Employers Holdings, Inc.
Form 10-K
March 30, 2007

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-K

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2006

OR

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

Commission file number 001-33245

EMPLOYERS HOLDINGS, INC.

(Exact name of registrant as specified in its charter)

NEVADA	04-3850065
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)

9790 Gateway Drive, Reno, Nevada 89521

(Address of principal executive offices and zip code)

(888) 682-6671

(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Common Stock, $0.01 par value per share	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act. Yes No

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 No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of ''accelerated filer and large accelerated filer'' in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer	Accelerated filer	Non-accelerated filer

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

The registrant completed the initial public offering of its common stock on February 5, 2007. Accordingly, there was no public market for the registrant's common stock as of June 30, 2006, the last day of the registrant's most recently completed second fiscal quarter.

Class	March 26, 2007
Common Stock, $0.01 par value per share	53,527,907 shares, outstanding

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's Definitive Proxy Statement relating to the 2007 Annual Meeting of Stockholders to be held May 31, 2007, are incorporated by reference in Items 10, 11, 12, 13 and 14 of Part III of this report.

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FORWARD-LOOKING STATEMENTS

This report contains forward-looking statements, within the meaning of Section 27A of the Securities Act of 1933 and 21E of the Securities Exchange Act of 1934. You should not place undue reliance on these statements. These forward-looking statements including statements regarding our expected financial position, business, financing plans, litigation, future premiums, revenues, earnings, pricing, investments, business relationships, expected losses, loss reserves, competition and rate increases with respect to our business and the insurance industry in general. These forward-looking statements reflect our views with respect to future events and financial performance. The words ''believe,'' ''expect,'' ''plans,'' ''intend,'' ''project,'' ''estimate,'' ''may,'' ''should,'' ''will,'' ''continue,'' ''potential,'' ''fo similar expressions identify forward-looking statements. Although we believe that these expectations reflected in such forward-looking statements are reasonable, we can give no assurance that the expectations will prove to be correct. Actual results may differ from those expected due to risks and uncertainties, including those discussed in ''Risk Factors'' in Item 1A of this report and the following:

- adequacy and accuracy of our pricing methodologies;
- our dependence on a concentrated geographic area and on the workers' compensation industry;
- developments in the frequency or severity of claims and loss activity that our underwriting, reserving or investment practices do not anticipate based on historical experience or industry data;
- changes in rating agency policies or practices;
- negative developments in the workers' compensation insurance industry;
- increased competition on the basis of coverage availability, claims management, safety services, payment terms, premium rates, policy terms, types of insurance offered, overall financial strength, financial ratings and reputation;
- changes in regulations or laws applicable to us, our policyholders or the agencies that sell our insurance;
- changes in legal theories of liability under our insurance policies;
- changes in general economic conditions, including interest rates, inflation and other factors;
- effects of acts of war, terrorism or natural or man-made catastrophes;
- non-receipt of expected payments, including reinsurance receivables;
- performance of the financial markets and their effects on investment income and the fair values of investments;
- possible failure of our information technology or communications systems;
- adverse state and federal judicial decisions;
- litigation and government proceedings;
- possible loss of the services of any of our executive officers or other key personnel;
- cyclical nature of the insurance industry;
- investigations into issues and practices in the insurance industry;
- changes in interest rates; and
- changes in demand for our products.

The foregoing factors should not be construed as exhaustive and should be read in conjunction with the other cautionary statements that are included in this report.

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These forward-looking statements are subject to certain 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 listed under the heading ‘‘Risk Factors’’ in Item 1A of this report. All subsequent written and oral forward-looking statements attributable to us or individuals acting on our behalf are expressly qualified in their entirety by these cautionary statements. We caution you not to place undue reliance on these forward-looking statements, which speak only as of the date of this report. 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. Before making an investment decision, you should carefully consider all of the factors identified in this report that could cause actual results to differ.

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GLOSSARY

Accident year	The year the claim occurred. When referring to a group of claims, the collection of all claims that occurred in the year.
Accident year losses and LAE ratio	Losses and LAE, regardless of when such losses and LAE are incurred and net of amounts ceded to reinsurers, for insured events that occurred during a particular year divided by the premiums earned for that year.
Accumulated surplus	The aggregation of all increases and decreases to surplus since inception of an insurance company to the valuation date.
Adverse development	An increase in the estimated ultimate losses and LAE from one valuation date to a subsequent valuation date for claims occurring in a given time period.
Assume	To receive from a ceding company all or a portion of a risk in consideration of receipt of a premium.
Assumed premiums written	Premiums received by our insurance subsidiaries from an authorized state-mandated pool or under previous fronting facilities.
Base direct premiums written	Direct premiums prior to any adjustments for final policy audits or retrospective ratings adjustments.
Cede	To transfer to a reinsurer all or a portion of a risk in consideration of payment of a premium.
Ceded premiums written	The portion of direct premiums written ceded to reinsurers.
Closed block	The accounting mechanism and procedure set up by the Company as described in ‘‘The Conversion—Closed Block.’’
Combined ratio	Expressed as a percentage, a key measurement of profitability traditionally used in the property-casualty insurance industry. The combined ratio is the sum of the losses and LAE ratio, the commission expense ratio and the underwriting and other operating expense ratio.
Commission expense ratio	Commission expense expressed as a percentage of net premiums earned.
Development	The amount by which estimated losses, measured subsequently by reference to payments and additional estimates, differ from those originally reported for a period. Development is favorable when losses ultimately settle for less than levels at which they were reserved or subsequent estimates indicate a basis for reserve decreases on open claims. Development is unfavorable when losses ultimately settle for more than levels at which they were reserved or subsequent estimates indicate a basis for reserve increases on open claims.

