

ARCH CAPITAL GROUP LTD.
Form 10-Q
August 08, 2007

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

FORM 10-Q

(Mark One)

**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE
SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended June 30, 2007

Or

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE
SECURITIES EXCHANGE ACT OF 1934**

For the transition period to

Commission file number: 0-26456

ARCH CAPITAL GROUP LTD.

(Exact name of registrant as specified in its charter)

Bermuda

(State or other jurisdiction of incorporation
or organization)

Not Applicable

(I.R.S. Employer Identification No.)

**Wessex House, 45 Reid Street
Hamilton HM 12, Bermuda**

(Address of principal executive offices)

(441) 278-9250

(Zip Code)

Registrant's telephone number, including area code:

(Former name, former address and former fiscal year, if changed since last report)

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Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes No

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

Large Accelerated Filer Accelerated Filer Non-Accelerated Filer

Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No

Indicate the number of shares outstanding of each of the issuer's classes of common shares as of the latest practicable date.

Class	Outstanding at July 31, 2007
Common Shares, \$0.01 par value	70,869,221

ARCH CAPITAL GROUP LTD.

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Report of Independent Registered Public Accounting Firm

To the Board of Directors and Shareholders of
Arch Capital Group Ltd.:

We have reviewed the accompanying consolidated balance sheet of Arch Capital Group Ltd. and its subsidiaries (the Company) as of June 30, 2007, and the related consolidated statements of income for each of the three-month and six-month periods ended June 30, 2007 and 2006, and the consolidated statements of changes in shareholders' equity, comprehensive income and cash flows for each of the six-month periods ended June 30, 2007 and 2006. These interim financial statements are the responsibility of the Company's management.

We conducted our review in accordance with the standards of the Public Company Accounting Oversight Board (United States). A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with the standards of the Public Company Accounting Oversight Board (United States), the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our review, we are not aware of any material modifications that should be made to the accompanying consolidated interim financial statements for them to be in conformity with accounting principles generally accepted in the United States of America.

We previously audited in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheet as of December 31, 2006, and the related consolidated statements of income, changes in shareholders' equity, comprehensive income, and cash flows for the year then ended (not presented herein), and in our report dated February 28, 2007 we expressed an unqualified opinion on those consolidated financial statements. In our opinion, the information set forth in the accompanying consolidated balance sheet information as of December 31, 2006, is fairly stated in all material respects in relation to the consolidated balance sheet from which it has been derived.

/s/ PricewaterhouseCoopers LLP
New York, New York
August 8, 2007

ARCH CAPITAL GROUP LTD. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(U.S. dollars in thousands, except share data)

	(Unaudited) June 30, 2007	December 31, 2006
Assets		
Investments:		
Fixed maturities available for sale, at fair value (amortized cost: 2007, \$6,972,705; 2006, \$6,858,970)	\$ 6,923,478	\$ 6,876,548
Short-term investments available for sale, at fair value (amortized cost: 2007, \$1,110,053; 2006, \$956,926)	1,114,485	957,698
Short-term investment of funds received under securities lending agreements, at fair value	1,114,959	891,376
Other investments (cost: 2007, \$429,486; 2006, \$282,923)	461,835	307,082
Total investments	9,614,757	9,032,704
Cash	245,143	317,017
Accrued investment income	71,064	68,440
Fixed maturities and short-term investments pledged under securities lending agreements, at fair value	1,085,757	860,803
Premiums receivable	1,041,921	749,961
Funds held by reinsureds	79,335	82,385
Unpaid losses and loss adjustment expenses recoverable	1,545,820	1,552,157
Paid losses and loss adjustment expenses recoverable	131,441	122,149
Prepaid reinsurance premiums	544,137	470,138
Deferred income tax assets, net	70,688	63,606
Deferred acquisition costs, net	309,651	290,999
Receivable for securities sold	54,954	190,168
Other assets	499,100	511,940
Total Assets	\$ 15,293,768	\$ 14,312,467
Liabilities		
Reserve for losses and loss adjustment expenses	\$ 6,782,433	\$ 6,463,041
Unearned premiums	2,001,736	1,791,922
Reinsurance balances payable	382,488	301,679
Senior notes	300,000	300,000
Deposit accounting liabilities	43,559	45,107
Securities lending collateral	1,114,959	891,376
Payable for securities purchased	434,624	418,109
Other liabilities	529,902	510,614
Total Liabilities	11,589,701	10,721,848
Commitments and Contingencies		
Shareholders Equity		
Non-cumulative preferred shares (\$0.01 par value, 50,000,000 shares authorized)		
- Series A (issued: 2007 and 2006, 8,000,000)	80	80
- Series B (issued: 2007 and 2006, 5,000,000)	50	50
Common shares (\$0.01 par value, 200,000,000 shares authorized, issued: 2007, 71,273,285; 2006, 74,270,466)	713	743
Additional paid-in capital	1,716,295	1,944,304
Retained earnings	1,993,963	1,596,018
Accumulated other comprehensive income (loss), net of deferred income tax	(7,034)	49,424
Total Shareholders Equity	3,704,067	3,590,619
Total Liabilities and Shareholders Equity	\$ 15,293,768	\$ 14,312,467

