ARCH CAPITAL GROUP LTD.
Form 10-K
March 03, 2014

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 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, 2013

OR

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

For the transition period from _____ to _____
Commission File No. 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.)
Waterloo House, Ground Floor 100 Pitts Bay Road Pembroke HM 08, Bermuda (Address of principal executive offices)	(441) 278-9250 (Registrant's telephone number, including area code)

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

Title of each class	Name of each exchange on which registered
Common Shares, $0.0033 par value per share	NASDAQ Stock Market (Common Shares)
6.75% Non-Cumulative Preferred Shares, Series C, $0.01 par value per share	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Exchange 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 o

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act.
Yes o 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 Exchange Act 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 o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No o

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 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. o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. Large accelerated Filer x Accelerated Filer o Non-accelerated Filer o Smaller reporting company o

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

The aggregate market value of the voting and non-voting common equity held by non-affiliates, computed by reference to the closing price as reported by the NASDAQ Stock Market as of the last business day of the Registrant's most recently completed second fiscal quarter, was approximately $6.62 billion.

As of February 24, 2014, there were 133,805,667 of the registrant's common shares outstanding.
DOCUMENTS INCORPORATED BY REFERENCE
Portions of Part III and Part IV incorporate by reference our definitive proxy statement for the 2014 annual meeting of shareholders to be filed with the Securities and Exchange Commission pursuant to Regulation 14A before April 30, 2014.

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CAUTIONARY NOTE REGARDING FORWARD LOOKING STATEMENTS

The Private Securities Litigation Reform Act of 1995 (“PSLRA”) provides a “safe harbor” for forward-looking statements. This report or any other written or oral statements made by or on behalf of us may include forward-looking statements, which reflect our current views with respect to future events and financial performance. All statements other than statements of historical fact included in or incorporated by reference in this report are forward-looking statements. Forward-looking statements, for purposes of the PSLRA or otherwise, can generally be identified by the use of forward-looking terminology such as “may,” “will,” “expect,” “intend,” “estimate,” “anticipate,” “believe” or “continue” similar statements of a future or forward-looking nature or their negative or variations or similar terminology. Forward-looking statements involve our current assessment of risks and uncertainties. Actual events and results may differ materially from those expressed or implied in these statements. Important factors that could cause actual events or results to differ materially from those indicated in such statements are discussed below, elsewhere in this report and in our periodic reports filed with the Securities and Exchange Commission (“SEC”), and include:

- our ability to successfully implement our business strategy during “soft” as well as “hard” markets;
- acceptance of our business strategy, security and financial condition by rating agencies and regulators, as well as by brokers and our insureds and reinsureds;
- our ability to maintain or improve our ratings, which may be affected by our ability to raise additional equity or debt financings, by ratings agencies’ existing or new policies and practices, as well as other factors described herein;
- general economic and market conditions (including inflation, interest rates, foreign currency exchange rates, prevailing credit terms and the depth and duration of a recession) and conditions specific to the reinsurance and insurance markets (including the length and magnitude of the current “soft” market) in which we operate;
- competition, including increased competition, on the basis of pricing, capacity, coverage terms or other factors;
- developments in the world’s financial and capital markets and our access to such markets;
- our ability to successfully enhance, integrate and maintain operating procedures (including information technology) to effectively support our current and new business;
- the loss of key personnel;
- the integration of businesses we have acquired or may acquire into our existing operations;
- accuracy of those estimates and judgments utilized in the preparation of our financial statements, including those related to revenue recognition, insurance and other reserves, reinsurance recoverables, investment valuations, intangible assets, bad debts, income taxes, contingencies and litigation, and any determination to use the deposit method of accounting, which for a relatively new insurance and reinsurance company, like our company, are even more difficult to make than those made in a mature company since relatively limited historical information has been reported to us through December 31, 2013;
- greater than expected loss ratios on business written by us and adverse development on claim and/or claim expense liabilities related to business written by our insurance and reinsurance subsidiaries;
- severity and/or frequency of losses;
- claims for natural or man-made catastrophic events in our insurance or reinsurance business could cause large losses and substantial volatility in our results of operations;
- acts of terrorism, political unrest and other hostilities or other unforecasted and unpredictable events;
- availability to us of reinsurance to manage our gross and net exposures and the cost of such reinsurance;
- the failure of reinsurers, managing general agents, third party administrators or others to meet their obligations to us;
- the timing of loss payments being faster or the receipt of reinsurance recoverables being slower than anticipated by us;
- our investment performance, including legislative or regulatory developments that may adversely affect the fair value of our investments;
- the impact of the continued weakness of the U.S., European countries and other key economies, projected budget deficits for the U.S., European countries and other governments and the consequences associated with possible additional downgrades of securities of the U.S., European countries and other governments by credit

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rating agencies, and the resulting effect on the value of securities in our investment portfolio as well as the uncertainty in the market generally;

- losses relating to aviation business and business produced by a certain managing underwriting agency for which we may be liable to the purchaser of our prior reinsurance business or to others in connection with the May 5, 2000 asset sale described in our periodic reports filed with the SEC;
- changes in accounting principles or policies or in our application of such accounting principles or policies;
- changes in the political environment of certain countries in which we operate or underwrite business;
- statutory or regulatory developments, including as to tax policy and matters and insurance and other regulatory matters such as the adoption of proposed legislation that would affect Bermuda-headquartered companies and/or Bermuda-based insurers or reinsurers and/or changes in regulations or tax laws applicable to us, our subsidiaries, brokers or customers; and
- the other matters set forth under Item 1A "Risk Factors," Item 7 "Management's Discussion and Analysis of Financial Condition and Results of Operations" and other sections of this Annual Report on Form 10-K, as well as the other factors set forth in Arch Capital Group Ltd.'s other documents on file with the SEC, and management's response to any of the aforementioned factors.

All subsequent written and oral forward-looking statements attributable to us or persons acting on our behalf are expressly qualified in their entirety by these cautionary statements. The foregoing review of important factors should not be construed as exhaustive and should be read in conjunction with other cautionary statements that are included herein or elsewhere. We undertake no obligation to publicly update or revise any forward-looking statement, whether as a result of new information, future events or otherwise.

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PART I

ITEM 1. BUSINESS

As used in this report, references to “we,” “us,” “our” or the “Company” refer to the consolidated operations of Arch Capital Group Ltd. (“ACGL”) and its subsidiaries. Tabular amounts are in U.S. Dollars in thousands, except share amounts, unless otherwise noted. We refer you to Item 1A “Risk Factors” for a discussion of risk factors relating to our business.

OUR COMPANY

General

Arch Capital Group Ltd. is a Bermuda public limited liability company with $6.55 billion in capital at December 31, 2013 and, through operations in Bermuda, the United States, Europe and Canada, writes insurance and reinsurance on a worldwide basis. While we are positioned to provide a full range of property and casualty insurance and reinsurance lines, we focus on writing specialty lines of insurance and reinsurance. For 2013, we wrote $3.35 billion of net premiums and reported net income available to common shareholders of $687.8 million. Book value per common share was $39.82 at December 31, 2013, compared to $36.19 per share at December 31, 2012.

ACGL’s registered office is located at Clarendon House, 2 Church Street, Hamilton HM 11, Bermuda (telephone number: (441) 295-1422), and its principal executive offices are located at Waterloo House, Ground Floor, 100 Pitts Bay Road, Pembroke HM 08, Bermuda (telephone number: (441) 278-9250). ACGL makes available free of charge through its website, located at www.archcapgroup.bm, its annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and all amendments to those reports as soon as reasonably practicable after such material is electronically filed with, or furnished to, the SEC. The public may read and copy any materials ACGL files with the SEC at the SEC’s Public Reference Room at 100 F Street, NE, Washington, D.C. 20549. The public may obtain information on the operation of the Public Reference Room by calling 1-800-SEC-0330. The SEC also maintains an Internet site that contains reports, proxy and information statements, and other information regarding issuers that file electronically with the SEC (such as ACGL) and the address of that site is www.sec.gov.

