

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, 2016**

**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**

(State or other jurisdiction  
of incorporation or organization)

**04-3850065**

(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

Common Stock, \$0.01 par value per share

October 20, 2016

32,087,739 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)

|                                                                                                                                                                                                                   | As of<br>September 30,<br>2016 | As of<br>December 31,<br>2015 |
|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--------------------------------|-------------------------------|
|                                                                                                                                                                                                                   | (unaudited)                    |                               |
| <b>Assets</b>                                                                                                                                                                                                     |                                |                               |
| Available for sale:                                                                                                                                                                                               |                                |                               |
| Fixed maturity securities at fair value (amortized cost \$2,273,100 at September 30, 2016 and \$2,221,100 at December 31, 2015)                                                                                   | \$ 2,383,900                   | \$ 2,288,500                  |
| Equity securities at fair value (cost \$114,400 at September 30, 2016 and \$137,500 at December 31, 2015)                                                                                                         | 184,500                        | 198,700                       |
| Short-term investments at fair value (amortized cost \$14,000 at September 30, 2016)                                                                                                                              | 14,000                         | —                             |
| <b>Total investments</b>                                                                                                                                                                                          | <b>2,582,400</b>               | <b>2,487,200</b>              |
| Cash and cash equivalents                                                                                                                                                                                         | 84,100                         | 56,600                        |
| Restricted cash and cash equivalents                                                                                                                                                                              | 2,700                          | 2,500                         |
| Accrued investment income                                                                                                                                                                                         | 20,300                         | 20,600                        |
| Premiums receivable (less bad debt allowance of \$10,700 at September 30, 2016 and \$12,200 at December 31, 2015)                                                                                                 | 317,100                        | 301,100                       |
| Reinsurance recoverable for:                                                                                                                                                                                      |                                |                               |
| Paid losses                                                                                                                                                                                                       | 8,300                          | 7,700                         |
| Unpaid losses                                                                                                                                                                                                     | 591,500                        | 628,200                       |
| Deferred policy acquisition costs                                                                                                                                                                                 | 46,800                         | 44,300                        |
| Deferred income taxes, net                                                                                                                                                                                        | 41,100                         | 67,900                        |
| Property and equipment, net                                                                                                                                                                                       | 22,600                         | 24,900                        |
| Intangible assets, net                                                                                                                                                                                            | 8,300                          | 8,500                         |
| Goodwill                                                                                                                                                                                                          | 36,200                         | 36,200                        |
| Contingent commission receivable—LPT Agreement                                                                                                                                                                    | 31,100                         | 29,200                        |
| Other assets                                                                                                                                                                                                      | 31,800                         | 40,900                        |
| <b>Total assets</b>                                                                                                                                                                                               | <b>\$ 3,824,300</b>            | <b>\$ 3,755,800</b>           |
| <b>Liabilities and stockholders' equity</b>                                                                                                                                                                       |                                |                               |
| Claims and policy liabilities:                                                                                                                                                                                    |                                |                               |
| Unpaid losses and loss adjustment expenses                                                                                                                                                                        | \$ 2,330,000                   | \$ 2,347,500                  |
| Unearned premiums                                                                                                                                                                                                 | 325,600                        | 308,900                       |
| <b>Total claims and policy liabilities</b>                                                                                                                                                                        | <b>2,655,600</b>               | <b>2,656,400</b>              |
| Commissions and premium taxes payable                                                                                                                                                                             | 50,500                         | 52,500                        |
| Accounts payable and accrued expenses                                                                                                                                                                             | 17,500                         | 24,100                        |
| Deferred reinsurance gain—LPT Agreement                                                                                                                                                                           | 177,800                        | 189,500                       |
| Notes payable                                                                                                                                                                                                     | 32,000                         | 32,000                        |
| Other liabilities                                                                                                                                                                                                 | 40,800                         | 40,500                        |
| <b>Total liabilities</b>                                                                                                                                                                                          | <b>\$ 2,974,200</b>            | <b>\$ 2,995,000</b>           |
| Commitments and contingencies                                                                                                                                                                                     |                                |                               |
| Stockholders' equity:                                                                                                                                                                                             |                                |                               |
| Common stock, \$0.01 par value; 150,000,000 shares authorized; 56,124,974 and 55,589,454 shares issued and 32,109,976 and 32,216,480 shares outstanding at September 30, 2016 and December 31, 2015, respectively | \$ 600                         | \$ 600                        |
| Preferred stock, \$0.01 par value; 25,000,000 shares authorized; none issued                                                                                                                                      | —                              | —                             |
| Additional paid-in capital                                                                                                                                                                                        | 368,600                        | 357,200                       |
| Retained earnings                                                                                                                                                                                                 | 744,500                        | 682,000                       |
| Accumulated other comprehensive income, net                                                                                                                                                                       | 117,600                        | 83,600                        |
| Treasury stock, at cost (24,014,998 shares at September 30, 2016 and 23,372,974 shares at December 31, 2015)                                                                                                      | (381,200)                      | (362,600)                     |
| <b>Total stockholders' equity</b>                                                                                                                                                                                 | <b>850,100</b>                 | <b>760,800</b>                |
| <b>Total liabilities and stockholders' equity</b>                                                                                                                                                                 | <b>\$ 3,824,300</b>            | <b>\$ 3,755,800</b>           |

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)

|                                                                                                                                                                                                                                                                             | <b>Three Months Ended</b> |                  | <b>Nine Months Ended</b> |                  |
|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|---------------------------|------------------|--------------------------|------------------|
|                                                                                                                                                                                                                                                                             | <b>September 30,</b>      |                  | <b>September 30,</b>     |                  |
|                                                                                                                                                                                                                                                                             | <b>2016</b>               | <b>2015</b>      | <b>2016</b>              | <b>2015</b>      |
| <b>Revenues</b>                                                                                                                                                                                                                                                             | (unaudited)               |                  | (unaudited)              |                  |
| Net premiums earned                                                                                                                                                                                                                                                         | \$ 173,300                | \$ 179,000       | \$ 522,800               | \$ 508,600       |
| Net investment income                                                                                                                                                                                                                                                       | 17,900                    | 18,500           | 54,100                   | 53,800           |
| Net realized gains on investments                                                                                                                                                                                                                                           | 1,600                     | 2,000            | 9,100                    | 5,100            |
| Other income                                                                                                                                                                                                                                                                | —                         | —                | 600                      | 100              |
| <b>Total revenues</b>                                                                                                                                                                                                                                                       | <b>192,800</b>            | <b>199,500</b>   | <b>586,600</b>           | <b>567,600</b>   |
| <b>Expenses</b>                                                                                                                                                                                                                                                             |                           |                  |                          |                  |
| Losses and loss adjustment expenses                                                                                                                                                                                                                                         | 109,000                   | 115,800          | 328,000                  | 323,500          |
| Commission expense                                                                                                                                                                                                                                                          | 21,300                    | 21,000           | 63,500                   | 62,600           |
| Underwriting and other operating expenses                                                                                                                                                                                                                                   | 31,700                    | 31,600           | 101,600                  | 97,600           |
| Interest expense                                                                                                                                                                                                                                                            | 400                       | 700              | 1,200                    | 2,100            |
| <b>Total expenses</b>                                                                                                                                                                                                                                                       | <b>162,400</b>            | <b>169,100</b>   | <b>494,300</b>           | <b>485,800</b>   |
| <b>Net income before income taxes</b>                                                                                                                                                                                                                                       | <b>30,400</b>             | <b>30,400</b>    | <b>92,300</b>            | <b>81,800</b>    |
| Income tax expense                                                                                                                                                                                                                                                          | 7,800                     | 5,900            | 21,100                   | 14,100           |
| <b>Net income</b>                                                                                                                                                                                                                                                           | <b>\$ 22,600</b>          | <b>\$ 24,500</b> | <b>\$ 71,200</b>         | <b>\$ 67,700</b> |
| <b>Comprehensive income</b>                                                                                                                                                                                                                                                 |                           |                  |                          |                  |
| Unrealized (losses) gains during the period (net of tax (benefit) expense of \$(2,300) and \$(5,900) for the three months ended September 30, 2016 and 2015, respectively, and \$21,500 and \$(14,200) for the nine months ended September 30, 2016 and 2015, respectively) | \$ (4,200)                | \$ (11,100)      | \$ 39,900                | \$ (26,500)      |
| Reclassification adjustment for realized gains in net income (net of taxes of \$600 and \$700 for the three months ended September 30, 2016 and 2015, respectively, and \$3,200 and \$1,800 for the nine months ended September 30, 2016 and 2015, respectively)            | (1,000)                   | (1,300)          | (5,900)                  | (3,300)          |
| Other comprehensive (loss) income, net of tax                                                                                                                                                                                                                               | (5,200)                   | (12,400)         | 34,000                   | (29,800)         |
| <b>Total comprehensive income</b>                                                                                                                                                                                                                                           | <b>\$ 17,400</b>          | <b>\$ 12,100</b> | <b>\$ 105,200</b>        | <b>\$ 37,900</b> |
| <b>Net realized gains on investments</b>                                                                                                                                                                                                                                    |                           |                  |                          |                  |
| Net realized gains on investments before credit related impairments                                                                                                                                                                                                         | \$ 1,600                  | \$ 2,100         | \$ 14,400                | \$ 5,300         |
| Other than temporary impairment recognized in earnings                                                                                                                                                                                                                      | —                         | (100)            | (5,300)                  | (200)            |
| <b>Net realized gains on investments</b>                                                                                                                                                                                                                                    | <b>\$ 1,600</b>           | <b>\$ 2,000</b>  | <b>\$ 9,100</b>          | <b>\$ 5,100</b>  |
| <b>Earnings per common share (Note 11):</b>                                                                                                                                                                                                                                 |                           |                  |                          |                  |
| Basic                                                                                                                                                                                                                                                                       | \$ 0.70                   | \$ 0.76          | \$ 2.19                  | \$ 2.12          |
| Diluted                                                                                                                                                                                                                                                                     | \$ 0.69                   | \$ 0.75          | \$ 2.16                  | \$ 2.08          |
| Cash dividends declared per common share                                                                                                                                                                                                                                    | \$ 0.09                   | \$ 0.06          | \$ 0.27                  | \$ 0.18          |