See Notes to Consolidated Financial Statements

ARCH CAPITAL GROUP LTD. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME
(U.S. dollars in thousands, except share data)

	(Unaudited) Three Months Ended June 30, 2007		(Unaudited) Six Months Ended June 30, 2007	
	2007	2006	2007	2006
Revenues				
Net premiums written	\$ 757,895	\$ 794,558	\$ 1,629,640	\$ 1,668,277
(Increase) decrease in unearned premiums	(6,483)	2,892	(132,735)	(109,226)
Net premiums earned	751,412	797,450	1,496,905	1,559,051
Net investment income	117,299	90,503	229,988	170,829
Net realized losses	(3,757)	(32,202)	(4,738)	(35,585)
Fee income	2,091	3,468	4,060	5,273
Other income	265		869	
Total revenues	867,310	859,219	1,727,084	1,699,568
Expenses				
Losses and loss adjustment expenses	425,663	462,255	845,724	930,433
Acquisition expenses	117,277	148,581	237,405	278,253
Other operating expenses	100,505	84,367	191,318	167,344
Interest expense	5,523	5,651	11,046	11,206
Net foreign exchange losses	6,450	1,146	16,192	11,399
Total expenses	655,418	702,000	1,301,685	1,398,635
Income before income taxes	211,892	157,219	425,399	300,933
Income tax expense	6,037	14,332	14,532	25,756
Net income	205,855	142,887	410,867	275,177
Preferred dividends	6,461	5,039	12,922	7,706
Net income available to common shareholders	\$ 199,394	\$ 137,848	\$ 397,945	\$ 267,471
Net income per common share				
Basic	\$ 2.75	\$ 1.88	\$ 5.44	\$ 3.66
Diluted	\$ 2.65	\$ 1.81	\$ 5.24	\$ 3.52
Weighted average common shares and common share equivalents outstanding				
Basic	72,494,823	73,188,101	73,209,439	73,044,473
Diluted	75,254,846	76,155,438	75,947,858	76,014,819

See Notes to Consolidated Financial Statements

ARCH CAPITAL GROUP LTD. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS EQUITY
(U.S. dollars in thousands)

	(Unaudited) Six Months Ended June 30,	
	2007	2006
Non-Cumulative Preferred Shares		
Balance at beginning of period	\$ 130	\$
Preferred shares issued		130
Balance at end of period	130	130
Common Shares		
Balance at beginning of year	743	733
Common shares issued, net	6	6
Purchases of common shares under share repurchase program	(36)	
Balance at end of period	713	739
Additional Paid-in Capital		
Balance at beginning of year	1,944,304	1,595,440
Cumulative effect of change in accounting for unearned stock grant compensation		(9,646)
Series A non-cumulative preferred shares issued		193,388
Series B non-cumulative preferred shares issued		120,866
Common shares issued	405	410
Exercise of stock options	13,373	15,572
Common shares retired	(257,162)	(658)
Amortization of share-based compensation	14,457	7,510
Other	918	274
Balance at end of period	1,716,295	1,923,156
Deferred Compensation Under Share Award Plan		
Balance at beginning of year		(9,646)
Cumulative effect of change in accounting for unearned stock grant compensation		9,646
Balance at end of period		
Retained Earnings		
Balance at beginning of year	1,593,907	901,348
Adjustment to adopt SFAS No. 155, <i>Accounting for Certain Hybrid Financial Instruments an amendment of FASB Statements No. 133 and 140</i>	2,111	
Balance at beginning of year, as adjusted	1,596,018	901,348
Dividends declared on preferred shares	(12,922)	(7,706)
Net income	410,867	275,177
Balance at end of period	1,993,963	1,168,819
Accumulated Other Comprehensive Income (Loss)		
Balance at beginning of year	51,535	(7,348)
Adjustment to adopt SFAS No. 155, <i>Accounting for Certain Hybrid Financial Instruments an amendment of FASB Statements No. 133 and 140</i>	(2,111)	
Balance at beginning of year, as adjusted	49,424	(7,348)
Change in unrealized appreciation (decline) in value of investments, net of deferred income tax	(67,513)	(64,272)
Foreign currency translation adjustments, net of deferred income tax	11,055	(5,444)
Balance at end of period	(7,034)	(77,064)
Total Shareholders Equity	\$ 3,704,067	\$ 3,015,780