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Direct premiums written	The premiums on all policies the Company's insurance subsidiaries have issued during the year.
Direct reserves	The estimates of future losses and LAE payments on policies written by an insurance company before the effect of ceded reinsurance.
Excess of loss reinsurance	A form of reinsurance in which the reinsurer pays all or a specified percentage of a loss caused by a particular occurrence or event in excess of a fixed amount and up to a stipulated limit.
Fronting facility	The issuance of insurance policies by an insurer as an accommodation to another insurer. Usually, the insurer providing the fronting facility cedes all or substantially all the risk, as well as a significant percentage of the premium, to the insurer being accommodated. This device often is used to enable an insurer to underwrite risks in a jurisdiction in which it is not licensed.
GAAP	U.S. generally accepted accounting principles.
Gross premiums written	The sum of both direct premiums written and assumed premiums written before the effect of ceded reinsurance and any inter-company pooling agreement.
Guaranteed cost	A fixed premium rate for the term of the workers' compensation insurance policy, provided that the final premium will vary based on the difference between the estimated term payroll at the time the policy is issued and the final audited payroll of the customer after the policy expires.
In force policy	An ''in force'' policy is a policy that has been issued and is in effect on a given date. Generally, a policy is in force if it has been issued, the required premium has been received and the policy has not been properly cancelled or terminated.
Incurred but not reported or IBNR	Relating to insured losses that have occurred but have not yet been reported to the insurer or reinsurer.
Loss adjustment expenses or LAE	The expenses of investigating, administering and settling claims, including legal expenses.
Losses and LAE	The sum of net incurred losses and loss adjustment expenses.
Losses and loss adjustment expenses ratio or losses and LAE ratio	The sum of net incurred losses and loss adjustment expenses expressed as a percentage of net premiums earned.
Losses and LAE reserves	The balance sheet liability representing estimates of amounts needed to pay reported and unreported claims and related loss adjustment expenses.

Net premiums earned	The portion of net premiums written equal to the expired portion of the time for which insurance protection was provided during the financial year and is recognized as revenue.

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Net premiums written	The sum of direct premiums written and assumed premiums written less ceded premiums written.
Net premiums written to total statutory surplus ratio	The ratio of our insurance subsidiaries' annual net premiums written to total statutory surplus.
Persistency	Percentage of insurance policies remaining in force between specified measurement dates. In addition, it is used with respect to premiums, to measure the amount of annualized premium remaining in force on a stated collection of policies between specified measurement dates.
Policyholder dividend	A payment to the policyholder on a type of policy upon which a portion of the premium may be repaid to the policyholder after expiration depending upon the loss experience.
Reinsurance	A transaction in which an original insurer, or ceding company, remits a portion of the premium to a reinsurer, or assuming company, as payment for the reinsurer's assumption of a portion of the risk.
Retention	The amount of loss(es) from a single occurrence or event which is paid by the company prior to the attachment of excess of loss reinsurance.
Retroactive reinsurance	A form of reinsurance in which a reinsurer agrees to reimburse a ceding company for liabilities incurred as a result of past insurable events.
Retrospective rating	A method of establishing rates in which the current year's premium is calculated to reflect the actual current year's loss experience. An initial premium is charged and then adjusted at the end of the policy year to reflect the actual loss experience of the business.
Risk based capital	A formula developed by the NAIC used to establish minimum surplus requirements beyond necessary reserve requirements.
Statutory accounting practices	Statutory requirements based on criteria established by the NAIC in regard to the preparation of an insurer's financial statements required to be filed with a state insurance department. Compared to GAAP, they are more regulatory by nature and give a more conservative depiction of an insurer's financial condition.
Statutory surplus	

	The amount remaining after all liabilities are subtracted from all admitted assets, as determined in accordance with statutory accounting practices. This amount is regarded as financial protection to policyholders in the event an insurance company suffers unexpected or catastrophic losses.
Treaty	A contract of reinsurance.

