HANOVER INSURANCE GROUP, INC.
Form 10-K
March 01, 2010
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

FORM 10-K

x **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the fiscal year ended December 31, 2009

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: 1-13754

THE HANOVER INSURANCE GROUP, INC.

(Exact name of registrant as specified in its charter)

Delaware	**04-3263626**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**
440 Lincoln Street, Worcester, Massachusetts	**01653**
(Address of principal executive offices)	**(Zip Code)**

Registrant s telephone number, including area code: (508) 855-1000

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

Title of each class	**Name of each exchange on which registered**
Common Stock, $.01 par value	**New York Stock Exchange**
7 5/8% Senior Debentures due 2025	**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 x No ¨

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the 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 x No ¨

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 during the preceding 12 months. Yes ¨ No ¨

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not be contained, to the best of the registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. x

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 definition of accelerated filer , large accelerated filer , and smaller reporting company in Rule 12b-2 of the Exchange Act (check one):

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

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

Based on the closing sales price of June 30, 2009 the aggregate market value of the voting and non-voting common stock held by non-affiliates of the registrant was $1,925,569,754.

The number of shares outstanding of the registrant s common stock, $.01 par value, was 47,497,347 shares as of February 24, 2010.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of The Hanover Insurance Group, Inc. s Proxy Statement relating to the 2010 Annual Meeting of Shareholders to be held May 11, 2010 to be filed pursuant to Regulation 14A are incorporated by reference in Part III.

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PART I

ITEM 1 BUSINESS

ORGANIZATION

The Hanover Insurance Group, Inc. (THG) is a holding company organized as a Delaware corporation in 1995. Our consolidated financial statements include the accounts of THG; The Hanover Insurance Company (Hanover Insurance) and Citizens Insurance Company of America (Citizens), which are our principal property and casualty subsidiaries, and certain other insurance and non-insurance subsidiaries. Our results of operations also included the results of our former life insurance company, First Allmerica Financial Life Insurance Company (FAFLIC), through December 31, 2008. On January 2, 2009, we sold FAFLIC to Commonwealth Annuity and Life Insurance Company (Commonwealth Annuity), a subsidiary of The Goldman Sachs Group, Inc. (Goldman Sachs). The results of operations for FAFLIC are reported as discontinued operations and prior periods in the Consolidated Statements of Income have been reclassified to conform to this presentation.

FINANCIAL INFORMATION ABOUT OPERATING SEGMENTS

Our primary business operations include insurance products and services in three property and casualty operating segments. These segments are Personal Lines, Commercial Lines, and Other Property and Casualty. We report interest expense related to our corporate debt separately from the earnings of our operating segments. Corporate debt consists of our senior debentures, our junior subordinated debentures, surplus notes and advances under our collateralized borrowing program with the Federal Home Loan Bank of Boston (FHLBB). Subordinated debentures are held by the holding company and several subsidiaries.

Information with respect to each of our segments is included in Segment Results on pages 35 to 54 in Management s Discussion and Analysis of Financial Condition and Results of Operations and in Note 15 on pages 122 and 123 of the Notes to the Consolidated Financial Statements included in Financial Statements and Supplementary Data of this Form 10-K.

DESCRIPTION OF BUSINESS BY SEGMENT

Following is a discussion of each of our operating segments.

PROPERTY AND CASUALTY

GENERAL

Our Property and Casualty group manages its operations principally through three segments: Personal Lines, Commercial Lines and Other Property and Casualty. We underwrite personal and commercial property and casualty insurance through Hanover Insurance, Citizens and other THG subsidiaries, primarily through an independent agent network concentrated in the Northeast, Southeast and Midwest United States. Additionally, our Other Property and Casualty segment consists of: Opus Investment Management, Inc. (Opus), which markets investment management services to institutions, pension funds and other organizations; earnings on holding company assets; and a voluntary pools business in which we have not actively participated since 1999.

Our strategy in the Property and Casualty group focuses on strong agency relationships, active agency management, disciplined underwriting, pricing, quality claim handling, effective expense management and customer service. We have a strong regional focus. Taken as a group, THG ranks among the top 30 property and casualty insurers in the United States based on 2008 direct premiums written.

RISKS

The industry s profitability and cash flow can be significantly affected by: price; competition; volatile and unpredictable developments such as extreme weather conditions and natural disasters, including catastrophes; legal developments affecting insurer and insureds liability; extra-contractual liability; size of jury awards; acts of terrorism; fluctuations in interest rates or the value of investments; and other general economic conditions and trends, such as inflationary pressure or unemployment, that may affect the adequacy of reserves or the demand for insurance products. Our investment portfolio and its future returns may be further impacted by the capital markets and current economic conditions, which could affect our liquidity, the amount of realized losses and impairments that will be recognized, credit default levels, our ability to hold such investments until recovery and other factors that may affect investment returns and our capital. Additionally, the economic conditions in geographic locations where we conduct business, especially those locations where our business is concentrated, may affect the

growth and profitability of our business. The regulatory environments in those locations, including any pricing, underwriting or product controls, shared market mechanisms or mandatory pooling arrangements, and other conditions, such as our

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agency relationships, affect the growth and profitability of our business. In addition, our loss and loss adjustment expense (LAE) reserves are based on our estimates, principally involving actuarial projections, at a given time, of what we expect the ultimate settlement and administration of claims will cost based on facts and circumstances then known, predictions of future events, estimates of future trends in claims frequency and severity and judicial theories of liability, costs of repairs and replacement, legislative activity and other factors. Changes to the estimates may affect our profitability.

Reference is also made to Item 1A Risk Factors on pages 16 to 27 and Risks and Forward-Looking Statements on page 77 of Management s Discussion and Analysis of Financial Condition and Results of Operations contained in this Form 10-K.

LINES OF BUSINESS

We underwrite personal and commercial property and casualty insurance coverage.

Personal Lines

Our Personal Lines segment accounted for $1.6 billion, or 55.9%, of consolidated segment revenues; $1.5 billion, or 56.4%, of net written premiums and $76.4 million, or 28.3%, of segment income before federal income taxes for the year ended December 31, 2009. Net written premiums by line of business for our Personal Lines segment are as follows:

FOR THE YEAR ENDED DECEMBER 31, 2009 (In millions, except ratios)	GAAP Net Premiums Written	% of Total
Personal automobile	$ 967.9	65.7%
Homeowners	464.3	31.5
Other	40.0	2.8
Total	$ 1,472.2	100.0%

In personal lines, the market continues to be very competitive with continued pressure on agents from direct writers, as well as the increased usage of real time comparative rating tools. We are focused on our partnerships with high quality, value added agencies and are stressing the importance of account rounding and consultative selling. We have and are continuing to make investments in the business that are intended to help us maintain profitability, build a distinctive position in the market, and provide us with profitable growth opportunities. We continue to refine our products and to work closely with these high potential agents to increase the percentage of business they place with us and to ensure that it is consistent with our preferred mix of business. Additionally, we remain focused on diversifying our state mix beyond our four core states of Michigan, Massachusetts, New York and New Jersey. We expect these efforts to contribute to profitable growth and improved retention in our Personal Lines segment over time.

Products

Personal Lines coverages include:

Personal automobile coverage insures individuals against losses incurred from personal bodily injury, bodily injury to third parties, property damage to an insured s vehicle, and property damage to other vehicles and other property. The majority of our new personal automobile business and approximately 50% of our personal automobile policies-in-force were written through ***Connections® Auto*****,** our multivariate auto product. ***Connections Auto*** utilizes a multivariate rating application which calculates rates based upon the magnitude and correlation of multiple risk factors and is intended to improve both our and our agents competitiveness in our target market segments by offering policies that are more appropriately priced to be commensurate with the underlying risks.

Homeowners coverage insures individuals for losses to their residences and personal property, such as those caused by fire, wind, hail, water damage (except for flooding), theft and vandalism, and against third party liability claims. Our homeowners product, Connections® Home, is available in sixteen states. It is intended to improve our competitiveness for total account business by making it easier and more efficient for our agents to write business with us and by providing more comprehensive coverage options for policyholders. In addition, in 11 states we have introduced a more sophisticated, multivariate pricing approach to our homeowners product which is designed to better align rates with the

underlying risk of each customer. We plan to continue to roll out this improved price segmentation to our other states.

Other personal lines are comprised of personal inland marine, umbrella, fire, personal watercraft, earthquake and other miscellaneous coverages.

Commercial Lines

Our Commercial Lines segment accounted for $1.2 billion, or 43.3%, of consolidated segment revenues; $1.1 billion, or 43.6%, of net written premium and $189.7 million, or 70.2%, of segment income before federal income taxes for the year ended December 31, 2009. The following table provides net written premiums by line of business for our Commercial Lines segment.

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FOR THE YEAR ENDED DECEMBER 31, 2009 (In millions, except ratios)	GAAP Net Premiums Written	% of Total
Commercial multiple peril	$ 366.7	32.3%
Commercial automobile	187.3	16.5
Inland marine	127.4	11.2
Workers compensation	109.7	9.7
Bonds	90.1	7.9
AIX program business	77.2	6.8
Other	177.9	15.6
Total	$ 1,136.3	100.0%

We continue to develop our specialty businesses, including bond and inland marine, which on average are expected to offer higher margins over time and enable us to deliver a more complete product portfolio to our agents and policyholders. In the Commercial Lines business, the market continues to be very competitive. Price competition requires us to continue to be highly disciplined in our underwriting process to ensure that we grow the business only at acceptable margins. Our specialty lines now account for approximately 34% of our Commercial Lines net written premium. Additional growth in our specialty lines continues to be a significant part of our strategy for the future.

We continue to focus on expanding our product offerings in specialty businesses as evidenced by our acquisitions. During 2008, we acquired Verlan Holdings, Inc. (Verlan), referred to as Hanover Specialty Property, a specialty company providing property insurance to small and medium-sized chemical, paint, solvent and other manufacturing and distribution companies, and AIX Holdings, Inc. (AIX), a property and casualty insurance carrier that focuses on underwriting and managing specialty program business. Additionally, we continue to grow our Hanover Professional business, which provides professional liability coverage for principally small to medium sized legal practices and management liability coverage. In January 2010, we entered into a definitive agreement through which we will acquire, subject to regulatory approvals, Campania Holding Company, Inc. (Campania), which specializes in insurance solutions for the healthcare professionals industry, including durable medical equipment suppliers, behavioral health specialists, eldercare providers, and podiatrists. Also, in January 2010, we acquired Benchmark Professional Insurance Services, Inc., a provider of insurance solutions to the design professionals industry, including architects and engineers. We believe these acquisitions provide us with better breadth and diversification of products and improve our competitive position with our agents.

We manage six primary niches in our core business, including human services, schools, religious institutions, moving and storage, manufactured homes and limousines. As a complimentary initiative, we also introduced products focused on management liability, specifically non-profit directors and officers liability and employment practices liability and we plan to extend coverage for private company directors and officers liability. In December 2009, we announced a renewal rights agreement with OneBeacon Insurance Group, further strengthening our competitive position and advancing our expansion efforts in the western states. Through the agreement, we acquired access to a portion of OneBeacon s small and middle market commercial business at renewal, which includes industry programs and middle market niches. At the same time, the transaction will expand our segment, niche and industry program business. This transaction included consideration of approximately $23 million, plus certain potential additional consideration, primarily representing purchased renewal rights intangible assets, which are included as Other assets in our Consolidated Balance Sheets. The agreement is effective for renewals beginning January 1, 2010.

In addition, we have made a number of enhancements to our core products and technology platforms that are intended to drive more total account placements in our Small Commercial business, which we believe will enhance margins. Our focus continues to be on improving and expanding our partnerships with agents. We believe our specialty capabilities and small commercial platform, coupled with distinctiveness in the middle market through our development of niches and better segmentation, enables us to deliver significant value to our agents and policyholders and to improve the overall mix of our business and ultimately our underwriting capability.

Products

Avenues®, our Commercial Lines product suite, provides agents and customers with products designed for small, middle, and specialized markets. Commercial Lines coverages include:

Commercial multiple peril coverage insures businesses against third party liability from accidents occurring on their premises or arising out of their operations, such as injuries sustained from products sold. It also insures business property for damage, such as that caused by fire, wind, hail, water damage (except for flooding), theft and vandalism.

Commercial automobile coverage insures businesses against losses incurred from personal bodily injury, bodily injury to third parties, property damage to an insured s vehicle, and property damage to other vehicles and other property.

Workers compensation coverage insures employers against employee medical and indemnity claims resulting from injuries related to work. Workers compensation policies are often written in conjunction with other commercial policies.

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Other commercial lines is comprised of inland marine, which insures businesses against physical losses to property, such as contractor s equipment, builders risk and goods in transit. It also includes bonds, which provides businesses with contract surety coverage in the event of performance or payment claims, and commercial surety coverage related to fiduciary or regulatory obligations. We also offer, through AIX, underwriting and managing of program business, including to under-served markets where there are specialty coverage or risk management needs. Other commercial lines coverages also include umbrella, general liability, fire, specialty property, and professional and management liability.

Other Property and Casualty

The Other Property and Casualty segment consists of: Opus, which provides investment advisory services to affiliates and also manages approximately $1.3 billion of assets for unaffiliated institutions such as insurance companies, retirement plans and foundations; earnings on holding company assets; and voluntary pools business in which we have not actively participated since 1999. See also Voluntary Pools on page 10 of this Form 10-K.

MARKETING AND DISTRIBUTION

Our Property and Casualty group s structure allows us to maintain a strong focus on local markets and the flexibility to respond to specific market conditions while achieving operational effectiveness. During 2009, we wrote 27.7% of our business in Michigan and 10.4% in Massachusetts. Our structure is a key factor in the establishment and maintenance of productive, long-term relationships with mid-sized, well-established independent agencies. We maintain thirty-one local branch sales and underwriting offices and maintain a presence in twenty-seven states, reflecting our strong regional focus. Processing support for these locations is provided from Worcester, Massachusetts; Howell, Michigan; Atlanta, Georgia; Salem, Virginia; and Buffalo, New York. Administrative functions are centralized in our headquarters in Worcester, Massachusetts.

Independent agents account for substantially all of the sales of our property and casualty products. Agencies are appointed based on profitability track record, financial stability, professionalism, and business strategy. Once appointed, we monitor each agency s performance and, in accordance with applicable legal and regulatory requirements, take actions as necessary to change these business relationships, such as discontinuing the authority of the agent to underwrite certain products or revising commissions or bonus opportunities. We compensate agents primarily through base commissions and bonus plans that are tied to an agency s written premium, growth and profitability.

We are licensed to sell property and casualty insurance in all fifty states in the United States, as well as in the District of Columbia. The following provides our top personal and commercial geographical markets based on total net written premium in the state in 2009:

	Personal Lines		Commercial Lines		Total	
FOR THE YEAR ENDED DECEMBER 31, 2009						
(In millions, except ratios)	**GAAP Net Premiums Written**	**% of Total**	**GAAP Net Premiums Written**	**% of Total**	**GAAP Net Premiums Written**	**% of Total**
Michigan	**$ 588.3**	**40.0%**	**$ 134.2**	**11.8%**	**$ 722.5**	**27.7%**
Massachusetts	**183.9**	**12.5**	**88.7**	**7.8**	**272.6**	**10.4**
New York	**116.4**	**7.9**	**131.5**	**11.6**	**247.9**	**9.5**
New Jersey	**82.3**	**5.6**	**74.6**	**6.6**	**156.9**	**6.0**
Florida	**37.9**	**2.6**	**74.0**	**6.5**	**111.9**	**4.3**
Louisiana	**65.5**	**4.4**	**31.1**	**2.7**	**96.6**	**3.7**
Illinois	**38.7**	**2.6**	**56.1**	**4.9**	**94.8**	**3.6**
Connecticut	**57.9**	**3.9**	**24.6**	**2.2**	**82.5**	**3.2**
Georgia	**47.3**	**3.2**	**32.9**	**2.9**	**80.2**	**3.1**
Virginia	**33.3**	**2.3**	**43.6**	**3.8**	**76.9**	**3.0**

Maine		**33.6**	**2.3**		**37.5**	**3.3**		**71.1**	**2.7**
Texas		**-**	**-**		**70.1**	**6.2**		**70.1**	**2.7**
Indiana		**39.2**	**2.7**		**30.5**	**2.7**		**69.7**	**2.7**
Oklahoma		**36.7**	**2.5**		**28.3**	**2.5**		**65.0**	**2.5**
Other		**111.2**	**7.5**		**278.6**	**24.5**		**389.8**	**14.9**
Total	**$**	**1,472.2**	**100.0%**	**$**	**1,136.3**	**100.0%**	**$**	**2,608.5**	**100.0%**

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We manage Personal Lines business with a focus on acquiring and retaining quality accounts through such programs as our Think Hanover initiative. This program provides agency automation and ease of access for agents to write more lines of business per household. More than 50% of our Personal Lines net written premium is generated in the combined states of Michigan and Massachusetts. In Michigan, according to A.M. Best, based upon direct written premium for 2008, we ranked 4th in the state for Personal Lines business, with approximately 8% of the state s total market. Approximately 64% of our Michigan Personal Lines business is in the personal automobile line and 34% is in the homeowners line. Michigan business represents approximately 39% of our total personal automobile net written premium and 44% of our total homeowners net written premium. In Michigan, we are a principal provider with many of our agencies, averaging over $1.5 million of total direct written premium per agency in 2009.

Approximately 72% of our Massachusetts Personal Lines business is in the personal automobile line and 25% is in the homeowners line. Massachusetts business represents approximately 14% of our total personal automobile net written premium and 10% of our total homeowners net written premium.

We manage our Commercial Lines portfolio, which includes our core and specialty businesses, with a focus on growth from the most profitable industry segments within our underwriting expertise, which varies by line of business and geography. Our core business is composed of several coordinated commercial lines of business, including small and middle market accounts, which include segmented businesses and niches and certain large accounts. Approximately 85% of core Commercial Lines direct written premium is comprised of small and mid-sized accounts; such business is approximately evenly split between small accounts having less than $25,000 in premium and first-tier middle market accounts, those with premium between $25,000 and $200,000. Additionally, we have multiple specialty lines of business, which consist of inland marine, bonds, AIX, Hanover Professionals and Hanover Specialty Property. The Commercial Lines segment seeks to maintain strong agency relationships as a strategy to secure and retain our agents best business. The quality of business written is monitored through an ongoing quality review program, accountability for which is shared at the local, regional and corporate levels.

We sponsor local and national agent advisory councils to gain the benefit of our agents insight and enhance our relationships. These councils provide feedback, input on the development of products and services, guidance on marketing efforts, and support for our strategies, and assist us in enhancing our local market presence.

For our Other Property and Casualty segment business, investment advisory services are marketed directly through Opus.

PRICING AND COMPETITION

We seek to achieve targeted combined ratios in each of our product lines. Our targets vary by product and geography and change with market conditions. The targeted combined ratios reflect competitive market conditions, current investment yield expectations, our loss payout patterns, and target returns on equity. This strategy is intended to better enable us to achieve measured growth and consistent profitability. In addition, we seek to utilize our knowledge of local markets to achieve superior underwriting results. We rely on market information provided by our local agents and on the knowledge of our staff in the local branch offices. Since we maintain a strong regional focus and a significant market share in a number of states, we can apply our knowledge and experience in making underwriting and rate setting decisions. Also, we seek to gather objective and verifiable information at a policy level during the underwriting process, such as past driving records and, where permitted, credit histories.

The property and casualty industry is a very competitive market. Our competitors include national, regional and local companies that sell insurance through various distribution channels, including independent agencies, captive agency forces and direct to consumers through the internet or otherwise. We market primarily through independent agents and compete for business on the basis of product, price, agency and customer service, local relationships and ratings, and effective claims handling, among other things. We believe that our emphasis on maintaining strong agency relationships and a local presence in our markets, coupled with investments in products, operating efficiency, technology and effective claims handling will enable us to compete effectively. Our total account strategy in Personal Lines and broad product offerings in Commercial Lines are instrumental to our strategy to capitalize on these relationships. Our Property and Casualty group is not dependent on a single customer or even a few customers, for which the loss of any one or more would have an adverse effect upon the group s insurance operation.

In our Michigan Personal Lines business, where we market our products under the Citizens Insurance brand name, we compete with a number of national direct writers and regional and local companies. Principal personal lines competitors in Michigan are AAA Auto Club of Michigan, State Farm Group and Auto Owners Insurance Group. We believe our agency relationships, Citizens Insurance brand recognition, and ***Connections Auto*** product enable us to distribute our products competitively in Michigan.

CLAIMS

We utilize experienced claims adjusters, appraisers, medical specialists, managers and attorneys to manage our claims. Our Property and Casualty group has field claims adjusters strategically located throughout our operating territories. Claims staff members work closely with the agents and seek to settle claims rapidly, fairly and efficiently.

Claims office adjusting staff is supported by general adjusters for large property and large casualty losses, by automobile and heavy equipment damage appraisers for automobile material damage losses, and by medical specialists whose principal concentration is on workers compensation and automobile injury cases. In addition, the claims offices are supported by staff attorneys who specialize in litigation defense and claim settlements. We also maintain a special investigative unit that investigates suspected insurance fraud and abuse. We utilize claims processing technology which allows most of the smaller and more routine Personal Lines claims to be processed at centralized locations.

CATASTROPHES

We are subject to claims arising out of catastrophes, which may have a significant impact on our results of operations and financial condition. We may experience catastrophe losses in the future, which could have a material adverse impact on us. Catastrophes can be caused by various events, including snow, ice storm, hurricane, earthquake, tornado, wind, hail, terrorism, fire, explosion, or other extraordinary events. The incidence and severity of catastrophes are inherently unpredictable. We manage our catastrophe risks through underwriting procedures, including the use of deductibles and specific exclusions for floods and earthquakes, as allowed, and other factors, through geographic exposure management and through reinsurance programs. The catastrophe reinsurance program is structured to protect us on a per-occurrence basis. We monitor geographic location and coverage concentrations in order to manage corporate exposure to catastrophic events. Although catastrophes can cause losses in a variety of property and casualty lines, homeowners and commercial multiple peril insurance have, in the past, generated the majority of catastrophe-related claims.

TERRORISM

Private sector catastrophe reinsurance is limited and generally unavailable for losses attributed to acts of terrorism, particularly those involving nuclear, biological, chemical and/or radiological events. As a result, our primary reinsurance protection against large-scale terrorist attacks is presently provided through a Federal program that provides compensation for insured losses resulting from acts of terrorism. Additionally, we are reinsured for certain terrorism related losses within existing Catastrophe, Property per Risk and Casualty Excess of Loss corporate treaties (see Reinsurance - on pages 13 and 14 of this Form 10-K).

The Terrorism Risk Insurance Act of 2002 established the Terrorism Risk Insurance Program (the Program). Coverage under the Program applies to workers compensation, commercial multiple peril and certain other Commercial Lines policies. The Terrorism Risk Insurance Program Reauthorization Act of 2007 (TRIPRA) extended the Program through December 31, 2014, and extended coverage to include both domestic and foreign acts of terrorism. There have recently been proposed amendments to TRIPRA which would, among other things, increase the retentions under the Program, reduce coverages and allow it to expire entirely after 2014.

In accordance with the current Program, we offer policyholders in specific lines of insurance the option to elect terrorism coverage. In order for a loss to be covered under the Program, the loss must meet aggregate industry loss minimums and must be the result of an act of terrorism as certified by the Secretary of the Treasury. The current Program requires us to retain 15% of any claims from a certified terrorist event in excess of our federally mandated deductible. Our deductible represents 20% of direct earned premium for the covered lines of business of the prior year. In 2009, the deductible was $178.0 million, which represents 11.1% of year-end 2008 statutory policyholder surplus, and is estimated to be $184.4 million in 2010, representing 10.6% of 2009 year-end statutory policyholder surplus. We may reinsure our retention and deductible under the Program, although at this time, we have not purchased additional specific terrorism-only reinsurance coverage.

Given the unpredictable nature of the frequency and severity of terrorism losses, future losses from acts of terrorism could be material to our operating results, financial position, and/or liquidity in the future. We manage our exposures on an individual line of business basis and in the aggregate by zip code.

REGULATION

Our property and casualty insurance subsidiaries are subject to extensive regulation in the various states in which they transact business and are supervised by the individual state insurance departments. Numerous aspects of our business are subject to regulatory requirements, including premium rates, mandatory risks that must be covered, limitations on the ability to non-renew or reject business, prohibited exclusions, licensing of agents, investments, restrictions on the size of risks that may be insured under a single policy, reserves and provisions for unearned premiums,

losses and other obligations, deposits of securities for

the benefit of policyholders, policy forms and coverages, advertising, and other conduct, including the use of credit information and other factors in underwriting, as well as other underwriting and claims practices. States also regulate various aspects of the contractual relationships between insurers and independent agents.

In addition, as a condition to writing business in certain states, insurers are required to participate in various pools or risk sharing mechanisms or to accept certain classes of risk, regardless of whether such risks meet its underwriting requirements for voluntary business. Some states also limit or impose restrictions on the ability of an insurer to withdraw from certain classes of business. For example, Massachusetts, New Jersey, New York, Louisiana and Florida each impose material restrictions on a company s ability to materially reduce its exposures or to withdraw from certain lines of business in their respective states. The state insurance departments can impose significant charges on a carrier in connection with a market withdrawal or refuse to approve withdrawal plans on the grounds that they could lead to market disruption. Laws and regulations that limit cancellation and non-renewal of policies or that subject withdrawal plans to prior approval requirements may significantly restrict an insurer s ability to exit unprofitable markets.

Over the past three years, other state-sponsored insurers, reinsurers or involuntary pools have increased significantly, particularly those states which have Atlantic or Gulf Coast storm exposures. As a result, the potential assessment exposure of insurers doing business in such states and the attendant collection risks have increased, particularly, in our case, in the states of Massachusetts, Louisiana and Florida. Such actions and related regulatory restrictions may limit our ability to reduce our potential exposure to hurricane related losses. At this time, we are unable to predict the likelihood or impact of any such potential assessments or other actions.

In February 2009, the Governor of Michigan called upon every automobile insurer operating in the state to freeze personal automobile insurance rates for 12 months to allow time for the legislature to enact comprehensive automobile insurance reform. In addition, she endorsed a number of proposals by her appointed Automobile and Home Insurance Consumer Advocate and which are currently under consideration by the Michigan State Legislature which would, among other things, change the current rate approval process from the current file and use system to prior approval , eliminate territorial rating, mandate affordable rates, reduce the threshold for lawsuits to be filed in at fault incidents, require insurers to offer a low cost policy, and prohibit the use of certain underwriting criteria such as credit-based insurance scores. The Office of Financial and Insurance Regulation (OFIR) had previously issued regulations prohibiting the use of credit scores to rate personal lines insurance policies, which regulations are the subject of litigation being reviewed by the Michigan Supreme Court. Oral arguments were held before the Supreme Court on October 7, 2009. Pending a determination by the Michigan Supreme Court, OFIR is enjoined from disapproving rates on the basis that they are based in part on credit-based insurance scores. On November 9, 2009, the Michigan Board of Canvassers issued preliminary approval allowing proponents to begin collecting signatures as the first step in placing a ballot initiative in front of voters in November of 2010. The proposed question would require a number of changes for the property and casualty market, including, subject to certain limitations, the rollback of rates by up to 20% for all lines with the exception of workers compensation and surety and an additional 20% rollback of personal automobile rates for good drivers . Proponents must present over 300,000 valid voter signatures by May 26, 2010 to put this measure on the ballot. At this time, we are unable to predict the likelihood of adoption or impact on our business of any such proposals or regulations, but any such restrictions could have an adverse affect on our results of operations.