*See accompanying unaudited notes to the consolidated financial statements.*

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

|                                                                                   | <b>Nine Months Ended</b> |             |
|-----------------------------------------------------------------------------------|--------------------------|-------------|
|                                                                                   | <b>September 30,</b>     |             |
|                                                                                   | <b>2016</b>              | <b>2015</b> |
|                                                                                   | (unaudited)              |             |
| <b>Operating activities</b>                                                       |                          |             |
| Net income                                                                        | \$ 71,200                | \$ 67,700   |
| Adjustments to reconcile net income to net cash provided by operating activities: |                          |             |
| Depreciation and amortization                                                     | 6,400                    | 5,900       |
| Stock-based compensation                                                          | 4,300                    | 3,200       |
| Amortization of premium on investments, net                                       | 11,400                   | 9,500       |
| Allowance for doubtful accounts                                                   | (1,500)                  | 3,700       |
| Deferred income tax expense                                                       | 8,500                    | 4,500       |
| Realized gains on investments, net                                                | (9,100)                  | (5,100)     |
| Excess tax benefits from stock-based compensation                                 | —                        | (800)       |
| Other                                                                             | (200)                    | (100)       |
| Change in operating assets and liabilities:                                       |                          |             |
| Premiums receivable                                                               | (14,500)                 | (14,300)    |
| Reinsurance recoverable for paid and unpaid losses                                | 36,100                   | 38,000      |
| Federal income taxes                                                              | 3,000                    | 2,200       |
| Unpaid losses and loss adjustment expenses                                        | (17,500)                 | (11,800)    |
| Unearned premiums                                                                 | 16,700                   | 16,300      |
| Accounts payable, accrued expenses and other liabilities                          | (6,200)                  | 2,400       |
| Deferred reinsurance gain—LPT Agreement                                           | (11,700)                 | (14,600)    |
| Contingent commission receivable—LPT Agreement                                    | (1,900)                  | (2,800)     |
| Other                                                                             | 2,000                    | (9,900)     |
| Net cash provided by operating activities                                         | 97,000                   | 94,000      |
| <b>Investing activities</b>                                                       |                          |             |
| Purchase of fixed maturity securities                                             | (325,200)                | (365,600)   |
| Purchase of equity securities                                                     | (38,800)                 | (77,700)    |
| Purchase of short-term investments                                                | (8,000)                  | (18,500)    |
| Proceeds from sale of fixed maturity securities                                   | 111,700                  | 87,000      |
| Proceeds from sale of equity securities                                           | 70,200                   | 21,400      |
| Proceeds from maturities and redemptions of investments                           | 145,100                  | 214,000     |
| Capital expenditures                                                              | (3,900)                  | (7,400)     |
| Change in restricted cash and cash equivalents                                    | (200)                    | 7,700       |
| Net cash used in investing activities                                             | (49,100)                 | (139,100)   |
| <b>Financing activities</b>                                                       |                          |             |
| Acquisition of treasury stock                                                     | (18,600)                 | —           |
| Cash transactions related to stock-based compensation                             | 7,100                    | 3,100       |
| Dividends paid to stockholders                                                    | (8,800)                  | (5,800)     |
| Payments on notes payable and capital leases                                      | (100)                    | (400)       |
| Excess tax benefits from stock-based compensation                                 | —                        | 800         |
| Net cash used in financing activities                                             | (20,400)                 | (2,300)     |
| Net increase (decrease) in cash and cash equivalents                              | 27,500                   | (47,400)    |
| Cash and cash equivalents at the beginning of the period                          | 56,600                   | 103,600     |
| Cash and cash equivalents at the end of the period                                | \$ 84,100                | \$ 56,200   |

*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, 2015.

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 maker 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 and 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, and investments.

**Reclassifications**

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

**2. Change in Estimates**

The Company reduced its estimated reserves ceded under the Loss Portfolio Transfer Agreement (LPT Reserve Adjustment) as a result of the determination that an adjustment was necessary to reflect observed favorable paid loss trends during the second quarter of 2016. The following table shows the financial statement impact related to the reduction in estimated reserves ceded under the Loss Portfolio Transfer Agreement (LPT Agreement).

|                                                            | <b>Nine Months Ended</b>             |       |
|------------------------------------------------------------|--------------------------------------|-------|
|                                                            | <b>September 30, 2016</b>            |       |
|                                                            | (in millions, except per share data) |       |
| Change in estimated reserves ceded under the LPT Agreement | \$                                   | (5.0) |
| Cumulative adjustment to the Deferred Gain <sup>(1)</sup>  |                                      | (3.1) |
| Net income impact of change in estimate                    |                                      | 3.1   |
| EPS impact of change in estimate                           |                                      |       |
| Basic                                                      |                                      | 0.10  |
| Diluted                                                    |                                      | 0.09  |

(1) The cumulative adjustment to the Deferred reinsurance gain-LPT Agreement (Deferred Gain) was also recognized in losses and LAE incurred 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.

The Company increased its estimate of contingent commission receivable – LPT Agreement (LPT Contingent Commission Adjustment) as a result of the determination that an adjustment was necessary to reflect observed favorable paid loss trends during the second quarter of 2016. The following table shows the financial statement impact related to these changes in estimates.

|                                                                        | <b>Nine Months Ended</b>             |       |
|------------------------------------------------------------------------|--------------------------------------|-------|
|                                                                        | <b>September 30, 2016</b>            |       |
|                                                                        | (in millions, except per share data) |       |
| Change in estimate of contingent commission receivable – LPT Agreement | \$                                   | 1.9   |
| Cumulative adjustment to the Deferred Gain <sup>(1)</sup>              |                                      | (1.8) |
| Net income impact of change in estimate                                |                                      | 1.8   |
| EPS impact of change in estimate                                       |                                      |       |
| Basic                                                                  |                                      | 0.06  |
| Diluted                                                                |                                      | 0.05  |

(1) The cumulative adjustment to the Deferred Gain was also recognized in losses and LAE incurred 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.

### 3. New Accounting Standards

#### *Recently Adopted Accounting Standards*

In March 2016, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) *Number 2016-09, Compensation - Stock Compensation* (Topic 718). This update simplifies several aspects of the accounting for share-based payment award transactions, including income taxes and classification of awards on the balance sheet and on the statement of cash flows. This update becomes effective for annual reporting periods, including interim periods within those annual periods, beginning after December 15, 2016 and early adoption is permitted. The Company elected to early adopt this standard in the quarter ended September 30, 2016 with an effective date of January 1, 2016. Adoption of this standard had the following impacts on the Company's consolidated financial statements:

- *Consolidated Statements of Comprehensive Income* – This standard requires that the tax effects of stock-based compensation be recognized in the income tax expense. Net tax benefits related to stock-based compensation of \$0.1 million and \$1.4 million were recognized as reductions to Income tax expense and increases to Net income in the Consolidated Statements of Comprehensive Income for the three and nine months ended September 30, 2016, respectively. These changes had no impact on the Company's basic and diluted earnings per share for the three months ended September 30, 2016, but increased basic and diluted earnings per share by \$0.04 for the nine months ended September 30, 2016. This standard also requires that assumed proceeds under the treasury stock method be modified to exclude the excess tax benefits that would have been recognized in Additional paid-in capital. These changes were applied on a prospective basis.
- *Consolidated Statements of Cash Flows* – This standard requires that the excess tax benefits from stock-based compensation be reported as cash flows from operating activities rather than the previous requirement to present the excess tax benefits from stock-based compensation as an inflow from financing activities and an outflow from operating activities. This update resulted in a change in presentation that was applied on a prospective basis and prior periods have not been adjusted.

This standard allows the Company to make a policy election as to whether it will include an estimate of stock-based compensation awards expected to be forfeited or whether it will account for forfeitures as they occur. The Company has elected to continue to estimate forfeitures in the computation of its stock-based compensation, consistent with previous guidance, and had no impact on the Company's consolidated financial statements.

Finally, this standard allows the Company to withhold an amount in excess of the supplemental rate from an employee's stock-based compensation for federal tax withholding purposes without triggering liability accounting. It also clarifies that all cash payments made to tax authorities on an employee's behalf should be presented as cash flows from financing activities in the Consolidated Statements of Cash Flows. This update related to tax withholding and presentation of cash flows had no impact on the Company's consolidated financial statements.

#### *Recently Issued Accounting Standards – Not Yet Adopted*

In January 2016, the FASB issued ASU *Number 2016-01, Financial Instruments - Overall* (Subtopic 825-10). This update replaces the guidance to classify equity securities with readily determinable fair values into different categories (trading or available-for-sale) and requires equity securities to be measured at fair value with changes in fair value recognized through net income.

Additionally, this update eliminates the method and significant assumptions used to estimate the fair value of financial instruments measured at amortized cost. It requires financial instruments to be measured at fair value using the exit price notion. Furthermore, this update clarifies that an evaluation of deferred tax assets related to available-for-sale securities is needed, in combination with an evaluation of other deferred tax assets, to determine if a valuation allowance is required. This update becomes effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. This update will result in a reclassification adjustment, net of tax, to retained earnings from accumulated other comprehensive income, which will be determined based on the fair value of securities at the effective date of adoption.

In February 2016, the FASB issued *ASU Number 2016-02, Leases (Topic 842)*. This update provides guidance on a new lessee model that includes the recognition of assets and liabilities arising from lease transactions on the balance sheet. Additionally, the update provides clarity on the definition of a lease and the distinction between finance and operating leases. Furthermore, the update requires certain qualitative and quantitative disclosures pertaining to the amounts recorded in the financial statements. This update becomes effective for annual reporting periods, including interim periods within those annual periods, beginning after December 15, 2018 and early adoption is permitted. The Company has not yet estimated the full impact that the adoption will have on its consolidated financial condition and results of operations.

In June 2016, the FASB issued *ASU Number 2016-13, Financial Instruments - Credit Losses (Topic 326)*. This update replaces the incurred loss impairment methodology for recognizing credit losses on financial instruments with a methodology that reflects an entity's current estimate of all expected credit losses. This update requires financial assets measured at amortized cost to be presented net of an allowance for credit losses. Additionally, this update requires credit losses on available-for-sale debt securities to be presented as an allowance rather than as a write-down, allowing an entity to also record reversals of credit losses in current period net income. This update becomes effective for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. Early adoption is permitted as of fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. The Company has not yet estimated the full impact that the adoption will have on its consolidated financial condition and results of operations.

In August 2016, the FASB issued *ASU Number 2016-15, Statement of Cash Flows (Topic 230)*. This update provides guidance and clarification on eight specific cash flow issues due to diversity in practice of how certain cash receipts and cash payments are presented and classified in the statement of cash flows. The cash flow issues affected are debt prepayment or debt extinguishment costs, settlement of zero-coupon debt instruments or other debt instruments with coupon rates that are insignificant in relation to the effective interest rate of the borrowing, contingent consideration payments made after a business combination, proceeds from the settlement of insurance claims, proceeds from the settlement of corporate-owned life insurance policies, distributions received from equity method investees, beneficial interest in securitization transactions, and separately identifiable cash flows and application of the predominance principle. This update becomes effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. Early adoption is permitted, including adoption in an interim period. The Company has not yet estimated the full impact that the adoption will have on its consolidated financial condition and 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, 2016 |                      | December 31, 2015 |                      |
|--------------------------------------|--------------------|----------------------|-------------------|----------------------|
|                                      | Carrying Value     | Estimated Fair Value | Carrying Value    | Estimated Fair Value |
| (in millions)                        |                    |                      |                   |                      |
| <b>Financial assets</b>              |                    |                      |                   |                      |
| Investments                          | \$ 2,582.4         | \$ 2,582.4           | \$ 2,487.2        | \$ 2,487.2           |
| Cash and cash equivalents            | 84.1               | 84.1                 | 56.6              | 56.6                 |
| Restricted cash and cash equivalents | 2.7                | 2.7                  | 2.5               | 2.5                  |
| <b>Financial liabilities</b>         |                    |                      |                   |                      |
| Notes payable                        | \$ 32.0            | \$ 35.0              | \$ 32.0           | \$ 36.6              |

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 willing market participants would use in pricing the assets or liabilities at the measurement date.

Fair values of available-for-sale fixed maturity and equity securities are based on quoted market prices, where available. 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.

The Company's estimates of fair value for financial liabilities are based on the interest rates for notes with similar durations to discount the projection of future payments on notes payable. The fair value measurements for notes payable have been determined to be Level 2.

