of rising interest rates, the fair value of the fixed income component of our investment portfolio may be negatively impacted, thereby reducing stockholders' equity. For the nine months ended September 30, 2013, the unrealized gain in our portfolio, net of deferred tax expense, declined by $38.3 million, principally as a result of the upward movement in interest rates year to date. The following table shows our stockholders' equity including the Deferred Gain, stockholders' equity on a GAAP basis, and number of common shares outstanding.

	September 30, 2013	December 31, 2012
	(in thousands, except share data)	
Stockholders' equity including the Deferred Gain(1)	$817,131	$820,424
GAAP stockholders' equity	$556,529	$539,381
Common shares outstanding	31,206,549	30,771,479

(1) Stockholders' equity, including the Deferred Gain, is a non-GAAP measure that is defined as total stockholders' equity plus the Deferred Gain, which we believe is an important supplemental measure of our capital position.

The comparative components of net income are set forth in the following table:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
	(in thousands)			
Gross premiums written	$168,569	$147,032	$533,600	$442,920
Net premiums written	165,885	144,353	524,907	435,081
Net premiums earned	$164,429	$131,766	$472,357	$360,621
Net investment income	17,799	17,506	52,849	54,188
Realized gains on investments, net	1,075	1,838	5,735	4,561
Other income	29	30	276	225
Total revenues	183,332	151,140	531,217	419,595
Losses and LAE	105,767	96,823	326,677	265,150
Commission expense	19,946	16,681	58,466	47,118
Underwriting and other operating expenses	32,493	30,147	96,282	93,452
Interest expense	815	896	2,420	2,656
Income tax benefit	(3,274)	(1,173)	(2,291)	(7,903)
Total expenses	155,747	143,374	481,554	400,473
Net income	$27,585	$7,766	$49,663	$19,122
Less amortization of the Deferred Gain related to losses	$3,195	$3,646	$9,775	$11,630
Less amortization of the Deferred Gain related to contingent commission	396	293	1,184	818
Less impact of the LPT Reserve Adjustment(1)	10,112	—	10,112	—
Less impact of LPT Contingent				