The Massachusetts Commissioner of Insurance issued decisions pertaining to personal automobile insurance to end the fix-and-establish system of setting automobile rates and replace it with a system of managed competition . It began implementing an Assigned Risk Plan beginning with new business as of April 1, 2008. The Assigned Risk Plan distributes the Massachusetts residual automobile market based on individual policyholder assignments rather than assigning carriers Exclusive Representative Producers as was done under the prior system. We believe the Assigned Risk Plan provides for a more equitable distribution of residual market risks across all carriers in the market. As a result of the implementation of managed competition, new insurance competitors, including direct writers who previously did not participate in the Massachusetts personal automobile market, have entered the market and we consider the market and pricing environment to be very competitive. The Massachusetts Attorney General has issued a report critical of aspects of the new regulatory approach and indicated that she will propose regulations to address these concerns. At this time, we are unable to predict whether the Attorney General will take such actions or what impact they may have.

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The insurance laws of many states generally provide that property and casualty insurers doing business in those states belong to statutory property and casualty guaranty funds. The purpose of these guaranty funds is to protect policyholders by requiring that solvent property and casualty insurers pay insurance claims of insolvent insurers. These guaranty associations generally pay these claims by assessing solvent insurers proportionately based on the insurer s share of voluntary written premium in the state. While most guaranty associations provide for recovery of assessments through subsequent rate increases, surcharges or premium tax credits, there is no assurance that insurers will ultimately recover these assessments, which could be material, particularly following a large catastrophe or in markets which become disrupted.

We are subject to periodic financial and market conduct examinations conducted by state insurance departments. We are also required to file annual and other reports relating to the financial condition of our insurance subsidiaries and other matters.

From time to time, there have been proposals for federal regulation of insurance companies, either in addition to or in lieu of, state regulations. In connection with proposals to reform regulation of bank and other financial institutions, there have been proposals to create a National Insurance Office. Current proposals provide that the National Insurance Office would collect information regarding insurance companies, work with the National Association of Insurance Commissions (the NAIC), the body which seeks to coordinate the activities of the various state regulators, and have certain authority with respect to state laws which affect foreign insurance companies. We are unable to predict whether any such proposals will be adopted or what impact, if any, they will have on our business.

See also Contingencies and Regulatory Matters on pages 73 to 75 and Other Significant Transactions on pages 67 and 68 in Management s Discussion and Analysis of Financial Condition and Results of Operations of this Form 10-K.

INVOLUNTARY RESIDUAL MARKETS

As a condition of our license to do business in various states, we are required to participate in mandatory property and casualty residual market mechanisms which provide various insurance coverages where such coverage may not otherwise be available at rates which are deemed reasonable. Such mechanisms provide coverage primarily for personal and commercial property, personal and commercial automobile, and workers compensation, and include assigned risk plans, reinsurance facilities and involuntary pools, joint underwriting associations, fair access to insurance requirements (FAIR) plans, and commercial automobile insurance plans. For example, since most states compel the purchase of a minimal level of automobile liability insurance, states have developed shared market mechanisms to provide the required coverages and in many cases, optional coverages, to those drivers who, because of their driving records or other factors, cannot find insurers who will insure them voluntarily. Also, FAIR plans and other similar property insurance shared market mechanisms increase the availability of property insurance in circumstances where homeowners are unable to obtain insurance at rates deemed reasonable, such as in coastal or other areas prone to natural catastrophes.

Our participation in such shared markets or pooling mechanisms is generally proportional to our direct writings for the type of coverage written by the specific pooling mechanism in the applicable state. We experienced an underwriting gain from participation in these mandatory residual market mechanisms of $2.3 million in 2009, compared to underwriting losses of $11.5 million and $12.3 million for 2008 and 2007, respectively. The underwriting gain in 2009 was primarily attributable to favorable development from the runoff of the Massachusetts Commonwealth Automobile Reinsures (CAR) facility of $9.4 million and gains in other state mandated residual market mechanisms of $3.0 million. These gains were partially offset by an underwriting loss resulting from our mandatory participation in the Michigan Assigned Claims (MAC) facility of $10.1 million. MAC is an assigned claim plan covering people injured in uninsured motor vehicle accidents. Our participation in the MAC facility is based on our share of personal and commercial automobile direct written premium in the state and resulted in underwriting losses of $11.2 million and $ 10.4 million in 2008 and 2007, respectively. Other than the MAC and CAR facilities, mandatory residual market mechanisms were not significant to our 2009, 2008 or 2007 results of operations. With respect to FAIR plans and other similar property insurance shared market mechanisms that have experienced increased exposures in recent years due to the growing residual market for coastal property, it is difficult to accurately estimate our potential financial exposure for future events. A large coastal event, particularly affecting Louisiana, Massachusetts, Florida, New York or New Jersey, would likely be material to our results of operations.

The Michigan Catastrophic Claims Association (MCCA) is a reinsurance mechanism that covers no-fault first party medical losses of retentions in excess of $460,000. All automobile insurers doing business in Michigan are required to participate in the MCCA. Insurers are reimbursed for their covered losses in excess

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of this threshold, which increased from $440,000 to $460,000 on July 1, 2009, and will continue to increase each July 1st in scheduled amounts until it reaches $500,000 in 2011. Funding for MCCA comes from assessments against automobile insurers based upon their proportionate market share of the state s automobile liability insurance market. Insurers are allowed to pass along this cost to Michigan automobile policyholders. We ceded to the MCCA premiums earned and losses and LAE of $55.8 million and $97.7 million in 2009, $60.9 million and $129.8 million in 2008, and $70.1 million and $84.6 million in 2007, respectively. At December 31, 2009, the MCCA was the only reinsurer or reinsurance facility that represented 10% or more of our total reinsurance assets. At December 31, 2009 and 2008, we had reinsurance recoverables on paid and unpaid losses from the MCCA of $652.8 million and $613.8 million, respectively. We believe that we are unlikely to incur any material loss as a result of non-payment of amounts owed to us by MCCA, because (i) the payment obligations of the MCCA are extended over many years, resulting in relatively small current payment obligations in terms of MCCA s total assets, (ii) the MCCA is supported by assessments permitted by statute, and (iii) we have not historically incurred losses as a result of non-payment of MCCA claims. Reference is made to Note 17 Reinsurance , on pages 123 and 124 and Note 20 Commitments and Contingencies , on pages 127 to 129 of the Notes to Consolidated Financial Statements included in Financial Statements and Supplementary Data of this Form 10-K.

VOLUNTARY POOLS

We have terminated our participation in virtually all voluntary pool business; however, we continue to be subject to claims related to years in which we were a participant. The most significant of these pools is a voluntary excess and casualty reinsurance pool known as the Excess and Casualty Reinsurance Association (ECRA), in which we were a participant from 1950 to 1982. In 1982, the pool was dissolved and since that time the business has been in runoff. Our participation in this pool has resulted in average paid losses of approximately $2 million annually over the past ten years. Because of the inherent uncertainty regarding the types of claims in this pool, there can be no assurance that the reserves will be sufficient. Loss and LAE reserves for our voluntary pools were $52.9 million and $67.0 million at December 31, 2009 and 2008, respectively, including $39.8 million and $52.0 million at December 31, 2009 and 2008, respectively, related to ECRA. During 2009, our ECRA pool reserves were lowered by $6.3 million as the result of an actuarial study completed by the ECRA pool. Management reviewed the ECRA actuarial study, concurred that the study was reasonable, and adopted its actuarial point estimate. In addition, we recognized favorable development of $4.3 million on a separate large claim settlement within the ECRA pool during 2009. Excluding the ECRA pool, the average annual paid losses and reserve balances at December 31, 2009 for other voluntary pools were not individually significant.

RESERVE FOR UNPAID LOSSES AND LOSS ADJUSTMENT EXPENSES

Reference is made to Property and Casualty Reserve for Losses and Loss Adjustment Expenses on pages 42 to 51 of Management s Discussion and Analysis of Financial Condition and Results of Operations of this Form 10-K.

The following table reconciles reserves determined in accordance with accounting principles and practices prescribed or permitted by insurance statutory authorities (Statutory) to reserves determined in accordance with generally accepted accounting principles (GAAP). The primary difference between the following Statutory reserves and our GAAP reserves is the requirement, on a GAAP basis, to present reinsurance recoverables as an asset, whereas Statutory guidance provides that reserves are reflected net of the corresponding reinsurance recoverables. We do not use discounting techniques in establishing GAAP reserves for losses and LAE in our Property and Casualty business, nor have we participated in any loss portfolio transfers or other similar transactions.

DECEMBER 31	**2009**	**2008**	**2007**
(In millions)			
Statutory reserve for losses and LAE	**$ 2,218.3**	$ 2,211.0	$ 2,225.3
GAAP adjustments:			
Reinsurance recoverable on unpaid losses	**1,060.2**	988.2	940.5
Reserves of discontinued operations(1)	**(127.5)**	-	-
Other	**1.1**	2.1	-
GAAP reserve for losses and LAE	**$ 3,152.1**	$ 3,201.3	$ 3,165.8

(1) Reserves on discontinued operations are included in liabilities of discontinued operations for GAAP and loss and loss adjustment expenses for Statutory.

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ANALYSIS OF LOSSES AND LOSS ADJUSTMENT EXPENSES RESERVE DEVELOPMENT

The following table sets forth the development of our GAAP reserves (net of reinsurance recoverables) for unpaid losses and LAE from 1999 through 2009:

DECEMBER 31 *(In millions)*	**2009**	**2008**	**2007**	**2006**	**2005**	**2004**	**2003**	**2002**	**2001**	**2000**	**1999**
Net reserve for losses and LAE[1]	**$$2,091.9**	$2,213.1	$2,225.3	$2,274.4	$2,351.1	$2,161.5	$2,078.9	$2,083.8	$2,056.9	$1,902.2	$1,924.5
Cumulative amount paid as of[2]:											
One year later		788.5	711.1	689.9	729.5	622.0	658.3	784.5	763.6	780.3	703.8
Two years later			1,050.5	1,061.8	1,121.9	967.0	995.4	1,131.7	1,213.6	1,180.1	1,063.8
Three years later				1,268.4	1,368.3	1,175.4	1,217.1	1,339.5	1,423.9	1,458.3	1,298.2
Four years later					1,499.6	1,312.9	1,351.6	1,478.9	1,551.5	1,567.8	1,471.8
Five years later						1,384.4	1,436.5	1,566.8	1,636.9	1,636.9	1,524.4
Six years later							1,486.5	1,629.3	1,696.3	1,689.0	1,560.6
Seven years later								1,668.9	1,742.3	1,731.0	1,596.4
Eight years later									1,773.6	1,768.5	1,627.2
Nine years later										1,793.6	1,657.5
Ten years later											1,677.5
Net reserve re-estimated as of[3]:											
End of year	**2,091.9**	2,213.1	2,225.3	2,274.4	2,351.1	2,161.5	2,078.9	2,083.8	2,056.9	1,902.2	1,924.5
One year later		2,057.8	2,073.7	2,138.0	2,271.1	2,082.0	2,064.4	2,124.2	2,063.3	2,010.8	1,837.1
Two years later			1,863.8	2,008.9	2,155.8	1,989.6	2,017.4	2,115.3	2,122.5	2,028.2	1,863.3
Three years later				1,850.6	2,072.0	1,899.6	1,971.5	2,093.9	2,124.3	2,066.6	1,863.0
Four years later					1,962.3	1,853.2	1,917.3	2,074.0	2,121.6	2,071.1	1,893.6
Five years later						1,776.0	1,896.1	2,041.6	2,121.7	2,078.3	1,901.6
Six years later							1,828.1	2,034.9	2,103.2	2,084.1	1,913.4
Seven years later								1,978.9	2,100.6	2,074.8	1,925.4
Eight years later									2,050.9	2,076.8	1,920.9
Nine years later										2,033.4	1,925.6
Ten years later											1,888.3
Redundancy (deficiency), net [4]	**$**	$ 155.3	$ 361.5	$ 423.8	$ 388.8	$ 385.5	$ 250.8	$ 104.9	$ 6.0	$ (131.2)	$ 36.2

(1) Sets forth the estimated net liability for unpaid losses and LAE recorded at the balance sheet date for each of the indicated years; represents the estimated amount of net losses and LAE for claims arising in the current and all prior years that are unpaid at the balance sheet date, including incurred but not reported (IBNR) reserves.

(2) Cumulative loss and LAE payments made in succeeding years for losses incurred prior to the balance sheet date.

(3) Re-estimated amount of the previously recorded liability based on experience for each succeeding year; increased or decreased as payments are made and more information becomes known about the severity of remaining unpaid claims.

(4) Cumulative redundancy or deficiency at December 31, 2009 of the net reserve amounts shown on the top line of the corresponding column. A redundancy in reserves means the reserves established in prior years exceeded actual losses and LAE or were re-evaluated at less than the original reserved amount. A deficiency in reserves means the reserves established in prior years were less than actual losses and LAE or were re-evaluated at more than the original reserved amount.

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The following table sets forth the development of gross reserve for unpaid losses and LAE from 2000 through 2009:

DECEMBER 31 ***(In millions)***	**2009**	**2008**	**2007**	**2006**	**2005**	**2004**	**2003**	**2002**	**2001**	**2000**
Reserve for losses and LAE:										
Gross liability	**$ 3,152.1**	$ 3,201.3	$ 3,165.8	$ 3,163.9	$ 3,458.7	$ 3,068.6	$ 3,018.9	$ 2,961.7	$ 2,921.5	$ 2,719.1
Reinsurance recoverable	**1,060.2**	988.2	940.5	889.5	1,107.6	907.1	940.0	877.9	864.6	816.9
Net liability	**$ 2,091.9**	$ 2,213.1	$ 2,225.3	$ 2,274.4	$ 2,351.1	$ 2,161.5	$ 2,078.9	$ 2,083.8	$ 2,056.9	$ 1,902.2
One year later:										
Gross re-estimated liability		$ 3,116.2	$ 3,037.1	$ 3,047.0	$ 3,409.9	$ 3,005.9	$ 2,972.2	$ 3,118.6	$ 2,926.4	$ 2,882.0
Re-estimated recoverable		1,058.4	963.4	909.0	1,138.8	923.9	907.8	994.4	863.1	871.2
Net re-estimated liability		$ 2,057.8	$ 2,073.7	$ 2,138.0	$ 2,271.1	$ 2,082.0	$ 2,064.4	$ 2,124.2	$ 2,063.3	$ 2,010.8
Two years later:										
Gross re-estimated liability			$ 2,901.9	$ 2,960.5	$ 3,334.1	$ 2,941.5	$ 2,970.7	$ 3,113.5	$ 3,118.9	$ 2,913.0
Re-estimated recoverable			1,038.1	951.6	1,178.3	951.9	953.3	998.2	996.4	884.8
Net re-estimated liability			$ 1,863.8	$ 2,008.9	$ 2,155.8	$ 1,989.6	$ 2,017.4	$ 2,115.3	$ 2,122.5	$ 2,028.2
Three years later:										
Gross re-estimated liability				$ 2,871.1	$ 3,288.8	$ 2,897.7	$ 2,951.0	$ 3,129.4	$ 3,146.6	$ 3,063.9
Re-estimated recoverable				1,020.5	1,216.8	998.1	979.5	1,035.5	1,022.3	997.3
Net re-estimated liability				$ 1,850.6	$ 2,072.0	$ 1,899.6	$ 1,971.5	$ 2,093.9	$ 2,124.3	$ 2,066.6
Four years later:										
Gross re-estimated liability					$ 3,254.7	$ 2,886.8	$ 2,935.1	$ 3,128.6	$ 3,178.8	$ 3,088.5
Re-estimated recoverable					1,292.4	1,033.6	1,017.8	1,054.6	1,057.2	1,017.4
Net re-estimated liability					$ 1,962.3	$ 1,853.2	$ 1,917.3	$ 2,074.0	$ 2,121.6	$ 2,071.1
Five years later:										
Gross re-estimated liability						$ 2,878.0	$ 2,946.1	$ 3,134.4	$ 3,197.0	$ 3,126.1
Re-estimated recoverable						1,102.0	1,050.0	1,092.8	1,075.3	1,047.8
Net re-estimated liability						$ 1,776.0	$ 1,896.1	$ 2,041.6	$ 2,121.7	$ 2,078.3

Six years later:				
Gross re-estimated liability	$ 2,940.7	$ 3,163.9	$ 3,213.9	$ 3,148.7
Re-estimated recoverable	1,112.6	1,129.0	1,110.7	1,064.6
Net re-estimated liability	$ 1,828.1	$ 2,034.9	$ 2,103.2	$ 2,084.1
Seven years later:				
Gross re-estimated liability		$ 3,168.3	$ 3,259.3	$ 3,172.9
Re-estimated recoverable		1,189.4	1,158.7	1,098.1
Net re-estimated liability		$ 1,978.9	$ 2,100.6	$ 2,074.8
Eight years later:				
Gross re-estimated liability			$ 3,265.6	$ 3,222.1
Re-estimated recoverable			1,214.7	1,145.3
Net re-estimated liability			$ 2,050.9	$ 2,076.8
Nine years later:				
Gross re-estimated liability				$ 3,227.8
Re-estimated recoverable				1,194.4
Net re-estimated liability				$ 2,033.4

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Reinsurance

We maintain a reinsurance program designed to protect against large or unusual loss and LAE activity. We utilize a variety of reinsurance agreements, which are intended to control our exposure to large property and casualty losses, stabilize earnings and protect capital resources, including facultative reinsurance, excess of loss reinsurance and catastrophe reinsurance. Catastrophe reinsurance serves to protect us, as the ceding insurer, from significant losses arising from a single event such as snow, ice storm, hurricane, earthquake, tornado, wind, hail, terrorism, fire, explosion, or other extraordinary events. We determine the appropriate amount of reinsurance based upon our evaluation of the risks insured, exposure analyses prepared by consultants and/or reinsurers and on market conditions, including the availability and pricing of reinsurance.

We cede to reinsurers a portion of our risk based upon insurance policies subject to such reinsurance. Reinsurance contracts do not relieve us from our obligations to policyholders. Failure of reinsurers to honor their obligations could result in losses to us. We believe that the terms of our reinsurance contracts are consistent with industry practice in that they contain standard terms with respect to lines of business covered, limit and retention, arbitration and occurrence. We believe our reinsurers are financially sound, based upon our ongoing review of their financial statements, financial strength ratings assigned to them by rating agencies, their reputations in the reinsurance marketplace, and the analysis and guidance of our reinsurance advisors.

As described under Terrorism above, although we exclude coverage of nuclear, chemical or biological events from the personal and commercial policies we write, we are required under TRIPRA to offer this coverage in our workers compensation policies. We have reinsurance coverage under our casualty reinsurance treaty for losses that result from nuclear, chemical or biological events of approximately $30 million. All other treaties exclude such coverage. Further, under TRIPRA, our retention of losses from such events, if deemed certified terrorist events, is limited to approximately $184.4 million deductible and 15% of losses in excess of this deductible in 2010. However, there can be no assurance that such events would not be material to our financial position or results of operations.

As described above under Involuntary Residual Markets , we are subject to concentration of risk with respect to reinsurance ceded to various mandatory residual market mechanisms.

Reference is made to Note 17 Reinsurance on pages 123 and 124 of the Notes to Consolidated Financial Statements included in Financial Statements and Supplementary Data of this Form 10-K. Reference is also made to Involuntary Residual Markets , and Voluntary Pools on pages 9 and 10 of this Form 10-K.

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Our 2010 reinsurance program is substantially consistent with our 2009 program. The following table summarizes both our 2009 and 2010 reinsurance programs (excluding coverage available under the federal terrorism reinsurance program which is described under Terrorism above):

(in millions)

Treaty	*Loss Amount*	*Loss Retention*	*Reinsurance Coverage, Including Non-Certified Terrorism*[1]	*Certified Terrorism Coverage (as defined by TRIPRA)*[1]
Property catastrophe occurrence treaty [2], [3]				
All perils, per occurrence	< $150.0	100%	NA	NA
	$150.0 to $250.0	48%	52%	52%; Personal Lines only
	$250.0 to $700.0	NA	100%	100%; Personal Lines only
	$700.0 to $900.0	50%	50%	50%; Personal Lines only
	> $900.0	100%	NA	NA
Commercial property excess of loss treaty[4]				
All perils, per occurrence, excludes Insurance Services Office (ISO) named storms	< $10.0	100%	NA	NA
	$10.0 to $50.0	NA	100%	NA
	> $50.0	100%	NA	NA
Property per risk treaty [2], [3], [5]				
All perils, including commercial marine, per risk	< $2.0	100%	NA	NA
	$2.0 to $5.0	NA	100%	100%
	$5.0 to $100.0	NA	100%	100%
	> $100.0	100%	N/A	NA
Casualty reinsurance [3], [6]				
Each loss, per occurrence for general liability, automobile liability, workers compensation and umbrella	< $2.0	100%	NA	NA
	$2.0 to $5.0	25%	75%	subject to $10M annual aggregate limit
	$5.0 to $10.0	NA	100%	subject to $5M annual aggregate limit
	$10.0 to $30.0	NA	100%	subject to $20M annual aggregate limit
	> $30.0	100%	NA	NA
Surety/fidelity bond reinsurance [2]				
Excess of loss treaty on bond business	< $5.0	100%	NA	NA
	$5.0 to $10.0	8%	92%	NA

	$10.0 to $35.0	5%	95%	NA
	> $35.0	100%	NA	NA
Professional liability reinsurance				
Lawyers , miscellaneous professional and technology errors and omissions	< $1.0	100%	NA	NA
	$1.0 to $10.0	10%	90%	NA
	> $10.0	100%	NA	NA
Management liability reinsurance				
Management liability and employment practices liability	< $1.0	100%	NA	NA
	$1.0 to $5.0	10%	90%	NA
	> $5.0	100%	NA	NA

NA Not applicable

(1) This table does not illustrate coverage available under the federal terrorism reinsurance program, but reinsurers typically define coverage for terrorist events based upon whenever such event is certified or non-certified .

(2) The property catastrophe occurrence treaty $200 million excess of $700 million layer was purchased effective July 1, 2009 for a twelve month term ending on June 30, 2010 and only provides coverage for perils in the Northeast. The property per risk and surety/fidelity bond treaties have annual effective dates of July 1st. All other treaties have January 1st annual effective dates.

(3) As discussed in Other Significant Transactions in Management s Discussion and Analysis on page 67 and 68 of this Form 10-K, we purchased AIX on November 28, 2008. In addition to certain layers of coverage from our reinsurance programs as described in this table, the AIX reinsurance program also includes surplus share, quota share, excess of loss, facultative and other forms of reinsurance that cover the writings from AIX specialty and proprietary programs. There are approximately 50 different AIX programs and the reinsurance program is customized to fit the exposure profile of each program.

(4) The commercial property excess of loss agreement is effective January 1, 2010 and reinsures commercial properties which have at least one location with multiple buildings covered by our policy. This agreement excludes catastrophe losses resulting from events declared by ISO. These Named Storms are excluded since losses from such storms are usually covered under property catastrophe occurrence treaties.

(5) The property per risk treaty $2 million to $5 million layer is subject to a $6 million annual aggregate deductible.

(6) Coverage between $10 million and $30 million under this agreement is clash reinsurance. Clash reinsurance is a type of excess of loss reinsurance in which an insurance company is reinsured in the event there is a casualty loss affecting two or more of its insureds. Umbrella is covered under our casualty reinsurance treaty subject to separate limits as defined. Umbrella and casualty lines share coverage at the $2 million to $10 million layers with the maximum umbrella limit subject to the casualty treaty of $5 million. There is also a separate layer that provides umbrella coverage of $15 million excess of $5 million per occurrence.

DISCONTINUED OPERATIONS

During 2009, we segregated our discontinued operations business into three components: Discontinued FAFLIC Business, Discontinued Operations of our Variable Life Insurance and Annuity Business, and Discontinued Accident and Health Business.

Our Discontinued FAFLIC Business, which was sold to Commonwealth Annuity on January 2, 2009, included traditional life insurance products, a block of retirement products and a guaranteed investment contract. Results from this business in 2009 reflect recoveries related to indemnification costs. Our Discontinued Operations of our Variable Life Insurance and Annuity business reflects the net costs and recoveries associated with the 2005 sale of this business and primarily includes recoveries of indemnification costs. Our Discontinued Accident and Health Business includes the accident and health business assumed by Hanover Insurance and includes interests in approximately 23 assumed accident and health reinsurance pools and arrangements. We ceased writing new premiums in this business in 1999, subject to certain contractual obligations. The reinsurance pool business consists primarily of direct and assumed medical stop loss, the medical and disability portions of workers compensation risks, small group managed care, long-term disability and long-term care pools, student accident and special risk business. Our total reserves for the assumed accident and health business were $130.5 million at December 31, 2009. The total amount recoverable from third party reinsurers was $6.6 million at December 31, 2009. Total net reserves were $123.9 million at December 31, 2009. We will continue to account for this business as Discontinued Operations.

Loss estimates associated with substantially all of this business are provided by managers of each pool. We adopt reserve estimates for this business that considers this information and other facts. We update these reserves as new information becomes available and further events occur that may affect the ultimate resolution of unsettled claims. We believe that the reserves recorded related to this business are adequate. However, since loss cost estimates related to our accident and health business are dependent on several assumptions, including, but not limited to, future health care costs, persistency of medical care inflation, claims, particularly in the long-term care business, morbidity and mortality assumptions, and these assumptions can be impacted by technical developments and advancements in the medical field and other factors, there can be no assurance that the reserves established for this business will prove sufficient. Revisions to these reserves could have a material adverse effect on our results of operations for a particular quarterly or annual period or on our financial position.

Our discontinued operations, in total, generated a net gain of $9.4 million during 2009. Reference is made to Segment Results Discontinued Operations on pages 52 and 53 of Management s Discussion and Analysis of Financial Condition and Results of Operations of this Form 10-K.

Assets and liabilities related to our accident and health business are reflected as assets and liabilities of discontinued operations.

INVESTMENT PORTFOLIO

We held $5.2 billion of investment assets at December 31, 2009, including $117.1 million of assets in our discontinued accident and health business. Approximately 92% of our investment assets are comprised of fixed maturities, which includes both investment grade and below investment grade public and private debt securities. An additional 6% of our investment assets are comprised of cash and cash equivalents, while the remaining 2% includes equity securities, commercial mortgage loans and other long-term investments. These investments are generally of high quality and our fixed maturities are broadly diversified across sectors of the fixed income market.

For our Property and Casualty business, we developed an investment strategy that is intended to maximize investment income with consideration towards driving long-term growth of shareholders equity and book value. The determination of the appropriate asset allocation is a process that focuses on the types of business written and the level of surplus required to support our different businesses and the risk return profiles of the underlying asset classes. We look to balance the goals of capital preservation, stability, liquidity and after-tax return.

The majority of our assets are invested in the fixed income markets. Through fundamental research and credit analysis, our investment professionals seek to identify a balance of stable income producing higher quality U.S. agency, municipal, corporate and mortgage-backed securities and undervalued securities in the credit markets. We have a general policy of diversifying investments both within and across all sectors to mitigate credit and interest rate risk. We monitor the credit quality of our investments and our exposure to individual markets, borrowers, industries, sectors and, in the case of direct commercial mortgages and commercial mortgage-backed securities, property types and geographic locations.

All investments held by our insurance subsidiaries are subject to diversification requirements under state insurance laws. Our investment asset portfolio duration is approximately four years and is generally maintained in the range of 1.5 to 3 times the duration of our insurance liabilities. We seek to maintain sufficient liquidity to support our cash flow requirements by monitoring the cash

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requirements associated with our insurance and corporate liabilities, laddering the maturities within the portfolio, closely monitoring our investment durations, holding highly liquid public securities and managing the purchases and sales of assets.