See Notes to Consolidated Financial Statements

ARCH CAPITAL GROUP LTD. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(U.S. dollars in thousands)

	(Unaudited) Six Months Ended June 30,	
	2007	2006
Comprehensive Income		
Net income	\$ 410,867	\$ 275,177
Other comprehensive loss, net of deferred income tax		
Unrealized decline in value of investments:		
Unrealized holding losses arising during period	(72,486)	(97,560)
Reclassification of net realized losses, net of income taxes, included in net income	4,973	33,288
Foreign currency translation adjustments	11,055	(5,444)
Other comprehensive loss	(56,458)	(69,716)
Comprehensive Income	\$ 354,409	\$ 205,461

See Notes to Consolidated Financial Statements

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ARCH CAPITAL GROUP LTD. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(U.S. dollars in thousands)

	(Unaudited) Six Months Ended June 30,	
	2007	2006
Operating Activities		
Net income	\$ 410,867	\$ 275,177
Adjustments to reconcile net income to net cash provided by operating activities:		
Net realized losses	4,854	35,673
Other income	(869)	
Share-based compensation	14,457	7,510
Changes in:		
Reserve for losses and loss adjustment expenses, net of unpaid losses and loss adjustment expenses recoverable	324,793	473,996
Unearned premiums, net of prepaid reinsurance premiums	135,525	117,298
Premiums receivable	(290,437)	(224,498)
Deferred acquisition costs, net	(18,702)	(5,971)
Funds held by reinsureds	3,050	82,879
Reinsurance balances payable	79,254	105,193
Deferred income tax assets, net	(3,757)	(5,555)
Other liabilities	1,737	18,331
Other items, net	16,231	(56,879)
Net Cash Provided By Operating Activities	677,003	823,154
Investing Activities		
Purchases of fixed maturity investments	(8,933,304)	(8,196,081)
Proceeds from sales of fixed maturity investments	8,407,340	7,440,922
Proceeds from redemptions and maturities of fixed maturity investments	305,847	96,360
Purchases of other investments	(185,357)	(63,813)
Proceeds from sales of other investments	62,309	6,062
Net purchases of short-term investments	(141,217)	(279,297)
Change in securities lending collateral	(223,583)	131,153
Purchases of furniture, equipment and other	(8,998)	(8,679)
Net Cash Used For Investing Activities	(716,963)	(873,373)
Financing Activities		
Purchases of common shares under share repurchase program	(254,973)	
Proceeds from common shares issued, net	7,427	11,212
Proceeds from preferred shares issued, net of issuance costs		314,538
Change in securities lending collateral	223,583	(131,153)
Excess tax benefits from share-based compensation	3,965	3,143
Preferred dividends paid	(12,922)	(4,622)
Net Cash Provided By Financing Activities	(32,920)	193,118
Effects of exchange rate changes on foreign currency cash	1,006	997
(Decrease) increase in cash	(71,874)	143,896
Cash beginning of year	317,017	222,477
Cash end of period	\$ 245,143	\$ 366,373
Income taxes paid, net	\$ 1,881	\$ 32,407
Interest paid	\$ 11,025	\$ 11,067

See Notes to Consolidated Financial Statements

ARCH CAPITAL GROUP LTD. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. General

Arch Capital Group Ltd. (ACGL) is a Bermuda public limited liability company which provides insurance and reinsurance on a worldwide basis through its wholly owned subsidiaries.

The interim consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America (GAAP) and include the accounts of ACGL and its wholly owned subsidiaries (together with ACGL, the Company). All significant intercompany transactions and balances have been eliminated in consolidation. The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates and assumptions. In the opinion of management, the accompanying unaudited interim consolidated financial statements reflect all adjustments (consisting of normally recurring accruals) necessary for a fair statement of results on an interim basis. The results of any interim period are not necessarily indicative of the results for a full year or any future periods.

Certain information and footnote disclosures normally included in financial statements prepared in accordance with GAAP have been condensed or omitted; however, management believes that the disclosures are adequate to make the information presented not misleading. This report should be read in conjunction with the Company s Annual Report on Form 10-K for the year ended December 31, 2006, including the Company s audited consolidated financial statements and related notes and the section entitled Risk Factors.