Our History

Our current operations were built on an existing underwriting platform through an underwriting initiative in October 2001 to meet current and future demand in the global insurance and reinsurance markets. Since that time, we have attracted a proven management team with extensive industry experience and enhanced our existing global underwriting platform for our insurance and reinsurance businesses. It is our belief that our underwriting platform, our experienced management team and our strong capital base that is unencumbered by significant pre-2002 risks have enabled us to establish a strong presence in the insurance and reinsurance markets.

Prior to the 2001 underwriting initiative, our insurance underwriting platform consisted of Arch Insurance (Bermuda), a division of Arch Reinsurance Ltd. (“Arch Re Bermuda”), our Bermuda-based reinsurer and insurer, and our U.S.-licensed insurers, Arch Insurance Company (“Arch Insurance”), Arch Excess & Surplus Insurance Company (“Arch E&S”) and Arch Specialty Insurance Company (“Arch Specialty”). We established Arch Insurance Company (Europe) Limited (“Arch Insurance Company Europe”), our United Kingdom-based subsidiary, in 2004, and we expanded our North American presence when Arch Insurance opened a branch office in Canada in 2005. In January 2013, Arch Insurance Canada Ltd. (“Arch Insurance Canada”), a Canada domestic company, commenced operations and replaced the Canada branch of Arch Insurance. In 2009, we established a managing agent and syndicate at Lloyd’s of London (“Lloyd’s”). Our Lloyd’s syndicate 2012 (“Arch Syndicate 2012”) commenced underwriting in 2009. See “Operations—Insurance Operations” for further details on our insurance operations.

Prior to the 2001 underwriting initiative, our reinsurance underwriting platform consisted of Arch Re Bermuda and Arch Reinsurance Company (“Arch Re U.S.”), our U.S.-licensed reinsurer. Our reinsurance operations in Europe began in November 2006 with the formation of a Swiss branch of Arch Re Bermuda, and the formation of a Danish underwriting agency in 2007. In addition to the U.S. reinsurance activities of Arch Re U.S., we launched our property facultative reinsurance underwriting operations in 2007, which underwrite in the U.S., Canada and Europe. We formed Arch Reinsurance Europe Underwriting Limited (“Arch Re Europe”), our Ireland-based reinsurance company, in 2008. In 2011, we formed Arch Mortgage Insurance Limited (“Arch MI Europe”), which is authorized to underwrite mortgage insurance from its base in Ireland, and launched treaty operations in Canada. We completed the acquisition of the credit and surety

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reinsurance operations of Ariel Reinsurance Company Ltd. (“Ariel Re”) based in Zurich, Switzerland in April 2012. See “Operations—Reinsurance Operations” for further details on our reinsurance operations.

On January 30, 2014, our U.S.-based subsidiaries completed the acquisition of CMG Mortgage Insurance Company from its current owners, PMI Mortgage Insurance Co. (“PMI”), which has been in rehabilitation under the receivership of the Arizona Department of Insurance since 2011, and CMFG Life Insurance Company (“CUNA Mutual”). We also acquired PMI’s mortgage insurance platform and related assets from PMI. In connection with the closing of the transactions, PMI and Arch Re Bermuda entered into a quota share reinsurance agreement pursuant to which Arch Re Bermuda agreed to provide 100% quota share indemnity reinsurance to PMI for all certificates of insurance that were issued by PMI between and including January 1, 2009 and December 31, 2011 that are not in default as of an agreed upon effective date. Other than this quota share, no PMI legacy exposures were assumed in the transaction. At closing, we paid aggregate consideration of $253.0 million. Additional amounts may be paid based on the actual results of CMG Mortgage Insurance Company's pre-closing portfolio over an agreed upon period. In addition, we entered into a services agreement with PMI to provide certain necessary operational services to administer the run-off of PMI's legacy business at the direction of PMI.

CMG Mortgage Insurance Company has been renamed “Arch Mortgage Insurance Company” (“Arch MI U.S.”) subject to receipt of applicable state approvals. As part of the transaction, Arch MI U.S. has been approved as an eligible mortgage insurer by Fannie Mae and Freddie Mac (each a “GSE”), subject to maintaining certain ongoing requirements. Prior to the acquisition, CMG Mortgage Insurance Company had been a GSE-approved mortgage insurance company limited only to credit union customers. The completion of the transaction enables us to enter the U.S. mortgage insurance marketplace immediately and allows us to serve all lenders nationwide, including Arch MI U.S.’s existing credit union customers. The acquisition provides us with mortgage insurance licenses across the United States and a comprehensive mortgage insurance operating platform. Arch MI U.S. is rated “BBB+” with a stable outlook by Standard & Poor’s Rating Services (“S&P”). In addition, we entered into a distribution agreement with CUNA Mutual and a reinsurance agreement with an affiliate of CUNA Mutual. These arrangements with CUNA Mutual will provide Arch MI U.S.’s existing customer base with a seamless transition and also will enable us to provide uninterrupted access and services to the credit union marketplace.

The growth of our insurance and reinsurance platforms was supported through the net proceeds of: (1) an equity capital infusion of $763 million led by funds affiliated with Warburg Pincus LLC and Hellman & Friedman LLC in late 2001; (2) a public offering of 7.5 million of our common shares with net proceeds of $179 million in April 2002; (3) the exercise of class A warrants by our principal shareholders and other investors in September 2002, which provided net proceeds of $74 million; (4) a March 2004 public offering of 4.7 million of our common shares with net proceeds of $179 million; (5) a May 2004 public offering of $300 million principal amount of our 7.35% senior notes due May 2034; (6) a February 2006 public offering of $200 million of our 8.00% series A non-cumulative preferred shares; (7) a May 2006 public offering of $125 million of our 7.875% series B non-cumulative preferred shares; (8) an April 2012 public offering of $325 million of our 6.75% series C non-cumulative preferred shares which was used to redeem all series A and series B preferred shares; and (9) a December 2013 public offering of $500 million principal amount of 5.144% senior notes due November 1, 2043 by Arch Capital Group (U.S.) Inc. (“Arch-U.S.”), a wholly owned subsidiary of ACGL, and fully and unconditionally guaranteed by ACGL.

The board of directors of ACGL has authorized the investment in ACGL’s common shares through a share repurchase program. Repurchases under the share repurchase program may be effected from time to time in open market or privately negotiated transactions. Since the inception of the share repurchase program in February 2007 through December 31, 2013, ACGL has repurchased 109.9 million common shares for an aggregate purchase price of $2.79 billion. At December 31, 2013, the total remaining authorization under the share repurchase program was $712.1 million.

Operations

For the periods presented, we classified our businesses into two underwriting segments, insurance and reinsurance. For an analysis of our underwriting results by segment, see note 3, “Segment Information,” of the notes accompanying our consolidated financial statements and “Management’s Discussion and Analysis of Financial Condition and Results of Operations—Results of Operations.”

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Our Insurance Operations

Our insurance operations are conducted in Bermuda, the United States, Europe, Canada, Australia and South Africa. Our insurance operations in Bermuda are conducted through Arch Insurance (Bermuda), a division of Arch Re Bermuda. In the U.S., our insurance group's principal insurance subsidiaries are Arch Insurance, Arch Specialty, Arch E&S and Arch Indemnity Insurance Company ("Arch Indemnity"). Arch Insurance is an admitted insurer in 50 states, the District of Columbia, Puerto Rico, the U.S. Virgin Islands and Guam. Arch Insurance operated a branch office in Canada through January 1, 2013, at which point its operations were assumed by Arch Insurance Canada. Arch Insurance Canada is a Canada domestic company which is authorized in all Canadian provinces and territories. Arch Specialty is an approved excess and surplus lines insurer in 49 states, the District of Columbia, Puerto Rico and the U.S. Virgin Islands and an admitted insurer in one state. Arch Indemnity is an admitted insurer in 49 states and the District of Columbia. Arch E&S, which is not currently writing business, is an approved excess and surplus lines insurer in 47 states and the District of Columbia and an admitted insurer in one state. The headquarters for our insurance group's U.S. support operations (excluding underwriting units) is in Jersey City, New Jersey. The insurance group has additional offices throughout the U.S., including four regional offices located in Alpharetta, Georgia, Chicago, Illinois, New York, New York and San Francisco, California. Arch Insurance Canada is headquartered in Toronto, Ontario with other regional offices in Canada.