Reference is made to Investment Portfolio on pages 55 to 61 of Management s Discussion and Analysis of Financial Condition and Results of Operations of this Form 10-K.

RATING AGENCIES

Insurance companies are rated by rating agencies to provide both industry participants and insurance consumers information on specific insurance companies. Higher ratings generally indicate the rating agencies opinion regarding financial stability and a stronger ability to pay claims.

We believe that strong ratings are important factors in marketing our products to our agents and customers, since rating information is broadly disseminated and generally used throughout the industry. We believe that a rating of A- or higher from A.M. Best Co. is particularly important for our business. Insurance company financial strength ratings are assigned to an insurer based upon factors deemed by the rating agencies to be relevant to policyholders and are not directed toward protection of investors. Such ratings are neither a rating of securities nor a recommendation to buy, hold or sell any security.

See Rating Agency Actions on pages 75 and 76 in Management s Discussion and Analysis of Financial Condition and Results of Operations of this Form 10-K.

EMPLOYEES

We have approximately 4,100 employees located throughout the United States as of December 31, 2009. We believe our relations with employees are good.

EXECUTIVE OFFICERS OF THE REGISTRANT

Reference is made to Directors and Executive Officers of the Registrant in Part III, Item 10 on pages 133 and 134 of this Form 10-K.

AVAILABLE INFORMATION

We file our annual report on Form 10-K, quarterly reports on Form 10-Q, periodic information on Form 8-K, our proxy statement, and other required information with the SEC. Shareholders may read and copy any materials on file with the SEC at the SEC s Public Reference Room at 100 F Street, NE, Washington, DC 20549. Shareholders may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. In addition, the SEC maintains an Internet website, http://www.sec.gov, which contains reports, proxy and information statements and other information with respect to our filings.

Our website address is http://www.hanover.com. We make available free of charge on or through our website, our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as soon as reasonably practicable after we electronically file such material with, or furnish it to, the SEC. Additionally, our Code of Conduct is also available, free of charge, on our website. The Code of Conduct applies to our directors, officers and employees, including our Chief Executive Officer, Chief Financial Officer and Controller. While we do not expect to grant waivers to our Code of Conduct, any such waivers granted to our Chief Executive Officer, Chief Financial Officer or Controller, or any amendments to our Code will be posted on our website as required by law or rules of the New York Stock Exchange. Our Corporate Governance Guidelines and the charters of our Audit Committee, Compensation Committee, Committee of Independent Directors and Nominating and Corporate Governance Committee, are available on our website. All documents are also available in print to any shareholder who requests them.

ITEM 1A RISK FACTORS

We wish to caution readers that the following important factors, among others, in some cases have affected and in the future could affect our actual results and could cause our actual results and needs to differ materially from historical results and from those expressed in any of our forward-looking statements made from time to time by us on the basis of our then-current expectations. When used in this Form 10-K, the words believes , anticipates , expects , projections , outlook , should , could , plan , guidance , likely , on track to , targeted and similar expressions are intended to identify forward-looking statements. The businesses in which we engage are in rapidly

changing and competitive markets and involve a high degree of risk. Accuracy with respect to forward-looking projections is difficult.

Our results may fluctuate as a result of cyclical changes in the property and casualty insurance industry.

We generate most of our total revenues and earnings through our property and casualty insurance subsidiaries. The results of companies in the property and casualty insurance industry historically have been subject to significant fluctuations and uncertainties. Our profitability could be affected significantly by the following items.

increases in costs, particularly those occurring after the time our insurance products are priced and including construction, automobile repair, and medical and rehabilitation costs. This includes cost shifting from health insurers to casualty and liability insurers (whether as a result of an increasing number of injured parties without health insurance, coverage changes in health policies to make such coverage, in certain circumstances, secondary to other policies, or implementation of the Medicare Secondary Payer Act which requires reporting and imposes other requirements with respect to medical and related claims paid with respect to Medicare eligible individuals). As it relates to construction, there are often temporary increases in the cost of building supplies and construction labor after a significant event (for example, so called demand surge that causes the cost of labor, construction materials and other items to increase in a geographic area affected by a catastrophe);

competitive and regulatory pressures, which may affect the prices of our products and the nature of the risks covered;

volatile and unpredictable developments, including severe weather, catastrophes and terrorist actions;

legal, regulatory and socio-economic developments, such as new theories of insured and insurer liability and related claims and increases in the size of jury awards or changes in state laws and regulations (such as changes in the thresholds affecting no fault liability or when non-economic damages are recoverable for bodily injury claims or coverage requirements);

fluctuations in interest rates, inflationary pressures, default rates and other factors that affect investment returns; and

other general economic conditions and trends that may affect the adequacy of reserves.

The demand for property and casualty insurance can also vary significantly based on general economic conditions (either nationally or regionally), rising as the overall level of economic activity increases and falling as such activity decreases. Loss patterns also tend to vary inversely with local economic conditions, increasing during difficult economic times and moderating during economic upswings or periods of stability. The fluctuations in demand and competition could produce underwriting results that would have a negative impact on our results of operations and financial condition.

Actual losses from claims against our property and casualty insurance subsidiaries may exceed their reserves for claims.

Our property and casualty insurance subsidiaries maintain reserves to cover their estimated ultimate liability for losses and loss adjustment expenses with respect to reported and unreported claims incurred as of the end of each accounting period. Reserves do not represent an exact calculation of liability. Rather, reserves represent estimates, involving actuarial projections and judgments at a given time, of what we expect the ultimate settlement and administration of incurred claims will cost based on facts and circumstances then known, predictions of future events, estimates of future trends in claims frequency and severity and judicial theories of liability, costs of repair and replacement, legislative activity and other factors.

The inherent uncertainties of estimating reserves are greater for certain types of property and casualty insurance lines. These include workers compensation, where a longer period of time may elapse before a definitive determination of ultimate liability may be made, environmental liability, where the technological, judicial and political climates involving these types of claims are changing, and various casualty coverages such as professional liability. There is also greater uncertainty in establishing reserves with respect to new business, particularly new business that is generated with respect to newly introduced product lines, such as ***Connections Auto***, by newly appointed agents or in geographies where we have less experience in conducting business. In such cases, there is less historical experience or knowledge and less data upon which the actuaries can rely. Additionally, the introduction of new Commercial Lines products, including through recently acquired subsidiaries, and the development of new niche and specialty lines, presents new risks. Certain new specialty products, such as the new Human Services non-profit directors and officers and employment practices liability policies, lawyers and other professional liability policies, healthcare lines and private company directors and officers coverage may also require a longer period of time to determine the ultimate liability associated with the claims and may produce more volatility in our results and less certainty in our accident year reserves.

We regularly review our reserving techniques, reinsurance and the overall adequacy of our reserves based upon, among other things:

- our review of historical data, legislative enactments, judicial decisions, legal developments in imposition of damages, changes in political attitudes and trends in general economic conditions;

- our review of per claim information;

- historical loss experience of our property and casualty insurance subsidiaries and the industry as a whole; and

- the provisions in our property and casualty insurance policies.

Underwriting results and segment income could be adversely affected by further changes in our net loss and LAE estimates related to significant events or emerging risks such as Chinese drywall claims. Chinese drywall

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claims consist of individual and class action litigation related to the installation of drywall manufactured in China which allegedly emits a foul odor and gases which cause respiratory, sleep and other health problems and cause corrosion of metal substances. Although it is too soon to assess the merits of such claims or our potential liability for indemnity and defense costs, such claims involve or may involve drywall distributors and installers, contractors, homeowners and others.

The risks and uncertainties in our business that may affect net loss, LAE and reserve estimates and future performance, including the difficulties in arriving at such estimates, should be considered. Estimating losses following any major catastrophe or with respect to emerging issues is an inherently uncertain process. Factors that add to the complexity in these events include the legal and regulatory uncertainty, the complexity of factors contributing to the losses, delays in claim reporting and with respect to areas with significant property damage, the impact of demand surge and a slower pace of recovery resulting from the extent of damage sustained in the affected areas due, in part, to the availability and cost of resources to effect repairs. Emerging issues may involve complex coverage, liability and other costs which could significantly affect LAE. As a result, there can be no assurance that our ultimate costs associated with these events or issues will not be substantially different from current estimates.

Anticipated losses associated with business interruption exposure, the impact of wind versus water as the cause of loss, supplemental payments on previously closed claims caused by the development of latent damages and inflationary pressures could have a negative impact on future loss reserve development.

Because of the inherent uncertainties involved in setting reserves, including those related to catastrophes, we cannot provide assurance that the existing reserves or future reserves established by our property and casualty insurance subsidiaries will prove adequate in light of subsequent events. Our results of operations and financial condition could therefore be materially affected by adverse loss development for events that we insure.

Due to geographical concentration in our property and casualty business, changes in the economic, regulatory and other conditions in the regions where we operate could have a significant negative impact on our business as a whole.

We generate a significant portion of our property and casualty insurance net premiums written and earnings in Michigan, Massachusetts and other states in the Northeast, including New Jersey and New York. For the year ended December 31, 2009, approximately 27.7% and 10.4% of our net written premium in our property and casualty business was generated in the states of Michigan and Massachusetts, respectively. Massachusetts and New Jersey in particular with respect to personal automobile insurance, are highly regulated, but undergoing regulatory change. These states impose significant rate control and residual market charges, and restrict a carrier s ability to exit such markets. The revenues and profitability of our property and casualty insurance subsidiaries are subject to prevailing economic, regulatory, demographic and other conditions, including adverse weather in Michigan and the Northeast. Because of our strong regional focus, our business as a whole could be significantly affected by changes in the economic, regulatory and other conditions in the regions where we transact business.

Results may also be adversely affected by pricing decreases and market disruptions including any caused by the current economic environment in Michigan, recent initiatives in Michigan to reduce rates and subject rates to prior regulatory approval, expand coverage, limit territorial ratings, require insurers to issue low-cost policies, increase penalties for delays in claim payments, or expand circumstances in which parties can recover non-economic damages for bodily claims (i.e., pending efforts to modify or overturn the so-called Kreiner decision), and the Michigan Commissioner of Insurance s proposed ban on the use of credit-based insurance scores. Additionally results may be adversely affected by disruptions caused by potential legislative and executive branches intervention related to regulations issued by the Massachusetts Commissioner of Insurance to reform the Massachusetts personal automobile market. The introduction of managed competition in Massachusetts has resulted in overall rate level reductions and an increase in regulatory scrutiny by the Massachusetts Attorney General. Additionally, there is uncertainty regarding our ability to attract and retain customers in this market as new and larger carriers enter the state of Massachusetts as a result of managed competition .

Further, certain new catastrophe models assume an increase in frequency and severity of certain weather events, whether as a result of potential global warming or otherwise, and financial strength rating agencies are placing increased emphasis on capital and reinsurance adequacy for insurers with certain geographic concentrations of risk. These factors, along with the increased cost of reinsurance, may result in insurers seeking to diversify their geographic exposure, which could result in increased regulatory restrictions in those markets where insurers seek to exit or reduce coverage, as well as an increase in competitive pressures in non-coastal markets such as the Midwest. As previously noted, we have significant concentration of exposures in certain areas, including portions of the Northeast and Southeast and derive a material amount of revenues from operations in the Midwest.

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Catastrophe losses could materially reduce our profitability or cash flow.

Our property and casualty insurance subsidiaries are subject to claims arising out of catastrophes that may have a significant impact on their results of operations and financial condition. We may experience catastrophe losses, which could have a material adverse impact on our business. Catastrophes can be caused by various events including hurricanes, earthquakes, tornadoes, wind, hail, fires, severe winter weather, sabotage, terrorist actions and explosion. The frequency and severity of catastrophes are inherently unpredictable.

The extent of gross losses from a catastrophe is a function of two factors: the total amount of insured exposure in the area affected by the event and the severity of the event. The extent of net losses depends on the amount and collectability of reinsurance.

Although catastrophes can cause losses in a variety of property and casualty lines, homeowners and commercial multiple peril insurance have, in the past, generated the vast majority of our catastrophe-related claims. Our catastrophe losses have historically been principally weather-related, particularly hurricanes, as well as snow and ice damage from winter storms.

We purchase catastrophe reinsurance as protection against catastrophe losses. Based upon an ongoing review of our reinsurers financial statements, reported financial strength ratings from rating agencies and the analysis and guidance of our reinsurance brokers, we believe that the financial condition of our reinsurers is sound. However, reinsurance is subject to credit risks, including those resulting from over-concentration of exposures within the industry. The availability, scope of coverage and cost of reinsurance could be adversely affected by past natural catastrophes or terrorist attacks and the perceived risks associated with possible future terrorist activities. The impact of these events on the industry or on us cannot currently be determined. Additionally, uncertainty regarding the reinsurance marketplace, which experienced significant losses over the past few years due to Hurricanes Katrina, Ike and Gustav, as well as other events, have caused and could continue to cause our cost and ability to obtain reinsurance coverages similar to our current programs to be adversely affected. We plan to renew the dedicated Northeast property catastrophe occurance treaty described above, but there is no assurance that such coverages will be available or at what price. Although we believe that our current retention levels are appropriate given our level of surplus and exposures, as well as the current reinsurance pricing environment, there can be no assurance that this reinsurance program will provide coverage levels that will prove adequate should we experience losses from one significant or several large catastrophes. We also cannot provide assurance that reinsurance will continue to be available to us at commercially reasonable rates or with coverage provisions reflective of the risks underwritten in our primary policies.

Climate change may adversely impact our results of operations.

There are concerns that the higher level of weather-related catastrophes and other losses incurred by the industry in recent years is indicative of changing weather patterns, whether as a result of changing climate (global warming) or otherwise, which could cause such events to persist. This would lead to higher overall losses which we may not be able to recoup, particularly in the current economic and competitive environment, and higher reinsurance costs. It would also likely increase the risks of writing property insurance in coastal areas, particularly in jurisdictions which restrict pricing and underwriting flexibility.

Although we cannot predict the certainty of such events, climate change could have an impact on issuers in which we invest, resulting in realized and unrealized losses in future periods which could have a material adverse impact on our results of operations and/or financial position. It is not possible to foresee which, if any, issuers, industries or markets will be materially and adversely affected, nor is it possible to foresee the magnitude of such effect.

We may incur financial losses resulting from our participation in shared market mechanisms and mandatory and voluntary pooling arrangements.

As a condition to conducting business in several states, our property and casualty insurance subsidiaries are required to participate in mandatory property and casualty shared market mechanisms or pooling arrangements. These arrangements are designed to provide various insurance coverages to individuals or other entities that otherwise are unable to purchase such coverage. We cannot predict whether our participation in these shared market mechanisms or pooling arrangements will provide underwriting profits or losses to us. For the year ended December 31, 2009, we experienced an underwriting gain of $2.3 million from participation in these mechanisms and pooling arrangements, compared to underwriting losses of $11.5 million and $12.3 million in 2008 and 2007, respectively. We may face similar or even more dramatic earnings fluctuations in the future.

Additionally, recent significant increases and expected further increases in the number of participants or insureds in state-sponsored reinsurance pools, FAIR Plans or other residual market mechanisms, particularly in the states of Massachusetts, Louisiana and Florida, combined with regulatory restrictions on the ability to adequately price, underwrite, or non-renew business, could expose us to significant exposures and assessment risks.

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In addition, we may be adversely affected by liabilities resulting from our previous participation in certain voluntary property and casualty assumed reinsurance pools. We have terminated participation in virtually all property and casualty voluntary pools, but remain subject to claims related to periods in which we participated. The property and casualty assumed reinsurance businesses have suffered substantial losses during the past several years, particularly related to environmental and asbestos exposure for property and casualty coverages. Due to the inherent volatility in these businesses, possible issues related to the enforceability of reinsurance treaties in the industry and the recent history of increased losses, we cannot provide assurance that our current reserves are adequate or that we will not incur losses in the future. Although we have discontinued participation in these reinsurance pools as described above, we are subject to claims related to prior years or from pools we could not exit in full. Our operating results and financial position may be adversely affected by liabilities resulting from any such claims in excess of our loss estimates.

We cannot guarantee our ability to maintain our current level of reinsurance coverage.

There is uncertainty regarding the reinsurance marketplace, primarily as a result of the significant amount of losses the industry, including the reinsurance industry, incurred in 2008 due to hurricanes Ike and Gustav and in 2005 due to hurricanes Katrina and Rita. There can be no assurance that we will be able to maintain our current levels of reinsurance coverage. Changes in the reinsurance marketplace, including as a result of investment losses or disruptions as a result of the current economic circumstances, may adversely affect our ability to obtain such coverages, as well as adversely affect the cost of obtaining that coverage.

Additionally, the availability, scope of coverage, cost, and creditworthiness of reinsurance could continue to be adversely affected as a result of new catastrophes, terrorist attacks, global conflicts, the changing legal and regulatory environment (including changes which could create new insured risks) and the perceived risks associated with future terrorist activities.

Recent proposals are being considered by the federal government to scale back federal terrorism coverage under TRIPRA. Such proposals would substantially reduce the federal subsidies to insurance companies and calls for an increase in deductibles and co-payments for insurers by 2011, and elimination of such coverage after 2014. They would also eliminate coverage for domestic acts of terrorism. At this time, we are unable to predict the likelihood of adoption of any such proposal, what will ultimately be included in such proposals if passed, or the predictability and severity of acts of terrorism; however, any such change in TRIPRA coverage could have an adverse effect on our results of operations and financial position.

Our businesses are heavily regulated and changes in regulation may reduce our profitability.

Our insurance businesses are subject to supervision and regulation by the state insurance authority in each state in which we transact business. This system of supervision and regulation relates to numerous aspects of an insurance company s business and financial condition, including limitations on the authorization of lines of business, underwriting limitations, the ability to utilize credit-based insurance scores in underwriting, the ability to terminate agents, supervisory and liability responsibilities for agents, the setting of premium rates, the requirement to write certain classes of business which we might otherwise avoid or charge different premium rates, restrictions on the ability to withdraw from certain lines of business, the establishment of standards of solvency, the licensing of insurers and agents, compensation of agents, concentration of investments, levels of reserves, the payment of dividends, transactions with affiliates, changes of control, protection of private information of our agents, policyholders, claimants and others, and the approval of policy forms. Several states and Congress have proposed to prohibit or otherwise restrict the use of credit-based insurance scores in underwriting or rating our Personal Lines business. The elimination of the use of credit-based insurance scores could cause significant disruption to our business and our confidence in our pricing and underwriting. Most insurance regulations are designed to protect the interests of policyholders rather than stockholders and other investors.

Additionally, from time to time, we are involved in litigation that challenges specific terms and language incorporated into property and casualty contracts, such as claims reimbursements, covered perils and exclusion clauses, among others. For example, we have been named a defendant in lawsuits filed in Louisiana resulting from disputes arising from damages associated with Hurricane Katrina. These claims involve, among other claims, disputes as to the amount of reimbursable claims in particular cases, as well as the scope of insurance coverage under homeowners and commercial property policies due to flooding, civil authority actions, loss of landscaping and business interruption.

From time to time, we are also involved in investigations and proceedings by governmental and self-regulatory agencies. We cannot provide assurance that these investigations, proceedings and inquiries will not result in actions that would adversely affect our results of operations or financial condition.

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State regulatory oversight and various proposals at the federal level may in the future adversely affect our ability to sustain adequate returns in certain lines of business or in some cases, operate the line profitably. In recent years, the state insurance regulatory framework has come under increased federal scrutiny, and certain state legislatures have considered or enacted laws that alter and, in many cases, increase state authority to regulate insurance companies and insurance holding company systems. Our business could be negatively impacted by adverse state and federal legislation or regulation, including those resulting in:

- decreases in rates;
- limitations on premium levels;
- coverage and benefit mandates;
- limitations on the ability to manage care and utilization;
- requirements to write certain classes of business or in certain geographies;
- restrictions on underwriting or on methods of compensating independent producers;
- increased assessments or higher premium or other taxes; and
- enhanced ability to pierce no fault thresholds or recover non-economic damages (such as pain and suffering).

These regulations serve to protect the customers and other third parties who deal with us. If we are found to have violated an applicable regulation, administrative or judicial proceedings may be initiated against us which could result in censures, fines, civil penalties (including punitive damages), the issuance of cease-and-desist orders, premium refunds or the reopening of closed claim files, among other consequences. These actions could have a material adverse effect on our financial position and results of operations.

In addition, there have been from time to time proposals to implement federal regulation of the insurance business, either as an alternative to, or in addition to, the current state regulation. We cannot predict the impact that any such legislation, including recent proposals to create a National Insurance Office, would have on our business.

In Michigan, the legislature is currently considering several proposals which would, among other things, change the rate approval process from the current file and use system to prior approval , eliminate territorial rating, mandate affordable rates, reduce the threshold for lawsuits to be filed in at fault incidents, require insurers to issue low-cost automobile policies, and prohibit the use of certain underwriting criteria such as credit-based insurance scores. The Office of Financial and Insurance Regulation (OFIR) had previously issued regulations prohibiting the use of credit scores to rate personal lines insurance policies, which regulations are the subject of litigation being reviewed by the Michigan Supreme Court. Oral arguments were held before the Supreme Court on October 7, 2009. Pending a determination by the Michigan Supreme Court, OFIR is enjoined from disapproving rates on the basis that they are based in part on credit-based insurance scores. At this time, we are unable to predict the likelihood of adoption or impact on the business of any such proposals or regulations, but any such restrictions could have an adverse effect on our results of operations.

Additionally, the federal government is considering various forms of national or universal health insurance. At this time we are unable to predict the likelihood or form of such proposals being adopted or the impact on demand for or costs of our products. Furthermore, Congress, as well as state and local governments, also consider from time to time legislation that could increase our tax costs. If such legislation is adopted, our consolidated net income could decline. We cannot predict whether such legislation will be enacted, what the specific terms of any such legislation will be or how, if at all, it might affect our products. Also, recently enacted federal legislation mandates new and significant reporting

requirements for property and casualty insurance companies which make payments to or on behalf of claimants who are eligible for various Medicare or other benefits. These requirements impose significant fines for non-compliance and reporting errors. The first quarter of 2010 is the first reporting period. It is not clear how claimants will respond in light of the reporting periods and it is possible that the federal government may seek to recover from insurers amounts paid to claimants in circumstances where the government had previously paid benefits.

We may be adversely affected by new and existing legislation in the states of Louisiana and Florida as a result of the losses incurred in those states from recent hurricanes. We also may incur a greater share of losses related to Louisiana s and Florida s shared market mechanisms due to these increased losses, as well as the declining number of carriers providing coverage in this region.

Louisiana s residual market mechanism for property experienced substantial losses related to Hurricane Katrina. Under the state s program, we are allowed to recover such losses from policyholders, subject to annual limitations. Although we have recognized an expense currently for our estimated losses from the Louisiana program, given the uncertainty in the marketplace in Louisiana, there can be no assurance that our estimate of this liability will be sufficient to cover our share of such losses or whether we will be able to recover such costs from policyholders. The Louisiana program is also subject to the litigation risks discussed above relating to the scope of insurance coverage and other questions arising out of Hurricane Katrina. Adverse decisions in these cases could

materially and adversely affect such liabilities, which in turn could have a material, adverse effect on us. Also, the availability of private homeowners insurance in the state is declining as carriers seek to exit or significantly reduce their exposure in the state. This may increase the number of insureds seeking coverage from the residual market mechanism and could result in increased losses to us.

Florida s residual market mechanism for property has increased in size in recent years and is expected to grow further following the announcement of several primary insurance companies plans to withdraw from the Florida homeowners insurance market or reduce their total exposures. Insurance companies which write business in Florida, including Commercial Lines and automobile coverage, are subject to assessment for losses from Florida s programs, which assessment could be substantial in the event of hurricanes or other catastrophic events. It is also possible that the reinsurance from the Florida Hurricane Catastrophe Fund will be uncollectible or we would be unable to recover such assessments from the Florida Insurance Guaranty Association in the event that other insurers doing business in the state become insolvent. We are unable to predict the likelihood or impact of such potential assessments or other actions.

We are subject to mandatory assessments by state guaranty funds; an increase in these assessments could adversely affect our results of operations and financial condition.

All fifty states of the United States, the District of Columbia and Puerto Rico have insurance guaranty fund laws requiring property and casualty insurance companies doing business within the state to participate in guaranty associations. These associations are organized to pay contractual obligations under insurance policies issued by impaired or insolvent insurance companies. The associations levy assessments, up to prescribed limits, on all member insurers in a particular state on the basis of the proportionate share of the premiums written by member insurers in the lines of business in which the impaired or insolvent insurer is engaged. Mandatory assessments by state guaranty funds are used to cover losses to policyholders of insolvent or rehabilitated companies and can be partially recovered through a reduction in future premium taxes in many states (provided the collecting insurer continues to write business in such state). During 2009, we had a total assessment of $2.7 million levied against us, with refunds of $0.6 million received in 2009 for a total net assessment of $2.1 million. As of December 31, 2009, we have $1.2 million of reserves related to guaranty fund assessments. In the future, these assessments may increase above levels experienced in the current and prior years. Future increases in these assessments depend upon the rate of insolvencies of insurance companies. An increase in assessments could adversely affect our results of operations and financial condition.

If we are unable to attract and retain qualified personnel, or if we experience the loss or retirement of key executives or other key employees, we may not be able to compete effectively and our operations could be impacted significantly.

Our future success will be affected by our continued ability to attract and retain qualified executives and other key employees, particularly those experienced in the property and casualty industry.

Our profitability could be adversely affected by periodic changes to our relationships with our agencies.

We periodically review agencies with which we do business to identify those that do not meet our profitability standards or are not strategically aligned with our business. Following these periodic reviews, we may restrict such agencies access to certain types of policies or terminate our relationship with them, subject to applicable contractual and regulatory requirements to renew certain policies for a limited time. We may not achieve the desired results from these measures, and our failure to do so could negatively affect our operating results and financial position.

We may be affected by disruptions caused by the introduction of new Personal and Commercial Lines products and related technology changes, new Personal and Commercial Lines operating models and recent or future acquisitions, including the renewal rights agreement we entered into with OneBeacon Insurance Company in December 2009, and expansion into new geographic areas. We could also be affected by an inability to retain profitable policies in force and attract profitable policies in our Personal Lines and Commercial Lines segments, particularly in light of an increasingly competitive product pricing environment and the adoption by competitors of strategies to increase agency appointments and commissions and increased advertising.

Our Personal Lines production and earnings may be unfavorably affected by the continued introduction of new products, including our multivariate auto product, as a proportion of our total personal automobile premium as compared to the historically more profitable legacy products, and our focus on account business (i.e., policyholders who have both automobile and homeowner insurance with us) which we believe, despite pricing discounts, will ultimately be more profitable business, if we experience adverse selection, which occurs when insureds with larger risks purchase our products because of favorable pricing, under-pricing, operational difficulties or implementation impediments with independent agents or the inability to grow new markets after the introduction of new products or the appointment of new agents. In addition, there are increased underwriting risks associated with premium growth and the introduction of new products or programs in both our Personal and Commercial Lines businesses, as well as the appointment of new agencies and the expansion

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into new geographical areas, and we have experienced increased loss ratios with respect to our new personal automobile business, which is written through our Connections Auto product, particularly in certain states where we have less experience and data.

Similarly, the introduction of new Commercial Lines products, including through our recently acquired subsidiaries and the development of new niche and specialty lines, presents new risks. Certain new specialty products may present longer tail risks and increased volatility in profitability. Our expansion into new western states, including California, presents additional underwriting risks since the regulatory, geographic, natural risk, legal environment, demographic, business, economic and other characteristics of these states present challenges different from those in the states in which we currently do business.

