

# The Hanover Insurance Group

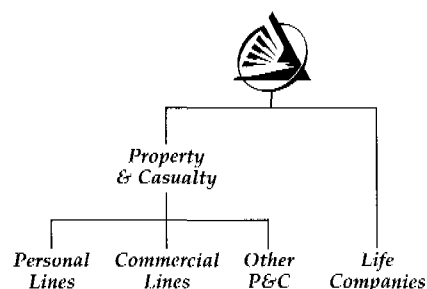
— *Annual Report 2005* —

## The Hanover Insurance Group Highlights

The Hanover Insurance Group, Inc., based in Worcester, Mass., is the holding company for a group of insurers that includes The Hanover Insurance Company, also based in Worcester, Citizens Insurance Company of America, headquartered in Howell, Michigan, and their affiliates. The Hanover offers a wide range of property and casualty products and services to individuals, families and businesses through an extensive network of independent agents, and has been meeting its obligations to its agent partners and their customers for more than 150 years. Taken as a group, The Hanover ranks among the top 35 of more than 950 property and casualty insurers in the United States.

The Hanover Insurance Group conducts its business in two areas: Property and Casualty and Life Companies. Our Property and Casualty business consists of three operating segments: *Personal Lines*, *Commercial Lines*, and *Other Property and Casualty*. Together these segments account for 93% of our consolidated revenues. Our fourth operating segment is the *Life Companies*, which is a relatively small portion of our operations and is in run-off.

NYSE: THG



*Personal Lines*—includes such property and casualty coverage as personal automobile, homeowners and other personal policies.

*Commercial Lines*—includes such property and casualty coverage as workers' compensation, commercial automobile, commercial multi peril and other commercial lines policies which include inland and ocean marine, fidelity and surety bonds, umbrella, general liability and fire.

*Other Property and Casualty*—consists of run-off voluntary pools business in which we have not actively participated since 1995, AMGRO—our premium financing business, and Opus Investment Management, Inc., which markets investment management services to institutions, pension funds and other organizations.

*Life Companies*—On December 30, 2005, we sold our run-off variable life insurance and annuity business to Goldman Sachs. After this sale, our remaining Life Companies segment, which is in run-off, now consists primarily of a block of traditional life insurance products, our GIC business, certain group retirement products and certain non-insurance subsidiaries.

## Financial Summary

(In millions, except per share)

Year Ended December 31	2005	2004	2003
Revenues	\$2,624	\$2,717	\$2,831
Net (Loss) Income	(325)	125	87
Pre-tax Segment Income <sup>(1)</sup>	55	136	63
Total Assets	10,634	23,810	25,510
Shareholders Equity	1,951	2,340	2,220
<b>Per Common Share</b>			
Net (Loss) Income—Diluted	\$(6.02)	\$2.34	\$1.63
Book Value	36.30	43.91	41.89

<sup>(1)</sup> Represents pre-tax income of the Company's four operating segments: Personal Lines, Commercial Lines, Other Property and Casualty and Life Companies, as well as the interest expense related to our corporate debt. In accordance with Statement of Financial Accounting Standards No. 131, the separate financial information of each segment is presented consistent with the manner in which results are regularly evaluated by the chief operating decision maker in deciding how to allocate resources and in assessing performance. Pre-tax segment income excludes realized gains and losses, gains or losses on disposal of businesses and discontinued operations and other items, the details of which are included on page 27 in the attached Annual Report on Form 10-K. We report interest expense related to our corporate debt separately from the earnings of our operating segments.

*The results of our work over the past three years are encouraging and give us great confidence in our future.*



## To Our Shareholders

FREDERICK H. EPPINGER  
*President and Chief Executive Officer*

2005 was a very important year for our company as we continued our journey to build a world class regional property and casualty company. We enhanced our strategic focus by selling our variable life insurance and annuity business and rebranded our company, taking "The Hanover Insurance Group" name. We improved our financial strength, despite being tested by unprecedented hurricanes that affected our industry. And, we continued to significantly enhance our capabilities in both our Personal and Commercial Lines businesses, creating very competitive product suites for both markets.

The improvements and investments we made in 2005, in addition to those made in the prior two years, have enabled us to deliver on our promises to our agents and their customers, and have created substantial value for our shareholders.

In fact, *The Wall Street Journal* in its annual Shareholders Scoreboard reported that our company generated the single best three-year shareholder return among all property and casualty companies tracked for the period through year-end 2005. Our average compound annual return for the three-year period was 60.9 percent—nearly three times higher than the average for all property and casualty companies.