To facilitate period-to-period comparisons, certain amounts in the 2006 consolidated financial statements have been reclassified to conform to the 2007 presentation. Such reclassifications had no effect on the Company s consolidated net income.

2. Share Transactions

Share Repurchase Program

On February 28, 2007, ACGL s board of directors authorized the investment of up to \$1 billion in ACGL s common shares through a share repurchase program. Repurchases under the program may be effected from time to time in open market or privately negotiated transactions through February 2009. During the 2007 second quarter and six months ended June 30, 2007, ACGL repurchased approximately 3.0 million and 3.6 million common shares, respectively, for an aggregate purchase price of \$210.5 million and \$255.0 million, respectively. As a result of share repurchase transactions through June 30, 2007, book value per common share was reduced by \$1.10 per share at June 30, 2007 and weighted average shares outstanding for the 2007 second quarter and six months ended June 30, 2007 were reduced by 1.8 million and 1.0 million shares, respectively. The timing and amount of the repurchase transactions under this program will depend on a variety of factors, including market conditions and corporate and regulatory considerations. In connection with the repurchase program, the Warburg Pincus funds waived their rights relating to share repurchases under its shareholders agreement with ACGL for all repurchases of common shares by ACGL under the repurchase program in open market transactions and certain privately negotiated transactions.

Non-Cumulative Preferred Shares

During 2006, ACGL completed two public offerings of non-cumulative preferred shares (Preferred Shares). On February 1, 2006, \$200.0 million principal amount of 8.0% series A non-cumulative preferred shares (Series A Preferred Shares) were issued with net proceeds of \$193.5 million and, on May 24, 2006, \$125.0 million principal amount of 7.875% series B non-cumulative preferred shares (Series B Preferred Shares) were issued with net proceeds of \$120.9 million. The net proceeds of the offerings were used to support the underwriting activities of ACGL's insurance and reinsurance subsidiaries. ACGL has the right to redeem all or a portion of each series of Preferred Shares at a redemption price of \$25.00 per share on or after (1) February 1, 2011 for the Series A Preferred Shares and (2) May 15, 2011 for the Series B Preferred Shares. Dividends on the Preferred Shares are non-cumulative. Consequently, in the event dividends are not declared on the Preferred Shares for any dividend period, holders of Preferred Shares will not be entitled to receive a dividend for such period, and such undeclared dividend will not accrue and will not be payable. Holders of Preferred Shares will be entitled to receive dividend payments only when, as and if declared by ACGL's board of directors or a duly authorized committee of the board of directors. Any such dividends will be payable from the date of original issue on a non-cumulative basis, quarterly in arrears. To the extent declared, these dividends will accumulate, with respect to each dividend period, in an amount per share equal to 8.0% of the \$25.00 liquidation preference per annum for the Series A Preferred Shares and 7.875% of the \$25.00 liquidation preference per annum for the Series B Preferred Shares. At June 30, 2007, the Company had declared an aggregate of \$3.3 million of dividends to be paid (subject to certain conditions) to holders of the Preferred Shares.

Share-Based Compensation

As required by the provisions of Financial Accounting Standards Board (FASB) Statement No. 123 (revised 2004), Share-Based Payment (SFAS No. 123(R)), the Company recorded after-tax share-based compensation expense related to stock options in the 2007 second quarter of \$2.8 million, or \$0.04 per diluted share, compared to \$1.7 million, or \$0.02 per diluted share, in the 2006 second quarter, and \$4.4 million, or \$0.06 per diluted share, for the six months ended June 30, 2007, compared to \$2.8 million, or \$0.04 per diluted share, for the six months ended June 30, 2006.

During the 2007 second quarter, the Company made a stock grant of 323,630 stock appreciation rights and stock options and 323,480 restricted shares and units to certain employees. The stock appreciation rights and stock options were valued at the grant date using the Black-Scholes option pricing model. The weighted average grant-date fair value of the stock appreciation rights and options and restricted shares and units granted were approximately \$22.50 and \$69.97 per share, respectively. Such value will be amortized over the respective substantive vesting period.

3. Debt and Financing Arrangements

Senior Notes

On May 4, 2004, ACGL completed a public offering of \$300 million principal amount of 7.35% senior notes (Senior Notes) due May 1, 2034 and received net proceeds of \$296.4 million. ACGL used \$200 million of the net proceeds to repay all amounts outstanding under a revolving credit agreement. The Senior Notes are ACGL's senior unsecured obligations and rank equally with all of its existing and future senior unsecured indebtedness. Interest payments on the Senior Notes are due on May 1st and November 1st of each year. ACGL may redeem the Senior Notes at any time and from time to time, in whole or in part, at a make-whole redemption price. For the six months ended June 30, 2007 and 2006, interest expense on the Senior Notes was approximately \$11.0 million. The market value of the Senior Notes at June 30, 2007 and December 31, 2006 was \$318.0 million and \$332.0 million, respectively.