There can also be no assurances that we will be able to successfully integrate recent and any future acquisitions or that we will not assume unknown liabilities and reserve deficiencies in connection with such acquisitions. The renewal rights transaction with OneBeacon Insurance Company presents us with an opportunity to renew a significant amount of Commercial Lines premium, but there are no assurances that the insurance agencies who control such business will renew such policies with us, that we will be able to appropriately rate and price such policies, that the additional expenses we incurred to acquire and process such business will not result in losses, that we will be able to process such business or that such business will prove to be profitable.

Intense competition could negatively affect our ability to maintain or increase our profitability.

We compete with a large number of companies in our property and casualty segment. We compete, and will continue to compete, with national and regional insurers, mutual companies, specialty insurance companies, so called off-shore companies which enjoy certan tax advantages, underwriting agencies and financial services institutions. In recent years, there has been substantial consolidation and convergence among companies in the financial services industry, resulting in increased competition from large, well-capitalized financial services firms. Many of our competitors have greater financial, technical and operating resources than we do. In addition, competition in the property and casualty insurance markets has intensified over the past several years. This competition has had and may continue to have an adverse impact on our revenues and profitability.

A number of new, proposed or potential legislative or industry developments could further increase competition in our industry. These developments include:

- the implementation of commercial lines deregulation in several states;
- programs in which state-sponsored entities provide property insurance in catastrophe prone areas or other alternative markets types of coverage;
- changes in, or restrictions on, the way independent agents may be compensated by insurance companies;
- increased competition from off-shore tax advantaged insurance companies;
- changing practices caused by the internet and the increased usage of real time comparative rating tools, which have led to greater competition in the insurance business in general; and
- proposals, from time to time, to provide for federal chartering of insurance companies.

In addition, we could face heightened competition resulting from the entry of new competitors and the introduction of new products by new and existing competitors. Increased competition could make it difficult for us to obtain new customers, retain existing customers or maintain policies in force by existing customers. It could also result in increasing our service, administrative, policy acquisition or general expense due to the need for additional advertising and marketing of our products. In addition, our administrative, technology and management information systems expenditures could also increase substantially as we try to maintain our competitive position. We cannot provide assurance that we will be able

to maintain a competitive position in the markets in which we operate, or that we will be able to expand our operations into new markets. If we fail to do so, our business could be materially adversely affected.

We are rated by several rating agencies, and changes to our ratings could adversely affect our operations.

Our ratings are important in establishing our competitive position and marketing the products of our insurance companies to our agents and customers, since rating information is broadly disseminated and generally used throughout the industry.

Our insurance company subsidiaries are rated by A.M. Best, Moody s, Fitch, and Standard & Poor s. These ratings reflect a rating agency s opinion of our insurance subsidiaries financial strength, operating performance, strategic position and ability to meet their obligations to policyholders. These ratings are not evaluations directed to investors, and are not recommendations to buy, sell or hold our securities. Our ratings are subject to periodic review by the rating agencies and we cannot guarantee the continued retention or improvement of our current ratings. This is particularly true in the current economic environment where rating agencies may increase their capital requirements or other criteria for various rating levels.

Downgrades in future periods could adversely affect our results of operations and financial position.

Negative changes in our level of statutory surplus could adversely affect our ratings and profitability.

The capacity for an insurance company s growth in premiums is in part a function of its statutory surplus. Maintaining appropriate levels of statutory surplus, as measured by state insurance regulators, is considered important by state insurance regulatory authorities and the private agencies that rate insurers claims-paying abilities and financial strength. Regulators may require that additional capital be contributed to increase the level of statutory surplus. Failure to maintain certain levels of statutory surplus could result in increased regulatory scrutiny, action by state regulatory authorities or a downgrade by private rating agencies. Our surplus is affected by, among other things, results of operations and investment gains, losses and impairments.

The National Association of Insurance Commissioners, or NAIC, uses a system for assessing the adequacy of statutory capital for property and casualty insurers. The system, known as risk-based capital, is in addition to the states fixed dollar minimum capital and other requirements. The system is based on risk-based formulas that apply prescribed factors to the various risk elements in an insurer s business and investments to report a minimum capital requirement proportional to the amount of risk assumed by the insurer. We believe that any failure to maintain appropriate levels of statutory surplus would have an adverse impact on our ability to grow our property and casualty business profitably.

We may not be able to grow as quickly as we intend, which is important to our current strategy.

Over the past several years, we have made and our current plans are to continue to make, significant investments in our Personal and Commercial Lines of businesses, and we have increased expenses and made acquisitions in order to, among other things, strengthen our product offerings and service capabilities, expand into new geographic areas, improve technology and our operating models, build expertise in our personnel, and expand our distribution capabilities, with the ultimate goal of achieving significant, sustained growth. The ability to achieve significant profitable premium growth in order to earn adequate returns on such investments and expenses, and to grow further without proportionate increases in expenses, is critical to our current strategy. There can be no assurance that we will be successful at profitably growing our business, or that we will not alter our current strategy due to changes in our markets or an inability to successfully maintain acceptable margins on new business or for other reasons, in which case written and earned premium, property and casualty segment income and net book value could be adversely affected.

We could be subject to additional losses related to the sale of our Discontinued FAFLIC and variable life insurance and annuity businesses.

On January 2, 2009, we sold our remaining life insurance subsidiary, First Allmerica Financial Life Insurance Company (FAFLIC), to Commonwealth Annuity and Life Insurance Company (Commonwealth Annuity), a subsidiary of The Goldman Sachs Group, Inc (Goldman Sachs). Coincident with the sale transaction, The Hanover Insurance Company (Hanover Insurance) and FAFLIC entered into a reinsurance contract whereby Hanover Insurance assumed FAFLIC s discontinued accident and health insurance business. Goldman Sachs previously purchased, in 2005, our variable life insurance and annuity business.

In connection with these transactions, we have agreed to indemnify Commonwealth Annuity and Goldman Sachs for certain contingent liabilities, including litigation and other regulatory matters (including with respect to existing and potential litigation), as well as other contractual obligations. We have established a reserve related to these contractual indemnifications. Although we believe that this liability is appropriate, we cannot provide assurance that costs related to these indemnifications when they ultimately settle, will not exceed our current liability.

We may incur financial losses related to our discontinued assumed accident and health reinsurance pools and arrangements.

We previously participated, through FAFLIC, in approximately 40 assumed accident and health reinsurance pools and arrangements. The business was assumed by Hanover Insurance through a reinsurance agreement with FAFLIC. During 1999, we ceased writing new premiums in this business, subject to certain contractual obligations. The reinsurance pool business consisted primarily of direct and assumed medical stop loss, the medical and disability portions of workers compensation risks, small group managed care, long-term disability and long-term care pools, student accident and special risk business. We are currently monitoring and managing the run-off of our related participation in the 23 pools with remaining liabilities.

Under these arrangements, we variously acted as a reinsurer, a reinsured or both. In some instances, we ceded significant exposures to other reinsurers in the marketplace. There are disputes ongoing within the industry, which relate to the placement of this type of business with various reinsurers and ultimately may result in an impact to the recovery of the placed reinsurance. The potential risk to us as a participant in these pools is primarily that other companies that reinsured this business from us may seek to avoid or fail to timely pay their reinsurance obligations (especially in light of the fact that historically these pools sometimes involved multiple layers of overlapping reinsurers,

or so-called spirals) or may become insolvent. Thus, we are exposed to both assumed losses and to credit risk related to these pools. We are not currently engaged in any significant disputes in respect to this business. At this time, we do not anticipate that any significant portion of recorded reinsurance recoverables will be uncollectible. However, we cannot provide assurance that all recoverables are collectible and should these recoverables prove to be uncollectible, our results of operations and financial position may be negatively affected.

We believe our reserves for the accident and health assumed and ceded reinsurance business appropriately reflect both current claims and unreported losses. However, due to the inherent volatility in this business and the reporting lag of losses that tend to develop over time and which ultimately affect excess covers, there can be no assurance that current reserves are adequate or that we will not have additional losses in the future. Although we have discontinued participation in these reinsurance arrangements, unreported claims related to the years in which we were a participant may be reported and previously reported claims may develop unfavorably. If any such unreported claims or unfavorable development is reported to us, our results of operations and financial position may be negatively impacted.

Other market fluctuations and general economic, market and political conditions may also negatively affect our business, profitability and investment portfolio.

It is difficult to predict the impact of the continuing recessionary economic environment on both our Personal and Commercial Lines segment. Our ability to increase pricing has been impacted as agents and policyholders have been more price sensitive, customers shop for policies more frequently or aggressively, utilize comparative rating models or, in Personal Lines in particular, turn to direct sales channels rather than independent agents. We have also experienced decreased new business premium levels, retention and renewal rates, and renewal premiums. Specifically in Personal Lines, policyholders may reduce coverages or change deductibles to reduce premiums, experience declining home values, or be subject to increased foreclosures, and policyholders may retain older or less expensive automobiles and purchase or insure fewer ancillary items such as boats, trailers and motor homes for which we provide coverages. Additionally if, as a result of the difficult economic environment, drivers continue to eliminate automobile insurance coverage or to reduce their bodily injury limit, we may be exposed to more uninsured and underinsured motorist coverage losses. In Commercial Lines, the overall decline in the economy has resulted in reductions in demand for insurance products and services as more companies cease to do business and there are fewer business start-ups, particularly as small businesses are affected by a decline in overall consumer and business spending. Additionally, claims frequency could increase as policyholders submit and pursue claims more aggressively than in the past, fraud incidences may increase, or we may experience higher incidents of abandoned properties or poorer maintenance, which may also result in more claims activity. We have experienced higher workers compensation claims as injured employees take longer to return to work, increased surety losses as construction companies experience financial pressures and higher retroactive premium returns as audit results reflect lower payrolls. Our business could also be affected by an ensuing consolidation of independent insurance agencies.

At December 31, 2009, we held approximately $5.2 billion of investment assets in categories such as fixed maturities, cash and short-term investments, equity securities, mortgage loans, and other long-term investments. Our investment returns, and thus our profitability, may be adversely affected from time to time by conditions affecting our specific investments and, more generally, by bond, stock, real estate and other market fluctuations and general economic, market and political conditions, including concerns regarding sub-prime and prime mortgages, as well as residential and commercial mortgage-backed or other debt securities, and concerns relating to the ratings and capitalization of municipal bond and mortgage guarantees. Our ability to make a profit on insurance products, depends in part on the returns on investments supporting our obligations under these products and the value of specific investments may fluctuate substantially depending on the foregoing conditions. We may use a variety of strategies to hedge our exposure to interest rate and other market risk. However, hedging strategies are not always available and carry certain credit risks, and our hedging could be ineffective.

In addition, debt securities comprise a material portion of our investment portfolio. The issuers of those securities, as well as borrowers under the loans we make, customers, trading counterparties, counterparties under swaps and other derivative contracts and reinsurers, may be affected by declining market conditions. These parties may default on their obligations to us due to lack of liquidity, downturns in the economy or real estate values, operational failure, bankruptcy or other reasons. Uncertain trends in the U.S. and other economies in 2009 and prior years have resulted in increased levels of investment impairments. We cannot assure you that further impairment charges will not be necessary in the future. Our ability to fulfill our debt and other obligations could be adversely affected by the default of third parties on their obligations owed to us.

Recent developments in the global financial markets may continue to adversely affect our investment portfolio and related impact on our other comprehensive income, shareholders equity and overall investment performance. Over the past two years, global financial markets have experienced unprecedented and challenging conditions,

including a tightening in the availability of credit and the failure of several large financial institutions. As a result, certain government bodies and central banks worldwide, including the U.S. Treasury Department and the U.S. Federal Reserve, have undertaken unprecedented intervention programs, the effects of which remain uncertain. Further government intervention continues to be discussed, specifically the creation of an agency to provide federal oversight of insurance companies, and the effect of such federal oversight that may transpire is unknown. The U.S. economy has experienced and continues to experience significant declines in employment, household wealth, and lending. If conditions further deteriorate, our business could be further affected in different ways. Continued turbulence in the U.S. economy and contraction in the credit markets could further adversely affect our profitability, demand for our products or our ability to raise rates, and could also result in further declines in market value and future impairments of our investment assets. There can be no assurances that conditions in the global financial markets will not worsen and/or further adversely affect our investment portfolio and overall performance. Recessionary economic periods and higher unemployment are historically accompanied by higher claims activity, particularly in the personal lines of business and in the workers compensation line of business and higher defaults in contractors bonds.

Market conditions also affect the value of assets under our employee pension plans, including our Cash Balance Plan. The expense or benefit related to our employee pension plans results from several factors, including changes in the market value of plan assets, interest rates, regulatory requirements or judicial interpretation of benefits. For the year ended December 31, 2009, we recognized net expenses of $33.9 million related to our employee pension plans. Additionally, in 2009, we contributed $45.2 million to our qualified pension plan. At December 31, 2009, our plan assets included approximately 42% of equity securities and 57% of fixed maturities. During 2010 and for the next few years, we expect to shift the assets that are held by the plan to include a higher level of fixed maturities. Also, declines in the market value of plan assets and interest rates from levels at December 31, 2009 could negatively affect our results of operations. At December 31, 2009, for both our qualified and non-qualified pension plans, our net liabilities exceeded assets by approximately $132 million. In January of 2010, we contributed $100 million to our qualified plan and do not expect to make any significant additional contributions in order to meet our minimum funding requirements. However, deterioration in market conditions and differences between our assumptions and actual occurances, and behaviors, including judicial determinations of ultimate benefit obligations, could result in a need to fund more into the qualified plan to maintain this funding level.

We have experienced and may continue to experience unrealized losses on our investments, especially during a period of heightened volatility, which could have a material adverse effect on our results of operations or financial condition.

Our investment portfolio and shareholders equity can be and has been significantly impacted by the changes in the market values of our securities. U.S. and global financial markets and economies are in an unprecedented period of uncertainty and instability. The financial market volatility and the resulting negative economic impact could continue and may be prolonged. This could result in additional unrealized and realized losses in future periods, and adversely affect the liquidity of our investments, which could have a material adverse impact on our results of operations and our financial position.

If, following such declines, we are unable to hold our investment assets until they recover in value, we would incur other-than-temporary impairments which would be recognized as realized losses in our results of operations and reduce net income and earnings per share. Temporary declines in market value are recorded as unrealized losses, which do not affect net income and earnings per share, but reduce other comprehensive income, which is reflected on our Consolidated Balance Sheets. We cannot provide assurance that the other-than-temporary impairments we have recognized will, in fact, be adequate to cover future losses or that we will not have substantial additional impairments and/or unrealized investment losses in the future.

We are a holding company and rely on our insurance company subsidiaries for cash flow; we may not be able to receive dividends from our subsidiaries in needed amounts.

We are a holding company for a diversified group of insurance and financial services companies and our principal assets are the shares of capital stock of our subsidiaries. Our ability to make required debt service payments, as well as our ability to pay operating expenses and pay dividends to shareholders, depends upon the receipt of sufficient funds from our subsidiaries. The payment of dividends by our insurance company subsidiaries is subject to regulatory restrictions and will depend on the surplus and future earnings of these subsidiaries, as well as the regulatory restrictions. We are required to notify insurance regulators prior to paying any dividends from our insurance subsidiaries and pre-approval is required with respect to extraordinary dividends .

Because of the regulatory limitations on the payment of dividends from our insurance company subsidiaries, we may not always be able to receive dividends from these subsidiaries at times and in amounts necessary to meet our debt and other obligations. The inability of our subsidiaries to pay dividends to us in an amount sufficient to meet our debt service and funding obligations would have a material

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adverse effect on us. These regulatory dividend restrictions also impede our ability to transfer cash and other capital resources among our subsidiaries.

Our dependence on our insurance subsidiaries for cash flow exposes us to the risk of changes in their ability to generate sufficient cash inflows from new or existing customers or from increased cash outflows. Cash outflows may result from claims activity, expense payments or investment losses. Reductions in cash flow from our subsidiaries would have a material adverse effect on our business and results of operations.

Although we monitor their financial soundness, we cannot be sure that our reinsurers will pay in a timely fashion, if at all.

We purchase reinsurance by transferring part of the risk that we have assumed (known as ceding) to reinsurance companies in exchange for part of the premium we receive in connection with the risk. As of December 31, 2009, our reinsurance receivable (including from MCCA) amounted to approximately $1.2 billion. Although reinsurance makes the reinsurer liable to us to the extent the risk is transferred or ceded to the reinsurer, it does not relieve us (the reinsured) of our liability to our policyholders or, in cases where we are a reinsurer to our reinsureds. Accordingly, we bear credit risk with respect to our reinsurers. Although we monitor the credit quality of our reinsurers, we cannot be sure that they will pay the reinsurance recoverables owed to us currently or in the future or that they will pay such recoverables on a timely basis.

Errors or omissions in connection with the administration of any of our products may cause our business and profitability to be negatively impacted.

We are responsible to our policyholders for administering their policies, premiums and claims and ensuring that appropriate records are maintained which reflect their transactions. We are subject to risks that errors or omissions of information occurred with respect to the administration of our products. As a result, we are subject to risks of liabilities associated with bad faith , unfair claims practices, unfair trade practices or similar allegations. Such risks may stem from allegations of agents, vendors, policyholders, claimants, regulators, states attorneys general or others. We may incur charges associated with any errors and omissions previously made with respect to both our current business operations and those operations which have been sold to Goldman Sachs or Commonwealth Annuity, or any errors or omissions in our ongoing business which are made in future periods. These charges may result from our obligation to policyholders to correct any errors or omissions, from fines imposed by regulatory authorities, or from other items, which may affect our financial position or results of operations.

Our business continuity and disaster recovery plans may not sufficiently address all contingencies.

Terrorist actions, catastrophes or other significant events affecting our infrastructure may interrupt our ability to conduct business, and delays in recovery of our operating capabilities could negatively affect our business and profitability.

U.S. inflation may negatively impact reserves and the value of investments.

U.S. inflationary pressures, particularly with respect to medical and health care, automobile repair and construction costs, all of which are significant components of our indemnity liabilities under policies we issue to our customers, and which could also impact the adequacy of reserves we have set aside for prior accident years may have a negative affect on our results of operations. Inflationary pressures which cause or contribute to, or are the result of, increases in interest rates, may reduce the fair value of our investment portfolio.

ITEM 1B UNRESOLVED STAFF COMMENTS

None.

ITEM 2 PROPERTIES

We own our headquarters, located at 440 Lincoln Street, Worcester, Massachusetts, with approximately 938,000 square feet.

We also own office space located at 645 W. Grand River, Howell, Michigan, which is approximately 111,000 square feet, and a three-building complex located at 808 North Highlander Way, Howell, Michigan, with approximately 176,000 square feet, where various business operations are conducted.

We lease offices throughout the country for branch sales, underwriting and claims processing functions, and the operations of our recently acquired subsidiaries.

We believe that our facilities are adequate for our present needs in all material respects. Certain of our properties may be made available for lease.

ITEM 3 LEGAL PROCEEDINGS

DURAND LITIGATION

On March 12, 2007, a putative class action suit captioned Jennifer A. Durand v. The Hanover Insurance Group, Inc., The Allmerica Financial Cash Balance Pension Plan was filed in the United States District Court for the Western District of Kentucky. The named plaintiff, a former employee who received a lump sum distribution from our Cash Balance Plan (the Plan) at or about the time of her termination, claims that she and others similarly situated did not receive the appropriate lump sum distribution because in computing the lump sum, we understated the

accrued benefit in the calculation. We filed a motion to dismiss on the basis that the plaintiff failed to exhaust administrative remedies, which motion was granted without prejudice in a decision dated November 7, 2007. This decision was reversed by an order dated March 24, 2009 issued by the United States Court of Appeals for the Sixth Circuit, and the case was remanded to the district court.

The plaintiff filed an Amended Complaint on December 11, 2009. In response, we filed a Motion to Dismiss on January 30, 2010. In addition to the pending calculation of the lump sum distribution claim, the Amended Complaint includes: (a) a claim that the Plan failed to calculate participants account balances properly because interest credits were based solely upon the performance of each participant s selection from among various hypothetical investment options (as the Plan provided) rather than crediting the greater of that performance or the 30 year Treasury rate; (b) a claim that the 2004 Plan amendment, which changed interest crediting for all participants from the performance of participant s investment selections to the 30 year Treasury rate, reduced benefits in violation of the Employee Retirement Income Security Act of 1974 (ERISA) for participants who had account balances as of the amendment date by not continuing to provide them performance-based interest crediting on those balances; and (c) claims for breach of fiduciary duty and ERISA notice requirements for not properly informing participants of the various interest crediting and lump sum distribution matters of which plaintiffs complain. In our judgment, the outcome is not expected to be material to our financial position, although it could have a material effect on the results of operations for a particular quarter or annual period and on the funding of the Plan.

Hurricane Katrina (Road Home) Litigation

On August 23, 2007, the State of Louisiana (individually and on behalf of the State of Louisiana, Division of Administration, Office of Community Development) filed a putative class action in the Civil District Court for the Parish of Orleans, State of Louisiana, entitled State of Louisiana, individually and on behalf of State of Louisiana, Division of Administration, Office of Community Development ex rel The Honorable Charles C. Foti, Jr., The Attorney General For the State of Louisiana, individually and as a class action on behalf of all recipients of funds as well as all eligible and/or future recipients of funds through The Road Home Program v. AAA Insurance, et al., No. 07-8970. The complaint named as defendants over 200 foreign and domestic insurance carriers, including us. Plaintiff seeks to represent a class of current and former Louisiana citizens who have applied for and received or will receive funds through Louisiana s Road Home program.

On August 29, 2007, Plaintiff filed an Amended Petition in this case, asserting myriad claims, including claims for breach of: contract, the implied covenant of good faith and fair dealing, fiduciary duty and Louisiana s bad faith statutes. Plaintiff seeks relief in the form of, among other things, declarations that (a) the efficient proximate cause of losses suffered by putative class members was windstorm, a covered peril under their policies; (b) the second efficient proximate cause of their losses was storm surge, which Plaintiff contends is not excluded under class members policies; (c) the damage caused by water entering affected parishes of Louisiana does not fall within the definition of flood ; (d) the damages caused by water entering Orleans Parish and the surrounding area was a result of a man-made occurrence and are properly covered under class members policies; (e) many class members suffered total losses to their residences; and (f) many class members are entitled to recover the full value for their residences stated on their policies pursuant to the Louisiana Valued Policy Law. In accordance with these requested declarations, Plaintiff seeks to recover amounts that it alleges should have been paid to policyholders under their insurance agreements, as well as penalties, attorneys fees, and costs. The case has been removed to the Federal District Court for the Eastern District of Louisiana.

On March 5, 2009, the court issued an Order granting in part and denying in part a Motion to Dismiss filed by defendants. The court dismissed all claims for bad faith and breach of fiduciary duty and all claims for flood damages under policies with flood exclusions or asserted under the Valued Policy Law, but rejected the insurers arguments that the purported assignments from individual claimants to the state were barred by anti-assignment provisions in the insurers policies. On April 16, 2009, the court denied a Motion for Reconsideration of its ruling regarding the anti-assignment provisions, but certified the issue as ripe for immediate appeal. On April 30, 2009, defendants filed a Petition for Permission to Appeal to the United States Court of Appeals for the Fifth Circuit, which was granted. Defendants appeal is currently pending.

We have established our loss and LAE reserves on the assumption that we will not have any liability under the Road Home or similar litigation.

ITEM 4 RESERVED

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PART II

ITEM 5 MARKET FOR REGISTRANT S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

COMMON STOCK AND STOCKHOLDER OWNERSHIP

Our common stock is traded on the New York Stock Exchange under the symbol THG . On February 24, 2010, we had approximately 27,529 shareholders of record and 47,497,347 shares outstanding. On the same date, the trading price of our common stock was $42.10 per share.

COMMON STOCK PRICES AND DIVIDENDS

	High [1]	Low [1]	Dividends
2009			
First Quarter	**$ 43.37**	**$ 28.49**	
Second Quarter	**$ 38.11**	**$ 29.19**	
Third Quarter	**$ 42.82**	**$ 37.23**	
Fourth Quarter	**$ 45.23**	**$ 40.67**	**$ 0.75**
2008			
First Quarter	$ 47.17	$ 40.14	
Second Quarter	$ 46.83	$ 41.71	
Third Quarter	$ 51.00	$ 38.01	
Fourth Quarter	$ 45.00	$ 31.92	$ 0.45

(1) Common stock prices were obtained from a third party broker.

DIVIDENDS

On October 20, 2009, the Board of Directors declared a 75 cents per share cash dividend, which was paid on December 9, 2009 to shareholders of record as of November 25, 2009. The Board also noted its intention to proceed on the basis of a quarterly instead of an annual dividend schedule. On February 26, 2010, the Board declared a quarterly dividend of $0.25 per share to shareholders of record on March 8, 2010, payable March 22, 2010. The payment of future dividends on our common stock will be a business decision made by the Board of Directors from time to time based upon cash available at our holding company, our results of operations and financial condition and such other factors as the Board of Directors considers relevant.

Dividends to shareholders may be funded from dividends paid to us from our subsidiaries. Dividends from insurance subsidiaries are subject to restrictions imposed by state insurance laws and regulations. See Liquidity and Capital Resources on pages 69 to 72 of Management s Discussion and Analysis of Financial Condition and Results of Operations and Note 14 Dividend Restrictions on page 121 of the Notes to Consolidated Financial Statements included in Financial Statements and Supplementary Data of this Form 10-K.

ISSUER PURCHASES OF EQUITY SECURITIES

On February 26, 2010, our Board of Directors authorized a $100 million increase to our existing common stock repurchase program. This increase was in addition to two previous increases of $100 million each, approved on December 8, 2009 and September 24, 2009. As a result of these most recent increase, the program provides for aggregate repurchases of up to $400 million of our common stock. Under this repurchase authorization, we may repurchase our common stock from time to time, in amounts and prices and at such times as we deem appropriate, subject to market conditions and other considerations. We are not required to purchase any specific number of shares or to make purchases by any certain date under this program. On December 8, 2009, we also entered into an accelerated share repurchase agreement with Barclays Bank PLC, acting through its agent, Barclays Capital, Inc., for the immediate repurchase of 2.4 million shares of our common stock at a cost of approximately $100.6 million. Including the repurchases from this accelerated share repurchase program, we repurchased 3.6 million shares at a cost of $148.1 million in 2009, 1.3 million shares at a cost of $58.5 million in 2008 and approximately 38,000 shares at a cost of $1.6 million in 2007. Total repurchases under this program as of February 24, 2010 were 5.2 million shares at a cost of approximately $218 million.

Shares purchased in the quarter are as follows:

Period	*Total Number of Shares Purchased*	*Average Price Paid per Share*	*Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs*	*Approximate Dollar Value of Shares That May Yet be Purchased Under the Plans or Programs*
October 1 31, 2009[1]	239,709	$ 42.96	238,834	$ 93,400,000
November 1 30, 2009[2]	42,329	41.63	41,987	91,700,000
December 1 31, 2009[3]	2,425,997	41.35	2,418,000	91,700,000
Total	2,708,035	$ 41.50	2,698,821	$ 91,700,000

(1) Includes 875 shares that were withheld to satisfy tax withholding amount due from employees upon the receipt of previously restricted shares.

(2) Includes 342 shares that were withheld to satisfy tax withholding amount due from employees upon the receipt of previously restricted shares.

(3) Includes 7,997 shares that were withheld to satisfy tax withholding amount due from employees related to the receipt of stock which resulted from the vesting of their performance based restricted stock units.