The following table presents the items on the accompanying Consolidated Balance Sheets that are stated at fair value and the corresponding fair value measurements.

|                                        | September 30, 2016 |                   |               | December 31, 2015 |                   |             |
|----------------------------------------|--------------------|-------------------|---------------|-------------------|-------------------|-------------|
|                                        | Level 1            | Level 2           | Level 3       | Level 1           | Level 2           | Level 3     |
|                                        | (in millions)      |                   |               |                   |                   |             |
| <b>Fixed maturity securities</b>       |                    |                   |               |                   |                   |             |
| U.S. Treasuries                        | \$ —               | \$ 127.9          | \$ —          | \$ —              | \$ 120.2          | \$ —        |
| U.S. Agencies                          | —                  | 13.0              | —             | —                 | 24.4              | —           |
| States and municipalities              | —                  | 897.2             | —             | —                 | 854.5             | —           |
| Corporate securities                   | —                  | 996.5             | —             | —                 | 925.3             | —           |
| Residential mortgage-backed securities | —                  | 235.0             | —             | —                 | 237.9             | —           |
| Commercial mortgage-backed securities  | —                  | 86.5              | —             | —                 | 80.3              | —           |
| Asset-backed securities                | —                  | 27.8              | —             | —                 | 45.9              | —           |
| <b>Total fixed maturity securities</b> | <b>\$ —</b>        | <b>\$ 2,383.9</b> | <b>\$ —</b>   | <b>\$ —</b>       | <b>\$ 2,288.5</b> | <b>\$ —</b> |
| <b>Equity securities</b>               |                    |                   |               |                   |                   |             |
| Corporate equity securities            | \$ 179.6           | \$ —              | \$ —          | \$ 198.7          | \$ —              | \$ —        |
| Federal Home Loan Bank stock           | —                  | —                 | 4.9           | —                 | —                 | —           |
| <b>Total equity securities</b>         | <b>\$ 179.6</b>    | <b>\$ —</b>       | <b>\$ 4.9</b> | <b>\$ 198.7</b>   | <b>\$ —</b>       | <b>\$ —</b> |
| <b>Short-term investments</b>          | <b>\$ —</b>        | <b>\$ 14.0</b>    | <b>\$ —</b>   | <b>\$ —</b>       | <b>\$ —</b>       | <b>\$ —</b> |

The following table provides a reconciliation of the beginning and ending balances that are measured using Level 3 inputs for the nine months ended September 30, 2016.

|                                           | <b>Equity Securities</b> |
|-------------------------------------------|--------------------------|
|                                           | (in millions)            |
| <b>Beginning balance, January 1, 2016</b> | \$ —                     |
| Purchases                                 | 4.9                      |
| <b>Ending balance, September 30, 2016</b> | <b>\$ 4.9</b>            |

Each of the Company's insurance operating subsidiaries is a member of the Federal Home Loan Bank (FHLB) of San Francisco. Members are required to purchase stock in the FHLB in addition to maintaining collateral deposits that back any funds advanced. Investment in FHLB stock is recorded at cost, as purchases and sales of these securities are at par value with the issuer. The stock is considered a restricted security and is periodically evaluated for impairment based on the ultimate recovery of par value. Due to the nature of FHLB stock, its carrying value approximates fair value.

## 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<br>Amortized<br>Cost | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Estimated<br>Fair Value |
|----------------------------------------|------------------------------|------------------------------|-------------------------------|-------------------------|
| (in millions)                          |                              |                              |                               |                         |
| <b>At September 30, 2016</b>           |                              |                              |                               |                         |
| <b>Fixed maturity securities</b>       |                              |                              |                               |                         |
| U.S. Treasuries                        | \$ 122.9                     | \$ 5.0                       | \$ —                          | \$ 127.9                |
| U.S. Agencies                          | 11.9                         | 1.1                          | —                             | 13.0                    |
| States and municipalities              | 842.9                        | 54.6                         | (0.3)                         | 897.2                   |
| Corporate securities                   | 957.9                        | 39.4                         | (0.8)                         | 996.5                   |
| Residential mortgage-backed securities | 225.3                        | 9.7                          | —                             | 235.0                   |
| Commercial mortgage-backed securities  | 84.5                         | 2.0                          | —                             | 86.5                    |
| Asset-backed securities                | 27.7                         | 0.1                          | —                             | 27.8                    |
| <b>Total fixed maturity securities</b> | <b>2,273.1</b>               | <b>111.9</b>                 | <b>(1.1)</b>                  | <b>2,383.9</b>          |
| <b>Equity securities</b>               |                              |                              |                               |                         |
| Corporate equity securities            | 109.5                        | 71.4                         | (1.3)                         | 179.6                   |
| Federal Home Loan Bank stock           | 4.9                          | —                            | —                             | 4.9                     |
| <b>Total equity securities</b>         | <b>114.4</b>                 | <b>71.4</b>                  | <b>(1.3)</b>                  | <b>184.5</b>            |
| <b>Short-term investments</b>          | <b>14.0</b>                  | <b>—</b>                     | <b>—</b>                      | <b>14.0</b>             |
| <b>Total investments</b>               | <b>\$ 2,401.5</b>            | <b>\$ 183.3</b>              | <b>\$ (2.4)</b>               | <b>\$ 2,582.4</b>       |
| <b>At December 31, 2015</b>            |                              |                              |                               |                         |
| <b>Fixed maturity securities</b>       |                              |                              |                               |                         |
| U.S. Treasuries                        | \$ 116.4                     | \$ 3.9                       | \$ (0.1)                      | \$ 120.2                |
| U.S. Agencies                          | 23.0                         | 1.4                          | —                             | 24.4                    |
| States and municipalities              | 809.4                        | 45.1                         | —                             | 854.5                   |
| Corporate securities                   | 913.4                        | 19.9                         | (8.0)                         | 925.3                   |
| Residential mortgage-backed securities | 231.8                        | 7.1                          | (1.0)                         | 237.9                   |
| Commercial mortgage-backed securities  | 81.1                         | 0.2                          | (1.0)                         | 80.3                    |
| Asset-backed securities                | 46.0                         | —                            | (0.1)                         | 45.9                    |
| <b>Total fixed maturity securities</b> | <b>2,221.1</b>               | <b>77.6</b>                  | <b>(10.2)</b>                 | <b>2,288.5</b>          |
| <b>Equity securities</b>               |                              |                              |                               |                         |
| Corporate equity securities            | 137.5                        | 65.8                         | (4.6)                         | 198.7                   |
| <b>Total equity securities</b>         | <b>137.5</b>                 | <b>65.8</b>                  | <b>(4.6)</b>                  | <b>198.7</b>            |
| <b>Total investments</b>               | <b>\$ 2,358.6</b>            | <b>\$ 143.4</b>              | <b>\$ (14.8)</b>              | <b>\$ 2,487.2</b>       |

The amortized cost and estimated fair value of fixed maturity securities at September 30, 2016, 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 millions)                          |                   |                      |
| Due in one year or less                | \$ 149.6          | \$ 151.2             |
| Due after one year through five years  | 920.1             | 958.6                |
| Due after five years through ten years | 600.6             | 641.2                |
| Due after ten years                    | 265.3             | 283.6                |
| Mortgage and asset-backed securities   | 337.5             | 349.3                |
| <b>Total</b>                           | <b>\$ 2,273.1</b> | <b>\$ 2,383.9</b>    |

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, 2016 and December 31, 2015.

|                                             | September 30, 2016   |                         |                  | December 31, 2015    |                         |                  |
|---------------------------------------------|----------------------|-------------------------|------------------|----------------------|-------------------------|------------------|
|                                             | Estimated Fair Value | Gross Unrealized Losses | Number of Issues | Estimated Fair Value | Gross Unrealized Losses | Number of Issues |
| (in millions, except number of issues data) |                      |                         |                  |                      |                         |                  |
| <b>Less than 12 months:</b>                 |                      |                         |                  |                      |                         |                  |
| Fixed maturity securities                   |                      |                         |                  |                      |                         |                  |
| U.S. Treasuries                             | \$ —                 | \$ —                    | —                | \$ 27.4              | \$ (0.1)                | 20               |
| States and municipalities                   | 44.3                 | (0.3)                   | 12               | —                    | —                       | —                |
| Corporate securities                        | —                    | —                       | —                | 328.4                | (4.7)                   | 122              |
| Residential mortgage-backed securities      | —                    | —                       | —                | 50.5                 | (0.8)                   | 24               |
| Commercial mortgage-backed securities       | —                    | —                       | —                | 51.5                 | (1.0)                   | 22               |
| Asset-backed securities                     | —                    | —                       | —                | 34.1                 | —                       | 27               |
| <b>Total fixed maturity securities</b>      | <b>44.3</b>          | <b>(0.3)</b>            | <b>12</b>        | <b>491.9</b>         | <b>(6.6)</b>            | <b>215</b>       |
| Equity securities                           | 13.5                 | (1.1)                   | 30               | 35.8                 | (4.6)                   | 45               |
| <b>Total less than 12 months</b>            | <b>\$ 57.8</b>       | <b>\$ (1.4)</b>         | <b>42</b>        | <b>\$ 527.7</b>      | <b>\$ (11.2)</b>        | <b>260</b>       |
| <b>12 months or greater:</b>                |                      |                         |                  |                      |                         |                  |
| Fixed maturity securities                   |                      |                         |                  |                      |                         |                  |
| Corporate securities                        | \$ 24.4              | \$ (0.8)                | 10               | \$ 34.6              | \$ (3.3)                | 15               |
| Residential mortgage-backed securities      | —                    | —                       | —                | 7.1                  | (0.2)                   | 25               |
| Asset-backed securities                     | —                    | —                       | —                | 11.1                 | (0.1)                   | 4                |
| <b>Total fixed maturity securities</b>      | <b>24.4</b>          | <b>(0.8)</b>            | <b>10</b>        | <b>52.8</b>          | <b>(3.6)</b>            | <b>44</b>        |
| Equity securities                           | 2.2                  | (0.2)                   | 7                | —                    | —                       | —                |
| <b>Total 12 months or greater</b>           | <b>\$ 26.6</b>       | <b>\$ (1.0)</b>         | <b>17</b>        | <b>\$ 52.8</b>       | <b>\$ (3.6)</b>         | <b>44</b>        |
| <b>Total available-for-sale:</b>            |                      |                         |                  |                      |                         |                  |
| Fixed maturity securities                   |                      |                         |                  |                      |                         |                  |
| U.S. Treasuries                             | \$ —                 | \$ —                    | —                | \$ 27.4              | \$ (0.1)                | 20               |
| States and municipalities                   | 44.3                 | (0.3)                   | 12               | —                    | —                       | —                |
| Corporate securities                        | 24.4                 | (0.8)                   | 10               | 363.0                | (8.0)                   | 137              |
| Residential mortgage-backed securities      | —                    | —                       | —                | 57.6                 | (1.0)                   | 49               |
| Commercial mortgage-backed securities       | —                    | —                       | —                | 51.5                 | (1.0)                   | 22               |
| Asset-backed securities                     | —                    | —                       | —                | 45.2                 | (0.1)                   | 31               |
| <b>Total fixed maturity securities</b>      | <b>68.7</b>          | <b>(1.1)</b>            | <b>22</b>        | <b>544.7</b>         | <b>(10.2)</b>           | <b>259</b>       |
| Equity securities                           | 15.7                 | (1.3)                   | 37               | 35.8                 | (4.6)                   | 45               |
| <b>Total available-for-sale</b>             | <b>\$ 84.4</b>       | <b>\$ (2.4)</b>         | <b>59</b>        | <b>\$ 580.5</b>      | <b>\$ (14.8)</b>        | <b>304</b>       |

Based on reviews of the fixed maturity securities, the Company determined that unrealized losses for the nine months ended September 30, 2016 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 amortized cost, or principal value upon maturity.