Letter of Credit and Revolving Credit Facilities

As of June 30, 2007, the Company had a \$300 million unsecured revolving loan and letter of credit facility and a \$1.0 billion secured letter of credit facility. The \$300 million unsecured revolving loan is also available for the issuance of unsecured letters of credit up to \$100 million for Arch Reinsurance Company (Arch Re U.S.). Borrowings of revolving loans may be made by ACGL and Arch Re U.S. at a variable rate based on LIBOR or an alternative base rate at the option of the Company. Secured letters of credit are available for issuance on behalf of the Company's insurance and reinsurance subsidiaries. Issuance of letters of credit and borrowings under the Credit Agreement are subject to the Company's compliance with certain covenants and conditions, including absence of a material adverse change. These covenants require, among other things, that the Company maintain a debt to shareholders' equity ratio of not greater than 0.35 to 1 and shareholders' equity in excess of \$1.95 billion plus 25% of future aggregate net income for each quarterly period (not including any future net losses) beginning after June 30, 2006 and 25% of future aggregate proceeds from the issuance of common or preferred equity and that the Company's principal insurance and reinsurance subsidiaries maintain at least a B++ rating from A.M. Best. In addition, certain of the Company's subsidiaries which are party to the Credit Agreement are required to maintain minimum shareholders' equity levels. The Company was in compliance with all covenants contained in the Credit Agreement at June 30, 2007. The Credit Agreement expires on August 30, 2011.

Including the secured letter of credit portion of the Credit Agreement and another letter of credit facility (together, the LOC Facilities), the Company has access to letter of credit facilities for up to a total of \$1.45 billion. The principal purpose of the LOC Facilities is to issue, as required, evergreen standby letters of credit in favor of primary insurance or reinsurance counterparties with which the Company has entered into reinsurance arrangements to ensure that such counterparties are permitted to take credit for reinsurance obtained from the Company's reinsurance subsidiaries in United States jurisdictions where such subsidiaries are not licensed or otherwise admitted as an insurer, as required under insurance regulations in the United States, and to comply with requirements of Lloyd's of London in connection with qualifying quota share and other arrangements. The amount of letters of credit issued is driven by, among other things, the timing and payment of catastrophe losses, loss development of existing reserves, the payment pattern of such reserves, the further expansion of the Company's business and the loss experience of such business. When issued, certain letters of credit are secured by a portion of the Company's investment portfolio. In addition, the LOC Facilities also require the maintenance of certain covenants, which the Company was in compliance with at June 30, 2007. At such date, the Company had approximately \$617.0 million in outstanding letters of credit under the LOC Facilities, which were secured by investments totaling \$653.7 million. The other letter of credit facility was amended and restated in December 2006. It is anticipated that the LOC Facilities will be renewed (or replaced) on expiry, but such renewal (or replacement) will be subject to the availability of credit from banks which the Company utilizes. In addition to letters of credit, the Company has and may establish insurance trust accounts in the U.S. and Canada to secure its reinsurance amounts payable as required.

4. Segment Information

The Company classifies its businesses into two underwriting segments—insurance and reinsurance—and a corporate and other segment (non-underwriting). The Company's insurance and reinsurance operating segments each have segment managers who are responsible for the overall profitability of their respective segments and who are directly accountable to the Company's chief operating decision makers, the President and Chief Executive Officer of ACGL and the Chief Financial Officer of ACGL. The chief operating decision makers do not assess performance, measure return on equity or make resource allocation decisions on a line of business basis. The Company determined its reportable operating segments using the management approach described in SFAS No. 131, Disclosures about Segments of an Enterprise and Related Information.

Management measures segment performance based on underwriting income or loss. The Company does not manage its assets by segment and, accordingly, investment income is not allocated to each underwriting segment. In addition, other revenue and expense items are not evaluated by segment. The accounting policies of the segments are the same as those used for the preparation of the Company's consolidated financial statements. Intersegment business is allocated to the segment accountable for the underwriting results.

The insurance segment consists of the Company's insurance underwriting subsidiaries which primarily write on both an admitted and non-admitted basis. The insurance segment consists of eight product lines: casualty; construction, surety and national accounts; executive assurance; healthcare; professional liability; programs; property, marine and aviation; and other (consisting of collateral protection, excess workers' compensation and employers' liability business).