The results of our work over the past three years are encouraging and give us great confidence in our future. But, we know we must remain focused on improving every day if we are going to build a world class regional company.

*We enhanced our capital position and affirmed our financial standing in the industry, gaining the trust and confidence of our key stakeholders.*

### *Foundational Strength in Place*

The significant advances we made during 2005 further strengthened our financial position, improved the overall risk profile of our company and increased our core earnings power. Our actions enhanced our company's focus and positioned us for greater success in 2006.

The progress we made in 2005 is not readily apparent in our financial results, however, due to the impact of two extraordinary events; the sale of our variable life insurance and annuity business and the impact of Hurricane Katrina.

While the life sale focused our company squarely on the property and casualty business and generated gross proceeds of \$360 million, it also resulted in an after-tax, non-cash loss of \$444 million, which reduced our net income.

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Hurricane Katrina also had a dramatic impact. While our strong reinsurance program minimized the impact, Katrina still generated losses of \$162 million on a net-of-tax basis.

It is important to note that in spite of these two events, we enhanced our capital position and affirmed our financial standing in the industry, maintaining our "A-" "Excellent" A.M. Best Co. financial strength ratings, and gaining the trust and confidence of our key stakeholders.

#### *Sale of the Variable Life Insurance and Annuity Business*

The sale of our variable life insurance and annuity business to The Goldman Sachs Group was an important transaction that clarified our future.

Our life business had been placed in run-off in late 2002. Since that time, our strategy had been to prudently manage this business in order to maximize and monetize the cash flow it generated. Our decision to sell the business was consistent with that strategy and was the best answer for our company.

This transaction will create value for us in both the short and long term. Over the long term, we will benefit from our enhanced focus on the property and casualty business. In the short term, the proceeds generated through the sale will enable us to deliver value for our shareholders by accelerating the release of capital from our life companies and providing us with considerably more financial flexibility.

Effective with the closing of the transaction at year-end, we instituted a share buyback program of up to \$200 million, which we plan to execute through 2006. This share repurchase program complemented the shareholder dividend that we also reinstated in 2005. Even after the execution of these capital management programs, our holding company is expected to have sufficient liquidity to cover its fixed obligations for several years.

*We quickly and effectively helped our agents and customers begin the process of rebuilding their lives after Hurricane Katrina.*

### *Impact of Hurricane Katrina*

Hurricane Katrina was an event of unparalleled magnitude for our industry and for our company. This storm hit directly in our largest concentration of coastal business, Louisiana, and it will cost us more than any single catastrophe in our company's history.



*Mark Welzenbach and John Urankar are leading our Claims organization through a total redesign that supports our business needs and financial objectives for the future.*

Providing for and responding to catastrophes of this nature is our business. It is what we must do well as a top-quartile company, and I am proud of the way our company and our people responded under extraordinarily difficult circumstances.

We overcame tremendous challenges, quickly getting adjusters on the ground in the affected areas, assessing damage, making advance payments and helping our agents and customers begin the process of rebuilding their lives.

Katrina tested many in our industry, insurers and re-insurers alike, requiring many to raise capital in order to meet their financial obligations. We passed the Katrina

test, confirming the progress we had made and the financial strength of our company.

Despite the significant losses sustained from Hurricane Katrina, we ended the year with \$54 million dollars in after-tax segment income, and with more statutory capital than we had at the beginning of the year. Our statutory surplus increased by over \$100 million during 2005, up 10% to \$1.2 billion, and we improved our capitalization ratios and operating leverage.

Our ability to withstand the impact of Hurricane Katrina while generating meaningful earnings and increasing our capital is a testimony to the strength of the underlying earnings power in our Property and Casualty business.

Catastrophes are very much a part of our business, and we manage our business with an objective of earning at least our cost of capital on average over time. However, given the events of 2005, it is helpful to look at earnings excluding catastrophes.

*Our ability to continue to grow Commercial Lines in 2006 will be driven by the strength and distinctiveness of the business model.*



Catastrophe losses were \$304 million in 2005, compared to \$99 million in 2004. Excluding the impact of these catastrophes, our 2005 Property and Casualty pre-tax segment earnings were up \$120 million, or 40%, compared to 2004. On this basis, both our Personal Lines and Commercial Lines businesses recorded earnings improvement, with a 38% earnings growth in Personal Lines and a 47% earnings growth in Commercial Lines.\*

The growing earnings power of our company clearly demonstrates that the investments and the improvements we have made in each of our business segments are having the desired effect.