Based on reviews of the equity securities, the Company recognized a total impairment of \$5.3 million in the fair value of 32 equity securities for the nine months ended September 30, 2016, as a result of the Company's intent to sell and/or the severity and duration of the change in fair value of the securities. The remaining unrealized losses on equity securities were not considered to be other-than-temporary due to the financial condition and near-term prospects of the issuers. The other-than-temporary impairment of

equity securities was primarily due to the Company's intent to sell certain securities and the downturn in the energy sector that continued through the first quarter of 2016.

Net realized gains on investments 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<br>September 30, |           | Nine Months Ended<br>September 30, |           |
|-------------------------------------------------|-------------------------------------|-----------|------------------------------------|-----------|
|                                                 | 2016                                | 2015      | 2016                               | 2015      |
|                                                 | (in millions)                       |           |                                    |           |
| <b>Net realized gains on investments</b>        |                                     |           |                                    |           |
| <b>Fixed maturity securities</b>                |                                     |           |                                    |           |
| Gross gains                                     | \$ —                                | \$ 0.2    | \$ 1.3                             | \$ 0.5    |
| Gross losses                                    | —                                   | (0.2)     | (0.5)                              | (0.4)     |
| Net realized gains on fixed maturity securities | \$ —                                | \$ —      | \$ 0.8                             | \$ 0.1    |
| <b>Equity securities</b>                        |                                     |           |                                    |           |
| Gross gains                                     | \$ 1.6                              | \$ 2.2    | \$ 14.3                            | \$ 5.6    |
| Gross losses                                    | —                                   | (0.2)     | (6.0)                              | (0.6)     |
| Net realized gains on equity securities         | \$ 1.6                              | \$ 2.0    | \$ 8.3                             | \$ 5.0    |
| Total                                           | \$ 1.6                              | \$ 2.0    | \$ 9.1                             | \$ 5.1    |
| <b>Change in unrealized gains (losses)</b>      |                                     |           |                                    |           |
| Fixed maturity securities                       | \$ (10.2)                           | \$ 8.0    | \$ 43.4                            | \$ (11.0) |
| Equity securities                               | 2.1                                 | (27.0)    | 8.9                                | (34.8)    |
| Total                                           | \$ (8.1)                            | \$ (19.0) | \$ 52.3                            | \$ (45.8) |

Net investment income was as follows:

|                                      | Three Months Ended<br>September 30, |         | Nine Months Ended<br>September 30, |         |
|--------------------------------------|-------------------------------------|---------|------------------------------------|---------|
|                                      | 2016                                | 2015    | 2016                               | 2015    |
|                                      | (in millions)                       |         |                                    |         |
| Fixed maturity securities            | \$ 16.9                             | \$ 17.3 | \$ 50.8                            | \$ 51.6 |
| Equity securities                    | 1.7                                 | 1.7     | 5.4                                | 4.0     |
| Cash equivalents and restricted cash | 0.1                                 | 0.1     | 0.2                                | 0.1     |
| Gross investment income              | 18.7                                | 19.1    | 56.4                               | 55.7    |
| Investment expenses                  | (0.8)                               | (0.6)   | (2.3)                              | (1.9)   |
| Net investment income                | \$ 17.9                             | \$ 18.5 | \$ 54.1                            | \$ 53.8 |

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. Securities having a fair value of \$1.0 billion and \$881.2 million were on deposit as of September 30, 2016 and December 31, 2015, respectively. These laws and regulations govern not only the amount, but also the types of securities that are eligible for deposit.

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 and restricted cash and cash equivalents held in trust for the benefit of ceding reinsurers was \$27.7 million and \$32.7 million at September 30, 2016 and December 31, 2015, 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<br>September 30, |        |
|------------------------------------------------------|------------------------------------|--------|
|                                                      | 2016                               | 2015   |
| Statutory tax rate                                   | 35.0 %                             | 35.0 % |
| Dividends received deduction and tax-exempt interest | (7.1)                              | (7.6)  |
| LPT deferred gain amortization                       | (3.3)                              | (4.3)  |
| LPT reserve adjustment                               | (1.5)                              | (2.0)  |
| Pre-privatization reserve adjustment, excluding LPT  | —                                  | (4.6)  |
| Stock based compensation                             | (1.1)                              | —      |
| Other                                                | 0.9                                | 0.7    |
| Effective tax rate                                   | 22.9 %                             | 17.2 % |

## 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<br>September 30, |            |
|--------------------------------------------------------------------------------------|------------------------------------|------------|
|                                                                                      | 2016                               | 2015       |
|                                                                                      | (in millions)                      |            |
| Unpaid losses and LAE, gross of reinsurance, at beginning of period                  | \$ 2,347.5                         | \$ 2,369.7 |
| Less reinsurance recoverable, excluding bad debt allowance, on unpaid losses and LAE | 628.2                              | 669.5      |
| Net unpaid losses and LAE at beginning of period                                     | 1,719.3                            | 1,700.2    |
| Losses and LAE, net of reinsurance, incurred during the period related to:           |                                    |            |
| Current period                                                                       | 343.1                              | 339.7      |
| Prior periods                                                                        | (1.5)                              | 1.3        |
| Total net losses and LAE incurred during the period                                  | 341.6                              | 341.0      |
| Paid losses and LAE, net of reinsurance, related to:                                 |                                    |            |
| Current period                                                                       | 42.8                               | 43.9       |
| Prior periods                                                                        | 279.6                              | 274.2      |
| Total net paid losses and LAE during the period                                      | 322.4                              | 318.1      |
| Ending unpaid losses and LAE, net of reinsurance                                     | 1,738.5                            | 1,723.1    |
| Reinsurance recoverable, excluding bad debt allowance, on unpaid losses and LAE      | 591.5                              | 634.8      |
| Unpaid losses and LAE, gross of reinsurance, at end of period                        | \$ 2,330.0                         | \$ 2,357.9 |

Total net losses and LAE included in the above table excludes the impact of the aggregate of amortization of the deferred reinsurance gain—LPT Agreement, LPT Reserve Adjustments, and LPT Contingent Commission Adjustments, which totaled \$13.6 million and \$17.5 million for the nine months ended September 30, 2016 and 2015, respectively (Note 8).

The changes in the estimates of incurred losses and LAE attributable to insured events for prior periods were 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 in 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 date through

which the Company is entitled to receive a contingent profit commission under the LPT Agreement. 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 \$8.7 million and \$8.5 million of the Deferred Gain for the nine months ended September 30, 2016 and 2015, respectively. Additionally, the Deferred Gain was reduced by \$3.1 million and \$6.4 million for the nine months ended September 30, 2016 and 2015, respectively, due to favorable LPT Reserve Adjustments and by \$1.8 million and \$2.6 million for the nine months ended September 30, 2016 and 2015, respectively, due to favorable LPT Contingent Commission Adjustments. The remaining Deferred Gain was \$177.8 million and \$189.5 million as of September 30, 2016 and December 31, 2015, respectively. The estimated remaining liabilities subject to the LPT Agreement were \$472.3 million and \$498.0 million as of September 30, 2016 and December 31, 2015, respectively. Losses and LAE paid with respect to the LPT Agreement totaled \$715.9 million and \$695.2 million from inception through September 30, 2016 and December 31, 2015, 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, 2016 |        | December 31, 2015 |        |
|---------------------------------------------------|--------------------|--------|-------------------|--------|
|                                                   | (in millions)      |        |                   |        |
| Net unrealized gain on investments, before taxes  | \$                 | 180.9  | \$                | 128.6  |
| Deferred tax expense on net unrealized gains      |                    | (63.3) |                   | (45.0) |
| Total accumulated other comprehensive income, net | \$                 | 117.6  | \$                | 83.6   |

### 10. Stock-Based Compensation

The Company awarded stock options, restricted stock units (RSUs) and performance share units (PSUs) to certain officers 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)                         |
| <b>March 2016</b>            |                |                                              |                                 |                                       |
| Stock options <sup>(1)</sup> | 67,431         | \$ 8.38                                      | \$ 27.72                        | \$ 0.6                                |
| RSUs <sup>(1)</sup>          | 80,816         | 27.72                                        | —                               | 2.2                                   |
| PSUs <sup>(2)</sup>          | 97,236         | 27.72                                        | —                               | 2.7                                   |
| <b>May 2016</b>              |                |                                              |                                 |                                       |
| RSUs <sup>(1)</sup>          | 17,892         | 30.18                                        | —                               | 0.5                                   |

(1) The stock options and RSUs awarded in March 2016 were awarded to certain officers of the Company and vest 25% on March 15, 2017, and each of the subsequent three anniversaries of that date. The stock options and RSUs are subject to accelerated vesting in certain circumstances, including but not limited to: death, disability, retirement, 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 2016 were awarded to non-employee Directors of the Company and have a service vesting period of one year from the date of grant.

(2) The PSUs awarded in March 2016 were awarded to certain officers of the Company and have a performance period of two years followed by an additional one year vesting period. The PSU awards are subject to certain performance goals with payouts that range from 0% to 200% of the target awards. The value shown in the table represents the aggregate number of PSUs awarded at the target level.

A total of 484,829 and 463,466 stock options were exercised during the nine months ended September 30, 2016 and the year ended December 31, 2015, respectively.

## 11. Earnings Per Share

Basic earnings per share excludes 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 RSUs and PSUs had vested and options were to be exercised. The following table presents the net income and the weighted average number of shares outstanding used in the earnings per common share calculations.

|                                                        | <b>Three Months Ended</b>        |             | <b>Nine Months Ended</b> |             |
|--------------------------------------------------------|----------------------------------|-------------|--------------------------|-------------|
|                                                        | <b>September 30,</b>             |             | <b>September 30,</b>     |             |
|                                                        | <b>2016</b>                      | <b>2015</b> | <b>2016</b>              | <b>2015</b> |
|                                                        | (in millions, except share data) |             |                          |             |
| Net income available to stockholders—basic and diluted | \$ 22.6                          | \$ 24.5     | \$ 71.2                  | \$ 67.7     |
| Weighted average number of shares outstanding—basic    | 32,449,617                       | 32,184,143  | 32,497,478               | 32,000,142  |
| Effect of dilutive securities:                         |                                  |             |                          |             |
| PSUs                                                   | 238,633                          | 72,612      | 196,898                  | 161,335     |
| Stock options                                          | 192,827                          | 245,708     | 251,068                  | 289,348     |
| RSUs                                                   | 67,885                           | 21,877      | 70,429                   | 47,268      |
| Dilutive potential shares                              | 499,345                          | 340,197     | 518,395                  | 497,951     |
| Weighted average number of shares outstanding—diluted  | 32,948,962                       | 32,524,340  | 33,015,873               | 32,498,093  |

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, PSUs, and RSUs that were excluded from diluted earnings per share.

|                                                                                                                                                                    | <b>Three Months Ended</b> |             | <b>Nine Months Ended</b> |             |
|--------------------------------------------------------------------------------------------------------------------------------------------------------------------|---------------------------|-------------|--------------------------|-------------|
|                                                                                                                                                                    | <b>September 30,</b>      |             | <b>September 30,</b>     |             |
|                                                                                                                                                                    | <b>2016</b>               | <b>2015</b> | <b>2016</b>              | <b>2015</b> |
| Options excluded as the exercise price was greater than the average market price                                                                                   | —                         | 80,800      | —                        | 26,933      |
| Options, PSUs and RSUs excluded under the treasury method as the potential proceeds on settlement or exercise price were greater than the value of shares acquired | 67,431                    | 336,006     | 98,021                   | 316,273     |

## 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, 2015 (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, strategic initiatives, 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-looking nature 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 34 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 strategy is to pursue profitable growth opportunities across market cycles and maximize total investment returns within the constraints of prudent portfolio management. We pursue profitable growth opportunities by focusing on disciplined underwriting and claims management, utilizing medical provider networks designed to produce superior medical and indemnity outcomes, establishing and maintaining strong, long-term relationships with independent insurance agencies, and developing important alternative distribution channels. We continue to execute a number of strategic initiatives, including: focusing on internal and customer facing business process excellence; emphasizing the settlement of open claims; diversifying our risk exposure across our geographic markets; utilizing a three-company pricing platform; utilizing territorial multipliers in California; and targeting profitable classes of business across all of our markets.