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ITEM 6-SELECTED FINANCIAL DATA

Five Year Summary Of Selected Financial Highlights

For The Years Ended December 31

(In millions, except per share data)	**2009**	**2008**	**2007**	**2006**	**2005**
Statements of Income					
Revenues					
Premiums	**$ 2,546.4**	$ 2,484.9	$ 2,372.0	$ 2,219.2	$ 2,161.2
Net investment income	**252.1**	258.7	247.0	228.5	209.7
Net realized investment gains (losses)	**1.4**	(97.8)	(0.9)	(0.2)	7.8
Fees and other income	**34.2**	34.6	56.0	57.9	42.6
Total revenues	**2,834.1**	2,680.4	2,674.1	2,505.4	2,421.3
Losses and Expenses					
Losses and loss adjustment expenses	**1,639.2**	1,626.2	1,457.4	1,387.1	1,601.6
Policy acquisition expenses	**581.3**	556.2	523.6	476.4	458.5
Gain from retirement of corporate debt	**(34.5)**				
Other operating expenses	**377.2**	333.6	351.6	370.9	307.8
Total losses and expenses	**2,563.2**	2,516.0	2,332.6	2,234.4	2,367.9
Income from continuing operations before federal income taxes	**270.9**	164.4	341.5	271.0	53.4
Federal income tax expense (benefit)	**83.1**	79.9	113.2	87.2	(6.3)
Income from continuing operations	**187.8**	84.5	228.3	183.8	59.7
Discontinued operations (net of taxes):					
Gain (loss) from discontinued FAFLIC business, (including gain (loss) on disposal of $7.1 and $(77.3) in 2009 and 2008)	**7.1**	(84.8)	10.9	7.9	16.8
Income (loss) from operations of discontinued variable life insurance and annuity business, (including gain (loss) on disposal of $4.9, $8.7, $7.9, $(29.8) and $(444.4) in 2009, 2008, 2007, 2006 and 2005)	**4.9**	11.3	13.1	(29.8)	(401.7)
Loss from discontinued accident and health business	**(2.6)**				
Income from operations of AMGRO (including gain on disposal of $11.1 in 2008)		10.1			
Other discontinued operations		(0.5)	0.8	7.8	
Income (loss) from discontinued operations	**9.4**	(63.9)	24.8	(14.1)	(384.9)
Income (loss) before cumulative effect of change in accounting principle	**197.2**	20.6	253.1	169.7	(325.2)
Cumulative effect of change in accounting principle				0.6	
Net income (loss)	**$ 197.2**	$ 20.6	$ 253.1	$ 170.3	$ (325.2)
Earnings (loss) per common share (diluted)	**$ 3.86**	$ 0.40	$ 4.83	$ 3.27	$ (6.02)
Dividends declared per common share (diluted)	**$ 0.75**	$ 0.45	$ 0.40	$ 0.30	$ 0.25

Balance Sheets (at December 31)					
Total assets	**$ 8,042.7**	$ 9,230.2	$ 9,815.6	$ 9,856.6	$ 10,634.0
Long-term debt	**433.9**	531.4	511.9	508.8	508.8
Total liabilities	**5,684.1**	7,343.0	7,516.6	7,857.4	8,682.7
Shareholders equity	**2,358.6**	1,887.2	2,299.0	1,999.2	1,951.3

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ITEM 7

MANAGEMENT S DISCUSSION AND ANALYSIS OF

FINANCIAL CONDITION AND RESULTS OF OPERATIONS

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INTRODUCTION

The following Management s Discussion and Analysis of Financial Condition and Results of Operations is intended to assist readers in understanding the consolidated results of operations and financial condition of The Hanover Insurance Group, Inc. and subsidiaries (THG) and should be read in conjunction with the Consolidated Financial Statements and related footnotes included elsewhere herein.

Our results of operations include the accounts of The Hanover Insurance Company (Hanover Insurance) and Citizens Insurance Company of America (Citizens), our principal property and casualty companies; and certain other insurance and non-insurance subsidiaries. Our results of operations also included the results of First Allmerica Financial Life Insurance Company (FAFLIC), our former run-off life insurance and annuity subsidiary through December 31, 2008. On January 2, 2009, we sold FAFLIC to Commonwealth Annuity and Life Insurance Company (Commonwealth Annuity), a subsidiary of The Goldman Sachs Group, Inc. (Goldman Sachs). As of December 31, 2008 and for all prior periods presented, operations from FAFLIC have been reclassified as discontinued operations. Additionally, as of December 31, 2008, FAFLIC s balance sheet accounts were classified as assets and liabilities of discontinued operations in the Consolidated Balance Sheets.

EXECUTIVE OVERVIEW

Our property and casualty business includes our Personal Lines segment, our Commercial Lines segment and our Other Property and Casualty segment. As noted above, on January 2, 2009, we sold FAFLIC to Commonwealth Annuity. Total net proceeds from the sale after transaction expenses were approximately $230 million. Coincident with the sale transaction, Hanover Insurance and FAFLIC entered into a reinsurance contract whereby Hanover Insurance assumed FAFLIC s discontinued accident and health insurance business.

During 2009, the U.S. and global financial markets and economies remain strained, as market values fluctuated significantly and are expected to continue to fluctuate. Defaults in corporate bonds may continue, particularly with respect to non-investment grade securities. Credit spreads, however, tightened during the period, resulting in a substantial improvement in unrealized losses in 2009 compared to the prior year. This improvement resulted in our investment portfolio having an unrealized gain position at December 31, 2009. Although 2009 has shown positive momentum in the financial markets, uncertainty still exists in these markets, and with respect to the potential impact on our business of the current difficult economy.

Our investment holdings totaled $5.1 billion at December 31, 2009 and consist primarily of investment grade fixed maturities and cash and cash equivalents, with net unrealized gain positions of approximately $104 million. The improvement in our net unrealized investment position, from a loss in 2008 to a gain in 2009, particularly in investment-grade securities, is due primarily to market appreciation. We recognized impairment charges of $36.2 million during the year ended December 31, 2009. These impairment charges primarily related to credit-related losses on below investment grade fixed maturities.

With respect to underwriting results, in 2009 we recorded pre-tax catastrophe losses of $98.9 million, a decrease of $70.8 million from the same period in 2008. This was essentially offset by higher current year claims, lower favorable development on prior year s loss and loss adjustment expenses (LAE) reserves, and higher expenses. The higher current year claims were primarily the result of an unusually high level of non-catastrophe weather-related losses. In light of these weather-related losses, we have sought and will continue to seek additional rate increases in Personal Lines.

We and the industry in general continue to experience pricing pressures and in recent years the property and casualty industry has reported overall negative growth. These pressures are particularly acute in Michigan, which accounts for almost 28% of our net written premium. We believe that our ongoing agency relationships, position in the marketplace and strong product set, position us well in Michigan relative to many of our competitors.

We have made an explicit decision to invest further in our business despite the fact that our expense ratio is higher than that of some of our peer companies and other competitors. In Personal Lines, we are investing to improve the competitiveness of our products and in technology and systems enhancements intended to make our interactions with agents more efficient. In Commercial Lines, most of our investments are directed toward expanding our product capabilities and offerings in various niches and differentiated products. We continue to invest in systems improvements, particularly with respect to small commercial business. In addition, we recently started to expand our Commercial Lines offerings into selected states in the western part of the country.

During May 2009, A.M. Best Company upgraded the financial strength ratings of our property and casualty companies to an A rating, from its prior rating of A- . A.M. Best also upgraded the rating related to our Senior Debt to bbb , from a prior rating of bbb- . We believe that these upgrades, which occurred at a time of uncertainty in the financial services industry, reflect the strength of our balance sheet, our solid capital position, and the results of our investments in the business over the past several years.

These upgrades are expected to provide access to certain business groups and markets, particularly in Commercial Lines, that have previously not been significant in our mix of business. However, there can be no assurance that the ratings upgrades will produce the results expected.

Personal Lines

In our Personal Lines business, the market continues to be very competitive, with continued pressure on agents from direct writers, as well as the increased usage of real time comparative rating tools. We maintain our focus on partnering with high quality, value added agencies which stress the importance of account rounding, which is the conversion of single policy customers to accounts with multiple policies and/or additional coverages, and consultative selling. We are focused on making investments that are intended to help us maintain profitability, build a distinctive position in the market, such as through our Think Hanover initiative, and provide us with profitable growth opportunities.

Our ***Think Hanover*** investments are intended to enhance retention and strengthen our value proposition for agents, including by introducing broad and innovative product offerings. We introduced a substantially improved product suite (*The Hanover Household*) and made it easier for agents to write more lines of business per household. We also modified our operating model and agency automation which is intended to deliver a competitive sales and services experience for agents (*Front Line Excellence*).

Current market conditions continue to be challenging as pricing pressures and economic conditions remain difficult, especially in Michigan. These competitive and economic pressures have adversely affected our ability to grow and retain business in Michigan, our largest state, and elsewhere. We are working closely with our partner agents in Michigan and our other core states to remain a significant writer with strong margins.

In 2009, we continued our mix management initiatives relating to our ***Connections® Auto*** product to improve the overall profitability of the business. We are focused on reducing our growth in less profitable automobile segments and increasing our multi-car and total account business consistent with our account rounding strategy. We believe that market conditions will remain challenging and competitive in Personal Lines. Despite these challenges, we experienced relatively flat growth levels in Personal Lines and expect that trend to continue into 2010 as the industry continues to be impacted by the difficult economic environment.

We believe that our ***Connections Auto*** product will help us profitably grow our market share over time. The ***Connections Auto*** product is designed to be competitively priced for a wide spectrum of drivers through its multivariate rating application, which calculates rates based upon the magnitude and correlation of multiple risk factors. At the same time, a core strategy is to broaden our portfolio offerings and write total accounts , which are accounts that include multiple personal line coverages for the same customer. Our homeowners product, ***Connections® Home*** is intended to improve our competitiveness for total account business by making it easier and more efficient for our agents to write business with us and by providing more comprehensive coverage options for policyholders. In addition, in 11 states we have introduced a more sophisticated, multi-variate pricing approach to our Homeowners product which is designed to better align rates with the underlying risk of each customer. We plan to continue to implement this more sophisticated price segmentation in our other states. We also continue to refine our products and work closely with high potential agents to increase the percentage of business they place with us and to ensure that it is consistent with our preferred mix of business. Additionally, we remain focused on diversifying our state mix beyond our four core states of Michigan, Massachusetts, New York and New Jersey. We expect these efforts to contribute to profitable growth and improved retention in our Personal Lines segment over time.

Commercial Lines

The Commercial Lines market remains competitive. Price competition requires us to be highly disciplined in our underwriting process to ensure that we write business only at acceptable margins. In certain lines of business where, in many instances, the economy may be a particularly important factor, such as surety and workers compensation, we have endeavored to adjust pricing to more appropriately reflect the higher risk of loss and/or we take a more conservative approach to risk selections. We focus on mid-sized agents and target small and first-tier middle market clients, whose premiums are generally below $200,000.

We also continue to develop our specialty businesses, which on average are expected to offer higher margins over time and enable us to deliver a more complete product portfolio to our agents and policyholders. Our specialty lines, including marine and bond lines, now account for approximately one third of our Commercial Lines premiums written. Growth in our specialty lines continues to be a significant part of our strategy. Our ongoing focus on expanding our product offerings in specialty businesses is evidenced by our acquisitions. Over the past three years, we have acquired Professionals Direct, Inc. (PDI), which we market as Hanover Professionals, a professional liability insurance carrier for principally small to medium-sized legal practices, Verlan Holdings, Inc. (Verlan), which we market as Hanover Specialty Property, a specialty company providing property insurance to small and medium-sized

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chemical, paint, solvent and other manufacturing and distribution companies; and AIX Holdings, Inc. (AIX), a specialty property and casualty insurance carrier that focuses on underwriting and managing program business. In January 2010, we entered into a definitive agreement through which we will acquire, subject to regulatory approvals, Campania Holding Company, Inc. (Campania), which specializes in insurance solutions for the healthcare professionals industry, including durable medical equipment suppliers, behavioral health specialists, eldercare providers, and podiatrists. Also in January 2010, we acquired Benchmark Professional Insurance Services, Inc., a provider of insurance solutions to the design professionals industry, including architects and engineers.

In addition to our specialty lines, we have developed several niche insurance programs, such as for schools, religious institutions and moving and storage companies, and have added additional segmentation to our core middle market commercial products, including real estate, hospitality and wholesale distributors. In January 2009, we introduced a specialty niche for human services organizations such as non-profit youth and community service organizations. As a complimentary initiative, we have introduced products focused on management liability, specifically non-profit directors and officers liability and employment practices liability, and we plan to extend coverage for private company directors and officers liability.

In December 2009, we announced a renewal rights agreement with OneBeacon Insurance Group (OneBeacon), further strengthening our competitive position and advancing our expansion efforts in the western states. Through the agreement, we acquired access to a portion of OneBeacon s small and middle market commercial business at renewal, which includes industry programs and middle market niches. At the same time, the transaction will expand our segment, niche and industry program business. The agreement is effective for renewals beginning January 1, 2010.

In addition, we have made a number of enhancements to our core products and technology platforms that are intended to drive more total account placements in our Small Commercial business, which we believe will enhance margins. Our focus continues to be on improving and expanding our partnerships with agents.

We believe our specialty capabilities and small commercial platform, coupled with increased distinctiveness in the middle market through these acquisitions, our development of niches, and better segmentation, provides us with a more diversified portfolio of products and enables us to deliver significant value to our agents and policyholders. We believe these efforts will enable us to improve the overall mix of our business and ultimately our underwriting profitability.

DESCRIPTION OF OPERATING SEGMENTS

Our primary business operations include insurance products and services in three property and casualty operating segments. These segments are Personal Lines, Commercial Lines and Other Property and Casualty. Personal Lines includes personal automobile, homeowners and other personal coverages, while Commercial Lines includes commercial multiple peril, commercial automobile, workers compensation and other commercial coverages, such as inland marine, bonds, specialty program business, professional liability and management liability. In addition, the Other Property and Casualty segment consists of: Opus Investment Management, Inc. (Opus), which markets investment management services to institutions, pension funds and other organizations; earnings on holding company assets, as well as voluntary pools business in which we have not actively participated since 1995. Prior to its sale on June 2, 2008, Amgro, Inc. (AMGRO), our premium financing business, was also included in the Other Property and Casualty segment. Additionally, prior to the sale of FAFLIC on January 2, 2009, our operations included the results of this run-off life insurance and annuity business as a separate segment. We present the separate financial information of each segment consistent with the manner in which our chief operating decision maker evaluates results in deciding how to allocate resources and in assessing performance.

We report interest expense related to our corporate debt separately from the earnings of our operating segments. Corporate debt consists of our senior debentures, our junior subordinated debentures, surplus notes and advances under our collateralized borrowing program with the Federal Home Loan Bank of Boston (FHLBB). Subordinated debentures were issued by the holding company and several subsidiaries.

RESULTS OF OPERATIONS

Our consolidated net income includes the results of our three operating segments (segment income), which we evaluate on a pre-tax basis, and our interest expense on corporate debt. Segment income excludes certain items which we believe are not indicative of our core operations. The income of our segments excludes items such as federal income taxes and net realized investment gains and losses, because fluctuations in these gains and losses are determined by interest rates, financial markets and the timing of sales. Also, segment income excludes net gains and losses on disposals of businesses, discontinued operations, restructuring costs, extraordinary items, the

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cumulative effect of accounting changes and certain other items. Although the items excluded from segment income may be significant components in understanding and assessing our financial performance, we believe segment income enhances an investor s understanding of our results of operations by highlighting net income attributable to the core operations of the business. However, segment income should not be construed as a substitute for net income determined in accordance with generally accepted accounting principles (GAAP).

Catastrophe losses are a significant component in understanding and assessing the financial performance of our business. However, catastrophic events, such as Hurricanes Katrina, Ike and Gustav make it difficult to assess the underlying trends in this business. Management believes that providing certain financial metrics and trends excluding the effects of catastrophes helps investors to understand the variability in periodic earnings and to evaluate the underlying performance of our operations.

Our consolidated net income was $197.2 million in 2009, compared to $20.6 million in 2008. The $176.6 million improvement is primarily due to a $99.2 million improvement in our net realized investment position, from a loss in 2008 of $97.8 million to a gain in 2009 of $1.4 million. Additionally, results associated with the discontinued FAFLIC business improved by $91.9 million. We recognized an $84.8 million loss in 2008 due to its then pending sale, whereas in 2009, we recognized a gain of $7.1 million. In 2009, we also recognized a pre-tax gain of $34.5 million ($22.3 million net of taxes) related to the retirement of corporate debt in connection with the repurchase of our mandatorily redeemable preferred securities and our senior debentures (see also Significant Transactions). These increases in earnings for the period compared to the same period in 2008 were partially offset by lower after-tax segment results of $23.3 million, and the recognition, in 2008, of a $10.1 million gain on the sale of AMGRO.

The following table reflects segment income as determined in accordance with generally accepted accounting principles and a reconciliation of total segment income to consolidated net income.

For The Years Ended December 31 *(In millions)*	**2009**	**2008**	**2007**
Segment income before federal income taxes:			
Property and Casualty			
Personal Lines	**$ 76.4**	$ 123.5	$ 208.2
Commercial Lines	**189.7**	169.7	169.3
Other Property and Casualty	**4.0**	9.0	4.8
Total Property and Casualty	**270.1**	302.2	382.3
Interest expense on corporate debt	**(35.1)**	(39.9)	(39.9)
Total segment income before federal income taxes	**235.0**	262.3	342.4
Federal income tax expense on segment income	**(77.5)**	(86.3)	(113.7)
Federal income tax settlement		6.4	
Net realized investment gains (losses)	**1.4**	(97.8)	(0.9)
Gain from retirement of corporate debt	**34.5**		
Other non-segment items		(0.1)	
Federal income tax (expense) benefit on non-segment items	**(5.6)**		0.5
Income from continuing operations, net of taxes	**187.8**	84.5	228.3
Discontinued operations, net of taxes:			
Gain (loss) from discontinued FAFLIC business (including loss on assets held-for-sale of $7.1 and $77.3 in 2009 and 2008)	**7.1**	(84.8)	10.9
Loss from discontinued accident and health business	**(2.6)**		
Income from discontinued variable life insurance and annuity business (including gain on disposal of $4.9, $11.3 and $7.9 in 2009, 2008 and 2007)	**4.9**	11.3	13.1
Income from operations of AMGRO (including gain on disposal of $11.1 in 2008)		10.1	
Other discontinued operations		(0.5)	0.8
Net income	**$ 197.2**	$ 20.6	$ 253.1

SEGMENT RESULTS

The following is our discussion and analysis of the results of operations by business segment. The segment results are presented before taxes and other items which management believes are not indicative of our core operations, including realized gains and losses.

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PROPERTY AND CASUALTY

The following table summarizes the results of operations for the Property and Casualty group for the periods indicated:

For the Years Ended December 31			
(In millions)	**2009**	**2008**	**2007**
Net premiums written	**$2,608.7**	$2,518.0	$2,415.3
Net premiums earned	**2,546.4**	2,484.9	2,372.0
Net investment income	**251.7**	258.0	246.3
Other income	**38.6**	40.9	64.9
Total segment revenues	**2,836.7**	2,783.8	2,683.2
Losses and LAE	**1,639.2**	1,626.2	1,457.4
Policy acquisition expenses	**581.3**	556.2	523.6
Other operating expenses	**346.1**	299.2	319.9
Total losses and operating expenses	**2,566.6**	2,481.6	2,300.9
Segment income	**$270.1**	$302.2	$ 382.3

The following table summarizes the impact of catastrophes on results for the years ended December 31, 2009, 2008 and 2007:

For the Years Ended December 31			
(In millions)	**2009**	**2008**	**2007**
Hurricanes Ike and Gustav	**$ (4.3)**	$ 90.9	$
Other	**103.2**	78.8	65.2
Pre-tax catastrophe effect	**$ 98.9**	$ 169.7	$ 65.2

2009 Compared to 2008

The Property and Casualty group s segment income decreased $32.1 million, or 10.6%, to $270.1 million, for the year ended December 31, 2009, compared to $302.2 million for the year ended December 31, 2008. Catastrophe related activity decreased $70.8 million, from $169.7 million in 2008 to $98.9 million in 2009. This decrease was primarily related to Hurricanes Ike and Gustav that resulted in unusually high catastrophes in 2008.

Excluding the impact of catastrophe related activity, segment income would have decreased $102.9 million. This decrease is primarily due to higher expenses, lower current accident year results, lower net investment income and lower favorable development on prior years loss and LAE reserves. Underwriting, loss adjustment and other operating expenses increased approximately $59 million, of which approximately $30 million relates to higher pension costs. Additionally, there were increased costs in our specialty lines, including the addition of our recently acquired AIX subsidiary, higher employee and employee benefit costs and higher technology costs, partially offset by lower variable compensation. Current accident year results decreased by approximately $29 million, primarily in personal lines, due to higher non-catastrophe weather-related losses throughout 2009 as compared to the prior year. Additionally, net investment income decreased by $6.3 million and favorable development on prior years loss and LAE reserves decreased by $3.7 million.

2008 Compared to 2007

The Property and Casualty group s segment income decreased $80.1 million, to $302.2 million for the year ended December 31, 2008, compared to $382.3 million in 2007. Catastrophe related activity increased $104.5 million, from $65.2 million in 2007 to $169.7 million in 2008. This increase was primarily related to Hurricanes Ike and Gustav in 2008. In addition, 2007 segment income was positively affected by a litigation settlement that resulted in an $11.8 million benefit.

Excluding the impact of all catastrophe related activity and the litigation settlement in 2007, segment income would have increased $36.2 million for the year ended December 31, 2008, as compared to 2007. This increase is due primarily to higher net investment income, more favorable current accident year results and lower expenses. Net investment income increased $11.7 million, primarily due to earnings on invested assets transferred from our Life Companies and higher partnership income, partially offset by non-recurring call premiums and prepayment fees received in 2007 and lower income due to the sale of securities to fund our stock repurchase program. Current accident year results improved approximately $12 million in 2008, primarily in Commercial Lines. Underwriting, loss adjustment and other operating expenses decreased approximately $9 million, primarily due to lower employee benefit and variable compensation expenses, partially offset by increased costs in our specialty business, including our recently acquired subsidiaries. Included in 2007 employee benefit costs is an approximate $6 million pension expense adjustment.

PRODUCTION AND UNDERWRITING RESULTS

The following table summarizes GAAP net premiums written and GAAP loss, LAE, expense and combined ratios for the Personal Lines and Commercial Lines segments. GAAP loss, LAE, catastrophe loss and combined ratios shown below include prior year reserve development. These items are not meaningful for our Other Property and Casualty segment.

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For the Years Ended December 31	2009			2008			2007		
(In millions, except ratios)	**GAAP Net Premiums Written**	**GAAP Loss Ratios (1)(2)**	**Catastrophe Loss Ratios (3)**	GAAP Net Premiums Written	GAAP Loss Ratios (1)(2)	Catastrophe Loss Ratios (3)	GAAP Net Premiums Written	GAAP Loss Ratios (1)(2)	Catastrophe Loss Ratios (3)
Personal Lines:									
Personal automobile	**$ 967.9**	**61.6**	**0.4**	$ 1,011.3	59.5	0.3	$ 1,018.6	57.4	0.3
Homeowners	**464.3**	**67.6**	**14.7**	432.5	64.4	18.4	423.6	49.7	5.3
Other personal	**40.0**	**34.7**	**2.3**	40.2	37.0	7.4	38.6	36.7	2.1
Total Personal Lines	**1,472.2**	**62.8**	**4.8**	1,484.0	60.4	5.8	1,480.8	54.6	1.7
Commercial Lines:									
Workers compensation	**109.7**	**43.9**		127.2	44.0		110.8	43.7	
Commercial automobile	**187.3**	**50.6**	**0.6**	192.8	49.0	0.3	194.8	49.1	(0.1)
Commercial multiple peril	**366.7**	**46.8**	**6.5**	368.5	54.1	16.2	349.1	48.9	7.8
Other commercial	**472.6**	**39.2**	**1.0**	345.2	39.2	7.6	279.5	32.7	2.0
Total Commercial Lines	**1,136.3**	**44.2**	**2.6**	1,033.7	47.1	8.3	934.2	43.7	3.5
Total	**$ 2,608.5**	**54.3**	**3.9**	$ 2,517.7	54.9	6.8	$ 2,415.0	50.5	2.4

For the Years Ended December 31	2009			2008			2007		
(In millions, except ratios)	**GAAP LAE Ratio**	**GAAP Expense Ratio**	**GAAP Combined Ratio (4)(5)**	GAAP LAE Ratio	GAAP Expense Ratio	GAAP Combined Ratio (4)(5)	GAAP LAE Ratio	GAAP Expense Ratio	GAAP Combined Ratio (4)(5)
Personal Lines	**11.0**	**28.3**	**102.1**	11.1	28.1	99.6	11.0	28.1	93.9
Commercial Lines	**8.6**	**41.3**	**94.1**	9.6	39.1	95.8	9.9	39.5	93.8
Total	**10.0**	**33.8**	**98.2**	10.5	32.5	98.0	10.6	32.5	93.6

(1) GAAP loss ratio is a common industry measurement of the results of property and casualty insurance underwriting. This ratio reflects incurred claims compared to premiums earned. GAAP loss ratios include catastrophe losses.

(2) Includes policyholders dividends.

(3) Catastrophe loss ratio reflects incurred catastrophe claims compared to premiums earned.

(4) GAAP combined ratio is a common industry measurement of the results of property and casualty insurance underwriting. This ratio is the sum of incurred claims, claim expenses and underwriting expenses incurred to premiums earned. GAAP combined ratios include the impact of catastrophes. Federal income taxes, net investment income and other non-underwriting expenses are not reflected in the GAAP combined ratio.

(5) Total includes favorable development of $11.8 million and $1.9 million for the years ended December 31, 2009 and 2008, and unfavorable development of $3.0 million for the year ended December 31, 2007, which is reflected in our Other Property and Casualty segment.

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The following table summarizes GAAP underwriting results for the Personal Lines, Commercial Lines and Other Property and Casualty segments and reconciles it to GAAP segment income.

For the Year Ended December 31, 2009

(In millions)	Personal Lines	Commercial Lines	Other Property and Casualty	Total
GAAP underwriting loss, excluding prior year reserve development and catastrophes	**$ (12.7)**	**$ (14.6)**	**$ (0.1)**	**$ (27.4)**
Prior year loss and LAE reserve development - favorable	**39.4**	**104.1**	**11.8**	**155.3**
Pre-tax catastrophe effect	**(70.3)**	**(28.6)**		**(98.9)**
GAAP underwriting (loss) profit	**(43.6)**	**60.9**	**11.7**	**29.0**
Net investment income (1)	**109.6**	**125.6**	**16.5**	**251.7**
Fees and other income	**14.4**	**18.4**	**5.8**	**38.6**
Other operating expenses	**(4.0)**	**(15.2)**	**(30.0)**	**(49.2)**
Segment income	**$ 76.4**	**$ 189.7**	**$ 4.0**	**$ 270.1**

For the Year Ended December 31, 2008

(In millions)	Personal Lines	Commercial Lines	Other Property and Casualty	Total
GAAP underwriting profit (loss), excluding prior year reserve development and catastrophes	$ 18.8	$ 25.9	$ (0.7)	$ 44.0
Prior year loss and LAE reserve development - favorable	58.9	98.2	1.9	159.0
Pre-tax catastrophe effect	(85.4)	(84.3)		(169.7)
GAAP underwriting (loss) profit	(7.7)	39.8	1.2	33.3
Net investment income (1)	118.9	124.4	14.7	258.0
Fees and other income	16.0	18.3	6.6	40.9
Other operating expenses	(3.7)	(12.8)	(13.5)	(30.0)
Segment income	$ 123.5	$ 169.7	$ 9.0	$ 302.2

For the Year Ended December 31, 2007

(In millions)	Personal Lines	Commercial Lines	Other Property and Casualty	Total
GAAP underwriting profit, excluding prior year reserve development and catastrophes	$ 34.1	$ 5.6	$ 0.1	$ 39.8
Prior year loss and LAE reserve development - favorable (unfavorable)	69.2	87.2	(3.0)	153.4
Pre-tax catastrophe effect	(26.8)	(38.4)		(65.2)
GAAP underwriting profit (loss)	76.5	54.4	(2.9)	128.0
Net investment income (1)	118.8	110.3	17.2	246.3
Fees and other income	18.8	16.1	30.0	64.9
Other operating expenses	(5.9)	(11.5)	(39.5)	(56.9)

Segment income	$ 208.2	$ 169.3	$ 4.8	$ 382.3

(1) We manage investment assets for our property and casualty business based on the requirements of the entire Property and Casualty group. We allocate net investment income to each of our Property and Casualty segments based on actuarial information related to the underlying business.