### *Creating a Distinctive Position*

While strengthening the foundation on which we are building our business, we also continued to make great progress on the strategic initiatives that we believe will sustain our performance and position us for greater success going forward.

The investments we have made in our business have enabled us to foster more and stronger relationships with our agents and to meet the product and service expectations of our agents and their customers. We have begun to see these investments generate growth in our business and we expect the rate of growth to accelerate as these and other enhancements take hold.



*Sophia Phillips and Dick Van Steenburgh have driven significant improvements in our Bond and Marine capabilities, generating excellent business results while strengthening our Commercial Lines value proposition.*

### *Commercial Lines*

In Commercial Lines, our company is positioned to be one of the very best in the small to mid-market business segment, offering a distinctive operating model by partnering our experienced field team with winning agents. We also have developed expertise in specialty businesses that can be leveraged across our distribution system and provide opportunity for higher growth and improved margins.

Despite competitive market conditions, we have been able to generate high-quality new business growth while improving our mix.

We will continue to leverage our position into 2006.

Our objective is to maintain the focus on growth in small commercial and first-tier middle market, which we define as policies with annual premiums up to \$200,000, where we can capitalize on our distinctive strategy and value proposition.

*In Personal Lines, our comprehensive approach to the needs of our agent partners and customers will make us a distinctive carrier in our agent's portfolio.*

Our ability to continue to grow in 2006 will be driven by the strength and distinctiveness of the business model that we have developed, which is aligned closely with the needs of growing mid-sized agents.

We are now ready to offer our agents a unique opportunity; what we call a "total solutions approach." This approach provides our agents with a broad product portfolio, quick turnaround on quoting activity, partnerships with knowledgeable underwriters, and a responsive, local service team.

We believe this business model will be a winning value proposition for our target agents and will make us a "must have" carrier in our agents' portfolio.

### *Personal Lines*

In Personal Lines, our strategy has been to strengthen our foundation by improving our profitability and mix of business, while investing in products and an operating model that will allow us to compete aggressively in the market.

Our growth objective in Personal Lines is supported by **Connections Auto**, our new multi-variate auto product, and is augmented by a broad product offering. Our focus in this business is to provide a "total account solution," offering the capability to meet customers' total personal insurance needs, with an integrated family of products and without gaps in coverage. At the same time, we have the sophistication in our product and the breadth of coverage to support the changing needs of our customers through their various life stages.

Backing up our growth efforts, we have created a field presence with regional vice presidents of the highest caliber in our key markets and we have made many enhancements to our service model that make it easy for agents to do business with us.

As in Commercial Lines, it is this comprehensive approach to the needs of our agent partners and customers that will make us a distinctive carrier in our agent's portfolio.

The successful launch of **Connections Auto** was critical to the execution of our Personal Lines strategy during 2005. This product was launched in April and was rolled out during the year in eight states: Florida, Illinois, Indiana, Maine, New York, Tennessee, Virginia and Michigan. It represents a dramatic improvement in our product portfolio and positions us to profitably write a much broader spectrum



*Jose Trasancos and Cilsy Harris led the development of **Connections Auto** in record time, providing a state-of-the-art product platform to support our Personal Lines value proposition.*

*Today, our company is in excellent financial condition, and we have the leadership team in place to build our business.*

of the market, with greater underwriting precision, and supports our efforts to boost penetration in our existing markets as well as our expansion efforts into new markets.

The initial market response to this product has been overwhelmingly positive, resulting in significant sales activity. Through the final eight months of 2005, we wrote more than 34,000 new **Connections Auto** policies.

We are encouraged that this product, in combination with significantly improved service, will help build more and deeper partnerships with winning agents going forward, as it did during 2005, when previously dormant agencies began working with us again and we appointed approximately 300 new Personal Lines agents.

We fully expect to continue the growth momentum created by the **Connections Auto** launch, as we roll the product out in nine additional states during 2006.

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### *Our Strategy is Sound and Remains Unchanged*

Our success in 2005 has confirmed that our strategy is sound.

Today, the foundation of our business is solid. Our company is in excellent financial condition, and we have the leadership team in place to build our business.



*The strong financial leadership of Joe Freitas and Michael Lorion has helped to deepen our understanding of the economics of our business, leading to better decision making and ultimately higher returns.*

Success in our industry has everything to do with strong execution and it is people that make that happen. I am very proud of the leadership team that we have assembled, complementing existing talent with some of the finest talent from the industry to create a company that has the capability and drive to make things happen.