## Results of Operations

A primary measure of our performance is our ability to increase our Adjusted stockholders' equity over the long term. The following table shows a reconciliation of our stockholders' equity on a GAAP basis to our Adjusted stockholders' equity and the number of common shares outstanding.

|                                                   | <b>September 30, 2016</b>        | <b>December 31, 2015</b> |
|---------------------------------------------------|----------------------------------|--------------------------|
|                                                   | (in millions, except share data) |                          |
| GAAP stockholders' equity                         | \$ 850.1                         | \$ 760.8                 |
| Deferred reinsurance gain–LPT Agreement           | 177.8                            | 189.5                    |
| Less: Accumulated other comprehensive income, net | 117.6                            | 83.6                     |
| Adjusted stockholders' equity <sup>(1)</sup>      | <u>\$ 910.3</u>                  | <u>\$ 866.7</u>          |
| Common shares outstanding                         | 32,109,976                       | 32,216,480               |

(1) Adjusted stockholders' equity is a non-GAAP measure that is defined as total stockholders' equity plus the Deferred reinsurance gain–LPT Agreement (Deferred Gain), less Accumulated other comprehensive income, net. We believe that Adjusted stockholders' equity is an important supplemental measure of our capital position.

Overall, net income was \$22.6 million and \$71.2 million for the three and nine months ended September 30, 2016, respectively, compared to \$24.5 million and \$67.7 million for the corresponding periods of 2015. We recognized underwriting income before tax of \$11.3 million and \$29.7 million for the three and nine months ended September 30, 2016, respectively, compared to \$10.6 million and \$24.9 million for the corresponding periods of 2015. Underwriting income or loss is determined by deducting losses and LAE, commission expense, and underwriting and other operating expenses from net premiums earned.

Our results of operations during the nine months ended September 30, 2016 were impacted by: (1) favorable development in the estimated reserves ceded under the LPT Agreement that resulted in a \$3.1 million cumulative adjustment to the Deferred Gain and reduced our losses and LAE by the same amount during the second quarter of 2016 (LPT Reserve Adjustment) and (2) an increase in the contingent commission receivable under the LPT Agreement that resulted in a \$1.8 million cumulative adjustment, which reduced our losses and LAE by the same amount (LPT Contingent Commission Adjustment) during the second quarter of 2016. Collectively, these items increased net income by \$4.9 million during the second quarter of 2016.

Our results of operations during the nine months ended September 30, 2015 were impacted by: (1) favorable development in the estimated reserves ceded under the LPT Agreement that resulted in a \$6.4 million LPT Reserve Adjustment during the nine months ended September 30, 2015; (2) an increase in the contingent commission receivable under the LPT Agreement that resulted in a \$2.6 million LPT Contingent Commission Adjustment during the nine months ended September 30, 2015; and (3) a reallocation of \$19.4 million of reserves from non-taxable periods prior to January 1, 2000 during the second quarter of 2015, which reduced our tax expenses by \$3.8 million and reduced our effective tax rate by 4.6 percentage points for the nine months ended September 30, 2015. Collectively, these items increased net income by \$12.8 million for the nine months ended September 30, 2015.

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

|                                                                         | <b>Three Months Ended</b> |             | <b>Nine Months Ended</b> |             |
|-------------------------------------------------------------------------|---------------------------|-------------|--------------------------|-------------|
|                                                                         | <b>September 30,</b>      |             | <b>September 30,</b>     |             |
|                                                                         | <b>2016</b>               | <b>2015</b> | <b>2016</b>              | <b>2015</b> |
|                                                                         | (in millions)             |             |                          |             |
| Gross premiums written                                                  | \$ 164.4                  | \$ 168.5    | \$ 545.7                 | \$ 533.1    |
| Net premiums written                                                    | \$ 163.0                  | \$ 166.5    | \$ 540.4                 | \$ 526.7    |
| Net premiums earned                                                     | \$ 173.3                  | \$ 179.0    | \$ 522.8                 | \$ 508.6    |
| Net investment income                                                   | 17.9                      | 18.5        | 54.1                     | 53.8        |
| Net realized gains on investments                                       | 1.6                       | 2.0         | 9.1                      | 5.1         |
| Other income                                                            | —                         | —           | 0.6                      | 0.1         |
| Total revenues                                                          | 192.8                     | 199.5       | 586.6                    | 567.6       |
| Losses and LAE                                                          | 109.0                     | 115.8       | 328.0                    | 323.5       |
| Commission expense                                                      | 21.3                      | 21.0        | 63.5                     | 62.6        |
| Underwriting and other operating expenses                               | 31.7                      | 31.6        | 101.6                    | 97.6        |
| Interest expense                                                        | 0.4                       | 0.7         | 1.2                      | 2.1         |
| Income tax expense                                                      | 7.8                       | 5.9         | 21.1                     | 14.1        |
| Total expenses                                                          | 170.2                     | 175.0       | 515.4                    | 499.9       |
| Net income                                                              | \$ 22.6                   | \$ 24.5     | \$ 71.2                  | \$ 67.7     |
| Less amortization of the Deferred Gain related to losses                | \$ 2.5                    | \$ 2.3      | \$ 7.2                   | \$ 7.1      |
| Less amortization of the Deferred Gain related to contingent commission | 0.5                       | 0.4         | 1.5                      | 1.4         |
| Less impact of LPT Reserve Adjustments <sup>(1)</sup>                   | —                         | —           | 3.1                      | 6.4         |
| Less impact of LPT Contingent Commission Adjustments <sup>(1)</sup>     | —                         | —           | 1.8                      | 2.6         |
| Net income before impact of the LPT Agreement <sup>(2)</sup>            | \$ 19.6                   | \$ 21.8     | \$ 57.6                  | \$ 50.2     |

(1) Any adjustment to the contingent profit commission under the LPT Agreement results in a cumulative adjustment to the Deferred Gain, which is recognized in losses and LAE incurred in the Consolidated Statements of Comprehensive Income, such that the Deferred Gain reflects the balance that would have existed had the revised contingent profit commission been recognized at the inception of the LPT Agreement (LPT Contingent Commission Adjustments).

(2) We define net income before impact of the LPT Agreement as net income before the impact of: (a) amortization of Deferred Gain; (b) adjustments to LPT Agreement ceded reserves; and (c) adjustments to contingent commission receivable–LPT Agreement. Deferred Gain reflects the unamortized gain from our LPT Agreement. Under GAAP, this gain is deferred and 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 reflected in losses and LAE. We periodically reevaluate the remaining direct reserves subject to the LPT Agreement and the expected losses and LAE subject to the contingent profit commission under the LPT Agreement. Our reevaluation results in corresponding adjustments, if needed, to reserves, ceded reserves, contingent commission receivable, and the Deferred Gain, with the net effect being an increase or decrease to net income. Net income before impact of the LPT Agreement is not a measurement of financial performance under GAAP, but rather reflects a difference in accounting treatment between statutory and GAAP, and should not be considered in isolation or as an alternative to net income before income taxes or net income, or any other measure of performance derived in accordance with GAAP.

We present net income before impact of the LPT Agreement because we believe that it is an important supplemental measure of operating performance to be used by analysts, investors, and other interested parties in evaluating us. The LPT Agreement was a non-recurring transaction under which the Deferred Gain does not effect our ongoing operations, and, consequently, we believe this presentation is useful in providing a meaningful understanding of our operating performance. In addition, we believe this non-GAAP measure, as we have defined it, is helpful to our management in identifying trends in our performance because the LPT Agreement has limited significance on our current and ongoing operations.

### **Gross Premiums Written**

Gross premiums written is the sum of both direct premiums written and assumed premiums written before the effect of ceded reinsurance. Gross premiums written decreased 2.4% for the three months ended September 30, 2016 and increased 2.4% for the nine months ended September 30, 2016, compared to the same periods of 2015. The year-over-year decrease in gross premiums written for the quarter was primarily due to a \$5.0 million decrease in our final audit premiums in the third quarter of 2016, compared to the third quarter of 2015. The year-over-year increase in gross premiums written for the nine months ended September 30, 2016 was primarily due to final audit premiums that were \$18.9 million higher, partially offset by declines in

premium due to lower levels of renewal premiums, year-over-year. The declines in renewal premiums year-over-year were due to declines in the LA Area of California, partially offset by increases in states outside California, as well as territories outside of southern California. While overall renewal premiums were down slightly year-over-year, primarily driven by lower net rates, our policy unit retention rate increased for the three and nine months ended September 30, 2016, compared to the same periods of 2015. Premiums from new business written increased for the three and nine months ended September 30, 2016, compared to the same periods of 2015.

### Net Premiums Earned

Net premiums earned are those portions of the premiums that apply to the expired portions of the policies in force. Net premiums earned are recognized as revenue. Net premiums earned decreased 3.2% for the three months ended September 30, 2016 and increased 2.8% for the nine months ended September 30, 2016, compared to the same periods of 2015. The year-over-year decrease in net premiums earned was primarily the result of \$5.0 million decrease in our final audit premiums for the three months ended September 30, 2016, while the year-over-year increase for the nine months ended September 30, 2016 was primarily due to final audit premiums that were \$18.9 million higher, partially offset by declines in premium due to lower levels of renewal premiums. The declines in renewal premiums year-over-year were due to declines in the LA Area of California, partially offset by increases in states outside California, as well as territories outside of southern California. Fifty-six percent of our in-force premiums were generated in California and no other state represented a significant concentration of business as of September 30, 2016.

The following table shows the percentage change in our in-force premiums, policy count, average policy size, payroll exposure upon which our premiums are based, and net rate overall and for California:

|                              | As of September 30, 2016         |            |                  |                                    |            |                  |
|------------------------------|----------------------------------|------------|------------------|------------------------------------|------------|------------------|
|                              | Year-to-Date (Decrease) Increase |            |                  | Year-Over-Year (Decrease) Increase |            |                  |
|                              | Overall                          | California | All Other States | Overall                            | California | All Other States |
| In-force premiums            | (0.3)%                           | (1.3)%     | 1.1 %            | (0.5)%                             | (2.5)%     | 2.3 %            |
| In-force policy count        | 0.6                              | (3.5)      | 5.0              | —                                  | (5.5)      | 6.2              |
| Average in-force policy size | (0.9)                            | 2.3        | (3.8)            | (0.5)                              | 3.1        | (3.7)            |
| In-force payroll exposure    | 1.2                              | 1.2        | 1.2              | 1.7                                | 0.8        | 2.2              |
| Net rate <sup>(1)</sup>      | (1.4)                            | (2.4)      | (0.2)            | (2.1)                              | (3.3)      | —                |

(1) Net rate, defined as total in-force premiums divided by total insured payroll exposure, is a function of a variety of factors, including rate changes, underwriting risk profiles and pricing, and changes in business mix related to economic and competitive pressures.