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Underwriting	The process whereby an insurer reviews applications submitted for insurance coverage and determines whether to accept all or part, and at what premium, of the coverage being requested.
Underwriting and other operating expense ratio	Underwriting and other operating expense expressed as a percentage to net premiums earned.
Underwriting and other operating expense	Includes the costs to acquire and maintain an insurance policy, excluding commissions, which costs are included in amortization of deferred policy acquisition costs. In addition, it includes state and local taxes based on premiums, as well as licenses, fees, assessments and contributions to workers' compensation security funds. Other underwriting expenses consist of policyholder dividends and general administrative expenses such as salaries, rent, office supplies, depreciation and all other operating expenses not otherwise classified separately, and boards, bureaus and assessments of statistical agencies for policy service and administration items such as rating manuals, rating plans and experience data.

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PART I

Item 1. Business

Overview

Employers Holdings, Inc. (Employers Holdings) is a holding company and is the successor to EIG Mutual Holding Company (EIG), which was incorporated in Nevada in 2005. Our two insurance subsidiaries, Employers Insurance Company of Nevada (EICN) and Employers Compensation Insurance Company (ECIC) are domiciled in Nevada and California, respectively. Unless otherwise indicated, all references to ‘‘Employers,’’ ‘‘we,’’ ‘‘us,’’ ‘‘our,’’ ‘‘the Company’’ or terms refer to Employers Holdings, Inc. together with its subsidiaries.

We are a specialty provider of workers' compensation insurance focused on select small businesses engaged in low to medium hazard industries. Workers' compensation is a statutory system under which an employer is required to provide coverage for its employees' medical, disability, vocational rehabilitation and death benefit costs for work-related injuries or illnesses. Our business has historically targeted businesses located in several western states, primarily California and Nevada. We distribute our products almost exclusively through independent agents and brokers and our strategic distribution partners. During 2005, based on net premiums written, we were the largest, seventh largest and seventeenth largest non-governmental writer of workers' compensation insurance in Nevada, California and the United States, respectively, as reported by A.M. Best Company (A.M. Best).

The workers' compensation insurance industry has historically classified risks into four hazard groups based on severity, with businesses in the first or lowest group having the lowest cost claims. In 2006, 66.8% and 31.8% of our base direct premiums written (which we define as direct written premiums prior to any final policy audits or retrospective rating adjustments) were generated by businesses in the second and third lowest hazard groups, respectively. Businesses in the second lowest hazard group include restaurants, physician offices, stores and educational institutions. Businesses in the third lowest hazard group include the residential carpentry, plumbing and real estate agency businesses. Within each hazard group, our underwriters use their local market expertise and disciplined underwriting to select specific types of businesses and risks that allow us to generate attractive returns. We underwrite these businesses and risks on an individual basis, as opposed to following an occupational class-based underwriting approach. For example, while we insure many physician offices, our underwriting guidelines do not allow us to insure offices that we believe have a higher risk profile, such as psychiatrist offices and drug treatment centers. In addition, our underwriters are selective on the basis of businesses' geographic location.

In 2006, we generated 73.5% and 19.4% of our direct premiums written in California and Nevada, respectively. In addition, we write business in seven other states (Arizona, Colorado, Idaho, Illinois, Montana, Texas and Utah) and are licensed to write business in eight additional states (Florida, Georgia, Maryland, Massachusetts, New Mexico, New York, Oregon and Pennsylvania). We leverage the extensive field knowledge and local experience of our underwriting and claims professionals to identify business opportunities and establish ourselves as a leader in workers' compensation insurance. We market and sell our workers' compensation insurance products through independent local and regional agents and brokers, and through our strategic distribution partners, including our principal partners ADP, Inc. (ADP), and Blue Cross of California, an operating subsidiary of Wellpoint, Inc. (Wellpoint). In 2006, policies underwritten directly or through our independent agents and brokers generated $275.4 million, or 70.5%, of our base direct premiums written, while those underwritten through our strategic relationships generated $114.9 million, or 29.5%, of our base direct premiums written.

We had net premiums written of $439.7 million and $387.2 million, total revenues of $496.5 million and $520.3 million and net income of $137.6 million and $171.6 million for the years ended December 31, 2005 and 2006, respectively. Our combined ratio on a statutory basis was 70.7% for the year ended December 31, 2006 (elsewhere in this report, unless otherwise stated, the term ''combined ratio'' refers to a calculation based on GAAP). Our average combined ratio on a statutory basis for the five years ended December 31, 2005 was 96.8%. This ratio was lower than the industry composite combined ratio

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calculated by A.M. Best for U.S. insurance companies having more than 50% of their premiums generated by workers' compensation insurance products. The industry combined ratio on a statutory basis for these companies was 106.8% during the same five years. Companies with lower combined ratios than their peers generally experience greater profitability. We had total assets of $3.2 billion at December 31, 2006.