Our insurance group's European operations are conducted on two platforms: Arch Insurance Company Europe and Arch Syndicate 2012 (the U.K. insurance operations are collectively referred to as "Arch Insurance Europe"). Arch Insurance Europe conducts its operations from London. Arch Insurance Company Europe is approved as an excess and surplus lines insurer in 27 states and the District of Columbia and also has branches in Denmark, Germany, Italy and Spain. Arch Underwriting at Lloyd's Ltd ("AUAL") is the managing agent of Arch Syndicate 2012 and is responsible for the daily management of Arch Syndicate 2012. Arch Syndicate 2012 has enhanced our underwriting platform by providing us with access to Lloyd's extensive distribution network and worldwide licenses. Arch Underwriting at Lloyd's (Australia) Pty Ltd, based in Sydney, Australia, and Arch Underwriting Managers at Lloyd's (South Africa) (Pty) Limited, based in Johannesburg, South Africa, are Lloyd's services companies which underwrite exclusively for Arch Syndicate 2012.

As of February 24, 2014, our insurance group had approximately 1,200 employees.

Strategy. Our insurance group's strategy is to operate in lines of business in which underwriting expertise can make a meaningful difference in operating results. The insurance group focuses on talent-intensive rather than labor-intensive business and seeks to operate profitably (on both a gross and net basis) across all of its product lines. To achieve these objectives, our insurance group's operating principles are to:

- Capitalize on Profitable Underwriting Opportunities. Our insurance group believes that its experienced management and underwriting teams are positioned to locate and identify business with attractive risk/reward characteristics. As profitable underwriting opportunities are identified, our insurance group will continue to seek to make additions to its product portfolio in order to take advantage of market trends. This may include adding underwriting and other professionals with specific expertise in specialty lines of insurance.
- Centralize Responsibility for Underwriting. Our insurance group consists of a range of product lines. The underwriting executive in charge of each product line oversees all aspects of the underwriting product development process within such product line. Our insurance group believes that centralizing the control of such product line with the respective underwriting executive allows for close management of underwriting and creates clear accountability for results. Our U.S. insurance group has four regional offices, and the executive in charge of each region is primarily responsible for all aspects of the marketing and distribution of our insurance group's products, including the management of broker and other producer relationships in such executive's respective region. In our non-U.S. offices, a similar philosophy is observed, with responsibility for the management of each product line residing with the senior underwriting executive in charge of such product line.
- Maintain a Disciplined Underwriting Philosophy. Our insurance group's underwriting philosophy is to generate an underwriting profit through prudent risk selection and proper pricing. Our insurance group believes that the key to this approach is adherence to uniform underwriting standards across all types of business. Our insurance group's senior management closely monitors the underwriting process.

- Focus on Providing Superior Claims Management. Our insurance group believes that claims handling is an integral component of credibility in the market for insurance products. Therefore, our insurance group believes that its ability to handle claims expeditiously and satisfactorily is a key to its success. Our insurance group

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employs experienced claims professionals and also utilizes experienced external claims managers (third party administrators) where appropriate.

- Utilize a Brokerage Distribution System. Our insurance group believes that by utilizing a brokerage distribution system, consisting of select international, national and regional brokers, both wholesale and retail, it can efficiently access a broad customer base while maintaining underwriting control and discipline.

Our insurance group writes business on both an admitted and non-admitted basis. Our insurance group focuses on the following areas:

- Casualty. Our insurance group's casualty unit writes primary and excess casualty insurance coverages, including railroad and middle market energy business.
- Construction. Our insurance group's construction unit provides primary and excess casualty coverages to middle and large accounts in the construction industry.
- Executive Assurance. Our insurance group's executive assurance unit focuses on directors' and officers' liability insurance coverages for corporate, private equity, venture capital, real estate investment trust, limited partnership, financial institution and not-for-profit clients of all sizes. This unit also writes employment practices liability insurance, pension trust errors and omissions/fiduciary liability insurance, fidelity bonds, kidnap and ransom extortion insurance, representations and warranties insurance and various financial institution professional liability coverages.
- Healthcare. Our insurance group's healthcare unit provides medical professional and general liability insurance coverages for the healthcare industry, including excess professional liability programs for large, integrated hospital systems, outpatient facilities, clinics and long-term care facilities.
- Lenders products. Our insurance group's lenders products unit provides collateral protection, debt cancellation and service contract reimbursement products to banks, credit unions, automotive dealerships and original equipment manufacturers. The unit also underwrites other specialty programs that pertain to automotive lending and leasing.
- National Accounts. Our insurance group's national accounts unit provides a wide range of products for middle and large accounts and specializes in loss sensitive primary casualty insurance programs, including large deductible, self-insured retention and retrospectively rated programs.
- Professional Liability. Our insurance group's professional liability unit insures large law firms and accounting firms and professional programs, as well as miscellaneous professional liability, including coverages for consultants, network security, securities broker-dealers, wholesalers, captive agents and managing general agents. The professional liability unit also provides coverage for environmental and design professionals, including coverages for architectural and engineering firms and construction projects and pollution legal liability coverage for fixed sites.
- Programs. Our insurance group's programs unit targets program managers with unique expertise and niche products offering general liability, commercial automobile, inland marine and property business with minimal catastrophe exposure. This unit offers primarily package policies, underwriting workers' compensation and umbrella liability business in support of desirable package programs.
- Property, Energy, Marine and Aviation. Our insurance group's property unit provides primary and excess general property insurance coverages, including catastrophe-exposed property coverage, for commercial clients. The property unit also provides contractors all risk, erection all risk, aviation and stand alone terrorism insurance coverage for commercial clients.
- Surety. Our insurance group's surety unit provides contract and commercial surety coverages, including contract bonds (payment and performance bonds) primarily for medium and large contractors and commercial surety bonds for Fortune 1,000 companies and smaller transaction business programs. The surety unit also provides specialty contract bonds for homebuilders and developers.
- Travel and Accident. Our insurance group's travel and accident unit provides specialty travel and accident and related insurance products for individual and group travelers, as well as travel agents and suppliers.

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Other. Our insurance group also includes the following units: (i) alternative market risks, including captive insurance programs; (ii) contract binding, which provides property and casualty coverage through a network of appointed agents to small and medium risks where it is cost effective to use technology to access this niche market; (iii) accident and health, which provides accident, disability and medical plan insurance coverages for employer groups, medical plan members, students and other participant groups; and (iv) excess workers' compensation, which provides excess workers' compensation and employer's liability insurance coverages for qualified self-insured groups, associations and trusts in a wide range of businesses.

Underwriting Philosophy. Our insurance group's underwriting philosophy is to generate an underwriting profit (on both a gross and net basis) through prudent risk selection and proper pricing across all types of business. One key to this philosophy is the adherence to uniform underwriting standards across each product line that focuses on the following:

- risk selection;
- desired attachment point;
- limits and retention management;
- due diligence, including financial condition, claims history, management, and product, class and territorial exposure;
- underwriting authority and appropriate approvals; and
- collaborative decision making.