Our in-force premiums and policy count in the LA Area of California declined 13.2% and 13.9%, respectively, year-over-year as of September 30, 2016, while our in-force premiums and policy count in California outside of the LA Area increased 10.3% and 4.1%, respectively, during the same period. The declines in total in-force premiums were driven by lower net rate.

Our net rate (total in-force premiums divided by total insured payroll exposure) in California decreased 3.3% year-over-year as of September 30, 2016. Net rate is a function of a variety of factors, including rate changes, underwriting risk profiles and pricing, and changes in business mix related to economic and competitive pressures.

Our in-force premiums and number of policies in-force for California and all other states combined were as follows:

| State                 | September 30, 2016 |                   | December 31, 2015 |                   | September 30, 2015 |                   | December 31, 2014 |                   |
|-----------------------|--------------------|-------------------|-------------------|-------------------|--------------------|-------------------|-------------------|-------------------|
|                       | In-force Premiums  | Policies In-force | In-force Premiums | Policies In-force | In-force Premiums  | Policies In-force | In-force Premiums | Policies In-force |
| (dollars in millions) |                    |                   |                   |                   |                    |                   |                   |                   |
| California            | \$ 347.8           | 42,550            | \$ 352.2          | 44,080            | \$ 356.8           | 45,021            | \$ 370.8          | 47,093            |
| Other                 | 270.1              | 42,450            | 267.3             | 40,416            | 264.1              | 39,981            | 257.1             | 38,209            |
| Total                 | \$ 617.9           | 85,000            | \$ 619.5          | 84,496            | \$ 620.9           | 85,002            | \$ 627.9          | 85,302            |

Our alternative distribution channels that utilize partnerships and alliances generated \$151.3 million and \$147.4 million, or 24.5% and 23.7%, of our in-force premiums as of September 30, 2016 and 2015, respectively. We believe that the bundling of products and services through these relationships contributes to higher retention rates than business generated by our independent agents. These relationships also allow us to access new customers that we may not have access to through our independent agent distribution channel. We continue to actively seek new partnerships and alliances.

### Net Investment Income and Net Realized Gains on Investments

We invest our holding company assets, statutory surplus, and the funds supporting our insurance liabilities, including unearned premiums and unpaid losses and LAE. We invest in fixed maturity securities, equity securities, and cash equivalents. Net investment

income includes interest and dividends earned on our invested assets and amortization of premiums and discounts on our fixed maturity securities, less bank service charges and custodial and portfolio management fees. We have established a high quality/short duration bias in our investment portfolio.

Net investment income decreased 3.2% for the three months ended September 30, 2016 and increased 0.6% for the nine months ended September 30, 2016, compared to the same periods of 2015. The average pre-tax book yield on invested assets was 3.1% and 3.2% at September 30, 2016 and 2015, respectively. The tax-equivalent yield on invested assets was 3.7% and 3.8% at September 30, 2016 and 2015, respectively. The decrease in investment income year-over-year for the quarter was primarily related to the decrease in pre-tax book yield. The slight increase in net investment income for the nine months ended September 30, 2016 was primarily related to a slight change in the mix of invested assets in the investment portfolio.

Realized gains and losses on our investments are reported separately from our net investment income. Realized gains and losses on investments include the gain or loss on a security at the time of sale compared to its original or adjusted cost (equity securities) or amortized cost (fixed maturity securities). Realized losses are also recognized when securities are written down as a result of an other-than-temporary impairment.

Net realized gains on investments were \$1.6 million and \$9.1 million for the three and nine months ended September 30, 2016, respectively, compared to \$2.0 million and \$5.1 million for the corresponding periods of 2015. The increase in net realized gains on investments year-over-year for the nine months ended September 30, 2016 was the result of the sale of equity securities as part of a regular rebalancing of our equity investment portfolio and to meet cash needs at the holding company. For the nine months ended September 30, 2016, these gains were partially offset by \$5.3 million in other-than-temporary impairments of certain equity securities due to our intent to sell certain securities and the downturn in the energy sector that occurred in the first quarter of 2016.

Additional information regarding our Investments is set forth under “—Liquidity and Capital Resources—Investments.”

### Combined Ratio

The combined ratio, a key measurement of underwriting profitability, is the sum of the loss and LAE ratio, the commission expense ratio, and the underwriting and other operating expenses ratio. When the combined ratio is below 100%, we have recorded underwriting income, and conversely, when the combined ratio is greater than 100%, we have recorded an underwriting loss and cannot be profitable without investment income. Because we have only one operating segment, holding company expenses are included in our calculation of the combined ratio and increased the combined ratio by 1.4 and 1.6 percentage points for the three and nine months ended September 30, 2016, respectively, compared to 1.7 and 1.9 percentage points for the corresponding periods of 2015.

The following table provides the calculation of our calendar period combined ratios.

|                                                 | Three Months Ended |       | Nine Months Ended |       |
|-------------------------------------------------|--------------------|-------|-------------------|-------|
|                                                 | September 30,      |       | September 30,     |       |
|                                                 | 2016               | 2015  | 2016              | 2015  |
| Loss and LAE ratio                              | 62.9%              | 64.7% | 62.7%             | 63.6% |
| Underwriting and other operating expenses ratio | 18.3               | 17.7  | 19.5              | 19.2  |
| Commission expense ratio                        | 12.3               | 11.7  | 12.1              | 12.3  |
| Combined ratio                                  | 93.5%              | 94.1% | 94.3%             | 95.1% |

*Loss and LAE Ratio.* This is the ratio of losses and LAE to net premiums earned. Losses and LAE represents our largest expense item and includes claim payments made, amortization of the Deferred Gain, estimates for future claim payments and changes in those estimates for current and prior periods, and costs associated with investigating, defending, and adjusting claims. The quality of our financial reporting depends in large part on accurately predicting our losses and LAE, which are inherently uncertain as they are estimates of the ultimate cost of individual claims based on actuarial estimation techniques.

Our indemnity claims frequency (the number of claims expressed as a percentage of payroll) has decreased year-over-year; however, our loss experience indicates a slight upward movement in medical and indemnity costs per claim that is reflected in our current accident year loss estimate. We believe our current accident year loss and LAE estimate is adequate; however, given the long-tail nature of our business, ultimate losses will not be known with any certainty for many years.

Our loss and LAE ratio decreased 1.8 and 0.9 percentage points for the three and nine months ended September 30, 2016, compared to the same periods of 2015, while the amount of our losses and LAE decreased 5.9% year-over-year for the quarter and increased 1.4% for the nine months ended September 30, 2016. The decreases in the loss and LAE ratio were primarily due to decreases in the current accident year loss estimates.

Our current accident year loss estimates were 64.1% and 65.6% for the three and nine months ended September 30, 2016, compared to 66.3% and 66.8% for the three and nine months ended September 30, 2015, respectively. The decreases in our current accident year loss estimate reflects the impact of key business initiatives, including but not limited to: emphasizing the settlement of open

claims; diversifying our risk exposure across our markets; non-renewing underperforming business; and targeting profitable classes of business across all of our markets. In addition, we have increased rates in the LA Area in California limiting our growth in that territory, while we continue to grow in other territories within and outside of California. The current accident year loss estimate for the nine months ended September 30, 2016 includes the impact of \$6.5 million in large losses recognized in the second quarter of 2016, which increased the current accident year loss estimate for the nine months ended September 30, 2016.

Prior accident year favorable (unfavorable) loss development was \$(0.8) million and \$1.5 million for the three and nine months ended September 30, 2016, compared to \$0.1 million and \$(1.3) million for the three and nine months ended September 30, 2015, respectively. Prior accident year loss development was related to our Assigned Risk Business.

Excluding the impact from the LPT Agreement, losses and LAE would have been \$112.0 million and \$118.5 million, or 64.6% and 66.2% of net premiums earned, for the three months ended September 30, 2016 and 2015, respectively. For the nine months ended September 30, 2016 and 2015, losses and LAE, excluding the impact of the LPT, would have been \$341.6 million and \$341.0 million, or 65.3% and 67.0% of net premium earned, respectively.

The table below reflects losses and LAE reserve adjustments and the impact of the LPT on net income before taxes.

|                                                                    | Three Months Ended |        | Nine Months Ended |          |
|--------------------------------------------------------------------|--------------------|--------|-------------------|----------|
|                                                                    | September 30,      |        | September 30,     |          |
|                                                                    | 2016               | 2015   | 2016              | 2015     |
|                                                                    | (in millions)      |        |                   |          |
| Prior accident year favorable (unfavorable) loss development, net  | \$ (0.8)           | \$ 0.1 | \$ 1.5            | \$ (1.3) |
| Amortization of the Deferred Gain related to losses                | \$ 2.5             | \$ 2.3 | \$ 7.2            | \$ 7.1   |
| Amortization of the Deferred Gain related to contingent commission | 0.5                | 0.4    | 1.5               | 1.4      |
| Impact of LPT Reserve Adjustments                                  | —                  | —      | 3.1               | 6.4      |
| Impact of LPT Contingent Commission Adjustments                    | —                  | —      | 1.8               | 2.6      |
| Total impact of the LPT on losses and LAE                          | 3.0                | 2.7    | 13.6              | 17.5     |
| Total losses and LAE reserve adjustments                           | \$ 2.2             | \$ 2.8 | \$ 15.1           | \$ 16.2  |

*Underwriting and Other Operating Expenses Ratio.* The underwriting and other operating expenses ratio is the ratio of underwriting and other operating expenses to net premiums earned and measures an insurance company's operational efficiency in producing, underwriting, and administering its insurance business.

Underwriting and other operating expenses are those costs that we incur to underwrite and maintain the insurance policies we issue, excluding commission. These expenses include premium taxes and certain other general expenses that vary with, and are primarily related to, producing new or renewal business. Other underwriting expenses include policyholder dividends, changes in estimates of future write-offs of premiums receivable, general administrative expenses such as salaries and benefits, rent, office supplies, depreciation, and all other operating expenses not otherwise classified separately. Policy acquisition costs are variable based on premiums earned. Other operating expenses are more fixed in nature and become a smaller percentage of net premiums earned as premiums increase.

Our underwriting and other operating expenses ratio increased 0.6 and 0.3 percentage points, while the amount of our underwriting and other operating expenses increased 0.3% and 4.1% for the three and nine months ended September 30, 2016, compared to the same periods of 2015. During the three months ended September 30, 2016 our policyholder dividends increased \$0.3 million and our compensation-related expenses increased \$0.2 million, partially offset by a \$0.4 million decrease in our bad debt expense, compared to the same period of 2015. During the nine months ended September 30, 2016 our premium taxes and assessments increased \$2.6 million, our compensation-related expenses increased \$2.1 million, policyholder dividends increased \$0.7 million and our IT related expenses increased \$0.6 million, partially offset by a \$1.6 million decrease in our bad debt expense, compared to the same period of 2015.

*Commission Expense Ratio.* The commission expense ratio is the ratio of commission expense to net premiums earned and measures the cost of compensating agents and brokers for the business we have written.

Commission expense includes direct commissions to our agents and brokers for the premiums that they produce for us, as well as incentive payments, other marketing costs, and fees.

Our commission expense ratio increased 0.6 percentage points for the three months ended September 30, 2016 and decreased 0.2 percentage points for the nine months ended September 30, 2016, compared to the same periods of 2015, while our commission expense was \$0.3 million higher for the three months ended September 30, 2016 and \$0.9 million lower nine months ended September 30, 2016, compared to the same periods of 2015.