2009 Compared to 2008

Personal Lines

Personal Lines net premiums written decreased $11.8 million, or 0.8%, to $1,472.2 million for the year ended December 31, 2009. The most significant factor contributing to lower net premiums written was a decrease in average premium size driven by changes in our premium mix toward what we expect to be more desirable account business that tends to have lower premium per policy commensurate with its better risk profile. Additionally, a decrease in premium from the Massachusetts Commonwealth Automobile Reinsurers (CAR) pool and increased reinsurance costs contributed to the decrease in net premiums written. The decrease in CAR related premium followed the introduction, in April 2008, of managed competition in Massachusetts, which restructured the private passenger automobile insurance market in the state and resulted in reduced premiums from the involuntary market. These decreases were partially offset by increases in net premiums written in our targeted growth states.

Net premiums written in the personal automobile line of business declined 4.3%, primarily as a result of declines in our core states of Massachusetts, New York and New Jersey of 11.4%, 8.5% and 10.5%, respectively. This decrease resulted primarily from lower policies in force in these core states. Policies in force in the personal automobile line of business decreased 2.0% during 2009 compared to 2008, primarily driven by our efforts to improve or maintain margins in our core states. Decreased policies in force in these states were partially offset by an increase in

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policies in force in our identified growth states as we continue to manage these states with a focus on profitable growth.

Net premium written in the homeowners line of business increased 7.4%, driven by an increase in policies in force of 5.3% compared to 2008, and rate increases. This increase in policies in force was primarily driven by increases across the majority of our states due to our account rounding initiatives, partially offset by a decrease in policies in force in Florida, where throughout 2008 we non-renewed all homeowners polices.

Personal Lines underwriting loss increased $35.9 million, to a loss of $43.6 million 2009, compared to a loss of $7.7 million in 2008. Catastrophe losses decreased $15.1 million in 2009, to $70.3 million, from $85.4 million in the prior year. Excluding the impact of catastrophes, our underwriting income would have decreased by $51.0 million. This decrease was primarily due to less favorable current accident year results of approximately $21 million, primarily due to higher non-catastrophe weather-related losses in the homeowners line caused by severe storms and higher claims severity across all personal lines, and to less favorable development on prior years loss and LAE reserves of $19.5 million. Also contributing to the decrease was higher operating expenses of approximately $11 million, primarily attributable to higher pension costs and higher technology costs.

Although we have been able to obtain rate increases in our Personal Lines markets, our ability to maintain and increase Personal Lines net written premium and to maintain and improve underwriting results could be affected by increasing price competition, regulatory and legal developments and the difficult economic conditions, particularly in Michigan, which is our largest state.

Most of our new personal automobile business and an increasing proportion of our entire personal automobile business, currently approximately 55%, is written with our ***Connections Auto*** product, with the remainder written with our legacy products. ***Connections Auto*** is designed to match the rate with the underlying risk for segmented groups of customers in a highly competitive marketplace. Because of the competitiveness of this market, it generally has lower margins than our established book of legacy products. Our ability to grow and be profitable will depend, in part, on our ability to improve margins in the ***Connections Auto*** product and through our agency-centric, account rounding strategy, particularly as ***Connections Auto*** products account for an increasing proportion of our total personal automobile business.

New business, whether written though our ***Connections Auto*** or legacy products, generally experiences higher loss ratios than our renewal business, and is more difficult to predict, particularly in states in which we have less experience and data. Our ability to maintain or increase earnings could be adversely affected if the loss ratios for new business on our rounded accounts do not meet our expectations. However, we believe that complete accounts offer better profitability and retention over time. Our ability to grow could be adversely affected by adjustments to enhance risk segmentation and by agency management actions.

It is difficult to predict the impact that the current recessionary environment will have on our Personal Lines business. Our ability to increase pricing may continue to be impacted as agents and consumers become more price sensitive, customers shop for policies more frequently or aggressively, utilize comparative rating models or turn to direct sales channels rather than independent agents. Additionally, new business premiums, retention levels and renewal premiums may decrease as policyholders reduce coverages or change deductibles to reduce premiums, home values decline, foreclosures increase and policyholders retain older or less expensive automobiles and purchase or insure fewer ancillary items such as boats, trailers and motor homes for which we provide coverages. Additionally, claims frequency could increase as policyholders submit and pursue claims more aggressively than in the past, fraud incidences may increase, or we may experience higher incidence of abandoned properties or poorer maintenance which may also result in more claims activity. We have also experienced higher incidents of claims for uninsured or underinsured policy coverages as a greater percentage of the motoring public eliminates or reduces their liability coverages, thus exposing our policyholders to the greater likelihood of making claims against their own uninsured or underinsured automobile coverages. Our Personal Lines segment could also be affected by an ensuing consolidation of independent insurance agencies.

In addition, as discussed under Contingencies and Regulatory Matters Other Regulatory Matters , certain states have taken, and others may take, actions which significantly affect the property and casualty insurance market, including ordering rate reductions for personal automobile and homeowners insurance products and subjecting insurance companies that do business in that state to onerous underwriting or other restrictions and potentially significant assessments. Such state actions or our responses thereto could have a significant impact on our underwriting margins and growth prospects, as well as on our ability to manage exposures to hurricane or other high risk losses.

Notwithstanding these concerns, we believe that our agency distribution strategy, the strength of our market share in key states, our account rounding strategy, the relatively inelastic demand for insurance products and our capital position, place us in a good position to manage these issues and concerns relative to many of our peer competitors.

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Commercial Lines

Commercial Lines net premiums written increased $102.6 million, or 9.9%, to $1,136.3 million for the year ended 2009. This increase was driven by growth in our specialty businesses, including the addition of our recently acquired subsidiary, AIX, which accounted for $110.2 million, and growth in our Hanover Professionals and marine businesses, which accounted for $13.0 million and $11.4 million, respectively, as well as growth in various niche and segmented businesses. Also affecting the overall growth comparison in net premiums was improved rate, partially offset by increased reinsurance costs. Renewal retention in our core commercial lines decreased compared to the prior year, particularly in our workers compensation line, as we sought to improve our mix of business through a variety of pricing and underwriting actions in a very competitive environment. Additionally, our core lines premium was affected by a decrease in exposures in workers compensation and commercial multiple peril as a result of the difficult economic conditions.

Commercial Lines underwriting income increased $21.1 million, to $60.9 million, in 2009, compared to $39.8 million in 2008. Catastrophe losses decreased $55.7 million in 2009, to $28.6 million, from $84.3 million in the prior year. Excluding the impact of catastrophes, our underwriting income would have decreased by $34.6 million. This decrease was primarily due to higher operating expenses of approximately $32 million, primarily attributable to increased costs in our specialty businesses, including our recently acquired subsidiaries, higher employee and employee benefit costs, higher pension costs and higher technology costs, partially offset by lower variable compensation. Current accident year results decreased approximately $9 million, primarily due to economic factors impacting our surety bond business. These decreases were partially offset by increased favorable development on prior years loss and LAE reserves of $5.9 million.

We continue to experience significant price competition in all lines of business in our Commercial Lines segment. The industry is also experiencing overall rate decreases. Our ability to increase Commercial Lines net premiums written while maintaining or improving underwriting results is expected to be affected by price competition and the difficult economic conditions.

It is difficult to measure and predict the impact of the current difficult economic environment on our Commercial Lines segment. We have and may continue to experience decreased new business levels, retention and renewal rates and renewal premiums. The overall decline in the economy has resulted in reductions in demand for insurance products and services as more companies cease to do business and there are fewer business start-ups, particularly as small businesses are affected by a decline in overall consumer and business spending. In addition, economic conditions may also continue to impact our surety bond business, especially in the small to middle market contractor business.

In addition, some businesses have reduced or eliminated coverages to reduce costs and there has been a reduction in payroll levels, which has reduced workers compensation premiums without a corresponding decrease in workers compensation losses. Our Commercial Lines segment could also be affected by an ensuing consolidation of independent insurance agencies.

Notwithstanding these concerns, we believe that our agency distribution strategy, our broad product offerings, the strength of our growing specialty businesses, disruptions in the marketplace which may result in improved pricing and new business, the relatively inelastic demand for insurance products and our capital position, place us in a good position to manage these issues and concerns relative to many of our peer competitors.

Other Property and Casualty

Segment income of the Other Property and Casualty segment decreased $5.0 million, to $4.0 million for the year ended December 31, 2009, from $9.0 million in 2008. The decrease is primarily due to $15.8 million of higher pension costs related to our discontinued life business, partially offset by $9.9 million of higher favorable development in our run-off voluntary pools.

2008 Compared to 2007

Personal Lines

Personal Lines net premiums written increased $3.2 million, or 0.2%, to $1,484.0 million for the year ended December 31, 2008. The most significant factor contributing to this increase was a favorable impact from changes in our reinsurance structure as discussed on pages 13 and 14 in Description of Business by Segment Property and Casualty of our 2008 Form 10-K, which increased net written premium by $19.1 million for the year ended December 31, 2008. In the personal automobile and homeowners lines of business, rate increases in all states except for Massachusetts also contributed to the increase. Additionally, net written premium benefited from an increase in new personal automobile policies issued in Massachusetts and from increases in new homeowners policies issued across most states. These increases were partially offset by decreases in net written premium related to our non-renewal of homeowners business in Florida, the impact of personal automobile rate decreases in Massachusetts and a decrease in net written premium in Michigan, which we attribute to the difficult economy in the state.

Policies in force in the personal automobile line of business decreased 1.7% during 2008 driven by a decrease in

Michigan, which we attribute to the difficult economic conditions in that state, partially offset by net growth in policies in force in Massachusetts.

Policies in force in the homeowners line of business decreased 0.2% during 2008, primarily as a result of exposure management actions taken in coastal states, particularly in Florida, where we have non-renewed all homeowners policies. Partially offsetting these reductions is an increase in policies in force outside of Florida, primarily in our targeted growth states.

Our underwriting profit, excluding prior year reserve development and catastrophes, decreased $15.3 million, to $18.8 million in 2008, from $34.1 million in 2007. This decrease was primarily due to less favorable current accident year results of approximately $9 million, attributable to higher frequency of non-catastrophe weather related claims, partially offset by the benefit of changes in our 2008 reinsurance programs. Additionally, underwriting expenses and loss adjustment expenses were approximately $6 million higher in 2008 primarily due to 2007 expenses being reduced by a litigation recovery of $11.8 million. This was partially offset by lower variable compensation and employee benefit costs in 2008 as compared to 2007.

Favorable development on prior years loss and LAE reserves (excluding Hurricane Katrina) decreased $10.3 million, to $58.9 million in 2008, from $69.2 million in 2007. This decrease was driven primarily by lower favorable development in the personal automobile line of business, particularly from bodily injury.

The pre-tax effect of catastrophes increased $58.6 million, to $85.4 million in 2008 from $26.8 million in 2007. This increase was driven primarily by Hurricane Gustav, and to a lesser extent, Hurricane Ike, in 2008. We also increased our catastrophe reserves, net of reinsurance, for Hurricane Katrina by $3.1 million in 2008. We did not increase our reserves for Hurricane Katrina in 2007.

Commercial Lines

Commercial Lines net premiums written increased $99.5 million, or 10.7%, to $1,033.7 million for the year ended December 31, 2008. This increase primarily resulted from the benefit of changes in our 2008 reinsurance programs and the effect of net premiums written related to recently acquired subsidiaries. During 2008 and as discussed under Reinsurance on page 13 in Description of Business by Segment Property and Casualty of our 2008 Form 10-K, we renewed our property and casualty reinsurance program with changes to the reinsurance structure. These changes resulted in an increase in net written premium of $50.2 million in 2008. Net written premium attributable to our recent acquisitions of PDI, Verlan and AIX, was $40.8 million in 2008. The remaining premium increase was primarily in our bond business.

Our underwriting profit, excluding prior year reserve development and catastrophes, increased $20.3 million, to $25.9 million in 2008 from $5.6 million in 2007. This increase was primarily due to more favorable current accident year results of approximately $21 million, primarily attributable to growth in specialty lines and the benefit of changes in our reinsurance programs. These increases were partially offset by higher underwriting and loss adjustment expenses of approximately $1 million, primarily attributable to increased expenses associated with our specialty lines of business, including our recently acquired subsidiaries, partially offset by lower variable compensation and employee benefit costs.

Favorable development on prior years loss and LAE reserves, excluding Hurricane Katrina, increased $11.0 million, to $98.2 million in 2008 from $87.2 million in 2007. This increase primarily relates to the commercial multiple peril and workers compensation lines of business, partially offset by decreases in the commercial automobile and other commercial lines of business.

The pre-tax effect of catastrophes increased $45.9 million, to $84.3 million in 2008 from $38.4 million in 2007. This increase was driven primarily by Hurricane Ike, and to a lesser extent, Hurricane Gustav, in 2008. In 2008 and 2007, we increased our catastrophe reserves, net of reinsurance, for Hurricane Katrina by $4.3 million and $17.0 million, respectively.

Other Property and Casualty

Segment income of the Other Property and Casualty segment increased $4.2 million, to $9.0 million for the year ended December 31, 2008, from $4.8 million in 2007. The increase is primarily due to lower pension related costs.

INVESTMENT RESULTS

Net investment income before taxes was $251.7 million for the year ended December 31, 2009, $258.0 million for the year ended December 31, 2008 and $246.3 million for the year ended December 31, 2007. The decrease in net investment income in 2009 compared to 2008 was primarily due to a decline in new money yields, to the utilization of fixed maturities to fund the repurchase of our corporate debt and to lower partnership

income. These decreases were partially offset by the addition of investment income from investments held by our recently acquired subsidiaries and also by higher prepayment fees. The increase in net investment income in 2008 compared to 2007 was primarily due to earnings on pension and benefit-related invested assets transferred from our former Life Companies segment to the Property and Casualty group. Effective January 1, 2008, Hanover Insurance became the common employer of all employees of THG and its subsidiaries and sponsorship of all employee benefit plans was transferred from FAFLIC to Hanover Insurance. Accordingly, we transferred assets from FAFLIC to

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Hanover Insurance with corresponding liabilities associated with these benefit plans. Additionally, net investment income increased due to higher partnership income in 2008. These increases were partially offset by non-recurring call premiums and prepayment fees received in 2007 and lower income due to the sale of securities to fund our stock repurchase program. Average pre-tax yields on fixed maturities were 5.5% for the year ended December 31, 2009, 5.7% for the year ended December 31, 2008, and 5.6% for the year ended December 31, 2007.

RESERVE FOR LOSSES AND LOSS ADJUSTMENT EXPENSES

Overview of Loss Reserve Estimation Process

We maintain reserves for our property and casualty products to provide for our ultimate liability for losses and loss adjustment expenses (our loss reserves) with respect to reported and unreported claims incurred as of the end of each accounting period. These reserves are estimates, taking into account past loss experience, modified for current trends, as well as prevailing economic, legal and social conditions. Loss reserves represent our largest liability.

Our loss reserves include case estimates for claims that have been reported and estimates for claims that have been incurred but not reported (IBNR) at the balance sheet date. They also include estimates of the expenses associated with processing and settling all reported and unreported claims, less estimates of anticipated salvage and subrogation recoveries. Our loss reserves are not discounted to present value.

Case reserves are established by our claim personnel individually on a claim by claim basis and based on information specific to the occurrence and terms of the underlying policy. For some classes of business, average case reserves are used initially. Case reserves are periodically reviewed and modified based on new or additional information pertaining to the claim.

IBNR reserves are estimated by management and our reserving actuaries on an aggregate basis for each line of business, coverage and accident year for all loss and loss expense liabilities not reflected within the case reserves. The sum of the case reserves and the IBNR reserves represents our estimate of total unpaid loss and loss adjustment expense.

We regularly review our loss reserves using a variety of actuarial techniques. We update the reserve estimates as historical loss experience develops, additional claims are reported and resolved and new information becomes available. Any changes in estimates are reflected in operating results in the period in which the estimates are changed.

IBNR reserve estimates are generally calculated by first projecting the ultimate cost of all claims that have occurred or are expected to occur in the future in aggregate and then subtracting reported losses and loss expenses. Reported losses include cumulative paid losses and loss expenses plus case reserves. The IBNR reserve includes a provision for claims that have occurred but have not yet been reported to us, some of which may not yet be known to the insured, as well as a provision for future development on reported claims. IBNR represents a significant proportion of our total net loss reserves, particularly for long tail liability classes. In fact, approximately 50% of our aggregate net loss reserves at December 31, 2009 were for IBNR losses and loss expenses.

Management s process for establishing loss reserves is primarily based on the results of our reserving actuaries quarterly reserving process; however, there are a number of other factors in addition to the actuarial point estimates as further described under the section below entitled Loss and LAE Reserves by Line of Business. In establishing our loss reserves, we consider facts currently known and the present state of the law and coverage litigation. Based on all information currently available, we believe that the aggregate loss reserves at December 31, 2009 were adequate to cover claims for losses that had occurred as of that date, including both those known to us and those yet to be reported. However, as described below, there are significant uncertainties inherent in the loss reserving process. It is therefore possible that management s estimate of the ultimate liability for losses that had occurred as of December 31, 2009 may change, which could have a material effect on our results of operations and financial condition.

Management s Review of Judgments and Key Assumptions

We determine the amount of our loss reserves based on an estimation process that is very complex and uses information from both company specific and industry data, as well as general economic information. The estimation process is a combination of objective and subjective information, the blending of which requires significant actuarial and business judgment. There are various assumptions required including future trends in frequency and severity of claims, trends in total loss costs, operational changes in claim handling processes, and trends related to general economic and social conditions. As a result, informed subjective estimates and judgments as to our ultimate exposure to losses are an integral component of our loss reserving process.

Given the inherent complexity of our loss reserving process and the potential variability of the assumptions used, the actual emergence of losses could vary, perhaps substantially, from the estimate of losses included in our financial statements, particularly in those instances where settlements do not occur until well into the future. Our net loss reserves at December 31, 2009 were $2.1 billion. Therefore, a relatively small percentage change in the estimate of net loss reserves would have a material effect on our results of operations.

There is greater inherent uncertainty in estimating insurance reserves for certain types of property and casualty insurance lines, particularly workers compensation and other liability lines, where a longer period of time may elapse before a definitive determination of ultimate liability and losses may be made. In addition, the technological, judicial, regulatory and political climates involving these types of claims change regularly. There is also greater uncertainty in establishing reserves with respect to new business, particularly new business which is generated with respect to newly introduced product lines, by newly appointed agents or in geographies in which we have less experience in conducting business, such as the program business written by our recently acquired AIX subsidiary. In such cases, there is less historical experience or knowledge and less data upon which the actuaries can rely. Historically, we have limited the issuance of long-tailed other liability policies, including directors and officers (D&O) liability, errors and omissions (E&O) liability and medical malpractice liability. With the acquisition of Hanover Professionals in 2007, which writes lawyers professional errors and omissions coverage, and the introduction of management liability and other new specialty coverages, we are modestly increasing and expect to continue to increase our exposure to longer-tailed liability lines, including D&O coverages.

We regularly update our reserve estimates as new information becomes available and further events occur which may impact the resolution of unsettled claims. Reserve adjustments are reflected in the results of operations as adjustments to losses and LAE. Often, these adjustments are recognized in periods subsequent to the period in which the underlying policy was written and the loss event occurred. These types of subsequent adjustments are described separately as prior year reserve development . Such development can be either favorable or unfavorable to our financial results and may vary by line of business.

Inflation generally increases the cost of losses covered by insurance contracts. The effect of inflation varies by product. Our property and casualty insurance premiums are established before the amount of losses and LAE and the extent to which inflation may affect such expenses are known. Consequently, we attempt, in establishing rates and reserves, to anticipate the potential impact of inflation and increasing medical costs in the projection of ultimate costs. We have experienced increasing medical and attendant care costs, including those associated with personal automobile personal injury protection claims, particularly in Michigan, as well as in our workers compensation line in most states. This increase is reflected in our reserve estimates, but continued increases could contribute to increased losses and LAE in the future.

We regularly review our reserving techniques, our overall reserving position and our reinsurance. Based on (i) our review of historical data, legislative enactments, judicial decisions, legal developments in impositions of damages and policy coverage, political attitudes and trends in general economic conditions, (ii) our review of per claim information, (iii) our historical loss experience and that of the industry, (iv) the relatively short-term nature of most policies written by us, and (v) our internal estimates of required reserves, we believe that adequate provision has been made for loss reserves. However, establishment of appropriate reserves is an inherently uncertain process and there can be no certainty that current established reserves will prove adequate in light of subsequent actual experience. A significant change to the estimated reserves could have a material impact on our results of operations and financial position. An increase or decrease in reserve estimates would result in a corresponding decrease or increase in financial results. For example, each one percentage point change in the aggregate loss and LAE ratio resulting from a change in reserve estimation is currently projected to have an approximate $25 million impact on property and casualty segment income, based on 2009 full year premiums.

As discussed below, estimated loss and LAE reserves for claims occurring in prior years developed favorably by $155.3 million, $159.0 million, and $153.4 million for the years ended December 31, 2009, 2008, and 2007 respectively, which represents 7.4%, 7.2% and 6.9% of net loss reserves held, respectively.

The major causes of material uncertainty relating to ultimate losses and loss adjustment expenses (risk factors) generally vary for each line of business, as well as for each separately analyzed component of the line of business. In some cases, such risk factors are explicit assumptions of the estimation method and in others, they are implicit. For example, a method may explicitly assume that a certain percentage of claims will close each year, but will implicitly assume that the legal interpretation of existing contract language will remain unchanged. Actual results will likely vary from expectations for each of these assumptions, resulting in an ultimate claim liability that is different from that being estimated currently.

Some risk factors will affect more than one line of business. Examples include changes in claim department practices, changes in settlement patterns, regulatory and legislative actions, court actions, timeliness of claim reporting, state mix of claimants, and degree of claimant fraud. Additionally, there is also a higher degree of uncertainty due to growth in our newly acquired businesses, for which we have limited historical claims experience. The extent of the impact of a risk factor will also vary by components within a line of business. Individual risk factors are also subject to interactions with other risk factors within line of business components. Thus, risk factors can have offsetting or compounding effects on required reserves.

We are also defendants in various litigation, including putative class actions, which claim punitive damages or claim a broader scope of policy coverage than our interpretation, including in connection with losses incurred from Hurricane Katrina. The reserves established with respect to Hurricane Katrina assume that we will prevail with respect to these matters (See also Contingencies and Regulatory Matters). Although we believe our current Hurricane Katrina reserves are adequate, there can be no assurance that our ultimate costs associated with this event will not substantially exceed these estimates. We have fully utilized all of our available reinsurance with respect to losses and LAE related to Hurricane Katrina.

Loss and LAE Reserves by Line of Business

Reserves Other than those Relating to Asbestos and Environmental Claims

Our loss reserves include amounts related to short tail and long tail classes of business. Tail refers to the time period between the occurrence of a loss and the settlement of the claim. The longer the time span between the incidence of a loss and the settlement of the claim, the more the ultimate settlement amount can vary.

Short tail classes consist principally of automobile physical damage, homeowners, commercial property and marine business. For these coverages, claims are generally reported and settled shortly after the loss occurs because the claims relate to tangible property and are more likely to be discovered shortly after the loss occurs. Consequently, the estimation of loss reserves for these classes is less complex.

While 59% of our written premium is in short tailed classes of business, most of our loss reserves relate to longer tail liability classes of business. Long tail classes include commercial liability, automobile liability, workers compensation and other types of third party coverage. For many liability claims, significant periods of time, ranging up to several years or more, may elapse between the occurrence of the loss, the discovery and reporting of the loss to us and the settlement of the claim. As a result, loss experience in the more recent accident years for the long tail liability coverage has limited statistical credibility because a relatively small proportion of losses in these accident years are reported claims and an even smaller proportion are paid losses. An accident year is the calendar year in which a loss is incurred. Liability claims are also more susceptible to litigation and can be significantly affected by changing contract interpretations, the legal environment and the expense of protracted litigation. Consequently, the estimation of loss reserves for these coverages is more complex and typically subject to a higher degree of variability compared to short tail coverages.

Most of our indirect business from voluntary and involuntary pools is long tail casualty reinsurance. Reserve estimates for this business are therefore subject to the variability caused by extended loss emergence periods. The estimation of loss reserves for this business is further complicated by delays between the time the claim is reported to the ceding insurer and when it is reported by the ceding insurer to the pool manager and us and by our dependence on the quality and consistency of the loss reporting by the ceding company and the management, claims handling and actuarial judgment of the pool manager.

Our reserving actuaries, who are independent of the business units, perform a comprehensive review of loss reserves for each of the numerous classes of business we write at the end of each quarter. This review process takes into consideration a variety of trends that impact the ultimate settlement of claims, including the emergence of paid and reported losses relative to expectations.

The loss reserve estimation process relies on the basic assumption that past experience, adjusted for the effects of current developments and likely trends, is an appropriate basis for predicting future outcomes. As part of this process, our actuaries use a variety of actuarial methods that analyze experience, trends and other relevant factors. The principal standard actuarial methods used by our actuaries in the loss reserve reviews include loss development factor methods, expected loss methods (Bornheutter-Ferguson), and adjusted loss methods (Berquist-Sherman).

Loss development factor methods generally assume that the losses yet to emerge for an accident year are proportional to the paid or reported loss amount observed so far. Historical patterns of the development of paid and reported losses by accident year can be predictive of the expected future patterns that are applied to current paid and reported losses to generate estimated ultimate losses by accident year.

Bornheutter-Ferguson methods calculate IBNR directly for each accident year as the product of expected ultimate losses times the proportion of ultimate losses estimated to be unreported or unpaid (obtained from the loss development factor methods). Expected ultimate losses are determined by multiplying the expected loss ratio times earned premium. The expected loss ratio uses loss ratios from prior accident years adjusted to reflect current revenue and cost levels. The expected loss ratio is a critical component of Bornheutter-Ferguson and provides a general reasonability guide for all reserving methods.

Berquist-Sherman methods are used in cases where historical development patterns may be deemed less optimal for use in estimating ultimate losses of recent accident

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years. Under these methods, patterns of historical paid or reported losses are first adjusted to reflect current payment settlement patterns and case reserve adequacy and then evaluated in the same manner as the paid or reported loss development factor methods described above. The reported loss development factor method can be less appropriate when the adequacy of case reserves suddenly changes, while the paid loss development factor method can likewise be less appropriate when settlement patterns suddenly change.