Premiums Written and Geographic Distribution. Set forth below is summary information regarding net premiums written for our insurance group:

	Year Ended December 31,					
	2013		2012		2011	
INSURANCE SEGMENT	Amount	% of Total	Amount	% of Total	Amount	% of Total
Net premiums written						
Programs	$419,673	22	$340,130	19	$290,378	17
Property, energy, marine and aviation	280,551	14	294,690	16	335,589	19
Professional liability	222,351	11	260,705	14	237,860	14
Executive assurance	213,727	11	250,904	14	231,405	13
Construction	161,877	8	130,201	7	120,405	7
Casualty	112,094	6	112,307	6	114,235	7
National accounts	109,233	6	80,929	4	80,973	5
Lenders products	101,576	5	99,724	5	94,301	5
Surety	64,911	3	53,271	3	42,475	2
Travel and accident	63,209	3	80,489	4	71,940	4
Healthcare	40,115	2	36,814	2	35,652	2
Other (1)	159,479	9	85,170	6	66,066	5
Total	$1,948,796	100	$1,825,334	100	$1,721,279	100
Net premiums written by client location						
United States	$1,526,156	78	$1,314,577	72	$1,208,007	70
Europe	226,254	12	271,278	15	273,578	16
Asia and Pacific	95,970	5	120,492	7	119,523	7
Other	100,416	5	118,987	6	120,171	7
Total	$1,948,796	100	$1,825,334	100	$1,721,279	100
Net premiums written by underwriting location						
United States	$1,478,930	76	$1,254,623	69	$1,153,834	67
Europe	389,763	20	472,132	26	463,855	27
Other	80,103	4	98,579	5	103,590	6

Total	$1,948,796	100	$1,825,334	100	$1,721,279	100

(1) Includes alternative markets, contract binding, accident and health and excess workers' compensation business.

Marketing. Our insurance group's products are marketed principally through a group of licensed independent retail and wholesale brokers. Clients (insureds) are referred to our insurance group through a large number of international, national and regional brokers and captive managers who receive from the insured or insurer a set fee or brokerage commission usually equal to a percentage of gross premiums. In the past, our insurance group also entered into contingent commission arrangements with some brokers that provide for the payment of additional commissions based on volume or profitability of business. Currently, some of our contracts with brokers provide for additional commissions based on volume. We have also entered into service agreements with select international brokers that provide access to their proprietary industry analytics. In general, our insurance group has no implied or explicit commitments to accept business from any particular broker and neither brokers nor any other third parties have the authority to bind our insurance group, except in the case where underwriting authority may be delegated contractually to select program administrators. Such administrators are subject to a due diligence financial and operational review prior to any such delegation of authority and ongoing reviews and audits are carried out as deemed necessary by our insurance group to assure the continuing integrity of underwriting and related business operations. See "Risk Factors—Risks Relating to Our Company—We could be materially adversely affected to the extent that managing general agents, general agents and other producers exceed their underwriting authorities or if our agents, our insureds or other third parties commit fraud or otherwise breach obligations owed to us." For information on major brokers, see note 14, "Commitments and Contingencies—Concentrations of Credit Risk," of the notes accompanying our consolidated financial statements.

Risk Management and Reinsurance. In the normal course of business, our insurance group may cede a portion of its premium on a quota share or excess of loss basis through treaty or facultative reinsurance agreements. Reinsurance arrangements do not relieve our insurance group from its primary obligations to insureds. Reinsurance recoverables are recorded as assets, predicated on the reinsurers' ability to meet their obligations under the reinsurance agreements. If the reinsurers are unable to satisfy their obligations under the agreements, our insurance subsidiaries would be liable for such defaulted amounts. Our principal insurance subsidiaries, with oversight by a group-wide reinsurance steering committee ("RSC"), are selective with regard to reinsurers, seeking to place reinsurance with only those reinsurers which meet and maintain specific standards of established criteria for financial strength. The RSC evaluates the financial viability of its reinsurers through financial analysis, research and review of rating agencies' reports and also monitors reinsurance recoverables and collateral with unauthorized reinsurers. The financial analysis includes ongoing qualitative and quantitative assessments of reinsurers, including a review of the financial stability, appropriate licensing, reputation, claims paying ability and underwriting philosophy of each reinsurer. Our insurance group will continue to evaluate its reinsurance requirements. See note 4, "Reinsurance," of the notes accompanying our consolidated financial statements.

For catastrophe-exposed insurance business, our insurance group seeks to limit the amount of exposure to catastrophic losses it assumes through a combination of managing aggregate limits, underwriting guidelines and reinsurance. For a discussion of our risk management policies, see "Management's Discussion and Analysis of Financial Condition and Results of Operations—Critical Accounting Policies, Estimates and Recent Accounting Pronouncements—Ceded Reinsurance" and "Risk Factors—Risks Relating to Our Industry—The failure of any of the loss limitation methods we employ could have a material adverse effect on our financial condition or results of operations."

Claims Management. Our insurance group's claims management function is performed by claims professionals, as well as experienced external claims managers (third party administrators), where appropriate. In addition to investigating, evaluating and resolving claims, members of our insurance group's claims departments work with underwriting professionals as functional teams in order to develop products and services desired by the group's clients.

Our Reinsurance Operations

Our reinsurance operations are conducted on a worldwide basis through our reinsurance subsidiaries, Arch Re Bermuda, Arch Re U.S. and Arch Re Europe. Arch Re Bermuda is a registered Class 4 insurer and long-term insurer and is headquartered in Hamilton, Bermuda. Arch Re U.S. is licensed or is an accredited or otherwise approved reinsurer in 50 states and the District of Columbia and operates out of its office in Morristown, New Jersey. Our property facultative reinsurance operations are conducted primarily through Arch Re U.S. with certain executive functions conducted through Arch Re Facultative Underwriters Inc. located in Farmington, Connecticut. The property facultative reinsurance operations have offices throughout the U.S., Canada and in Europe. Arch Re Europe, licensed and authorized as a non-life reinsurer and a life reinsurer, is headquartered in Dublin, Ireland with branch offices in Zurich and London. In 2011, we formed Arch MI Europe, which was authorized as a non-life insurer in Ireland in December 2011. Treaty operations in Canada were commenced in 2011 through the Canadian branch of Arch Insurance, but, from January 1, 2013, are conducted through Arch Insurance Canada. Mortgage insurance and reinsurance is underwritten in Europe through Arch MI Europe. Arch Risk

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Partners Ltd. (“Arch Risk Partners”), a U.K. based insurance intermediary authorized by the FSA in February 2012, acts on behalf of Arch MI Europe and Arch Re Bermuda in the arrangement of mortgage insurance and reinsurance. Our reinsurance operations acquired the credit and surety reinsurance operations of Ariel Re based in Zurich, Switzerland in April 2012. In the transaction, which was accounted for as a business combination under GAAP, we acquired approximately $84.1 million of net unearned premiums along with other insurance balances.

As of February 24, 2014, our reinsurance group had approximately 240 employees.

Strategy. Our reinsurance group’s strategy is to capitalize on our financial capacity, experienced management and operational flexibility to offer multiple products through our operations. The reinsurance group’s operating principles are to:

- Actively Select and Manage Risks. Our reinsurance group only underwrites business that meets certain profitability criteria, and it emphasizes disciplined underwriting over premium growth. To this end, our reinsurance group maintains centralized control over reinsurance underwriting guidelines and authorities.
- Maintain Flexibility and Respond to Changing Market Conditions. Our reinsurance group’s organizational structure and philosophy allows it to take advantage of increases or changes in demand or favorable pricing trends. Our reinsurance group believes that its existing platforms in Bermuda, the U.S., Europe and Canada, broad underwriting expertise and substantial capital facilitates adjustments to its mix of business geographically and by line and type of coverage. Our reinsurance group believes that this flexibility allows it to participate in those market opportunities that provide the greatest potential for underwriting profitability.
- Maintain a Low Cost Structure. Our reinsurance group believes that maintaining tight control over its staffing level and operating primarily as a broker market reinsurer permits it to maintain low operating costs relative to its capital and premiums.