## ***Income Tax Expense***

Income tax expense was \$7.8 million and \$21.1 million for the three and nine months ended September 30, 2016, respectively, compared to \$5.9 million and \$14.1 million for the corresponding periods of 2015. Our effective tax rate was 25.7% and 22.9% for the three and nine months ended September 30, 2016, respectively, compared to 19.4% and 17.2% for the same periods of 2015, respectively. The increases in income tax expense were primarily due to increases in our projected annual net income before taxes. Additionally, our income tax expense was decreased by \$0.1 million and \$1.4 million for the three and nine months ended September 30, 2016, respectively, as a result of the implementation of new accounting guidance related to stock-based compensation in the third quarter of 2016.

## **Liquidity and Capital Resources**

### ***Holding Company Liquidity***

We are a holding company and our ability to fund our operations is contingent upon existing capital and the ability of our insurance subsidiaries to pay dividends up to the holding company. Payment of dividends by our insurance subsidiaries is restricted by state insurance laws and regulations, including laws establishing minimum solvency and liquidity thresholds. We require cash to pay stockholder dividends, repurchase common stock, make interest and principal payments on our outstanding debt obligations, provide additional surplus to our insurance subsidiaries, and fund our operating expenses.

The holding company had \$53.6 million of cash and cash equivalents and fixed maturity securities maturing within the next 24 months at September 30, 2016. Total cash and investments at the holding company was \$65.1 million at September 30, 2016. We believe that the liquidity needs of the holding company over the next 24 months will be met with cash, investments, and dividends from our insurance subsidiaries.

### ***Operating Subsidiaries' Liquidity***

The primary sources of cash for our insurance operating subsidiaries are funds generated from underwriting operations, investment income, maturities and sales of investments, and capital contributions from the parent holding company. The primary uses of cash are payments of claims and operating expenses, purchases of investments, and payments of dividends to the parent holding company, which are subject to state insurance laws and regulations.

Our insurance subsidiaries had \$452.1 million of cash and cash equivalents, short-term investments, and fixed maturity securities maturing within the next 24 months at September 30, 2016. We believe that our subsidiaries' liquidity needs over the next 24 months will be met with cash from operations, investment income, and maturing investments.

Each of our insurance subsidiaries, EICN, ECIC, EPIC, and EAC, became a member of the Federal Home Loan Bank of San Francisco (FHLB) in January 2016. Membership allows our subsidiaries access to collateralized advances, which may be used to support and enhance liquidity management. The amount of advances that may be taken is dependent on statutory admitted assets on a per company basis. Currently, none of our subsidiaries has advances outstanding under the FHLB facility.

We purchase reinsurance to protect us against the costs of severe claims and catastrophic events. On July 1, 2016, we entered into a reinsurance program that is effective through June 30, 2017. The reinsurance program consists of one treaty covering excess of loss and catastrophic loss events in four layers of coverage. Our reinsurance coverage is \$190.0 million in excess of our \$10.0 million retention on a per occurrence basis, subject to certain exclusions. We believe that our reinsurance program meets our needs and that we are sufficiently capitalized.

Various state laws and regulations require us to hold securities or letters of credit on deposit with certain states in which we do business. Securities having a fair value of \$1.0 billion and \$0.9 billion were on deposit at September 30, 2016 and December 31, 2015, respectively. These laws and regulations govern both the amount and types of fixed maturity securities that are eligible for deposit. Additionally, certain reinsurance contracts require Company funds to be held in trust for the benefit of the ceding reinsurer to secure the outstanding liabilities we assumed. The fair value of fixed maturity securities held in trust for the benefit of ceding reinsurers was \$27.7 million and \$32.7 million at September 30, 2016 and December 31, 2015, respectively.

### ***Sources of Liquidity***

We monitor cash flows at both the consolidated and subsidiary levels. We use trend and variance analyses to project future cash needs, making adjustments to our forecasts as appropriate. For additional information regarding our cash flows, see Item 1, Unaudited Consolidated Statements of Cash Flows.

The table below shows our net cash flows for the nine months ended:

|                                                         | September 30, |           |
|---------------------------------------------------------|---------------|-----------|
|                                                         | 2016          | 2015      |
|                                                         | (in millions) |           |
| <b>Cash and cash equivalents provided by (used in):</b> |               |           |
| Operating activities                                    | \$ 97.0       | \$ 94.0   |
| Investing activities                                    | (49.1)        | (139.1)   |
| Financing activities                                    | (20.4)        | (2.3)     |
| Increase (Decrease) in cash and cash equivalents        | \$ 27.5       | \$ (47.4) |

*Operating Cash Flows.* Major components of net cash provided by operating activities for the nine months ended September 30, 2016 included net premiums received of \$525.0 million and investment income received of \$65.8 million. These were partially offset by claims payments of \$323.0 million (net of \$22.7 million recovered from reinsurers), underwriting and other operating expenses paid of \$97.2 million (including premium taxes paid of \$24.1 million), and commissions paid of \$62.3 million.

Major components of net cash provided by operating activities for the nine months ended September 30, 2015 included net premiums received of \$510.7 million and investment income received of \$63.8 million. These were partially offset by claims payments of \$314.9 million (net of \$25.7 million recovered from reinsurers), underwriting and other operating expenses paid of \$95.9 million (including premium taxes paid of \$16.2 million), and commissions paid of \$61.4 million.

*Investing Cash Flows.* The major components of net cash used in investing activities for the nine months ended September 30, 2016 and 2015 were the purchases of fixed maturity and equity securities, partially offset by proceeds from sales, maturities, and redemptions of investments.

*Financing Cash Flows.* Cash used in financing activities for the nine months ended September 30, 2016 was to repurchase common stock and to pay dividends to stockholders, partially offset by cash received related to the exercise of stock options.

The majority of cash used in financing activities for the nine months ended September 30, 2015 was to pay dividends to stockholders, partially offset by cash received related to the exercise of stock options.

*Dividends.* Dividends paid to stockholders were \$8.8 million and \$5.8 million for the nine months ended September 30, 2016 and 2015, respectively. On October 26, 2016, the Board of Directors declared a \$0.09 dividend per share, payable November 23, 2016, to stockholders of record on November 9, 2016.

*Share Repurchases.* On February 16, 2016, the Board of Directors authorized a share repurchase program for up to \$50.0 million of our common stock from February 22, 2016 through February 22, 2018 (the 2016 Program). Through September 30, 2016, we repurchased a total of 642,024 shares of common stock under the 2016 Program at an average price of \$28.91 per share, including commissions, for a total cost of \$18.6 million.

#### Capital Resources

Our capital structure is comprised of outstanding debt and stockholders' equity. As of September 30, 2016, our capital structure consisted of \$32.0 million in surplus notes maturing in 2034, and \$1.0 billion of stockholders' equity, including the Deferred Gain. Outstanding debt was 3.0% of total capitalization, including the Deferred Gain, as of September 30, 2016.

*Contractual Obligations and Commitments.* The following table identifies our long-term debt and contractual obligations as of September 30, 2016.

|                                           | Payment Due By Period |                     |           |           |                      |
|-------------------------------------------|-----------------------|---------------------|-----------|-----------|----------------------|
|                                           | Total                 | Less Than<br>1-Year | 1-3 Years | 4-5 Years | More Than<br>5 Years |
|                                           | (in millions)         |                     |           |           |                      |
| Operating leases                          | \$ 16.9               | \$ 5.1              | \$ 7.3    | \$ 4.2    | \$ 0.3               |
| Purchased liabilities                     | 5.4                   | 3.4                 | 1.4       | 0.6       | —                    |
| Notes payable <sup>(1)</sup>              | 60.6                  | 1.6                 | 3.2       | 3.2       | 52.6                 |
| Capital leases                            | 0.7                   | 0.3                 | 0.3       | 0.1       | —                    |
| Losses and LAE reserves <sup>(2)(3)</sup> | 2,330.0               | 375.6               | 465.0     | 273.4     | 1,216.0              |
| Total contractual obligations             | \$ 2,413.6            | \$ 386.0            | \$ 477.2  | \$ 281.5  | \$ 1,268.9           |

(1) Notes payable obligations reflect payments for the principal and estimated interest expense based on LIBOR plus a margin. The estimated interest expense was based on the contractual obligations of the debt outstanding as of September 30, 2016. The interest rates range from 4.9% to 5.1%.

- (2) Estimated losses and LAE reserve payment patterns have been computed based on historical information. Our calculation of loss and LAE reserve payments by period is subject to the same uncertainties associated with determining the level of reserves and to the additional uncertainties arising from the difficulty of predicting when claims (including claims that have not yet been reported to us) will be paid. Actual payments of losses and LAE by period will vary, perhaps materially, from the above table to the extent that current estimates of losses and LAE reserves vary from actual ultimate paid claims due to variations between expected and actual payout patterns.
- (3) The losses and LAE reserves are presented gross of reinsurance recoverables for unpaid losses, which are as follows for each of the periods presented above:

|                                            | <b>Recoveries By Period</b> |                             |                  |                  |                              |
|--------------------------------------------|-----------------------------|-----------------------------|------------------|------------------|------------------------------|
|                                            | <b>Total</b>                | <b>Less Than<br/>1-Year</b> | <b>1-3 Years</b> | <b>4-5 Years</b> | <b>More Than<br/>5 Years</b> |
|                                            | (in millions)               |                             |                  |                  |                              |
| Reinsurance recoverables for unpaid losses | \$ (591.5)                  | \$ (30.5)                   | \$ (57.7)        | \$ (53.6)        | \$ (449.7)                   |

### Investments

The cost or amortized cost of our investment portfolio was \$2.4 billion and the fair value was \$2.6 billion as of September 30, 2016.

We employ an investment strategy that emphasizes asset quality and considers the durations, maturities, and anticipated cash flows of securities against anticipated claim payments, other expenditures and liabilities, and capital and liquidity needs. Our investment portfolio is structured so that investments mature periodically in reasonable relation to current expectations of future claim payments. Currently, we make claim payments from positive cash flow from operations and use excess cash to fund growth in our business, invest in operations, invest in marketable securities, and return capital to our stockholders.

As of September 30, 2016, our investment portfolio, which is classified as available-for-sale, consisted of 92.9% fixed maturity securities whose fair values may fluctuate due to prevailing market interest rates. We strive to limit interest rate risk by managing the duration of our fixed maturity securities. Our fixed maturity securities (excluding cash and cash equivalents) had a duration of 4.2 at September 30, 2016. To minimize interest rate risk, our portfolio is weighted toward short-term and intermediate-term bonds; however, our investment strategy balances consideration of duration, yield, and credit risk. Our investment guidelines require that the minimum weighted average quality of our fixed maturity securities portfolio be "AA-," using ratings assigned by Standard & Poor's (S&P). Our fixed maturity securities portfolio had a weighted average quality of "AA-" as of September 30, 2016, with 56.9% of the portfolio rated "AA" or better, based on fair value.

We carry our portfolio of equity securities on our balance sheet at fair value. We seek to minimize our exposure to equity price risk by investing primarily in the equity securities of mid-to-large capitalization issuers and by diversifying our equity holdings across several industry sectors. Equity securities represented 7.1% of our investment portfolio at September 30, 2016.

Given current economic uncertainty and continuing market volatility, we believe that our current asset allocation best meets our strategy to preserve capital for policyholders, to provide sufficient income to support our insurance operations, and to effectively grow book value over a long-term investment horizon.