For some low volume and high volatility classes of business, special reserving techniques are utilized that estimate IBNR by selecting the loss ratio that balances actual reported losses to expected reported losses as defined by the estimated underlying reporting pattern.

In completing their loss reserve analysis, our actuaries are required to determine the most appropriate actuarial methods to employ for each line of business, coverage and accident year. Each estimation method has its own pattern, parameter and/or judgmental dependencies, with no estimation method being better than the others in all situations. The relative strengths and weaknesses of the various estimation methods when applied to a particular class of business can also change over time, depending on the underlying circumstances. In many cases, multiple estimation methods will be valid for the particular facts and circumstances of the relevant class of business. The manner of application and the degree of reliance on a given method will vary by line of business and coverage, and by accident year based on our actuaries evaluation of the above dependencies and the potential volatility of the loss frequency and severity patterns. The estimation methods selected or given weight by our actuaries at a particular valuation date are those that are believed to produce the most reliable indication for the loss reserves being evaluated. Selections incorporate input from claims personnel, pricing actuaries, and underwriting management on loss cost trends and other factors that could affect ultimate losses.

For short tail classes, the emergence of paid and incurred losses generally exhibits a reasonably stable pattern of loss development from one accident year to the next. Thus, for these classes in the vast majority of cases, the loss development factor method is generally appropriate. In certain cases where there is a relatively low level of reliability placed on the available paid and incurred loss data, expected loss methods or adjusted loss methods are considered appropriate for the most recent accident year.

For long tail lines of business, applying the loss development factor method often requires more judgment in selecting development factors as well as more significant extrapolation. For those long tail lines of business with high frequency and relatively low per-loss severity (e.g., personal automobile liability), volatility will often be sufficiently modest for the loss development factor method to be given significant weight, even in the most recent accident years, but expected loss methods and adjusted loss methods are always considered and frequently utilized in the selection process. For those long tail lines of business with low frequency and high loss potential (e.g., commercial liability), anticipated loss experience is less predictable because of the small number of claims and erratic claim severity patterns. In these situations, the loss development factor methods may not produce a reliable estimate of ultimate losses in the most recent accident years since many claims either have not yet been reported or are only in the early stages of the settlement process. Therefore, the actuarial estimates for these accident years are based on methods less reliant on extrapolation, such as Bornheutter-Ferguson. Over time, as a greater number of claims are reported and the statistical credibility of loss experience increases, loss development factor methods or adjusted loss methods are given increasingly more weight.

Using all the available data, our actuaries select an indicated loss reserve amount for each line of business, coverage and accident year based on the various assumptions, projections and methods. The total indicated reserve amount determined by our actuaries is an aggregate of the indicated reserve amounts for the individual classes of business. The ultimate outcome is likely to fall within a range of potential outcomes around this indicated amount, but the indicated amount is not expected to be precisely the ultimate liability.

As stated above, numerous factors (both internal and external) contribute to the inherent uncertainty in the process of establishing loss reserves, including changes in the rate of inflation for goods and services related to insured damages (e.g., medical care, home repairs, etc.), changes in the judicial interpretation of policy provisions, changes in the general attitude of juries in determination of damages, legislative actions, changes in the extent of insured injuries, changes in the trend of expected frequency and/or severity of claims, changes in our book of business (e.g., change in mix due to new product offerings, new geographic areas, etc.), changes in our underwriting norms, and changes in claim handling procedures and/or systems. Regarding our indirect business from voluntary and involuntary pools, we are provided loss estimates by managers of each pool. We adopt reserve estimates for the pools that consider this information and other facts.

In addition, we must consider the uncertain effects of emerging or potential claims and coverage issues that arise as legal, judicial and social conditions change. These issues could have a negative effect on our loss reserves by either extending coverage beyond the original underwriting intent or by increasing the number or size of claims. As a result of these potential issues, the uncertainties inherent in estimating ultimate claim costs on the basis of past experience have further complicated the already complex loss reserving process. For example, in the state of Michigan, tort compensation for non-economic damages (for example, pain and suffering) caused by ownership or use of a motor vehicle is limited by statute to circumstances where the injured person suffered death, serious impairment of body function or permanent serious disfigurement. The application of this statute has been defined by the Supreme Court of Michigan in the so-called Kreiner decision. Accordingly, we establish our loss picks and our claim, IBNR and loss adjustment expense reserves based upon our understanding of the current state of the law. There have been and currently are efforts to change the controlling statute or judicial interpretation in ways which would expand an injured person s right to sue for non-economic damages. If implemented, such changes may not only impact future claims, but also past claims which are not settled and therefore an unfavorable adjustment to existing loss reserves could be required.

As part of our loss reserving analysis, we take into consideration the various factors that contribute to the uncertainty in the loss reserving process. Those factors that could materially affect our loss reserve estimates include loss development patterns and loss cost trends, rate and exposure level changes, the effects of changes in coverage and policy limits, business mix shifts, the effects of regulatory and legislative developments, the effects of changes in judicial interpretations, the effects of emerging claims and coverage issues and the effects of changes in claim handling practices. In making estimates of reserves, however, we do not necessarily make an explicit assumption for each of these factors. Moreover, all estimation methods do not utilize the same assumptions and typically no single method is determinative in the reserve analysis for a line of business and coverage. Consequently, changes in our loss reserve estimates generally are not the result of changes in any one assumption. Instead, the variability will be affected by the interplay of changes in numerous assumptions, many of which are implicit to the approaches used.

For each line of business and coverage, we regularly adjust the assumptions and actuarial methods used in the estimation of loss reserves in response to our actual loss experience, as well as our judgments regarding changes in trends and/or emerging patterns. In those instances where we primarily utilize analyses of historical patterns of the development of paid and reported losses, this may be reflected, for example, in the selection of revised loss development factors. In those long tail classes of business that comprise a majority of our loss reserves and for which loss experience is less predictable due to potential changes in judicial interpretations, potential legislative actions, the cost of litigation or determining liability and the ultimate loss, inflation and potential claims issues, this may be reflected in a judgmental change in our estimate of ultimate losses for particular accident years.

The future impact of the various factors that contribute to the uncertainty in the loss reserving process is extremely difficult to predict. There is potential for significant variation in the development of loss reserves, particularly for long tail classes of business. We do not derive statistical loss distributions or confidence levels around our loss reserve estimate, and as a result, do not have reserve range estimates to disclose. Actuarial ranges of reasonable estimates are not a true reflection of the potential volatility between carried loss reserves and the ultimate settlement amount of losses incurred prior to the balance sheet date. This is due, among other reasons, to the fact that actuarial ranges are developed based on known events as of the valuation date whereas the ultimate disposition of losses is subject to the outcome of events and circumstances that were unknown as of the valuation date.

The following tables and related discussion includes disclosure of possible variation from current actuarial estimates of loss reserves due to a change in certain key assumptions for the primary long tail coverages within our major lines of business which typically represent the areas of greatest uncertainty in our reserving process. We believe that the estimated variation in reserves detailed below is a reasonable estimate of the possible variation that may occur in the future, and are provided to illustrate the relationship between claim reporting patterns and expected loss ratios, respectively, on actuarial loss reserve estimates for the lines identified. However, if such variation did occur, it would likely occur over a period of several years and therefore its impact on our results of operations would be spread over the same period. It is important to note, however, that there is the potential for future variation greater than the amounts discussed below and for any such variations to be recognized in a single quarterly or annual period.

As noted, the following tables illustrate the relationship between the impact on our actuarial loss reserve estimates of reasonably likely variations to claim reporting patterns and expected actuarial estimates of ultimate loss costs, two key actuarial assumptions used to estimate our net reserves at December 31, 2009, from the assumptions utilized by our actuaries. The five point change to our expected loss

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ratio selections, which incorporate variability in both ultimate frequency and severity, are within the historical variation present in our prior accident year development. The three month change to reporting patterns represent claims reporting that is both faster and slower than our current reporting assumption for reported loss patterns and this degree of change is within the historical variation present in actual reporting patterns. A faster reporting pattern results in lower indicated net loss reserves due to the presumption that a higher proportion of ultimate claims have been reported thus far; and therefore, a lower proportion of ultimate claims needs to be carried as IBNR. A slower reporting pattern results in higher indicated net loss reserves due to the presumption that a lower proportion of ultimate claims have been reported thus far; and therefore, a higher proportion of ultimate claims need to be carried as IBNR.

The results show the cumulative dollar difference between our current actuarial estimate and the estimate that we would develop if our understanding with respect to loss reporting patterns and ultimate loss costs were different by three months or five points, respectively. No consideration has been given to potential correlation or lack of correlation among key assumptions or among lines of business and coverage. As a result, it would be inappropriate to take the amounts described below and add them together in an attempt to estimate volatility in total. While we believe these are reasonably likely scenarios, we do not believe the reader should consider the below sensitivity analysis as an actual reserve range.

Expected Dollar Effect on Actuarial Loss Reserve Estimates

Personal Automobile Bodily Injury

(In millions)

	Change in Expected Loss Ratio		
Reporting Pattern	5 points lower	Unchanged	5 points higher
3 months faster	$ (28)	$ (24)	$ (20)
Unchanged	(6)	-	6
3 months slower	13	20	27

Example: Personal Automobile Bodily Injury, if losses are actually developing and emerging three months slower than we anticipate in our models, our actuarial estimate for this coverage would be understated by $20 million. If our assumed payment patterns are consistent with our expectations, but the expected loss ratio in our model is 5% too low, then our actuarial estimate for this coverage would be understated by $6 million.

Expected Dollar Effect on Actuarial Loss Reserve Estimates
Workers Compensation Indemnity

(In millions)

	Change in Expected Loss Ratio		
Reporting Pattern	5 points lower	Unchanged	5 points higher
3 months faster	$ (4)	$ (1)	$ 2
Unchanged	(3)	-	3
3 months slower	1	5	9

Workers Compensation Medical

(In millions)

	Change in Expected Loss Ratio		
Reporting Pattern	5 points lower	Unchanged	5 points higher
3 months faster	$ (2)	$ (1)	$ -

Unchanged	(1)	-	1
3 months slower	2	4	5

Commercial Multiple Peril Liability

(In millions)

	Change in Expected Loss Ratio		
Reporting Pattern	5 points lower	Unchanged	5 points higher
3 months faster	$ (6)	$ (4)	$ (1)
Unchanged	(3)	-	3
3 months slower	-	3	6

Senior management meets with our reserving actuaries at the end of each quarter to review the results of the latest actuarial loss reserve analysis. Management s evaluation process to determine our ultimate losses includes various quarterly reserve committee meetings, culminating with the approval of single point best estimates by our Chief Financial Officer that reflect but often differ from our actuarial reserve analysis. Based on this quarterly process, management determines the carried reserve for each line of business and coverage and assesses the reasonableness of the difference between recorded and actuarially indicated reserves. In making the determination, management considers numerous factors, such as changes in actuarial indications in the period, the maturity of the accident year, trends observed over the recent past, the level of volatility within a particular class of business, general economic trends, and other factors not fully captured in the actuarial reserve analysis. In doing so, management must evaluate whether a change in the data represents credible actionable information or an anomaly. Such an assessment requires considerable judgment. Even if a change is determined to be apparent, it is not always possible to determine the extent of the change. As a result, there can be a time lag between the emergence of a change and a determination that the change should be reflected in the carried loss reserves. In general, changes are made more quickly to more mature accident years and less volatile classes of business.

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The table below shows our recorded reserves, net of reinsurance, and the related actuarial reserve point estimates by line of business at December 31, 2009 and 2008.

December 31	**2009**		2008	
(In millions)	**Recorded Net Reserves**	**Actuarial Point Estimate**	Recorded Net Reserves	Actuarial Point Estimate
Personal Automobile	**$ 663.6**	**$ 632.9**	$ 668.4	$ 638.0
Homeowners	**88.6**	**83.9**	98.5	96.4
Other Personal Lines	**20.2**	**19.2**	21.0	18.1
Workers Compensation	**334.5**	**324.6**	361.7	347.4
Commercial Automobile	**157.4**	**152.2**	159.2	153.1
Commercial Multiple Peril	**395.3**	**372.7**	443.4	409.0
Other Commercial Lines	**287.5**	**274.8**	269.2	257.0
Asbestos and Environmental	**11.3**	**11.4**	18.3	18.3
Pools and Other	**133.5**	**133.5**	173.4	173.4
Total	**$ 2,091.9**	**$ 2,005.2**	$ 2,213.1	$ 2,110.7

The principal factors considered by management, in addition to the actuarial point estimates, in determining the reserves at December 31, 2009 and 2008 vary by line of business.

In our Commercial Lines segment, management considered the growth and product mix changes and recent adverse frequency and severity trends in certain coverages. In addition, management also considered the significant growth in our inland marine and bond businesses for which we have limited actuarial data to estimate losses and the product mix change in our bond business towards a greater proportion of contract surety bonds where higher loss trends have emerged in 2009 related to declining general economic conditions. Moreover, in our Commercial Lines segment, although frequency trends in our workers compensation line have been favorable throughout 2009, management considered the potential for adverse development in this line where losses tend to emerge over long periods of time, trends are cyclical related to general economic conditions, and rising medical costs, while moderating, have continued to be a concern. With the acquisitions and associated growth of Hanover Professionals and AIX, we are modestly increasing our exposure to longer-tailed liability lines and there is less historical experience and less actuarial data available, all of which results in less certainty when estimating ultimate reserves. Also, higher retentions on our reinsurance program, beginning January 1, 2008, compared to prior years, may impact the emergence of trends in underlying data that could add to the uncertainty and variability of our actuarial estimates going forward. In our commercial multiple peril line, although the adverse loss frequency trends observed in 2008 have moderated during 2009, management considered the potential for adverse development due to increasing legal defense costs related to exposures, such as personal injury, advertising injury, Chinese drywall, and other complex cases that may continue to trend higher than expected.

In our Personal Lines segment, management considered the adverse automobile personal and bodily injury frequency and development trends in the 2008 and 2009 accident years and the related potential for continued adverse trends due to costs shifting from health insurers to property and casualty insurers resulting from continued economic concerns and health insurance coverage trends, the potential impact of the Michigan Supreme Court s pending review of the so-called Kreiner decision and developments in automobile property and physical damage costs in the 2007 and 2008 accident years, all of which have added additional uncertainty to future development in our personal automobile line. Additionally, management considered the growth in our new business with our ***Connections Auto*** product and related growth in a number of states where there is additional uncertainty in the ultimate profitability and development of reserves due to the unseasoned nature of our new business and new agency relationships in these markets, as well as emerging loss trends which continue to be higher than expected. Although our experience and data in these areas is growing with the passage of time, a sufficient number of years of actuarial data is not yet available to base loss estimates solely on this data in new geographical areas and agency relationships and with new products. As a results, there is less certainty when estimating ultimate reserves and more judgment by management is required.

Although management believes that the likelihood of future adverse development related to hurricanes Katrina, Ike and Gustav as of December 31, 2009 is lower compared to a year prior, there is still the potential for adverse development related to these events, as well as to our 2009 catastrophe losses, primarily in the homeowners and commercial multiple peril lines. Regarding our indirect business from voluntary and involuntary pools, we are provided loss estimates by managers of each pool. We adopt reserve estimates for the pools that consider this information and other factors.

At December 31, 2009 and 2008, total recorded net reserves were 4.3% and 4.9% greater than actuarially indicated reserves, respectively.

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The table below provides a reconciliation of the beginning and ending gross reserve for unpaid losses and LAE as follows:

For the Years Ended December 31

(In millions)	**2009**	2008	2007
Reserve for losses and LAE, beginning of year	**$ 3,201.3**	$ 3,165.8	$ 3,163.9
Incurred losses and LAE, net of reinsurance recoverable:			
Provision for insured events of current year	**1,793.5**	1,777.2	1,591.5
Decrease in provision for insured events of prior years; favorable development	**(155.3)**	(159.0)	(153.4)
Hurricane Katrina		7.4	17.0
Total incurred losses and LAE	**1,638.2**	1,625.6	1,455.1
Payments, net of reinsurance recoverable:			
Losses and LAE attributable to insured events of current year	970.9	999.9	832.4
Losses and LAE attributable to insured events of prior years	**771.3**	679.9	630.6
Hurricane Katrina	**17.2**	32.5	59.3
Total payments	**1,759.4**	1,712.3	1,522.3
Change in reinsurance recoverable on unpaid losses	**72.0**	(11.9)	35.4
Purchase of Verlan Fire Insurance Company		4.2	
Purchase of AIX Holdings, Inc.		129.9	
Purchase of Professionals Direct, Inc.			33.7
Reserve for losses and LAE, end of year	**$ 3,152.1**	$ 3,201.3	$ 3,165.8

The table below summarizes the gross reserve for losses and LAE by line of business:

December 31

(In millions)	**2009**	2008	2007
Personal Automobile	**$ 1,303.4**	$ 1,292.5	$ 1,277.4
Homeowners and Other	**140.1**	152.1	162.5
Total Personal	**1,443.5**	1,444.6	1,439.9
Workers Compensation	**524.1**	547.0	593.8
Commercial Automobile	**217.4**	226.4	250.8
Commercial Multiple Peril	**449.7**	499.5	541.8
Other Commercial	**517.4**	483.8	339.5
Total Commercial	**1,708.6**	1,756.7	1,725.9
Total reserve for losses and LAE	**$ 3,152.1**	$ 3,201.3	$ 3,165.8

The total reserve for losses and LAE as disclosed in the above tables decreased by $49.2 million in 2009 and increased by $35.5 million in 2008. The decrease in 2009 is primarily due to favorable development of prior years loss and LAE reserves.

Prior Year Development by Line of Business

When trends emerge that we believe affect the future settlement of claims, we adjust our reserves accordingly. Reserve adjustments are reflected in the Consolidated Statements of Income as adjustments to losses and LAE. Often, we recognize these adjustments in periods subsequent to the period in which the underlying loss event occurred. These types of subsequent adjustments are disclosed and discussed separately as prior year reserve development . Such development can be either favorable or unfavorable to our financial results.

The following table summarizes the change in provision for insured events of prior years, excluding those related to Hurricane Katrina (see Management s Review of Judgments and Key Assumptions on pages 42 to 44 of this Form 10-K for a further discussion of Hurricane Katrina) by line of business.

For the Years Ended December 31

(In millions)	**2009**	**2008**	**2007**
(Decrease) increase in loss provision for insured events of prior years:			
Personal Automobile	**$ (44.9)**	$ (54.6)	$ (66.6)
Homeowners and Other	**4.8**	(6.9)	(5.6)
Total Personal	**(40.1)**	(61.5)	(72.2)
Workers Compensation	**(28.2)**	(27.6)	(24.1)
Commercial Automobile	**(7.1)**	(9.3)	(11.8)
Commercial Multiple Peril	**(28.8)**	(36.1)	(25.1)
Other Commercial	**(17.1)**	(18.0)	(22.5)
Total Commercial	**(81.2)**	(91.0)	(83.5)
Voluntary Pools	**(11.8)**	(1.9)	3.0
Decrease in loss provision for insured events of prior years	**(133.1)**	(154.4)	(152.7)
Decrease in LAE provision for insured events of prior years	**(22.2)**	(4.6)	(0.7)
Decrease in total loss and LAE provision for insured events of prior years	**$ (155.3)**	$ (159.0)	$ (153.4)

Estimated loss reserves for claims occurring in prior years developed favorably by $133.1 million, $154.4 million and $152.7 million during 2009, 2008 and 2007, respectively. The favorable loss reserve development during the year ended December 31, 2009 is primarily the result of lower than expected severity of bodily injury in the personal automobile line, primarily in the 2005 through 2008 accident years, lower than expected severity in the workers compensation line, primarily in the 2000 through 2008

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accident years and lower than expected severity in the commercial multiple peril line, primarily in the 2005 through 2007 accident years. In addition, lower than expected severity in the bond line, lower projected losses in our run-off voluntary pools and lower projected exposures to asbestos and environmental liability for our direct written business contributed to the favorable development. Partially offsetting the favorable development was unfavorable non-catastrophe weather-related property loss development of $15.1 million, primarily related to our homeowners, commercial property and personal automobile physical damage lines, which developed unfavorably by $6.8 million, $6.7 million and $1.6 million, respectively.

The favorable loss reserve development during the year ended December 31, 2008 is primarily the result of lower than expected severity of bodily injury in the personal automobile line, primarily in the 2003 through 2007 accident years, and lower than expected severity of liability claims in the commercial multiple peril line for the 2003 though 2007 accident years. In addition, lower than expected severity in the workers compensation line, primarily in the 2003 through 2007 accident years, contributed to the favorable development.

The favorable loss reserve development during the year ended December 31, 2007 is primarily the result of lower than expected bodily injury and personal injury protection claim severity in the personal automobile line, primarily in the 2003 through 2006 accident years, and lower than expected severity of liability claims in the commercial multiple peril line for the 2005 and prior accident years. In addition, lower than expected severity in the workers compensation and other commercial lines, also primarily in the 2003 through 2006 accident years, contributed to the favorable development.

During the years ended December 31, 2009, 2008 and 2007, estimated LAE reserves for claims occurring in prior years developed favorably by $22.2 million, $4.6 million and $0.7 million, respectively. A change in our actuarial methodology for estimating loss adjustment expense reserves increased favorable development of prior year LAE reserves by $20.0 million in 2009. The favorable development in 2008 was primarily attributable to the aforementioned improvement in ultimate loss activity on prior accident years, primarily in the commercial multiple peril line. The favorable development in 2007 is primarily attributable to improvements in ultimate loss activity on prior accident years, primarily in the commercial multiple peril line, partially offset by an adverse litigation settlement in the first quarter of 2007, primarily impacting the personal automobile line.

Although we have experienced significant favorable development in both losses and LAE in recent years, there can be no assurance that this level of favorable development will occur in the future. We believe that we will experience less favorable prior year development in future years than we experienced recently. The factors that resulted in the favorable development of prior year reserves, including the aforementioned change in LAE reserve methodology, are considered in our ongoing process for establishing current accident year reserves. In light of our recent years of favorable development, the factors driving this development were considered to varying degrees in setting the more recent years accident year reserves. As a result, we expect the current and most recent accident year reserves not to develop as favorably as they have in the past. In light of the significance, in recent periods, of favorable development to our Property and Casualty group s segment income, declines in favorable development could be material to our results of operations.

Asbestos and Environmental Reserves

Although we attempt to limit our exposures to asbestos and environmental damage liability through specific policy exclusions, we have been and may continue to be subject to claims related to these exposures. The following table summarizes our asbestos and environmental reserves (net of reinsurance and excluding pools).

For the Years Ended December 31

(In millions)	**2009**			2008			2007		
	Asbestos	**Environmental**	**Total**	Asbestos	Environmental	Total	Asbestos	Environmental	Total
Beginning reserves	**$ 10.3**	**$ 8.2**	**$ 18.5**	$ 11.3	$ 8.1	$ 19.4	$ 13.6	$ 11.1	$ 24.7
Incurred losses and LAE	**(3.7)**	**(3.4)**	**(7.1)**	(0.3)	(2.0)	(2.3)	(1.9)	(2.6)	(4.5)
Paid (reimbursed) losses and LAE	**0.1**	**-**	**0.1**	0.7	(2.1)	(1.4)	0.4	0.4	0.8
Ending reserves	**$ 6.5**	**$ 4.8**	**$ 11.3**	$ 10.3	$ 8.2	$ 18.5	$ 11.3	$ 8.1	$ 19.4

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Ending loss and LAE reserves for all direct business written by our property and casualty companies related to asbestos and environmental damage liability, included in the reserve for losses and LAE, were $11.3 million, $18.5 million and $19.4 million, net of reinsurance of $19.9 million, $13.9 million and $11.1 million in 2009, 2008 and 2007, respectively. In recent years, average asbestos and environmental payments have declined modestly. As a result of the declining payments, our actuarial indicated point estimate of asbestos and environmental liability reserves was lowered resulting in favorable reserve development of $7.1 million during the year ended December 31, 2009. During 2008, our asbestos and environmental reserves decreased by $0.9 million, primarily due to a favorable cash recovery from a reinsurer on a prior year environmental claim. During 2007, we reduced our asbestos and environmental reserves by $4.5 million. As a result of our historical direct underwriting mix of Commercial Lines policies toward smaller and middle market risks, past asbestos and environmental damage liability loss experience has remained minimal in relation to our total loss and LAE incurred experience.

In addition, and not included in the numbers above, we have established loss and LAE reserves for assumed reinsurance pool business with asbestos and environmental damage liability of $45.6 million and $58.4 million at December 31, 2009 and 2008, respectively. These reserves relate to pools in which we have terminated our participation; however, we continue to be subject to claims related to years in which we were a participant. A significant part of our pool reserves relates to our participation in the Excess and Casualty Reinsurance Association (ECRA) voluntary pool from 1950 to 1982. In 1982, the pool was dissolved and since that time, the business has been in runoff. Our percentage of the total pool liabilities varied from 1% to 6% during these years. Our participation in this pool has resulted in average paid losses of approximately $2 million annually over the past ten years. During the year ended December 31, 2009, our ECRA pool reserves were lowered by $6.3 million as the result of an actuarial study completed by the ECRA pool. Management reviewed the ECRA actuarial study, concurred that the study was reasonable, and adopted its actuarial point estimate. In addition, during the year, management recorded favorable development of $4.3 million on a separate large claim settlement within these pools. Because of the inherent uncertainty regarding the types of claims in these pools, we cannot provide assurance that our reserves will be sufficient.

We estimate our ultimate liability for asbestos, environmental and toxic tort liability claims, whether resulting from direct business, assumed reinsurance or pool business, based upon currently known facts, reasonable assumptions where the facts are not known, current law and methodologies currently available. Although these outstanding claims are not significant, their existence gives rise to uncertainty and are discussed because of the possibility that they may become significant or similar claims may arise. We believe that, notwithstanding the evolution of case law expanding liability in asbestos and environmental claims, recorded reserves related to these claims are adequate. Nevertheless, the asbestos, environmental and toxic tort liability reserves could be revised, and any such revisions could have a material adverse effect on our results of operations for a particular quarterly or annual period or on our financial position.

REINSURANCE

Our Property and Casualty group maintains a reinsurance program designed to protect against large or unusual losses and LAE activity. We utilize a variety of reinsurance agreements that are intended to control our exposure to large property and casualty losses, stabilize earnings and protect capital resources, including facultative reinsurance, excess of loss reinsurance and catastrophe reinsurance. We determine the appropriate amount of reinsurance based upon our evaluation of the risks insured, exposure analyses prepared by consultants and/or reinsurers, our capital allocation models and on market conditions, including the availability and pricing of reinsurance. Reinsurance contracts do not relieve us from our primary obligations to policyholders. Failure of reinsurers to honor their obligations could result in losses to us. We believe that the terms of our reinsurance contracts are consistent with industry practice in that they contain standard terms and conditions with respect to lines of business covered, limit and retention, arbitration and occurrence. Based on an ongoing review of our reinsurers financial statements, reported financial strength ratings from rating agencies, and the analysis and guidance of our reinsurance advisors, we believe that our reinsurers are financially sound.