Our reinsurance group writes business on both a proportional and non-proportional basis and writes both treaty and facultative business. In a proportional reinsurance arrangement (also known as pro rata reinsurance, quota share reinsurance or participating reinsurance), the reinsurer shares a proportional part of the original premiums and losses of the reinsured. The reinsurer pays the cedent a commission which is generally based on the cedent’s cost of acquiring the business being reinsured (including commissions, premium taxes, assessments and miscellaneous administrative expenses) and may also include a profit factor. Non-proportional (or excess of loss) reinsurance indemnifies the reinsured against all or a specified portion of losses on underlying insurance policies in excess of a specified amount, which is called a “retention.” Non-proportional business is written in layers and a reinsurer or group of reinsurers accepts a band of coverage up to a specified amount. The total coverage purchased by the cedent is referred to as a “program.” Any liability exceeding the upper limit of the program reverts to the cedent.

The reinsurance group’s treaty operations generally seek to write significant lines on less commoditized classes of coverage, such as specialty property and casualty reinsurance treaties. However, with respect to other classes of coverage, such as property catastrophe and casualty clash, the reinsurance group’s treaty operations participate in a relatively large number of treaties where they believe that they can underwrite and process the business efficiently. The reinsurance group’s property facultative operations write reinsurance on a facultative basis whereby they assume part of the risk under primarily single insurance contracts. Facultative reinsurance is typically purchased by ceding companies for individual risks not covered by their reinsurance treaties, for unusual risks or for amounts in excess of the limits on their reinsurance treaties.

Our reinsurance group focuses on the following areas:

- Casualty. Our reinsurance group reinsures third party liability and workers’ compensation exposures from ceding company clients primarily on a treaty basis. The exposures that it reinsures include, among others, executive assurance, professional liability, workers’ compensation, excess and umbrella liability and healthcare business. Our reinsurance group writes this business on a proportional and non-proportional basis. On proportional and non-proportional “working casualty business,” which is treated separately from casualty clash business, our reinsurance group prefers to write treaties where there is a meaningful amount of actuarial data and where loss activity is more predictable.
- Marine and Aviation. Our reinsurance group writes marine business, which includes coverages for energy, hull, cargo, specie, liability and transit, and aviation business, which includes coverages for airline and general

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aviation risks. Business written may also include space business, which includes coverages for satellite assembly, launch and operation for commercial space programs.

- Other Specialty. Our reinsurance group writes other specialty lines, including U.K. motor primarily emanating from one significant client, surety, accident and health, private passenger auto, workers' compensation catastrophe, agriculture, trade credit and political risk.
- Property Catastrophe. Our reinsurance group reinsures catastrophic perils for our reinsureds on a treaty basis. Treaties in this type of business provide protection for most catastrophic losses that are covered in the underlying policies written by our reinsureds. The primary perils in our reinsurance group's portfolio include hurricane, earthquake, flood, tornado, hail and fire. Our reinsurance group may also provide coverage for other perils on a case-by-case basis. Property catastrophe reinsurance provides coverage on an excess of loss basis when aggregate losses and loss adjustment expense from a single occurrence of a covered peril exceed the retention specified in the contract. The multiple claimant nature of property catastrophe reinsurance requires careful monitoring and control of cumulative aggregate exposure.
- Property Excluding Property Catastrophe. Our reinsurance group's treaty reinsurance operations reinsure individual property risks of a ceding company. Property per risk treaty and pro rata reinsurance contracts written by our treaty reinsurance group cover claims from individual insurance policies issued by reinsureds and include both personal lines and commercial property exposures (principally covering buildings, structures, equipment and contents). The primary perils in this business include fire, explosion, collapse, riot, vandalism, wind, tornado, flood and earthquake. Our reinsurance group's property facultative operations focus on commercial property risks on an excess of loss basis.
- Other. Our reinsurance group writes mortgage reinsurance on both a proportional and non-proportional basis on a global basis and direct mortgage insurance in Europe along with life reinsurance business on both a proportional and non-proportional basis. Besides death risk, the portfolio may include short and long-term disability risk from accident or natural causes. In addition, our reinsurance group writes casualty clash business and, in limited instances, writes non-traditional business which is intended to provide insurers with risk management solutions that complement traditional reinsurance.

Underwriting Philosophy. Our reinsurance group employs a disciplined, analytical approach to underwriting reinsurance risks that is designed to specify an adequate premium for a given exposure commensurate with the amount of capital it anticipates placing at risk. A number of our reinsurance group's underwriters are also actuaries. It is our reinsurance group's belief that employing actuaries on the front-end of the underwriting process gives it an advantage in evaluating risks and constructing a high quality book of business.

As part of the underwriting process, our reinsurance group typically assesses a variety of factors, including:

- adequacy of underlying rates for a specific class of business and territory;
- the reputation of the proposed cedent and the likelihood of establishing a long-term relationship with the cedent, the geographic area in which the cedent does business, together with its catastrophe exposures, and our aggregate exposures in that area;
- historical loss data for the cedent and, where available, for the industry as a whole in the relevant regions, in order to compare the cedent's historical loss experience to industry averages;
- projections of future loss frequency and severity; and
- the perceived financial strength of the cedent.

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Premiums Written and Geographic Distribution. Set forth below is summary information regarding net premiums written for our reinsurance group:

	Year Ended December 31,					
	2013		2012		2011	
REINSURANCE SEGMENT	Amount	% of Total	Amount	% of Total	Amount	% of Total
Net premiums written						
Other specialty (1)	$417,865	30	$308,104	25	$219,632	23
Casualty (2)	306,304	22	205,925	17	173,344	18
Property excluding property catastrophe (3)	292,536	21	265,783	22	226,013	24
Property catastrophe	220,749	16	283,677	23	246,793	26
Marine and aviation	64,380	5	84,649	7	77,309	8
Other (4)	100,737	6	78,763	6	8,956	1
Total	$1,402,571	100	$1,226,901	100	$952,047	100
Net premiums written by client location						
United States	$770,080	55	$629,614	51	$512,319	54
Europe	327,172	23	341,674	28	250,809	26
Asia and Pacific	120,017	9	104,398	8	75,590	8
Bermuda	87,047	6	72,864	6	60,246	6
Other	98,255	7	78,351	7	53,083	6
Total	$1,402,571	100	$1,226,901	100	$952,047	100
Net premiums written by underwriting location						
Bermuda	$548,924	39	$595,999	49	$531,254	56
United States	507,183	36	379,239	31	323,731	34
Europe	309,242	22	225,491	18	84,919	9
Other	37,222	3	26,172	2	12,143	1
Total	$1,402,571	100	$1,226,901	100	$952,047	100

(1) Includes U.K. motor, trade credit, surety, workers' compensation catastrophe, accident and health, private passenger auto and other.
(2) Includes professional liability, executive assurance and healthcare business.
(3) Includes facultative business.
(4) Includes mortgage, life, casualty clash and other.

Marketing. Our reinsurance group generally markets its reinsurance products through brokers, except our property facultative reinsurance group, which generally deals directly with the ceding companies. Brokers do not have the authority to bind our reinsurance group with respect to reinsurance agreements, nor does our reinsurance group commit in advance to accept any portion of the business that brokers submit to them. Our reinsurance group generally pays brokerage fees to brokers based on negotiated percentages of the premiums written through such brokers. For information on major brokers, see note 14, "Commitments and Contingencies—Concentrations of Credit Risk," of the notes accompanying our consolidated financial statements.

Risk Management and Retrocession. Our reinsurance group currently purchases a combination of per event excess of loss, per risk excess of loss and proportional retrocessional agreements. Such arrangements reduce the effect of individual or aggregate losses, and in certain cases may also increase the underwriting capacity of, our reinsurance group. Our reinsurance group will continue to evaluate its retrocessional requirements based on its net appetite for risk. See note 4, "Reinsurance," of the notes accompanying our consolidated financial statements.

For catastrophe exposed reinsurance business, our reinsurance group seeks to limit the amount of exposure it assumes from any one reinsured and the amount of the aggregate exposure to catastrophe losses from a single event in any one geographic zone. For a discussion of our risk management policies, see “Management’s Discussion and Analysis of Financial Condition and Results of Operations—Critical Accounting Policies, Estimates and Recent Accounting Pronouncements—Ceded Reinsurance” and “Risk Factors—Risks Relating to Our Industry—The failure of any of the loss limitation methods we employ could have a material adverse effect on our financial condition or results of operations.”