The quality of our people enabled us to achieve a great deal during 2005, including completing the complex sale of our variable life insurance and annuity business, responding effectively to Hurricane Katrina, and bringing **Connections Auto** to market in record time.

*Our company is uniquely positioned as a super regional, offering our independent agent partners and their customers the best attributes of both national and regional companies.*

## Outlook

With competition increasing and a shakeout underway in the property and casualty business, we have a clear vision for the future—to become a world class regional property and casualty insurance company—one that achieves top-quartile financial position, provides our agent partners with top-quartile products and service, and is a place where the best people in our business want to work.

We entered 2006 poised to grow both our Personal and Commercial Lines of business. The signs of our progress are everywhere. But, we are not done. We take pride in all we have accomplished, but we focus every day on what we have yet to achieve.

Our immediate focus is to further improve our overall financial condition, continually strengthen our team, create more and stronger partnerships with our agent partners, develop better products and provide more responsive service.

Our company is uniquely positioned today as a super regional, offering our independent agent partners and their customers the best attributes of both national and regional companies. In the months and years ahead, our goal is to exploit that competitive advantage, creating significant value for our shareholders and all of our other stakeholders, as we create a very special, truly great company.

I have every confidence we will do just that.

Sincerely,



FREDERICK H. EPPINGER  
*President and Chief Executive Officer*



*Dan Mastrototaro and Mike Christiansen are part of one of the most experienced and responsive field leadership teams in the business, driving strong results today while building our leadership capabilities for the future.*

**Personal Lines**  
*At-A-Glance*

*The total account writer, delivering sophisticated products and ease of doing business*

**Products**

An integrated suite of competitive products with the sophistication and breadth of coverage to support the changing needs of a customer through all of life's stages

- **Multi-Variate Auto Product**
- **Enhanced Homeowners Product**
- **Ancillary Products**
  - Umbrella
  - Valuable items
  - Watercraft
  - Dwelling fire

**Highlights**

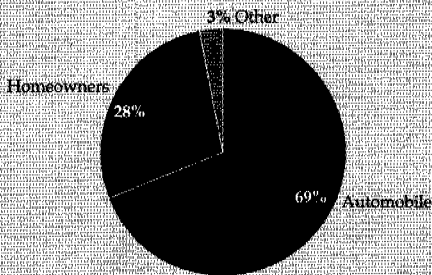
- Introduced **Connections Auto**— a sophisticated multi-variate product
- Generated 2005 new business written premium of \$44 million from **Connections Auto**
- Local sales power—eight dedicated regional vice presidents supported by 60 sales people and technology trainers, serving 1,850 agencies
- Easy to do business with— technology, service, accuracy, problem resolution

**Outlook**

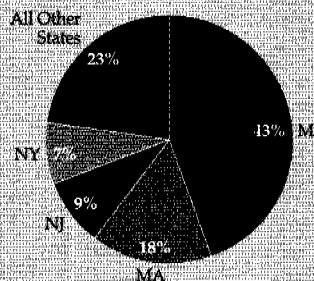
- Growth in premium driven by product and execution
- Further diversification of geographic presence
- Expanded distribution force
- Distinctive “go to” relationships with the right producers
- A competitive advantage as an easy carrier to work with and a reputation for service excellence



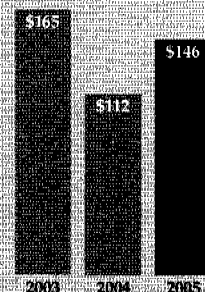
**Personal Lines Product Mix**  
2005 Net Written Premium



**Personal Lines Geographic Mix**  
2005 Net Written Premium



**Personal Lines New Business**  
Net Written Premium in Millions



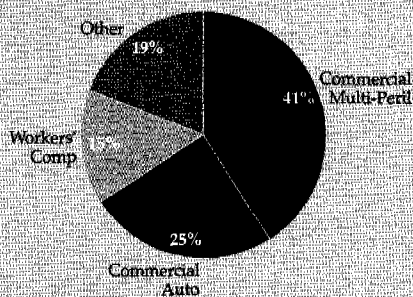
## Commercial Lines At-A-Glance

*The best growth partner for mid-sized agents, leveraging our broad risk appetite and excellent service*