The reinsurance segment consists of the Company's reinsurance underwriting subsidiaries. The reinsurance segment generally seeks to write significant lines on specialty property and casualty reinsurance treaties. Classes of business include: casualty; marine and aviation; other specialty; property catastrophe; property excluding property catastrophe (losses on a single risk, both excess of loss and pro rata); and other (consisting of non-traditional and casualty clash business).

The corporate and other segment (non-underwriting) includes net investment income, other income (loss), other expenses incurred by the Company, interest expense, net realized gains or losses, net foreign exchange gains or losses and income taxes. In addition, results for the corporate and other segment include dividends on the Company's non-cumulative preferred shares.

The following tables set forth an analysis of the Company's underwriting income by segment, together with a reconciliation of underwriting income to net income available to common shareholders:

(U.S. dollars in thousands)	(Unaudited) Three Months Ended June 30, 2007			
	Insurance	Reinsurance	Total	
Gross premiums written(1)	\$ 684,725	\$ 427,348	\$ 1,102,210	
Net premiums written(1)	451,828	306,067	757,895	
Net premiums earned(1)	\$ 432,560	\$ 318,852	\$ 751,412	
Fee income	1,276	815	2,091	
Losses and loss adjustment expenses	(272,658)	(153,005)	(425,663)	
Acquisition expenses, net	(47,532)	(69,745)	(117,277)	
Other operating expenses	(70,269)	(19,999)	(90,268)	
Underwriting income	\$ 43,377	\$ 76,918	120,295	
Net investment income			117,299	
Net realized losses			(3,757)	
Other income			265	
Other expenses			(10,237)	
Interest expense			(5,523)	
Net foreign exchange losses			(6,450)	
Income before income taxes			211,892	
Income tax expense			(6,037)	
Net income			205,855	
Preferred dividends			(6,461)	
Net income available to common shareholders			\$ 199,394	
Underwriting Ratios				
Loss ratio	63.0	% 48.0	% 56.6	%
Acquisition expense ratio(2)	10.8	% 21.9	% 15.5	%
Other operating expense ratio	16.2	% 6.3	% 12.0	%
Combined ratio	90.0	% 76.2	% 84.1	%

(1) Certain amounts included in the gross premiums written of each segment are related to intersegment transactions. Accordingly, the sum of gross premiums written for each segment does not agree to the total gross premiums written as shown in the table above due to the elimination of intersegment transactions in the total. The insurance segment and reinsurance segment results include \$0.3 million and \$9.6 million, respectively, of gross and net premiums written and \$0.3 million and \$10.8 million, respectively, of net premiums earned assumed through intersegment transactions.

(2) The acquisition expense ratio is adjusted to include policy-related fee income.

(U.S. dollars in thousands)	(Unaudited) Three Months Ended June 30, 2006			
	Insurance	Reinsurance	Total	
Gross premiums written (1)	\$ 647,817	\$ 499,241	\$ 1,136,274	
Net premiums written (1)	409,302	385,256	794,558	
Net premiums earned (1)	\$ 385,877	\$ 411,573	\$ 797,450	
Fee income	1,253	2,215	3,468	
Losses and loss adjustment expenses	(251,172)	(211,083)	(462,255)	
Acquisition expenses, net	(41,275)	(107,306)	(148,581)	
Other operating expenses	(63,689)	(14,179)	(77,868)	
Underwriting income	\$ 30,994	\$ 81,220	112,214	
Net investment income			90,503	
Net realized losses			(32,202)	
Other income				
Other expenses			(6,499)	
Interest expense			(5,651)	
Net foreign exchange losses			(1,146)	
Income before income taxes			157,219	
Income tax expense			(14,332)	
Net income			142,887	
Preferred dividends			(5,039)	
Net income available to common shareholders			\$ 137,848	
Underwriting Ratios				
Loss ratio	65.1	% 51.3	% 58.0	%
Acquisition expense ratio (2)	10.5	% 26.1	% 18.5	%
Other operating expense ratio	16.5	% 3.4	% 9.8	%
Combined ratio	92.1	% 80.8	% 86.3	%

(1) Certain amounts included in the gross premiums written of each segment are related to intersegment transactions. Accordingly, the sum of gross premiums written for each segment does not agree to the total gross premiums written as shown in the table above due to the elimination of intersegment transactions in the total. The insurance segment and reinsurance segment results include nil and \$10.9 million, respectively, of gross and net premiums written and \$0.5 million and \$12.3 million, respectively, of net premiums earned assumed through intersegment transactions.