Claims Management. Claims management includes the receipt of initial loss reports, creation of claim files, determination of whether further investigation is required, establishment and adjustment of case reserves and payment of claims. Additionally, audits are conducted for both specific claims and overall claims procedures at the offices of selected ceding companies. Our reinsurance group makes use of outside consultants for claims work from time to time.

Employees

As of February 24, 2014, ACGL and its subsidiaries employed approximately 1,820 full-time employees, including approximately 300 employees in our U.S. mortgage operations following the closing of the Arch MI U.S. acquisition on January 30, 2014.

Reserves

Reserve estimates are derived after extensive consultation with individual underwriters, actuarial analysis of the loss reserve development and comparison with industry benchmarks. Our reserves are established and reviewed by experienced internal actuaries. Generally, reserves are established without regard to whether we may subsequently contest the claim. We do not currently discount our loss reserves except for excess workers' compensation and employers' liability loss reserves in our insurance operations.

Loss reserves represent estimates of what the insurer or reinsurer ultimately expects to pay on claims at a given time, based on facts and circumstances then known, and it is probable that the ultimate liability may exceed or be less than such estimates. Even actuarially sound methods can lead to subsequent adjustments to reserves that are both significant and irregular due to the nature of the risks written. Loss reserves are inherently subject to uncertainty. In establishing the reserves for losses and loss adjustment expenses, we have made various assumptions relating to the pricing of our reinsurance contracts and insurance policies and have also considered available historical industry experience and current industry conditions. The timing and amounts of actual claim payments related to recorded reserves vary based on many factors including large individual losses and changes in the legal environment, as well as general market conditions. The ultimate amount of the claim payments could differ materially from our estimated amounts. Certain lines of business written by us, such as excess casualty, have loss experience characterized as low frequency and high severity. This may result in significant variability in loss payment patterns and, therefore, may impact the related asset/liability investment management process in order to be in a position, if necessary, to make these payments. See "Management's Discussion and Analysis of Financial Condition and Results of Operations—Critical Accounting Policies, Estimates and Recent Accounting Pronouncements—Reserves for Losses and Loss Adjustment Expenses."

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The table below represents the development of loss reserves as determined under accounting principles generally accepted in the United States of America ("GAAP") for 2003 through 2013:
Development of GAAP Reserves
Cumulative Redundancy (Deficiency)

(U.S. dollars in millions)	Year Ended December 31, 2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
Reserve for losses and loss adjustment expenses, net of reinsurance recoverables	$1,543	$2,875	$4,063	$4,911	$5,483	$5,938	$6,214	$6,395	$6,638	$7,104	$7,076
Cumulative net paid losses as of:											
One year later	278	449	745	843	954	1,167	1,106	1,127	1,169	1,351	
Two years later	437	811	1,332	1,486	1,817	2,114	1,943	1,938	2,096		
Three years later	596	1,110	1,688	2,040	2,308	2,768	2,561	2,613			
Four years later	706	1,300	1,993	2,375	2,755	3,222	3,070				
Five years later	787	1,478	2,249	2,680	3,023	3,596					
Six years later	853	1,629	2,447	2,867	3,254						
Seven years later	930	1,740	2,603	3,005							
Eight years later	967	1,797	2,684								
Nine years later	993	1,829									
Ten years later	1,009										
Net re-estimated reserve as of:											
One year later	1,444	2,756	3,986	4,726	5,173	5,749	6,067	6,110	6,416	6,840	
Two years later	1,353	2,614	3,809	4,387	4,959	5,620	5,826	5,927	6,160		
Three years later	1,259	2,487	3,541	4,164	4,849	5,466	5,711	5,748			

Four years later	1,237	2,353	3,381	4,107	4,740	5,403	5,570				
Five years later	1,187	2,305	3,359	4,026	4,680	5,308					
Six years later	1,183	2,291	3,301	3,989	4,604						
Seven years later	1,191	2,255	3,327	3,944							
Eight years later	1,177	2,271	3,280								
Nine years later	1,201	2,247									
Ten years later	1,198										
Cumulative net redundancy	$345	$628	$783	$967	$879	$630	$644	$647	$478	$264	
Cumulative net redundancy as a percentage of net reserves	22.4%	21.8%	19.3%	19.7%	16.0%	10.6%	10.4%	10.1%	7.2%	3.7%	
Gross reserve for losses and loss adjustment expenses	$1,912	$3,493	$5,453	$6,463	$7,092	$7,667	$7,873	$8,098	$8,456	$8,933	$8,824
Reinsurance recoverable	(369)	(618)	(1,390)	(1,552)	(1,609)	(1,729)	(1,659)	(1,703)	(1,818)	(1,829)	(1,748)
Net reserve for losses and loss adjustment expenses	$1,543	$2,875	$4,063	$4,911	$5,483	$5,938	$6,214	$6,395	$6,638	$7,104	$7,076
Gross re-estimated reserve	$1,453	$2,704	$4,568	$5,242	$5,977	$6,754	$6,999	$7,193	$7,739	$8,633	
Re-estimated reinsurance recoverable	(255)	(457)	(1,288)	(1,298)	(1,373)	(1,446)	(1,429)	(1,445)	(1,579)	(1,793)	
Net re-estimated reserve	1,198	2,247	3,280	3,944	4,604	5,308	5,570	5,748	6,160	6,840	
Gross re-estimated	$459	$789	$885	$1,221	$1,115	$913	$874	$905	$717	$300	

redundancy

The preceding table does not present accident or policy year development data and, instead, presents an analysis of the claim development of gross and net balance sheet reserves existing at each calendar year-end in subsequent calendar years. The top line of the table shows the reserves, net of reinsurance recoverables, at the balance sheet date for each of the indicated years. This represents the estimated amounts of net losses and loss adjustment expenses arising in all prior years that are unpaid at the balance sheet date, including incurred but not reported ("IBNR") reserves. The table also shows the re-estimated amount of the previously recorded reserves based on experience as of the end of each succeeding year. The estimate changes as more information becomes known about the frequency and severity of claims for individual years. The "cumulative redundancy (deficiency)" represents the aggregate change in the estimates over all prior years. The table also

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shows the cumulative amounts paid as of successive years with respect to that reserve liability. In addition, the table reflects the claim development of the gross balance sheet reserves for ending reserves at December 31, 2003 through December 31, 2012.

The following table represents an analysis of losses and loss adjustment expenses and a reconciliation of the beginning and ending reserve for losses and loss adjustment expenses. The reserves of acquired business relate to our purchase of the credit and surety reinsurance operations of Ariel Re in April 2012.

	Year Ended December 31,		
	2013	2012	2011
Reserve for losses and loss adjustment expenses at beginning of year	$8,933,292	$8,456,210	$8,098,454
Unpaid losses and loss adjustment expenses recoverable	1,829,070	1,818,047	1,703,201
Net reserve for losses and loss adjustment expenses at beginning of year	7,104,222	6,638,163	6,395,253
Net incurred losses and loss adjustment expenses relating to losses occurring in:			
Current year	1,943,466	2,082,805	2,012,569
Prior years	(264,042)	(221,528)	(285,016)
Total net incurred losses and loss adjustment expenses	1,679,424	1,861,277	1,727,553
Net losses and loss adjustment expense reserves of acquired business	—	31,977	—
Foreign exchange losses (gains)	1,617	38,184	(32,020)
Net paid losses and loss adjustment expenses relating to losses occurring in:			
Current year	(288,114)	(295,984)	(325,273)
Prior years	(1,420,703)	(1,169,395)	(1,127,350)
Total net paid losses and loss adjustment expenses	(1,708,817)	(1,465,379)	(1,452,623)
Net reserve for losses and loss adjustment expenses at end of year	7,076,446	7,104,222	6,638,163
Unpaid losses and loss adjustment expenses recoverable	1,748,250	1,829,070	1,818,047
Reserve for losses and loss adjustment expenses at end of year	$8,824,696	$8,933,292	$8,456,210

Our initial reserving method to date has to a large extent been the expected loss method, which is commonly applied when limited loss experience exists. We select the initial expected loss and loss adjustment expense ratios based on information derived by our underwriters and actuaries during the initial pricing of the business, supplemented by industry data where appropriate. These ratios consider, among other things, rate changes and changes in terms and conditions that have been observed in the market. Any estimates and assumptions made as part of the reserving process could prove to be inaccurate due to several factors, including the fact that relatively limited historical information has been reported to us through December 31, 2013. We employ a number of different reserving methods depending on the segment, the line of business, the availability of historical loss experience and the stability of that loss experience. Over time, we have given additional weight to our historical loss experience in our reserving process due to the continuing maturation of our reserves, and the increased availability and credibility of the historical experience. For additional information regarding the key underlying movements in our losses and loss adjustment expenses by segment, see "Management's Discussion and Analysis of Financial Condition and Results of Operations—Results of Operations."