The following table shows the estimated fair value, the percentage of the fair value to total invested assets, the average book yield, and the average tax equivalent yield based on the fair value of each category of invested assets as of September 30, 2016.

| <b>Category</b>                        | <b>Estimated Fair<br/>Value</b>   | <b>Percentage<br/>of Total</b> | <b>Book Yield</b> | <b>Tax Equivalent<br/>Yield</b> |
|----------------------------------------|-----------------------------------|--------------------------------|-------------------|---------------------------------|
|                                        | (in millions, except percentages) |                                |                   |                                 |
| U.S. Treasuries                        | \$ 127.9                          | 5.0%                           | 1.8%              | 1.8%                            |
| U.S. Agencies                          | 13.0                              | 0.5                            | 4.3               | 4.3                             |
| States and municipalities              | 897.2                             | 34.7                           | 3.1               | 4.5                             |
| Corporate securities                   | 996.5                             | 38.7                           | 3.1               | 3.1                             |
| Residential mortgage-backed securities | 235.0                             | 9.1                            | 3.0               | 3.0                             |
| Commercial mortgage-backed securities  | 86.5                              | 3.3                            | 2.5               | 2.5                             |
| Asset-backed securities                | 27.8                              | 1.1                            | 1.8               | 1.8                             |
| Equity securities                      | 184.5                             | 7.1                            | 5.7               | 7.5                             |
| Short-term investments                 | 14.0                              | 0.5                            | 1.0               | 1.0                             |
| Total                                  | <u>\$ 2,582.4</u>                 | <u>100.0%</u>                  |                   |                                 |
| Weighted average yield                 |                                   |                                | 3.1%              | 3.7%                            |

The following table shows the percentage of total estimated fair value of our fixed maturity securities as of September 30, 2016 by credit rating category, using the lower of ratings assigned by Moody's Investor Services and/or S&P.

| Rating                 | Percentage of Total<br>Estimated Fair Value |
|------------------------|---------------------------------------------|
| "AAA"                  | 9.7%                                        |
| "AA"                   | 47.2                                        |
| "A"                    | 28.8                                        |
| "BBB"                  | 13.5                                        |
| Below investment grade | 0.8                                         |
| Total                  | 100.0%                                      |

Investments that we currently own could be subject to default by the issuer or could suffer declines in fair value that become other-than-temporary. We regularly assess individual securities as part of our ongoing portfolio management, including the identification of other-than-temporary declines in fair value. Our other-than-temporary impairment assessment includes reviewing the extent and duration of declines in the fair value of investments below amortized cost, historical and projected financial performance and near-term prospects of the issuer, the outlook for industry sectors, credit rating, and macro-economic changes. We also make a determination as to whether it is not more likely than not that we will be required to sell the security before its fair value recovers above cost, or maturity.

Based on our reviews of fixed maturity and equity securities, we believe that we appropriately identified the declines in the fair values of our unrealized losses for the nine months ended September 30, 2016. We determined that the unrealized losses on fixed maturity securities were primarily the result of prevailing interest rates and not the credit quality of the issuers. The fixed maturity securities whose 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 a total impairment of \$5.3 million in the fair value of 32 equity securities for the nine months ended September 30, 2016, as a result of our intent to sell and/or the severity and duration of the change in fair value of the securities. The remaining unrealized losses on equity securities were not considered to be other-than-temporary due to the financial condition and near-term prospects of the issuers. The other-than-temporary impairment of equity securities was primarily due to the downturn in the energy sector that occurred in the first quarter of 2016.

#### Off-Balance Sheet Arrangements

We have no off-balance sheet arrangements.

#### Critical Accounting Policies

These unaudited interim consolidated financial statements include amounts based on the use of estimates and judgments of management for those transactions that are not yet complete. We believe that the estimates and judgments that were most critical to the preparation of the consolidated financial statements involved the following: (a) reserves for losses and LAE; (b) reinsurance recoverables; (c) recognition of premium income; (d) deferred income taxes; and (e) valuation of investments. These estimates and judgments require the use of assumptions about matters that are highly uncertain and therefore are subject to change as facts and circumstances develop. Our accounting policies are discussed under "Critical Accounting Policies" in Management's Discussion and Analysis of Financial Condition and Results of Operations in our Annual Report.

#### Item 3. Quantitative and Qualitative Disclosures About Market Risk

Market risk is the risk of potential economic loss principally arising from adverse changes in the fair value of financial instruments. The major components of market risk affecting us are credit risk, interest rate risk, and equity price risk, and are described in detail in our Annual Report. We have not experienced any material changes in market risk since December 31, 2015.

The primary market risk exposure to our investment portfolio, which consists primarily of fixed maturity securities, is interest rate risk. We have the ability to hold fixed maturity securities to maturity and we strive to limit interest rate risk by managing duration. As of September 30, 2016, our fixed maturity securities portfolio had a duration of 4.2. We continually monitor the impact of interest rate changes on our investment portfolio and liquidity obligations. Changes to our market risk, if any, since December 31, 2015 are reflected in Management's Discussion and Analysis of Financial Condition and Results of Operations and the financial statements contained in this Form 10-Q.

**Item 4. Controls and Procedures**

Under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, we have evaluated the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (Exchange Act)) as of the end of the period covered by this report. Based on that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective as of the end of the period covered by this report.

There have not been any changes in our internal control over financial reporting (as defined in Rule 13a-15(f) under the Exchange Act) during the period covered by this report that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

## PART II – OTHER INFORMATION

### Item 1. Legal Proceedings

From time-to-time, the Company is involved in pending and threatened litigation in the normal course of business in which claims for monetary damages are asserted. In the opinion of management, the ultimate liability, if any, arising from such pending or threatened litigation is not expected to have a material effect on our results of operations, liquidity, or financial position.

### Item 1A. Risk Factors

We have disclosed in our Annual Report the most significant risk factors that can impact year-to-year comparisons and that may affect the future performance of the Company's business. On a quarterly basis, we review these disclosures and update the risk factors, as appropriate. As of the date of this report, there have been no material changes to the risk factors contained in our Annual Report.

### Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

The following table summarizes the repurchases of our common stock for each month within the third quarter of 2016:

| Period                           | Total Number of Shares Purchased | Average Price Paid Per Share <sup>(1)</sup> | Total Number of Shares Purchased as Part of Publicly Announced Program | Approximate Dollar Value of Shares that May Yet be Purchased Under the Program <sup>(2)</sup> |
|----------------------------------|----------------------------------|---------------------------------------------|------------------------------------------------------------------------|-----------------------------------------------------------------------------------------------|
|                                  |                                  |                                             |                                                                        | (in millions)                                                                                 |
| July 1 – July 31, 2016           | 39,950                           | \$ 29.63                                    | 39,950                                                                 | \$ 41.9                                                                                       |
| August 1 – August 31, 2016       | 255,634                          | 28.65                                       | 255,634                                                                | 34.6                                                                                          |
| September 1 – September 30, 2016 | 104,155                          | 30.01                                       | 104,155                                                                | 31.4                                                                                          |
| Total                            | 399,739                          | \$ 29.10                                    | 399,739                                                                |                                                                                               |

(1) Includes fees and commissions paid on stock repurchases.

(2) On February 16, 2016, the Board of Directors authorized a share repurchase program for repurchases of up to \$50 million of the Company's common stock (the 2016 Program). We expect that shares may be purchased at prevailing market prices through February 22, 2018 through a variety of methods, including open market or private transactions, in accordance with applicable laws and regulations and as determined by management. The timing and actual number of shares repurchased will depend on a variety of factors, including the share price, corporate and regulatory requirements, and other market and economic conditions. Repurchases under the 2016 Program may be commenced, modified, or suspended from time to time without prior notice, and the program may be suspended or discontinued at any time.

### Item 3. Defaults Upon Senior Securities

None.

### Item 4. Mine Safety Disclosures

Not applicable.

### Item 5. Other Information

None.

**Item 6. Exhibits**

| <b>Exhibit No.</b> | <b>Description of Exhibit</b>                                                                                                                              | <b>Included Herewith</b> | <b>Incorporated by Reference Herein</b> |                |                    |
|--------------------|------------------------------------------------------------------------------------------------------------------------------------------------------------|--------------------------|-----------------------------------------|----------------|--------------------|
|                    |                                                                                                                                                            |                          | <b>Form</b>                             | <b>Exhibit</b> | <b>Filing Date</b> |
| *10.1              | Amendment No. 1, dated January 29, 2016, to Employment Agreement effective November 10, 2014 by and between Employers Holdings, Inc. and Terry Eleftheriou |                          | 8-K                                     | 10.1           | February 2, 2016   |
| 31.1               | Certification of Douglas D. Dirks Pursuant to Section 302                                                                                                  | X                        |                                         |                |                    |
| 31.2               | Certification of Terry Eleftheriou Pursuant to Section 302                                                                                                 | X                        |                                         |                |                    |
| 32.1               | Certification of Douglas D. Dirks Pursuant to Section 906                                                                                                  | X                        |                                         |                |                    |
| 32.2               | Certification of Terry Eleftheriou Pursuant to Section 906                                                                                                 | X                        |                                         |                |                    |
| 101.INS            | XBRL Instance Document                                                                                                                                     | X                        |                                         |                |                    |
| 101.SCH            | XBRL Taxonomy Extension Schema Document                                                                                                                    | X                        |                                         |                |                    |
| 101.CAL            | XBRL Taxonomy Extension Calculation Linkbase Document                                                                                                      | X                        |                                         |                |                    |
| 101.DEF            | XBRL Taxonomy Extension Definition Linkbase Document                                                                                                       | X                        |                                         |                |                    |
| 101.LAB            | XBRL Taxonomy Extension Label Linkbase Document                                                                                                            | X                        |                                         |                |                    |
| 101.PRE            | XBRL Taxonomy Extension Presentation Linkbase Document                                                                                                     | X                        |                                         |                |                    |

## SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

EMPLOYERS HOLDINGS, INC.

Date: October 27, 2016

/s/ Douglas D. Dirks

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Douglas D. Dirks  
President and Chief Executive Officer  
Employers Holdings, Inc.

Date: October 27, 2016

/s/ Terry Eleftheriou

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Terry Eleftheriou  
Executive Vice President and Chief Financial Officer  
Employers Holdings, Inc.  
(Principal Financial and Accounting Officer)

## CERTIFICATIONS

I, Douglas D. Dirks, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Employers Holdings, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting;
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: October 27, 2016

/s/ Douglas D. Dirks

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Douglas D. Dirks

President and Chief Executive Officer

Employers Holdings, Inc.

## CERTIFICATIONS

I, Terry Eleftheriou, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Employers Holdings, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting;
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: October 27, 2016

/s/ Terry Eleftheriou

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Terry Eleftheriou

Executive Vice President and Chief Financial Officer

Employers Holdings, Inc.

(Principal Financial and Accounting Officer)

**CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350**  
**as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002**

In connection with the Form 10-Q of Employers Holdings, Inc. (the Company) for the quarter ended September 30, 2016, as filed with the Securities and Exchange Commission on the date hereof (the Report), the undersigned hereby, certifies, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that, to the best of his knowledge:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: October 27, 2016

/s/ Douglas D. Dirks

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Douglas D. Dirks

President and Chief Executive Officer

Employers Holdings, Inc.

**CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350**  
**as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002**

In connection with the Form 10-Q of Employers Holdings, Inc. (the Company) for the quarter ended September 30, 2016, as filed with the Securities and Exchange Commission on the date hereof (the Report), the undersigned hereby, certifies, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that, to the best of his knowledge:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: October 27, 2016

/s/ Terry Eleftheriou

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Terry Eleftheriou  
Executive Vice President and Chief Financial Officer  
Employers Holdings, Inc.  
(Principal Financial and Accounting Officer)