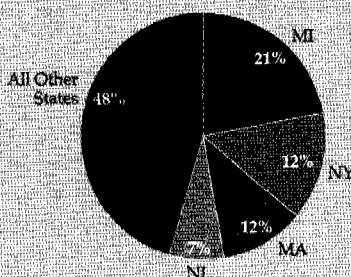
Products	Highlights	Outlook
<p>A full breadth of flexible products that meet the needs of the small to mid-sized commercial agent</p> <ul style="list-style-type: none"> <li>▪ <b>Enhanced Business Owners Policy</b></li> <li>▪ <b>Competitive Standard Products</b> <ul style="list-style-type: none"> <li>▪ Commercial Package Product</li> <li>▪ Workers' Compensation</li> <li>▪ Commercial Auto</li> </ul> </li> <li>▪ <b>Complementary Specialty Products</b> <ul style="list-style-type: none"> <li>▪ Inland Marine</li> <li>▪ Umbrella</li> <li>▪ Expanded Bond Offering</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>▪ Net written premium growth exceeded industry average</li> <li>▪ A distinctive operating model designed for the small to mid-sized market</li> <li>▪ Top-tier field executives and local underwriters supporting our target market of policies with premiums of less than \$200 thousand</li> <li>▪ Broad risk appetite and specialty capabilities—true problem solvers</li> <li>▪ Excellent responsiveness and customer service</li> <li>▪ A total solutions provider of standard and specialty products</li> </ul>	<ul style="list-style-type: none"> <li>▪ Sustain growth rates that exceed industry average</li> <li>▪ Stable margins and improved mix</li> <li>▪ Continue growth momentum in small to mid-sized commercial market, in policies with premiums of less than \$200 thousand</li> <li>▪ Growth in complementary specialty business</li> <li>▪ Strengthen key agency partnerships to achieve growth objective</li> </ul>



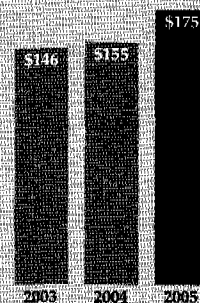
**Commercial Lines Product Mix**  
2005 Net Written Premium



**Commercial Lines Geographic Mix**  
2005 Net Written Premium



**Commercial Lines New Business**  
Net Written Premium in Millions



## Board of Directors

**MICHAEL P. ANGELINI** <sup>(N)</sup>

*Chairman of the Board  
Chairman and Partner  
Bowditch & Dewey, LLP*

**FREDERICK H. EPPINGER**

*President and Chief Executive Officer  
The Hanover Insurance Group, Inc.*

**GAIL L. HARRISON** <sup>(C)</sup>

*Executive Vice President  
Powell Tate*

**WENDELL J. KNOX** <sup>(C) (N)</sup>

*President and Chief Executive Officer  
Abt Associates*

**ROBERT J. MURRAY** <sup>(A) (C)</sup>

*Retired Chairman  
New England Business Service, Inc.*

**EDWARD J. PARRY, III**

*Executive Vice President and  
Chief Financial Officer  
The Hanover Insurance Group, Inc.*

**JOSEPH R. RAMRATH** <sup>(A)</sup>

*Managing Director  
Colchester Partners LLC*

**HERBERT M. VARNUM** <sup>(A) (N)</sup>

*Retired Chairman and  
Chief Executive Officer  
Quabaug Corporation*

## Operating Committee

**FREDERICK H. EPPINGER**

*President and Chief Executive Officer  
The Hanover Insurance Group, Inc.*

**EDWARD J. PARRY, III**

*Executive Vice President and  
Chief Financial Officer*

**MARITA ZURAITIS**

*Executive Vice President and  
President, Property and Casualty Companies*

**WARREN E. BARNES**

*Vice President and Corporate Controller*

**MARK D. BRISSMAN**

*Vice President and Chief Actuary  
Property and Casualty Companies*

**JOHN W. CHANDLER**

*Vice President and Chief Marketing Officer*

**MICHAEL CHRISTIANSEN**

*Regional President  
New England*

**ALAN K. CRATER**

*Regional President  
New York / New Jersey*

**DAVID J. FIRSTENBERG**

*President, Commercial Lines*

**J. KENDALL HUBER**

*Senior Vice President and General Counsel*

**JAMES S. HYATT**

*President, Personal Lines*

**RICHARD W. LAVEY**

*Vice President and  
Chief Operations Officer*

**DOUGLAS McDONOUGH**

*Regional President  
Southeast Region*

**MARK C. MCGIVNEY**

*Vice President, Treasurer and  
Chief Financial Officer  
Property and Casualty Companies*