Catastrophe reinsurance serves to protect us, as the ceding insurer, from significant losses arising from a single event such as snow, ice storm, windstorm, hail, hurricane, tornado, riot or other extraordinary events. There were no ceded losses under our catastrophe reinsurance agreements in 2009, and $0.3 million and $0.5 million in 2008 and 2007, respectively. In 2009, we purchased catastrophe reinsurance coverage, which provided for maximum loss coverage limits of $700 million and a combined co-participation and retention level of $197 million of losses for a single event. Also, effective July 1, 2009, for a twelve month term, we purchased an additional $200 million layer and a co-participation of $100 million of losses for a single event in the Northeast. The 2009 program contains

an automatic reinstatement premium provision in the event we exhaust this maximum coverage. Although we believe our retention and co-participation amounts for 2009 and 2010 are appropriate given our surplus level and the current reinsurance pricing environment, there can be no assurance that our reinsurance program will provide coverage levels that will prove adequate should we experience losses from one significant or several large catastrophes during 2010. Additionally, as a result of the current economic environment as well as losses incurred by reinsurers in recent years, the availability and pricing of appropriate reinsurance programs may be adversely affected in future renewal periods. We may not be able to pass these costs on to policyolders in the form of higher premiums or assessments.

We also are subject to concentration of risk with respect to reinsurance ceded to various residual market mechanisms. As a condition to conduct certain businesses in various states, we are required to participate in residual market mechanisms and pooling arrangements which provide insurance coverage to individuals or other entities that are otherwise unable to purchase such coverage. These market mechanisms and pooling arrangements include, among others, the Michigan Assigned Claims facility and the Michigan Catastrophic Claims Association.

See Reinsurance in Item 1 Business on pages 13 and 14 of this Form 10-K for further information on our reinsurance programs.

Discontinued Operations

Discontinued operations consist of: (i) FAFLIC s discontinued operations, including both the loss associated with the sale of FAFLIC on January 2, 2009 and the loss or income resulting from its prior business operations; (ii) losses or gains associated with the sale of the variable life insurance and annuity business in 2005; and (iii) discontinued accident and health business.

FAFLIC Discontinued Operations

On January 2, 2009, we sold our remaining life insurance subsidiary, FAFLIC, to Commonwealth Annuity, a subsidiary of Goldman Sachs. In connection with the sale, FAFLIC paid a dividend consisting of designated assets with a statutory book value of approximately $130 million. Total net proceeds from the sale, including the dividend, were approximately $230 million, net of transaction costs. Additionally, coincident with the sale transaction, Hanover Insurance and FAFLIC entered into a reinsurance contract whereby Hanover Insurance assumed FAFLIC s discontinued accident and health insurance business. We also agreed to indemnify Commonwealth Annuity for certain litigation, regulatory matters and other liabilities related to the pre-closing activities of the business transferred.

The following table summarizes the results for this discontinued business for the periods indicated:

For the Years Ended December 31 *(In millions)*	**2009**	**2008**	**2007**
Gain (loss) on sale of FAFLIC, net of taxes	**$ 7.1**	$ (77.3)	$ -
(Loss) income from operations of FAFLIC business, including net realized (losses) gains of $(14.4) and $1.5 for the years ended December 31, 2008 and 2007	**-**	(7.5)	10.9
Gain (loss) from discontinued FAFLIC business, net of taxes	**$ 7.1**	$ (84.8)	$ 10.9

Gain (Loss) on sale of FAFLIC

The following table summarizes the components of the loss recognized in 2008 related to the sale of FAFLIC.

For the Year Ended December 31, ***(In millions)***	**2008**
Carrying value of FAFLIC before pre-close dividend	$ 267.7(1)
Pre-close net dividend	(129.8)(2)
	137.9
Proceeds from sale	105.8(3)

Loss on sale before impact of transaction and other costs		(32.1)
Transaction costs		(3.9)(4)
Liability for certain legal indemnities and employee-related costs		(8.2)(5)
Other miscellaneous adjustments		(33.1)(6)
Net loss	$	(77.3)

(1) Shareholder s equity in the FAFLIC business, prior to the impact of the sale transaction.
(2) Net pre-close dividends.
(3) Proceeds to THG from Commonwealth Annuity.
(4) Transaction costs include legal, actuarial and other professional fees.
(5) Liability for expected contractual indemnities of FAFLIC recorded at December 31, 2008. These costs also include severance and retention payments anticipated to result from this transaction.
(6) Included in other miscellaneous adjustments are investment losses of $48.5 million, as well as favorable reserve adjustments related to the accident and health business of $15.6 million.

In 2009, we recognized a gain of $7.1 million related to the sale of FAFLIC. This gain primarily reflects our change in our estimate of indemnification liabilities related to the sale, the release of sale related accruals, and a tax adjustment relating to FAFLIC s operations in prior tax years.

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(Loss) Income from Operations of FAFLIC Business

The following table summarizes the results of FAFLIC s operations for the periods indicated:

For the Years Ended December 31 *(In millions)*	2008	2007
Premiums	$ 25.6	$ 32.8
Fees and other (loss) income	(0.7)	0.4
Net investment income	66.2	77.0
Net realized investment (losses) gains	(14.4)	2.4
Total revenue	76.7	112.6
Policy benefits, claims and losses	69.7	89.7
Policy acquisition and other operating expenses	9.9	16.0
(Loss) income included in discontinued operations before federal income taxes	(2.9)	6.9
Federal income tax expense (benefit)	4.6	(4.0)
(Loss) income from discontinued operations of FAFLIC	$ (7.5)	$ 10.9

The loss from FAFLIC s discontinued operations was $7.5 million for the year ended December 31, 2008, compared to income of $10.9 million for the year ended December 31, 2007. The decrease in income in 2008 compared to 2007 primarily resulted from an increase in other-than-temporary impairments in 2008 and losses associated with the sale of fixed maturities. Also, lower net investment income resulted from an intercompany transfer of employee benefit related assets to our Property and Casualty segment. Partially offsetting this decrease were lower operating expenses and favorable mortality experience in both our traditional and group retirement lines of business.

In connection with the sales transaction, we agreed to indemnify Commonwealth Annuity for certain legal, regulatory and other matters that existed as of the sale. Accordingly, we established a gross liability in accordance with ASC 460, *Guarantees* (ASC 460) (formerly included under FASB Interpretation No. 45, *Guarantor s Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others*) of $9.9 million. As of December 31, 2009, our total gross liability related to these guarantees was $1.7 million. Although we believe our current estimate for this liability is appropriate, there can be no assurance that this estimate will be sufficient to pay future expenses associated with these guarantees.

Variable Life Insurance and Annuity Business

On December 30, 2005, we sold our run-off variable life insurance and annuity business to Goldman Sachs. Results currently consist primarily of expense and recoveries relating to indemnification obligations incurred in connection with this sale. The following table summarizes the results for this discontinued business for the periods indicated:

For the Years Ended December 31 *(In millions)*	2009	2008	2007
Gain on sale of variable life and annuity business, net of taxes (including a gain on disposal of $4.9, $8.7 and $7.9 in 2009, 2008 and 2007)	$ 4.9	$ 11.3	$ 13.1

For the year ended December 31, 2009, we recorded a gain of $4.9 million, net of tax, primarily related to a change in our estimate of liabilities related to certain indemnities to Goldman Sachs relating to pre-sale activities of the business sold. For the year ended December 31, 2008, we recorded a gain of $11.3 million, net of tax, primarily from an $8.6 million release of liabilities related to certain contractual indemnities to Goldman Sachs, and a $2.7 million tax benefit from a settlement with Internal Revenue Service(IRS) related to tax years 1995 through 2001. In 2007, we recorded a gain of $13.1 million, primarily related to a $7.5 million tax benefit from the utilization of net operating loss carryforwards previously generated and $5.2 million related to the favorable settlement of IRS audits for the 2002 to 2004 tax years (See Income Taxes on pages 63 to 65 of this Form 10-K for further discussion).

As of December 31, 2009, our total gross liability for guarantees and indemnifications provided in connection with the disposal of our former variable life insurance and annuity business was $5.3 million on a pre-tax basis. Although we believe our current estimate for this liability is

appropriate, there can be no assurance that this estimate will be sufficient to pay future expenses associated with these guarantees.

Accident and Health Business

In 2009, we recognized a loss from the discontinued accident and health business of $2.6 million, primarily from net realized investment losses resulting from other-than-temporary impairments. The accident and health business had no financial results that impacted 2008 and 2007. For a description of the business, see Discontinued Operations in the Business Section on page 15 of this Form 10-K.

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OTHER ITEMS

Net realized gains on investments were $1.4 million for 2009 compared to losses of $97.8 million for 2008. Net investment gains in 2009 resulted from $34.3 million of gains recognized principally from the sale of $2.1 billion of fixed maturities, partially offset by $32.9 million of other-than-temporary impairments, primarily from fixed maturity and equity securities. In 2008, losses resulted primarily from $113.1 million of other-than-temporary impairments, primarily from fixed maturities, partially offset by $15.3 million of gains recognized principally from the sale of $778.1 million of fixed maturities. Net realized investment losses were $0.9 million in 2007, primarily due to $3.6 million of impairments from fixed maturities and other invested assets, partially offset by $2.7 million of gains recognized principally from the sale of $340.4 million of fixed maturities.

During 2008, we recognized a $6.4 million tax benefit resulting from a settlement with the IRS for tax years 1995 through 2001.

We completed a cash tender offer to repurchase a portion of our 8.207% Series B Capital Securities due in 2027 that were issued by AFC Capital Trust I and a portion of our 7.625% Senior Debentures due in 2025 that were issued by THG. AFC Capital Trust I was subsequently liquidated as of July 30, 2009. As a result of these actions and including securities repurchased prior and subsequent to the tender offer, we recorded a pre-tax gain of $34.5 million in 2009 (see Other Significant Transactions for further discussion regarding these items).

During 2008, we recognized income of $10.1 million, which reflects an $11.1 million gain on the sale of AMGRO, partially offset by losses from the operations of AMGRO during that period.

Net income includes the following items by segment:

	2009				
	Property and Casualty				
(In millions)	**Personal Lines**	**Commercial Lines**	**Other Property and Casualty (2)**	**Discontinued Operations**	**Total**
Net realized investment (losses) gains (1)	**$ (0.8)**	**$ 0.3**	**$ 1.9**	**$**	**$ 1.4**
Gain from retirement of corporate debt			**34.5**		**34.5**
Gain from discontinued FAFLIC business, net of taxes				**7.1**	**7.1**
Loss from discontinued accident and health business, net of taxes				**(2.6)**	**(2.6)**
Gain on disposal of variable life insurance and annuity business, net of taxes				**4.9**	**4.9**

	2008				
	Property and Casualty				
(In millions)	**Personal Lines**	**Commercial Lines**	**Other Property and Casualty (2)**	**Discontinued Operations**	**Total**
Net realized investment (losses) gains (1)	$ (53.6)	$ (53.4)	$ 9.2	$	$ (97.8)
Federal income tax settlement	5.6	2.1	(1.3)		6.4
Other non-segment items		(0.1)			(0.1)
Loss from discontinued FAFLIC business (including loss on disposal of $77.3), net of taxes				(84.8)	(84.8)
Gain on disposal of variable life insurance and annuity business, net of taxes				11.3	11.3
Income from operations of AMGRO (including gain on disposal of $11.1), net of taxes			10.1		10.1
Other, discontinued operations				(0.5)	(0.5)

	2007				
	Property and Casualty				
(In millions)	**Personal Lines**	**Commercial Lines**	**Other Property and Casualty (2)**	**Discontinued Operations**	**Total**
Net realized investment (losses) gains (1)	$ (0.7)	$ (0.7)	$ 0.5	$	$ (0.9)
Income from discontinued FAFLIC business, net of taxes				10.9	10.9
Income from operations of variable life insurance and annuity business (including gain on disposal of $7.9), net of taxes				13.1	13.1
Other discontinued operations				0.8	0.8

(1) We manage investment assets for our property and casualty business based on the requirements of the entire property and casualty group. We allocate the investment income, expenses and realized gains (losses) to our Personal Lines, Commercial Lines and Other Property and Casualty segments based on actuarial information related to the underlying business.

(2) Includes corporate eliminations.

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INVESTMENT PORTFOLIO

We held general account investment assets diversified across several asset classes, as follows:

December 31	2009		2008	
(In millions, except percentage data)	Carrying Value	% of Total Carrying Value	Carrying Value	% of Total Carrying Value
Fixed maturities (1)	**$ 4,732.4**	**91.9%**	$ 4,226.3	88.5%
Equity securities (1)	**69.3**	**1.3**	76.2	1.6
Mortgages	**14.1**	**0.3**	31.1	0.6
Cash and cash equivalents (1)	**316.7**	**6.1**	425.4	8.9
Other long-term investments	**18.2**	**0.4**	18.4	0.4
Total, including assets of discontinued operations (2)	**5,150.7**	**100.0%**	4,777.4	100.0%
Investment assets of discontinued operations (2)	**(117.1)**		(113.1)	
Total investment assets of continuing operations	**$ 5,033.6**		$ 4,664.3	

(1) We carry these investments at fair value.
(2) Investment assets of discontinued operations as of December 31, 2009 and 2008 include our discontinued accident and health business. Investment assets of discontinued operations as of December 31, 2008 in this table exclude our discontinued FAFLIC business. Due to the January 2, 2009 sale of FAFLIC, $1,124.6 million of investment assets were transferred to the buyer in 2009.

Investment Assets

The following discussion includes the investment assets of our continuing operations, as well as the investment assets of our discontinued accident and health business.

Total investment assets increased $373.3 million, or 7.8%, to $5.2 billion for the year ended December 31, 2009, of which fixed maturities increased $506.1 million and cash and cash equivalents decreased $108.7 million. The increase in fixed maturities is primarily due to market value appreciation and from the investment of proceeds from the sale of FAFLIC, as well as our investment of a portion of our cash in the bond markets. This was partially offset by the sale of fixed maturities to fund our common stock repurchase program.

Our fixed maturity portfolio is comprised primarily of investment grade corporate securities, residential mortgage-backed securities, taxable and tax-exempt issues of state and local governments, U.S. government and agency securities, commercial mortgage-backed securities and asset-backed securities.

The following table provides information about the investment type and credit quality of our fixed maturities portfolio:

December 31 *(In millions, except percentage data)*		2009			
Investment Type	Rating Agency Equivalent Designation	Amortized Cost	Fair Value	Net Unrealized Gain (Loss) (1)	Change in Net Unrealized for the Year
Corporates:					
NAIC 1	Aaa/Aa/A	**$ 844.1**	**$ 876.4**	**$ 32.3**	**$ 92.1**
NAIC 2	Baa	**1,038.9**	**1,087.4**	**48.5**	**121.2**
NAIC 3 and below	Ba, B, Caa and lower	**300.6**	**304.5**	**3.9**	**60.4**
Total corporates		**2,183.6**	**2,268.3**	**84.7**	**273.7**
Asset-backed:					

Residential mortgage-backed securities	**858.8**	**874.4**	**15.6**	**16.9**
Commercial mortgage-backed securities	**334.5**	**337.2**	**2.7**	**33.6**
Asset-backed securities	**63.1**	**65.6**	**2.5**	**9.8**
Municipals:				
Taxable	**685.6**	**669.0**	**(16.6)**	**(2.0)**
Tax exempt	**159.1**	**163.2**	**4.1**	**20.6**
U.S. government	**355.2**	**354.7**	**(0.5)**	**(5.1)**
Total fixed maturities (2)	**$ 4,639.9**	**$ 4,732.4**	**$ 92.5**	**$ 347.5**

(1) Includes $40.6 million unrealized loss related to other-than-temporary impairment losses recognized in other comprehensive income.

(2) Includes discontinued accident and health business of $119.6 million in amortized cost and $116.8 million in fair value at December 31, 2009.

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During 2009, our net unrealized position improved $347.5 million from a net unrealized loss of $255.0 million at December 31, 2008 to a net unrealized gain of $92.5 million at December 31, 2009.

Amortized cost and carrying value by rating category for the years ended December 31, 2009 and 2008 were as follows:

DECEMBER 31 *(In millions, except percentage data)*	**Rating Agency Equivalent**	**2009**			**2008**		
NAIC Designation	**Designation**	**Amortized Cost**	**Carrying Value**	**% of Total Carrying Value**	**Amortized Cost**	**Carrying Value**	**% of Total Carrying Value**
1	Aaa/Aa/A	**$ 3,120.8**	**$ 3,168.0**	**66.9%**	$ 3,098.1	$ 2,997.8	70.9%
2	Baa	**1,198.0**	**1,240.3**	**26.2**	1,074.8	981.5	23.2
3	Ba	**138.2**	**130.5**	**2.8**	151.5	133.2	3.2
4	B	**93.1**	**98.0**	**2.1**	111.0	83.8	2.0
5	Caa and lower	**84.0**	**88.0**	**1.9**	37.1	24.5	0.6
6	In or near default	**5.8**	**7.6**	**0.1**	8.8	5.5	0.1
Total fixed maturities (1)		**$ 4,639.9**	**$ 4,732.4**	**100.0%**	$ 4,481.3	$ 4,226.3	100.0%

(1) Includes discontinued accident and health business of $119.6 million in amortized cost and $116.8 million in fair value at December 31, 2009, and $99.3 million in amortized cost and $85.4 million in fair value at December 31, 2008.

Based on ratings by the National Association of Insurance Commissioners (NAIC), approximately 93% of our fixed maturity portfolio consisted of investment grade securities at December 31, 2009, compared to 94% at December 31, 2008.

The quality of our fixed maturity portfolio remains strong based on ratings, capital structure position, support through guarantees, underlying security and parent ownership and yield curve position. We do not hold any securities in the following sectors: subprime mortgages, either directly or through our mortgage-backed securities; collateralized debt obligations; collateralized loan obligations; or credit derivatives. Our residential mortgage-backed securities constitute $874.4 million of our invested assets, with 21% held in non-agency prime securities, and the remaining invested in agency-sponsored securities. Commercial mortgage-backed securities (CMBS) constitute $337.2 million of our invested assets, of which approximately 20% is fully defeased with U.S. government securities. The portfolio is seasoned, with approximately 76% of our CMBS holdings from pre-2005 vintages, 10% from the 2007 vintage, 6% from the 2006 vintage and 8% from the 2005 vintage. The CMBS portfolio is of high quality with approximately 79% being AAA rated and 21% rated AA or A. The CMBS portfolio has a weighted average loan-to-value ratio of approximately 70% as of December 31, 2009. Our direct commercial mortgage portfolio is only $23.9 million as of December 31, 2009, including credit tenant loan fixed maturities. These mortgages are of high quality, with 42% maturing by the end of 2010. Our municipal bond portfolio constitutes approximately 16% of invested assets and is substantially all investment grade. Financial guarantor insurance enhanced municipal bonds were $271.1 million, or approximately 33% of our municipal bond portfolio as of December 31, 2009. Without regard to the insurance enhancement, 98% of our municipal bond portfolio is investment grade as of December 31, 2009. U.S. agency debt securities represent about 5% of the portfolio and we have no investments in its preferred stock or equity except for our $8.1 million equity investment in FHLBB required by our membership in its collateralized borrowing program.

At December 31, 2009, $77.9 million of our fixed maturities were invested in traditional private placement securities, as compared to $75.8 million at December 31, 2008. Fair values of traditional private placement securities are determined either by a third party broker or by pricing models that use discounted cash flow analyses.

Our fixed maturity and equity securities are classified as available-for-sale and are carried at fair value. Financial instruments whose value is determined using significant management judgment or estimation constitute approximately 1% of the total assets and liabilities we measured at fair value. (See also Note 6 Fair Value).

Although we expect to invest new funds primarily in cash, cash equivalents and investment grade fixed maturities, we have invested a small portion of funds in common equity securities, and we may invest a portion in below investment grade fixed maturities and other assets. The average earned yield on fixed maturities was 5.5% and 5.7% for the years ended December 31, 2009 and 2008, respectively.

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Other-than-Temporary Impairments

Cumulative Effect

As more fully described in Note 5 of the consolidated financial statements, we account for other-than-temporary impairments (OTTI) in accordance with ASC 320, *Investments - Debt and Equity Securities (ASC 320)* (formerly included under FASB Staff Position No. FAS 115-2 and FAS 124-2, *Recognition and Presentation of Other-Than-Temporary Impairments*). On April 1, 2009, we adopted accounting guidance that is now included in ASC 320, which required us to modify our assessment of OTTI on debt securities, as well as our method of recording and reporting OTTI. In accordance with ASC 320, we reviewed OTTI previously recorded through realized losses on securities held at April 1, 2009, which were $121.6 million, and determined that $33.3 million of these impairments were related to non-credit factors, such as interest rates and market conditions. Accordingly, we increased the amortized cost basis of these debt securities and recorded a cumulative effect adjustment of $33.3 million within shareholders equity. The cumulative effect adjustment had no effect on total shareholders equity as it increased retained earnings and reduced accumulated other comprehensive income.

Under the new accounting guidance, if a company does not intend to sell the debt security, or more likely than not will not be required to sell it, the credit loss portion of an other-than-temporary impairment is recorded through earnings while the portion attributable to all other factors is recorded separately as a component of other comprehensive income.

Other-Than-Temporary Impairments

For the year ended December 31, 2009, we recorded $42.2 million of other-than-temporary impairments of fixed maturities and equity securities, of which $32.9 million was recognized in earnings and the remaining $9.3 million was recorded as an unrealized loss in accumulated other comprehensive income. OTTI recognized in earnings in 2009 primarily included losses on below investment grade fixed maturities of $21.2 million, principally from corporate bonds in the industrial sector, and $9.5 million from perpetual preferred securities, primarily in the financial sector. In 2008, we recognized OTTI of $113.1 million, resulting from credit-related losses on corporate bonds, particularly in the financial sector and in certain higher yielding, below investment grade fixed maturities. OTTI in 2008 included $68.6 million related to the financial sector, $38.5 million related to the industrial sector and $6.0 million related to the utilities sector. Approximately $54.7 million of impairments were related to investment grade fixed maturities, $50.2 million to below investment grade fixed maturities and $8.2 million to equities and other investments.

In our determination of other-than-temporary impairments, we consider several factors and circumstances, including the issuer s overall financial condition; the issuer s credit and financial strength ratings; the issuer s financial performance, including earnings trends, dividend payments, and asset quality; any specific events which may influence the operations of the issuer; a weakening of the general market conditions in the industry or geographic region in which the issuer operates; the length of time and the degree to which the fair value of an issuer s securities remains below our cost; with respect to fixed maturity investments, any factors that might raise doubt about the issuer s ability to pay all amounts due according to the contractual terms and whether we expect to recover the entire amortized cost basis of the security; and with respect to equity securities, our ability and intent to hold the investment for a period of time to allow for a recovery in value. We apply these factors to all securities.

We monitor corporate fixed maturity securities with unrealized losses on a quarterly basis and more frequently when necessary to identify potential credit deterioration whether due to ratings downgrades, unexpected price variances, and/or company or industry specific concerns. We apply consistent standards of credit analysis which includes determining whether the issuer is current on its contractual payments, and we consider past events, current conditions and reasonable forecasts to evaluate whether we expect to recover the entire amortized cost basis of the security. We utilize valuation declines as a potential indicator of credit deterioration, and apply additional levels of scrutiny in our analysis as the severity of the decline increases or duration persists.

For our impairment review of asset-backed fixed maturity securities, we forecast our best estimate of the prospective future cash flows of the security to determine if we expect to recover the entire amortized cost basis of the security. Our analysis includes estimates of underlying collateral default rates based on historical and projected delinquency rates and estimates of the amount and timing of potential recovery. We consider all available information relevant to the collectibility of the security, including information about the remaining payment terms of the security, prepayment speeds, the financial condition of the issuer, industry analyst reports, sector credit ratings and other market data when developing our estimate of the expected cash flows.

When an other-than-temporary impairment of a debt security occurs, and we intend to sell or more likely than not will be required to sell the investment before recovery of its amortized cost basis, the amortized cost of the security is reduced to its fair value, with a corresponding charge to earnings, which reduces net income and earnings per

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share. If we do not intend to sell the fixed maturity investment or more likely than not will not be required to sell it, we separate the other-than-temporary impairment into the amount we estimate represents the credit loss and the amount related to all other factors. The amount of the estimated loss attributable to credit is recognized in earnings, which reduces net income and earnings per share. The amount of the estimated other-than-temporary impairment that is non-credit related is recognized in other comprehensive income, net of applicable taxes.

We estimate the amount of the other-than-temporary impairment that relates to credit by comparing the amortized cost of the debt security with the net present value of the debt security s projected future cash flows, discounted at the effective interest rate implicit in the investment prior to impairment. The non-credit portion of the impairment is equal to the difference between the fair value and the net present value of the fixed maturity security at the impairment measurement date.

Other-than-temporary impairments of equity securities are recorded as realized losses, which reduce net income and earnings per share. The new cost basis of an impaired security is not adjusted for subsequent increases in estimated fair value.

Temporary declines in market value are recorded as unrealized losses, which do not affect net income and earnings per share, but reduce other comprehensive income, which is reflected in our Consolidated Balance Sheets. We cannot provide assurance that the other-than-temporary impairments will be adequate to cover future losses or that we will not have substantial additional impairments in the future.

Unrealized Losses

The following table provides information about our fixed maturities and equity securities that are in an unrealized loss position.

	December 31, 2009					
	12 Months or Less		Greater than 12 Months		Total	
(In millions)	Gross Unrealized Losses and OTTI	Fair Value	Gross Unrealized Losses and OTTI	Fair Value	Gross Unrealized Losses and OTTI (1)	Fair Value
Fixed maturities:						
Investment grade:						
U.S. Treasury securities and U.S. government and agency securities	$ 3.7	$ 170.8	$ -	$ -	$ 3.7	$ 170.8
States and political subdivisions	9.0	275.2	15.6	176.5	24.6	451.7
Corporate fixed maturities (2)	3.4	115.8	13.3	152.7	16.7	268.5
Residential mortgage-backed securities	6.6	89.1	7.5	62.6	14.1	151.7
Commercial mortgage-backed securities	0.4	13.5	7.0	30.0	7.4	43.5
Total investment grade	23.1	664.4	43.4	421.8	66.5	1,086.2
Below investment grade (3):						
States and political subdivisions	0.2	8.7	0.8	8.2	1.0	16.9
Corporate fixed maturities (2)	10.6	84.1	16.9	150.1	27.5	234.2
Total below investment grade	10.8	92.8	17.7	158.3	28.5	251.1
Total fixed maturities	33.9	757.2	61.1	580.1	95.0	1,337.3
Equity securities:						
Common equity securities	-	-	0.3	1.4	0.3	1.4
Total equity securities	-	-	0.3	1.4	0.3	1.4
Total (4)	$ 33.9	$ 757.2	$ 61.4	$ 581.5	$ 95.3	$ 1,338.7

(1) Includes $40.6 million of unrealized losses related to OTTI recognized in other comprehensive income, of which $14.8 million are below investment grade aged greater than 12 months.

(2) Gross unrealized losses on corporate fixed maturities include $31.7 million in the financial sector, $10.3 million in the industrial sector, and $2.2 million in utilities and other.

(3) Substantially all below investment grade securities with an unrealized loss had been rated by the NAIC, Standard & Poor s or Moody s at December 31, 2009.

(4) Includes discontinued accident and health business of $8.8 million in gross unrealized losses with $55.0 million in fair value at December 31, 2009.

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	December 31, 2008					
	12 Months or Less		Greater than 12 Months		Total	
(In millions)	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value
Fixed maturities:						
Investment grade:						
U.S. Treasury securities and U.S. government and agency securities	$ 0.7	$ 70.2	$ -	$ -	$ 0.7	$ 70.2
States and political subdivisions	26.8	352.3	3.9	56.9	30.7	409.2
Corporate fixed maturities (1)	89.4	1,028.4	70.2	295.5	159.6	1,323.9
Residential mortgage-backed securities	18.6	110.4	3.2	30.2	21.8	140.6
Commercial mortgage-backed securities	14.7	162.8	17.1	87.2	31.8	250.0
Total investment grade	150.2	1,724.1	94.4	469.8	244.6	2,193.9