As of the date of this filing, our insurance subsidiaries were assigned a group letter rating of A– (Excellent), with a ‘‘positive’’ financial outlook, by A.M. Best, the fourth highest of 16 ratings. This A.M. Best rating is a financial strength rating designed to reflect our ability to meet our obligations to policyholders. This rating does not refer to our ability to meet non-insurance obligations and is not a recommendation to purchase or discontinue any policy or contract issued by us or to buy, hold or sell our securities.

Our Competitive Strengths

We believe we benefit from the following competitive strengths:

Focused Operations

We focus on providing workers' compensation insurance to select small businesses in low to medium hazard groups in specific geographic markets. We believe that this focus provides us with a unique competitive advantage because we are able to gain in-depth customer and market knowledge and expertise. In addition, we believe that we benefit by focusing on small businesses, as they are not generally the principal focus of large insurance companies. As a result, we believe we enjoy strong persistency and attractive pricing. We have also benefited from the attractive pricing resulting from the bundling of our workers' compensation insurance product with the small group health insurance product marketed to our targeted customers by one of our strategic distribution partners, Wellpoint.

Disciplined Underwriting

We employ a disciplined, conservative and highly automated underwriting approach designed to individually select specific types of businesses, which we believe will have fewer and less costly claims relative to other businesses in the same hazard group. Our underwriting guidelines are designed to minimize underwriting of classes and subclasses of business which have historically demonstrated claims severity that do not meet our target risk profiles. We price our policies based on the specific risks associated with each potential insured rather than solely on the industry class in which a potential insured is classified. In 2006, policyholders in the second lowest industry defined hazard group generated approximately 66.8% of our base direct premiums written. Our statutory losses and LAE ratio, a measure which relates inversely to our underwriting profitability, was 38.0% and 58.3% in 2006 and 2005 respectively, 38.6 and 18.2 percentage points below the 2005 statutory industry composite losses and LAE ratio calculated by A.M. Best for U.S. insurance companies having more than 50% of their premiums generated by workers' compensation insurance products. Our statutory losses and LAE ratio was at least ten percentage points below the A.M. Best composite losses and LAE ratio for the industry for each of the five years ended December 31, 2005. Our disciplined underwriting approach is a critical element of our culture and has allowed us to realize competitive prices, diversify our risks and achieve profitable growth.

Long-Standing and Strategic Distribution Relationships

We have established long-standing, strong relationships with independent agents and brokers by emphasizing personal interaction, offering responsive service and competitive commissions and maintaining a focus on workers' compensation insurance. We are able to use these long-standing relationships to identify new business opportunities. Our field underwriters continue to work closely with independent agents and brokers to market and underwrite our business, regularly visit their offices and participate in presentations to customers, which results in enhanced understanding of the businesses and risks we underwrite and the needs of prospective customers. To expand our distribution reach, we have also developed important and long-standing strategic distribution relationships with ADP and Wellpoint and have recently entered into a strategic distribution relationship with E-chx, Inc. (E-chx), a payroll outsourcing company. Through our strategic distribution partnership with ADP, we jointly market our workers' compensation insurance products with ADP's payroll services, primarily to small businesses in California, as well as in

Colorado, Idaho, Illinois, Texas and Utah, generating $44.0 million in gross

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premiums written in 2006. Through our strategic distribution partnership with Wellpoint, we jointly market our workers' compensation insurance products with Wellpoint's group health insurance plans to small businesses in California, generating $70.9 million in gross premiums written in 2006.

Scalable and Cost-Effective Infrastructure

We have three strategic business units overseeing 13 territorial offices serving the various states in which we are currently doing business. We believe we have created an efficient, cost-effective, scalable infrastructure that complements our geographic reach, our focus on workers' compensation insurance and our targeting of small businesses. As part of our cost-effective infrastructure, we have developed a highly automated underwriting software program that allows for electronic submission and review of insurance applications, employing our underwriting standards and guidelines. This automated process leads to efficient and timely processing of applications for small, straight-forward policies that meet our standards and saves our independent agents and brokers considerable time in processing customer applications.

Financial Strength

As of December 31, 2006, our insurance subsidiaries had total consolidated statutory surplus of $640.5 million and, as of the date of this filing, were assigned a group letter rating of A– (Excellent), with a ''positive'' financial outlook, by A.M. Best, the fourth highest of 16 ratings. The amount of statutory surplus is regarded as financial protection to policyholders in the event an insurance company suffers unexpected or catastrophic losses. We have a proven history of conservative reserving. There have been no prior year adverse developments or increases in the estimated ultimate losses and LAE from one valuation date to a subsequent valuation date, in our reserves since we commenced operations in Nevada in 2000. Our insurance subsidiaries' ratio of net premiums written to total consolidated statutory surplus, a measure of underwriting leverage, of 0.60:1 and 0.83:1 at December 31, 2006 and 2005 respectively, compared to an industry average of 1.1:1 at such dates, further demonstrates the strength of our balance sheet. In connection with our assumption in 2000 of the assets, liabilities and operations of the Nevada State Industrial Insurance System (the Fund), including in force policies and historical liabilities associated with the Fund for losses prior to January 1, 2000, our Nevada insurance subsidiary assumed the Fund's rights and obligations under a retroactive 100% quota share reinsurance agreement (referred to as the LPT Agreement) which the Fund had entered into with third party reinsurers. The LPT Agreement substantially reduced the exposure to losses for pre-July 1995 Nevada insured risks.