**ROBIN NICKS**

*Regional President  
Central Region*

**GREGORY D. TRANTER**

*Vice President and  
Chief Information Officer*

**ANN K. TRIPP**

*Vice President and  
Chief Investment Officer*

**JOHN URANKAR**

*Vice President, Claims*

**MARK J. WELZENBACH**

*Vice President, Claims*

## Industry Ratings

Financial Strength Ratings

A.M. Best  
Standard  
& Poor's  
Moody's

### Property and Casualty Insurance Companies:

The Hanover Insurance Company	A-	BBB+	Baa1
Citizens Insurance Company of America	A-	BBB+	-

### Life Insurance Companies:

First Allmerica Financial Life Insurance Company	B+	BBB-	Ba1
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Debt Ratings

A.M. Best  
Standard  
& Poor's  
Moody's

Allmerica Financial Corporation Senior Debt	bbb-	BB+	Ba1
Allmerica Financial Corporation Capital Securities	bb	B+	Ba2
First Allmerica Financial Life Insurance Company Short-Term Insurance Financial Strength Rating	-	-	NP

## Registrar and Stock Transfer Agent

Computershare Trust Company, N.A.  
PO Box 43076, Providence, RI 02940-3076  
1-800-317-4454

## Independent Accountants

PricewaterhouseCoopers LLP  
125 High Street, Boston, MA 02110

## Corporate Offices & Principal Subsidiaries

The Hanover Insurance Group, Inc.  
440 Lincoln Street, Worcester, MA 01653

The Hanover Insurance Company  
440 Lincoln Street, Worcester, MA 01653

Citizens Insurance Company of America  
645 West Grand River, Howell, MI 48843

## Shareholder Information

### Annual Meeting of Shareholders

The management and Board of Directors of The Hanover Insurance Group, Inc. invite you to attend the company's Annual Meeting of Shareholders. The meeting will be held on May 16, 2006, at 9:00 a.m. at The Hanover, 440 Lincoln Street, Worcester, Massachusetts.

### Common Stock and Shareholder Ownership Profile

The common stock of The Hanover Insurance Group, Inc. is traded on the New York Stock Exchange under the symbol "THG". As of the end of business on February 28, 2006, the company had 34,217 shareholders of record. On the same date, the trading price of the company's common stock closed at \$48.45 per share.

### Common Stock Prices

2005	High	Low	2004	High	Low
First Quarter	\$36.50	\$30.27	First Quarter	\$38.25	\$30.84
Second Quarter	\$37.29	\$32.85	Second Quarter	\$36.10	\$30.71
Third Quarter	\$42.11	\$37.13	Third Quarter	\$34.61	\$26.05
Fourth Quarter	\$42.03	\$37.20	Fourth Quarter	\$33.00	\$25.45

## Investor Information

Call our toll-free investor information line, 1-800-407-5222, to receive additional printed information, including Form 10-Ks or quarterly reports on Form 10-Q filed with the Securities and Exchange Commission, and for access to fax-on-demand services, shareholder services, pre-recorded messages and other services. In addition, the company's filings with the Securities and Exchange Commission are available on our web site at [www.hanover.com](http://www.hanover.com). Alternatively, investors may address questions to:

Sujata Mutalik  
Vice President, Investor Relations  
The Hanover Insurance Group  
t. 508-855-3457 / f. 508-853-4481  
smutalik@hanover.com

Debra Casey, CPA  
Director, Investor Relations  
The Hanover Insurance Group  
t. 508-855-6658 / f. 508-852-7588  
dcasey@hanover.com

## Corporate Governance

Our Corporate Governance Guidelines, Board Committee Charters, Code of Conduct and other information are available on our web site at [www.hanover.com](http://www.hanover.com) under "Corporate Governance." For a printed copy of any of these documents, shareholders may contact the company's secretary at our corporate offices.

Regarding the quality of our public disclosures: The Company has filed its CEO and CFO Section 302 certifications as exhibits to its Annual Report on Form 10-K for the year ended December 31, 2005. The company has also submitted its annual CEO certification to the New York Stock Exchange, a copy of which is available on the company's website, [www.hanover.com](http://www.hanover.com), under "Corporate Governance-Certification."



The Hanover Insurance Company | 440 Lincoln Street, Worcester, MA 01653  
Citizens Insurance Company of America | 645 West Grand River Avenue, Howell, MI 48843

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[www.Hanover.com](http://www.Hanover.com)