(2) The acquisition expense ratio is adjusted to include certain fee income.

(U.S. dollars in thousands)	(Unaudited) Six Months Ended June 30, 2007			
	Insurance	Reinsurance	Total	
Gross premiums written (1)	\$ 1,345,935	\$ 986,002	\$ 2,312,824	
Net premiums written (1)	880,172	749,468	1,629,640	
Net premiums earned (1)	\$ 846,407	\$ 650,498	\$ 1,496,905	
Fee income	2,701	1,359	4,060	
Losses and loss adjustment expenses	(531,980)	(313,744)	(845,724)	
Acquisition expenses, net	(94,227)	(143,178)	(237,405)	
Other operating expenses	(139,163)	(33,780)	(172,943)	
Underwriting income	\$ 83,738	\$ 161,155	244,893	
Net investment income			229,988	
Net realized losses			(4,738)	
Other income			869	
Other expenses			(18,375)	
Interest expense			(11,046)	
Net foreign exchange losses			(16,192)	
Income before income taxes			425,399	
Income tax expense			(14,532)	
Net income			410,867	
Preferred dividends			(12,922)	
Net income available to common shareholders			\$ 397,945	
Underwriting Ratios				
Loss ratio	62.9	% 48.2	% 56.5	%
Acquisition expense ratio (2)	10.9	% 22.0	% 15.8	%
Other operating expense ratio	16.4	% 5.2	% 11.6	%
Combined ratio	90.2	% 75.4	% 83.9	%

(1) Certain amounts included in the gross premiums written of each segment are related to intersegment transactions. Accordingly, the sum of gross premiums written for each segment does not agree to the total gross premiums written as shown in the table above due to the elimination of intersegment transactions in the total. The insurance segment and reinsurance segment results include \$0.8 million and \$18.3 million, respectively, of gross and net premiums written and \$0.8 million and \$21.4 million, respectively, of net premiums earned assumed through intersegment transactions.

(2) The acquisition expense ratio is adjusted to include policy-related fee income.

(U.S. dollars in thousands)	(Unaudited) Six Months Ended June 30, 2006			
	Insurance	Reinsurance	Total	
Gross premiums written (1)	\$ 1,263,301	\$ 1,063,909	\$ 2,304,088	
Net premiums written (1)	806,556	861,721	1,668,277	
Net premiums earned (1)	\$ 766,131	\$ 792,920	\$ 1,559,051	
Fee income	2,657	2,616	5,273	
Losses and loss adjustment expenses	(499,174)	(431,259)	(930,433)	
Acquisition expenses, net	(79,160)	(199,093)	(278,253)	
Other operating expenses	(125,765)	(27,431)	(153,196)	
Underwriting income	\$ 64,689	\$ 137,753	202,442	
Net investment income			170,829	
Net realized losses			(35,585)	
Other income				
Other expenses			(14,148)	
Interest expense			(11,206)	
Net foreign exchange losses			(11,399)	
Income before income taxes			300,933	
Income tax expense			(25,756)	
Net income			275,177	
Preferred dividends			(7,706)	
Net income available to common shareholders			\$ 267,471	
Underwriting Ratios				
Loss ratio	65.2	% 54.4	% 59.7	%
Acquisition expense ratio (2)	10.1	% 25.1	% 17.7	%
Other operating expense ratio	16.4	% 3.5	% 9.8	%
Combined ratio	91.7	% 83.0	% 87.2	%

(1) Certain amounts included in the gross premiums written of each segment are related to intersegment transactions. Accordingly, the sum of gross premiums written for each segment does not agree to the total gross premiums written as shown in the table above due to the elimination of intersegment transactions in the total. The insurance segment and reinsurance segment results include \$0.8 million and \$22.4 million, respectively, of gross and net premiums written and \$1.4 million and \$25.1 million, respectively, of net premiums earned assumed through intersegment transactions.

(2) The acquisition expense ratio is adjusted to include policy-related fee income.