Strong Senior Management with Extensive Industry Experience

We have a strong senior management team with significant insurance industry experience across a variety of markets and market conditions. Our executive officers and senior management team also have significant experience with the state-by-state workers' compensation legislative and regulatory environment, particularly in the states in which we operate or are licensed, and they have been proactive in encouraging legislation that allows us to operate profitably within a balanced framework. Douglas D. Dirks, our President and Chief Executive Officer and four of our other executive officers have an average of over 18 years of insurance industry experience and over 16 years of workers' compensation insurance experience. Additionally, our underwriting and claims senior managers on average have over

20 years of experience in the insurance industry.

Our Strategies

We plan to pursue profitable growth by focusing on the following strategies:

Maintain Focus on Underwriting Profitability

We are committed to disciplined underwriting, and we will continue this approach in pursuing profitable growth opportunities. We will carefully monitor market trends to assess new business opportunities, only pursuing opportunities that we expect to meet our pricing and risk standards. We will seek to underwrite our portfolio of low to medium hazard risks with a view toward maintaining long-term underwriting profitability across market cycles.

Continue to Grow in Our Existing Markets

Since commencing operations in Nevada in 2000, we have expanded our operations to California, were able to establish important strategic distribution relationships with ADP and Wellpoint, entered

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seven other states and obtained licenses in eight new states. We plan to continue to seek profitable growth in our existing markets by addressing the workers' compensation insurance needs of small businesses, which we believe represent a large and profitable market segment and by entering new strategic distribution agreements such as our recent agreement with E-chx. Small businesses generally grow faster than large businesses and, according to the United States Small Business Administration, 60% to 80% of new jobs over the past decade ending in 2005 were created by small businesses. Accordingly, we believe that the characteristics of our existing markets should be favorable over the long term. In the states in which we operate, the workers' compensation market for small businesses is not highly concentrated, with a significant portion of premiums being written by numerous insurance companies with small individual market shares. We believe that our focus on workers' compensation insurance, our disciplined underwriting and risk selection, and our loss control and claims management expertise for small businesses position us to profitably increase our market share in our existing markets.

Enter New Markets Through Our Existing Distribution Relationships

Since commencing operations in Nevada in 2000, we have expanded our operations to California, established important strategic distribution relationships with ADP and Wellpoint, entered seven new states and obtained licenses in eight other states. We intend to continue to selectively enter new markets, taking into account the adequacy of premium rates, market dynamics, the labor market, political and economic conditions and the regulatory environment. Our strategic distribution partnerships with ADP and Wellpoint have allowed us to access new customers and to write attractive business in an efficient manner. For example, we entered Illinois in the fourth quarter of 2006 and we intend to enter Florida and Oregon in the second quarter of 2007. Additionally, we will seek to leverage our existing independent agent and broker relationships to enter new states.

Capitalize on the Flexibility of Our New Corporate Structure

The initial public offering (IPO) completed on February 5, 2007, occurred in conjunction with our conversion from a mutual insurance holding company owned by our Nevada policyholder members to a stock corporation owned by our public stockholders. We believe that our conversion to a publicly traded stock corporation gives us enhanced financial and strategic flexibility. This allows us to consider acquisitions, joint ventures and other strategic transactions, as well as new product offerings, which make strategic sense for our business while achieving our goal of profitable growth.

Manage Capital Prudently

We intend to manage our capital prudently relative to our overall risk exposure, establishing adequate loss reserves to protect against future adverse developments while seeking to grow profits and long-term stockholder value, maintain our financial strength, fund growth, invest in our infrastructure or return capital to stockholders, which may include share repurchases. We will target an optimal level of overall leverage to support our underwriting activities and are committed to maintaining our financial strength and ratings over the long term.

Leverage Infrastructure, Technology and Systems

We will continue to invest in our scalable, cost-effective infrastructure and our underwriting and claims processing technology and systems. We recently introduced a new automated underwriting system, E ACCESS, which over time will replace three legacy underwriting systems. We anticipate that this new system will reduce transaction costs and support future profitable growth. In the first quarter of 2008, we expect to implement a new claims system designed to enhance our ability to support best-in-class claims processing.

Our History

Our Nevada insurance subsidiary was incorporated and domiciled in Nevada in December 1999. On January 1, 2000, our Nevada insurance subsidiary assumed all the assets, liabilities and operations of the Fund, pursuant to legislation enacted in the 1999 Nevada legislature. The Fund, which was an agency of the State of Nevada, had over 80 years of workers' compensation experience in Nevada. Following our assumption of the Fund's assets, liabilities and operations, Nevada no longer had a monopolistic state

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agency that provided workers' compensation coverage to businesses in the state. Businesses in Nevada could obtain their coverage from an insurer in the private market (including from us), join a self insured group or, if they met the financial qualifications required by statute, self insure their own losses.