Unpaid and paid losses and loss adjustment expenses recoverable were approximately $1.75 billion at December 31, 2013. We are subject to credit risk with respect to our reinsurance and retrocessions because the ceding of risk to reinsurers and retrocessionaires does not relieve us of our liability to the clients or companies we insure or reinsure. Our failure to establish adequate reinsurance or retrocessional arrangements or the failure of our existing reinsurance or retrocessional arrangements to protect us from overly concentrated risk exposure could materially adversely affect our financial condition and results of operations. Although we monitor the financial condition of our reinsurers and retrocessionaires and attempt to place coverages only with substantial, financially sound carriers, we may not be successful in doing so.

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Investments

At December 31, 2013, consolidated cash and invested assets totaled approximately $14.05 billion, as summarized in the table below. See "Management's Discussion and Analysis of Financial Condition and Results of Operations—Financial Condition, Liquidity and Capital Resources—Financial Condition—Investable Assets" and note 6, "Investment Information," of the notes accompanying our financial statements.

The following table summarizes our invested assets:

	December 31, 2013		December 31, 2012	
	Amount	% of Total	Amount	% of Total
Fixed maturities available for sale, at fair value	$9,571,776	68.1	$9,839,988	75.4
Fixed maturities, at fair value (1)	448,254	3.2	363,541	2.8
Fixed maturities pledged under securities lending agreements, at fair value (2)	105,081	0.7	42,600	0.3
Total fixed maturities	10,125,111	72.1	10,246,129	78.5
Short-term investments available for sale, at fair value	1,478,367	10.5	722,121	5.5
Short-term investments pledged under securities lending agreements, at fair value (2)	—	—	8,248	0.1
Cash	434,057	3.1	371,041	2.8
Equity securities available for sale, at fair value	496,824	3.5	312,749	2.4
Equity securities, at fair value (1)	—	—	25,954	0.2
Other investments available for sale, at fair value	498,310	3.5	549,280	4.2
Other investments, at fair value (1)	773,280	5.5	527,971	4.0
Investments accounted for using the equity method (3)	244,339	1.7	307,105	2.4
Total cash and investments	14,050,288	100.0	13,070,598	100.2
Securities sold but not yet purchased (4)	—	—	(6,924)	(0.1)
Securities transactions entered into but not settled at the balance sheet date	(763)	—	(18,540)	(0.1)
Total investable assets	$14,049,525	100.0	$13,045,134	100.0

(1) Represents securities which are carried at fair value under the fair value option and reflected as "investments accounted for using the fair value option" on our balance sheet. Changes in the carrying value of such securities are recorded in net realized gains or losses.

(2) This table excludes the collateral received and reinvested and includes the fixed maturities and short-term investments pledged under securities lending agreements, at fair value.

(3) Changes in the carrying value of investment funds accounted for using the equity method are recorded as "equity in net income (loss) of investments funds accounted for using the equity method" rather than as an unrealized gain or loss component of accumulated other comprehensive income.

(4) Represents our obligation to deliver equity securities that we did not own at the time of sale. Such amounts are included in "other liabilities" on our balance sheet.

Our current investment guidelines and approach stress preservation of capital, market liquidity and diversification of risk. Our investments are subject to market-wide risks and fluctuations, as well as to risks inherent in particular securities. While maintaining our emphasis on preservation of capital and liquidity, we expect our portfolio to become more diversified and, as a result, we may in the future expand into areas which are not part of our current investment strategy. At December 31, 2013, 92.6% of our fixed maturities and fixed maturities pledged under securities lending agreements were rated investment grade, compared to 93.2% at December 31, 2012. Our fixed maturities, fixed maturities pledged under securities lending agreements and short-term investments had an average credit quality rating of “AA-” from S&P and “Aa2” from Moody’s Investors Service (“Moody’s”) at December 31, 2013, compared to “AA-” from S&P and “Aa2” from Moody’s at December 31, 2012. Our investment portfolio had an average effective duration of approximately 2.62 years and 3.06 years at December 31, 2013 and 2012, respectively.

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The credit quality distribution of our fixed maturities and fixed maturities pledged under securities lending agreements are shown below:

	December 31, 2013		December 31, 2012	
Rating (1)	Fair Value	% of Total	Fair Value	% of Total
U.S. government and government agencies (2)	$2,284,053	22.6	$2,523,212	24.6
AAA	3,709,872	36.6	3,413,431	33.3
AA	1,720,605	17.0	1,563,846	15.3
A	1,359,193	13.4	1,501,156	14.7
BBB	304,543	3.0	538,140	5.3
BB	180,125	1.8	174,527	1.7
B	188,119	1.9	220,772	2.2
Lower than B	241,463	2.4	175,866	1.7
Not rated	137,138	1.3	135,179	1.2
Total	$10,125,111	100.0	$10,246,129	100.0

(1) For individual fixed maturities, S&P ratings are used. In the absence of an S&P rating, ratings from Moody's are used, followed by ratings from Fitch Ratings.

(2) Includes U.S. government-sponsored agency mortgage backed securities and agency commercial mortgage backed securities.

For 2013, 2012 and 2011, set forth below is the pre-tax total return (before investment expenses) of our investment portfolio (including fixed maturities, short-term investments and fixed maturities and short-term investments pledged under securities lending agreements) compared to the benchmark return against which we measured our portfolio during the year. The benchmark return index is a customized combination of indices intended to approximate a target portfolio by asset mix and average credit quality while also matching the approximate estimated duration and currency mix of our insurance and reinsurance liabilities (see "Management's Discussion and Analysis of Financial Condition and Results of Operations—General—Financial Measures—Total Return on Investments").

	Arch Portfolio (1)		Benchmark Return	
Pre-tax total return (before investment expenses):				
Year ended December 31, 2013	1.28	%	0.85	%
Year ended December 31, 2012	5.88	%	4.90	%
Year ended December 31, 2011	3.81	%	4.80	%

(1) Our investment expenses were approximately 0.26%, 0.22% and 0.22%, respectively, of average invested assets in 2013, 2012 and 2011.

Ratings

Our ability to underwrite business is dependent upon the quality of our claims paying ability and financial strength ratings as evaluated by independent agencies. Such ratings from third party internationally recognized statistical rating organizations or agencies are instrumental in establishing the competitive positions of companies in our industry. We believe that the primary users of such ratings include commercial and investment banks, policyholders, brokers, ceding companies and investors. Insurance ratings are also used by insurance and reinsurance intermediaries as an important means of assessing the financial strength and quality of insurers and reinsurers, and have become an increasingly important factor in establishing the competitive position of insurance and reinsurance companies. These ratings are often an important factor in the decision by an insured or intermediary of whether to place business with a particular insurance or reinsurance provider. Periodically, rating agencies evaluate us to confirm that we continue to meet their criteria for the ratings assigned to us by them. A.M. Best Company ("A.M. Best") maintains a letter scale rating system ranging from "A++" (Superior) to "F" (In Liquidation). Moody's maintains a letter scale rating from "Aaa" (Exceptional) to "NP" (Not Prime). S&P maintains a letter scale rating system ranging from "AAA" (Extremely Strong) to

"R" (Under Regulatory Supervision). Fitch Ratings ("Fitch") maintains a letter scale rating system ranging from "AAA" (Exceptionally Strong) to "C" (Distressed).