Set forth below is summary information regarding net premiums written and earned by major line of business and net premiums written by client location for the insurance segment:

INSURANCE SEGMENT (U.S. dollars in thousands)	(Unaudited) Three Months Ended June 30, 2007		2006	
	Amount	% of Total	Amount	% of Total
Net premiums written (1)				
Property, marine and aviation	\$ 104,705	23.2	\$ 74,712	18.2
Professional liability	81,603	18.1	63,555	15.5
Construction, surety and national accounts Programs	68,482	15.1	66,717	16.3
Casualty	59,154	13.1	56,512	13.8
Executive assurance	57,240	12.7	66,643	16.3
Healthcare	47,904	10.6	53,841	13.2
Other	12,383	2.7	14,199	3.5
Total	20,357	(2) 4.5	13,123	3.2
Total	\$ 451,828	100.0	\$ 409,302	100.0
Net premiums earned (1)				
Property, marine and aviation	\$ 92,387	21.4	\$ 54,783	14.2
Professional liability	82,142	19.0	65,639	17.0
Construction, surety and national accounts Programs	67,562	15.6	67,967	17.6
Casualty	57,036	13.2	57,478	14.9
Executive assurance	52,570	12.1	61,121	15.9
Healthcare	47,408	11.0	49,707	12.9
Other	17,107	3.9	17,869	4.6
Total	16,348	(2) 3.8	11,313	2.9
Total	\$ 432,560	100.0	\$ 385,877	100.0
Net premiums written by client location (1)				
United States	\$ 361,733	80.1	\$ 343,923	84.0
Europe	60,968	13.5	39,886	9.8
Other	29,127	6.4	25,493	6.2
Total	\$ 451,828	100.0	\$ 409,302	100.0

(1) Insurance segment results include premiums written and earned assumed through intersegment transactions of \$0.3 million for the 2007 second quarter and nil and \$0.5 million, respectively, for the 2006 second quarter. Insurance segment results exclude premiums written and earned ceded through intersegment transactions of \$9.6 million and \$10.8 million, respectively, for the 2007 second quarter and \$10.9 million and \$12.3 million, respectively, for the 2006 second quarter.

(2) Includes excess workers compensation and employers liability business.

INSURANCE SEGMENT (U.S. dollars in thousands)	(Unaudited) Six Months Ended June 30, 2007		2006	
	Amount	% of Total	Amount	% of Total
Net premiums written (1)				
Property, marine and aviation	\$ 189,568	21.5	\$ 143,358	17.8
Professional liability	152,006	17.3	126,009	15.6
Construction, surety and national accounts	147,711	16.8	147,346	18.3
Programs	117,478	13.3	117,046	14.5
Casualty	100,330	11.4	117,393	14.6
Executive assurance	91,995	10.4	99,432	12.3
Healthcare	33,914	3.9	32,314	4.0
Other	47,170	(2) 5.4	23,658	2.9
Total	\$ 880,172	100.0	\$ 806,556	100.0
Net premiums earned (1)				
Property, marine and aviation	\$ 174,191	20.6	\$ 117,751	15.4
Professional liability	159,272	18.8	119,684	15.6
Construction, surety and national accounts	134,666	15.9	134,670	17.6
Programs	113,245	13.4	114,867	15.0
Casualty	104,112	12.3	123,929	16.2
Executive assurance	92,786	10.9	99,783	13.0
Healthcare	36,951	4.4	34,546	4.5
Other	31,184	(2) 3.7	20,901	2.7
Total	\$ 846,407	100.0	\$ 766,131	100.0
Net premiums written by client location (1)				
United States	\$ 681,738	77.5	\$ 668,388	82.9
Europe	135,903	15.4	87,466	10.8
Other	62,531	7.1	50,702	6.3
Total	\$ 880,172	100.0	\$ 806,556	100.0

(1) Insurance segment results include premiums written and earned assumed through intersegment transactions of \$0.8 million for the six months ended June 30, 2007 and \$0.8 million and \$1.4 million, respectively, for the six months ended June 30, 2006. Insurance segment results exclude premiums written and earned ceded through intersegment transactions of \$18.3 million and \$21.4 million, respectively, for the six months ended June 30, 2007 and \$22.4 million and \$25.1 million, respectively, for the six months ended June 30, 2006.

(2) Includes excess workers compensation and employers liability business.

The following table sets forth the reinsurance segment's net premiums written and earned by major line of business and type of business, together with net premiums written by client location:

REINSURANCE SEGMENT (U.S. dollars in thousands)	(Unaudited) Three Months Ended June 30, 2007		2006	
	Amount	% of Total	Amount	% of Total
Net premiums written (1)				
Casualty (2)	\$ 110,106	36.0	\$ 176,116	45.7
Property catastrophe	77,514	25.3	33,786	8.8
Property excluding property catastrophe	69,353	22.7	88,785	23.0
Other specialty	27,971	9.1	64,493	16.7
Marine and aviation	19,812	6.5	20,626	5.4
Other	1,311	0.4	1,450	0.4
Total	\$ 306,067	100.0	\$ 385,256	100.0