In connection with our assumption of the assets, liabilities and operations of the Fund, our Nevada insurance subsidiary assumed the Fund's rights and obligations associated with a retroactive 100% quota share reinsurance agreement with third party reinsurers (LPT Agreement), which substantially reduced our exposure to losses for pre-July 1, 1995, Nevada insured risks. For further discussion of the LPT Agreement, see ''Item 6—Selected Financial Data'', ''Item 7—Management's Discussion and Analysis of Financial Condition and Results of Operations—Reinsurance—L Agreement'' and ''Item 8—Financial Statements and Supplementary Data—Note 7 to our Consolidated Financial Statements'' which are included elsewhere in this report.

As the workers' compensation regulatory and marketplace environment in Nevada became more competitive, and the monopolistic Fund was eliminated, we adjusted our staffing, programs and insurance products accordingly. In 2000, we moved our corporate headquarters from Carson City to Reno, Nevada and, in 2001, we closed an injured worker rehabilitation center that we considered to be operating uneconomically, terminating the center's staff and selling the associated properties. During 2002, we closed offices in rural Nevada, either terminating the associated staff or relocating them to Reno or Henderson. We began focusing our business model on select small businesses engaged in low to medium hazard industries.

Through July 2002, we operated exclusively in Nevada. During the first half of 2002, we recognized that the California small business workers' compensation insurance market presented potentially attractive opportunities. The California market had experienced the insolvency or departure of a number of workers' compensation companies as companies competed for California business by pricing workers' compensation insurance products at low levels. As the underwriting capacity decreased in California, the rates charged by the remaining workers' compensation insurance providers and by California's state workers' compensation fund increased significantly. In order to capitalize on the opportunity for potential profit presented by these circumstances, we formed and capitalized a wholly owned stock corporation incorporated in California, ECIC, and on July 1, 2002 we acquired the renewal rights to a book of workers' compensation insurance business, and certain other tangible and intangible assets from Fremont Compensation Insurance Group and its affiliates, or collectively, Fremont. The book of business we acquired from Fremont was primarily comprised of accounts in California and, to a lesser extent, in Colorado, Idaho, Montana and Utah.

Because of that transaction, we were able to establish our important relationships and distribution agreements with ADP and Wellpoint. The Fremont transaction also involved the acquisition of in force policies that were written through a fronting facility with Clarendon Insurance Group (Clarendon), and the entry by ECIC into a fronting facility with Clarendon. The fronting facility was placed into run off in the fourth quarter of 2003. For further discussion of the Clarendon fronting facility, see ‘‘—Reinsurance —Clarendon Fronting Facility.’’

In 2003, EICN and ECIC, as well as our wholly-owned subsidiaries Employers Occupational Health, Inc. (EOH), and Elite Insurance Services, Inc. (EIS), began to operate under the Employers Insurance Group trade name. On April 1, 2005, we reorganized into a mutual insurance holding company, EIG Mutual Holding Company, wholly-owned by the policyholders of EICN. Effective February 5, 2007, we converted into a Nevada stock corporation and changed our name to ‘‘Employers Holdings, Inc.’’ and all of the membership interests in EIG were extinguished. In exchange, eligible members of EIG received shares of our common stock or cash. Upon conversion and the completion of the IPO EIG became Employers Holdings, Inc., a publicly traded company.

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The Conversion

The following section provides a summary of the conversion and the terms of our plan of conversion. The description of the conversion in the following sections is only a summary and is qualified in its entirety by reference to the complete terms of the plan of conversion, a copy of which was filed as an exhibit to our registration statement which was declared effective January 30, 2007.

Plan of Conversion

On August 17, 2006, the board of directors of EIG unanimously proposed, approved and adopted a plan of conversion under which EIG would convert from a mutual insurance holding company to a publicly traded stock corporation.

On August 22, 2006, EIG filed an application for conversion with the Nevada Commissioner of Insurance. The Nevada Commissioner of Insurance held a public hearing on the application for conversion on October 26, 2006 and issued an initial order approving the application for conversion on November 29, 2006. At a special meeting of EIG's members on January 13, 2007, the plan of conversion, including the amended and restated articles of incorporation of EIG, was approved by the required vote of EIG's members. On January 13, 2007, the Nevada Commissioner of Insurance issued a final order approving EIG's application for conversion.

Under applicable Nevada law, those persons who were owners of one or more policies issued by EICN that were in force as of August 17, 2006, the date the plan of conversion was initially proposed, approved and adopted by EIG's board of directors, and who therefore had a membership interest in EIG as of such date, were eligible members entitled to receive consideration in the conversion. Persons who became members after the adoption date were not eligible under Nevada law to receive consideration in the conversion although their membership interests were extinguished when the conversion was completed. In addition, persons who were policyholders of our California domiciled insurance subsidiary, ECIC, did not have membership interests in EIG and therefore were not entitled to receive consideration in the conversion.

Effective February 5, 2007, under the terms of the plan of conversion, EIG converted from a mutual insurance holding company to a stock company. In connection with the conversion, EIG's name was changed to Employers Holdings, Inc. and all membership interests in EIG were extinguished. On March 9, 2007 eligible members of EIG received, in the aggregate, 22,765,407 shares of the Company's common stock and cash totaling $462,988,115.

Closed Block

As required by Nevada law, we established a closed block as of February 5, 2007 for the preservation of the reasonable dividend expectations of eligible members and other policyholders holding policies entitling the holder to distributions from the surplus of EICN in accordance with the terms of a dividend plan or program with respect to such policy. The closed block was created for the benefit of (1) all policies issued by EICN that were in force as of February 5, 2007, and that were participating pursuant to a dividend plan or program of EICN and (2) all policies that were no longer in force as of February 5, 2007, but that were participating pursuant to a dividend plan or program of EICN, that had an inception date that was not earlier than 24 months prior to and not later than February 5, 2007, and for which a participating policy dividend has not been calculated, declared and paid by EICN as of February 5, 2007.

Workers' Compensation Insurance Market

Overview

Workers' compensation is a statutory system under which an employer is required to provide coverage for its employees' medical, disability, vocational rehabilitation and death benefit costs for work-related injuries or illnesses. Most businesses comply with this requirement by purchasing workers' compensation insurance. The principal concept underlying workers' compensation laws is that an employee injured in the course of his or her employment has only the legal remedies available under workers' compensation laws and does not have any other recourse against his or her employer. Generally, workers are covered for injuries that occur in the course and within the scope of their employment. An

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employer's obligation to pay workers' compensation benefits does not depend on any negligence or wrongdoing on the part of the employer and exists even for injuries that result from the negligence or wrongdoings of another person, including the employee. The level of benefits varies by state, the nature and severity of the injury or disease and the wages of the injured worker.

Workers' compensation insurance policies generally provide that the carrier will pay all benefits that the insured employer may become obligated to pay under applicable workers' compensation laws. Each state has a regulatory and adjudicatory system that quantifies the level of wage replacement to be paid, determines the level of medical care required to be provided and the cost of permanent impairment and specifies the options in selecting healthcare providers available to the injured employee or the employer. These state laws generally require two types of benefits for injured employees: (1) medical benefits, which include expenses related to diagnosis and treatment of an injury and/or disease, as well as any required rehabilitation, and (2) indemnity payments, which consist of temporary wage replacement, permanent disability payments and death benefits to surviving family members. To fulfill these mandated financial obligations, virtually all businesses are required to purchase workers' compensation insurance or, if permitted by state law or approved by the U.S. Department of Labor, to self-insure. The businesses may purchase workers' compensation insurance from a private insurance carrier such as EICN or ECIC, a state-sanctioned assigned risk pool, a state agency, a self-insurance fund (an entity that allows businesses to obtain workers' compensation coverage on a pooled basis, typically subjecting each employer to joint and several liability for the entire fund) or, may self insure, thereby retaining all risk.

Workers' compensation was the fourth largest property and casualty insurance line in the U.S. in 2005, on a net written premium basis, according to the National Council on Compensation Insurance (NCCI). According to the NCCI, net premiums written in 2005 for the workers' compensation industry were approximately $37.8 billion, or 8.9% of the estimated $425.7 billion in net premiums written for the property and casualty industry as a whole. Premium volume in the workers' compensation industry was up 8.8% in 2005 compared to 2004, while the entire property and casualty industry experienced a 0.4% increase in net premium written in 2005 from 2004, according to the NCCI.

Industry Developments

We believe the workers' compensation sector has recovered from a period characterized by deteriorating operating profitability caused primarily by rising medical claim costs, rising indemnity claim costs and poor investment performance. We believe that these challenges to the workers' compensation sector have been resolved, resulting in current pricing conditions that are more favorable for us.

During the period from 1994 to 2001, we believe that rising loss costs, despite declines in the frequency of losses, severely eroded underwriting profitability in the workers' compensation insurance industry. According to the Insurance Information Institute, the workers' compensation industry's accident year combined ratios rose from 97% in 1994 to a high of 138% in 1999. In addition, the NCCI estimated that workers' compensation loss reserves for private carriers were deficient by $9 billion at year end 2005, which are significantly up from just $0.5 billion year end 1994, yet down from a high of $21 billion at year end 2001.

California Market. We believe that during the late 1990's, California faced even greater challenges than the U.S. workers' compensation market as a whole. California is the largest workers' compensation insurance market in the United States. In 2005, California accounted for an estimated $15.1 billion in written premiums (net of deductibles) according to the Workers' Compensation Insurance Rating Bureau of California (WCIRB), or approximately 27.2% of the entire U.S. workers' compensation market.

From 1995, when California imposed an open rating system where carriers set their own rates, through 1999, California's workers' compensation market was characterized by severe price competition. Carriers were reducing rates in order to maintain, or increase, their market share. Workers' compensation rates in California declined approximately 47% from 1993 to 1998, according to the WCIRB. These lower rates, together with increases in medical and indemnity claim costs, severely eroded underwriting profitability.

This deterioration in underwriting profitability compelled many workers' compensation carriers to significantly reduce their California workers' compensation premium writings, creating a reduction in

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market capacity. It is noteworthy that, according to the WCIRB, insurance carriers representing approximately 35% of the California market in 1994 are no longer writing workers' compensation insurance in California.

We believe that this reduction in capacity in California led to significant rate increases from 2000 through 2003. In addition to, and as a result of, these rate increases, the California legislature passed reform bills which were designed to reduce loss costs. Among other things, these bills addressed medical fee schedules, chiropractic and physical therapy visits, medical utilization guidelines, vocational rehabilitation, permanent disability schedules and the presumption of the treating physician.

As a result of the rate increases from 2000 to 2003 and the legislative reforms, underwriting profitability in California improved significantly according to the WCIRB estimates as of March 31, 2006 (after reflecting the estimate of California reform legislation on unpaid losses). The WCIRB has reported that 2005 marked the third consecutive year with combined ratios in California estimated to be below 80%, following eight consecutive years in which they exceeded 100%.

Despite rate decreases in 2004, 2005 and in 2006, we believe that California remains a profitable operating environment. According to the WCIRB, total estimated ultimate losses in California were down to $7.1 billion in accident year 2005 compared to $12.3 billion in 2002, a reduction of 42%. Indemnity claim counts were down 36% during that same time period. We believe that the impact of reforms will continue to result in loss costs that are supportable by current rate levels.

Nevada Market. The Nevada workers' compensation market has changed dramatically over the past decade. A fully competitive, private market is a relatively recent phenomenon in Nevada. From 1913 until July 1999, the workers' compensation market was served by a monopolistic state fund. In the 1980's, businesses were also allowed to opt for self insurance. In July of 1999, the Nevada workers' compensation insurance market was opened to competition by private carriers, and the state fund was privatized in January of 2000.

Nevada has adopted a ''loss cost'' rate regulation system, under which insurance companies are permitted to file to deviations upwards or downwards from the benchmark rates set by the Insurance Commissioner. As a result, the primary way in which private carriers compete with one another is based on expense differentiation and dividends. The rate environment has been stable. Although some new capital continues to enter the state, the total number of competitors has remained fairly stable at around 210. Competition among the private insurance carriers has stabilized, and we have seen fewer insured's changing carriers. However, we are beginning to see signs that the self insurance market is attracting increasing numbers of employers from the private carrier market.

Our Business Operations

Customers

Our target customers are select small businesses engaged in low to medium hazard industries. Through December 31, 2006, the workers' compensation insurance industry classified risks into four hazard groups based on severity of claims, with businesses in the first, or lowest, hazard group having the most predictable and least costly claims and those in the fourth, or highest, hazard group having the least predictable and most costly claims. All references to hazard groups are to the four hazard groups as defined by the NCCI prior to January 1, 2007. Our historical loss experience has been more favorable for lower hazard groups than for higher hazard groups. Further, we believe it is generally more costly to service and manage the risks associated with higher hazard groups, thereby comparatively reducing the profit margin derived from underwriting business in higher hazard groups. By targeting lower hazard groups, we believe that we improve our ability to generate profitable underwriting results. In 2006, 66.8% and 31.8% of our base direct premiums written were generated by insureds in the second and third lowest hazard groups, respectively. Insureds in the second lowest hazard group include restaurants, physician offices, stores and educational institutions. Insureds in the third lowest hazard group include the residential carpentry, plumbing, and real estate agency businesses.

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The following table sets forth our base direct premiums written by type of insured for our top ten types of insureds and as a percentage of our total base direct premiums written for the year ended December 31, 2006:

Type of Employer	Hazard Group level	Base Direct Premiums Written	Percentage of Total
		(in thousands)	
Restaurants	2	$ 27,654	7.1%
Physicians and physician office clerical	2	24,858	6.4
Store: Wholesale not otherwise classified	2	18,854	4.8
College: Professional employees and clerical	2	11,590	3.0
Store: Retail not otherwise classified	2	11,189	2.9
Clerical office employees not otherwise classified	2	9,846	2.5
Machine shops not otherwise classified	2	9,455	2.4
Clothing manufacturers	2	9,040	2.3
Dentists and dental surgeons–all employees including clerical	2	7,939	2.0