Our reinsurance subsidiaries, Arch Re U.S., Arch Re Bermuda, Arch Re Europe (S&P and Fitch only) and Arch MI Europe (S&P only), and our principal insurance subsidiaries, Arch Insurance, Arch E&S, Arch Specialty, Arch Insurance

Company Europe and Arch Insurance Canada (S&P and A.M. Best only), each currently has a financial strength rating of “A+” (the second highest out of fifteen rating levels) with a stable outlook from A.M. Best, “A1” (the fifth highest out of 21 rating levels) with a stable outlook from Moody’s, “A+” (the fifth highest out of 21 rating levels) with a stable outlook from S&P, and “A+” (the fifth highest out of 24 rating levels) with a stable outlook from Fitch. A.M. Best has assigned a financial strength rating of “NR-3” (Rating Procedure Inapplicable) to Arch Indemnity, which is not writing business currently. Lloyd’s has financial strength ratings of “A” (the third highest out of fifteen rating levels) with a stable outlook from A.M. Best, “A+” with a stable outlook from S&P and “A+” with a stable outlook from Fitch. Our U.S. mortgage insurance subsidiary, Arch MI U.S., is rated “BBB+” (the eighth highest out of 21 rating levels) with a stable outlook by S&P.

ACGL has received counterparty (issuer) credit ratings of “A-” (seventh highest out of 21 rating levels) with a stable outlook from S&P, “A3” (seventh highest out of 21 rating levels) with a stable outlook from Moody’s and “A” long term issuer rating (sixth highest out of 23 rating levels) with a stable outlook from Fitch. A counterparty credit rating provides an opinion on an issuer’s overall capacity and willingness to meet its financial commitments as they become due, but is not specific to a particular financial obligation.

The financial strength ratings assigned by rating agencies to insurance and reinsurance companies represent independent opinions of financial strength and ability to meet policyholder obligations and are not directed toward the protection of investors, nor are they recommendations to buy, hold or sell any securities. We can offer no assurances that our ratings will remain at their current levels, or that our security will be accepted by brokers and our insureds and reinsureds. A ratings downgrade or the potential for such a downgrade, or failure to obtain a necessary rating, could adversely affect both our relationships with agents, brokers, wholesalers and other distributors of our existing products and services and new sales of our products and services. In addition, under certain of the reinsurance agreements assumed by our reinsurance operations, upon the occurrence of a ratings downgrade or other specified triggering event with respect to our reinsurance operations, such as a reduction in surplus by specified amounts during specified periods, our ceding company clients may be provided with certain rights, including, among other things, the right to terminate the subject reinsurance agreement and/or to require that our reinsurance operations post additional collateral. In the event of a ratings downgrade or other triggering event, the exercise of such contract rights by our clients could have a material adverse effect on our financial condition and results of operations, as well as our ongoing business and operations. See “Management’s Discussion and Analysis of Financial Condition and Results of Operations—Financial Condition, Liquidity and Capital Resources—Liquidity and Capital Resources.”

Competition

The worldwide reinsurance and insurance businesses are highly competitive. We compete, and will continue to compete, with major U.S. and non-U.S. insurers and reinsurers, some of which have greater financial, marketing and management resources than we have and have had longer-term relationships with insureds and brokers than us. We compete with other insurers and reinsurers primarily on the basis of overall financial strength, ratings assigned by independent rating agencies, geographic scope of business, strength of client relationships, premiums charged, contract terms and conditions, products and services offered, speed of claims payment, reputation, employee experience, and qualifications and local presence.

In our insurance business, we compete with insurers that provide specialty property and casualty lines of insurance, including: ACE Limited, Alleghany Corporation, Allied World Assurance Company, Ltd., American International Group, Inc., AXIS Capital Holdings Limited, Berkshire Hathaway, Inc., Chubb Corporation, CNA, Endurance Specialty Holdings Ltd., The Hartford Financial Services Group, Inc., HCC Insurance Holdings, Inc., Ironshore Inc., Liberty Mutual Insurance, Lloyd’s, Markel Insurance Company, RLI Corp., The Travelers Companies, W.R. Berkley Corp., XL Group plc and Zurich Insurance Group. In our reinsurance business, we compete with reinsurers that provide property and casualty lines of reinsurance, including ACE Limited, Alleghany Corporation, Argo International Holdings, Ltd., AXIS Capital Holdings Limited, Berkshire Hathaway, Inc., Endurance Specialty Holdings Ltd., Everest Re Group Ltd., Hannover Rückversicherung AG, Lloyd’s, Markel Global Reinsurance, Montpelier Re Holdings Ltd., Munich Re Group, PartnerRe Ltd., Platinum Underwriters Holdings, Ltd., RenaissanceRe Holdings Ltd., Swiss Reinsurance Company, Third Point Reinsurance Ltd., Validus Holdings Ltd and XL Group plc. We do not believe that we have a significant market share in any of our markets.

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Enterprise Risk Management

Enterprise Risk Management ("ERM") is a key element in our philosophy, strategy and culture. We employ an ERM framework that includes underwriting, reserving, investment, credit and operational risks. Risk appetite and exposure limits are set by our executive management team, reviewed with our board of directors and board level committees and routinely discussed with business unit management. These limits are integrated into our operating guidelines and the exposures are aggregated and monitored periodically by our corporate risk management team. The reporting, review and approval of risk management information is integrated into our annual planning process, capital modeling and allocation, reinsurance purchasing strategy and reviewed at insurance business reviews, reinsurance underwriting meetings and board level committees. For a discussion of our risk management policies, see "Management's Discussion and Analysis of Financial Condition and Results of Operations—Critical Accounting Policies, Estimates and Recent Accounting Pronouncements—Ceded Reinsurance" and "Risk Factors—Risks Relating to Our Industry—The failure of any of the loss limitation methods we employ could have a material adverse effect on our financial condition or results of operations."

Regulation

Bermuda Insurance Regulation

The Insurance Act 1978 of Bermuda and Related Regulations ("Insurance Act"). Arch Re Bermuda is subject to the Insurance Act, which provides that no person shall carry on any insurance business in or from within Bermuda unless registered as an insurer under the Insurance Act by the Bermuda Monetary Authority (the "BMA"), which is responsible for the day-to-day supervision of insurers. Under the Insurance Act, insurance business includes reinsurance business. We believe that we are in compliance with all applicable regulations under the Insurance Act.

The Insurance Act imposes solvency and liquidity standards and auditing and reporting requirements on Bermuda insurance companies and grants to the BMA powers to supervise, investigate and intervene in the affairs of insurance companies. Certain significant aspects of the Bermuda insurance regulatory framework are set forth below.

Classification of Insurers. The Insurance Act distinguishes between insurers carrying on long-term business, insurers carrying on general business and insurers carrying on special purpose business. There are six general business classifications (Classes 1, 2, 3, 3A, 3B and 4), five long-term business classifications (Classes A, B, C, D and E) and one classification of special purpose insurer.

As Arch Re Bermuda carries on both long-term and general business, it is required to be registered as both a long-term and as a general business insurer under the Insurance Act. Accordingly, Arch Re Bermuda is registered as a Class 4 general business insurer and as a Class C long-term insurer. Class 4 insurers are regarded as large commercial underwriters and are subject to the strictest regulation. Class C insurers are regarded as small commercial underwriters and are subject to less stringent regulation.

Minimum Paid-Up Share Capital. Arch Re Bermuda is required to maintain fully paid-up share capital of $1.25 million.

Principal Representative and Principal Office. An insurer is required to maintain a principal office and to appoint and maintain a principal representative in Bermuda. It is the duty of the principal representative upon reaching the view that there is a likelihood of the insurer for which the principal representative acts becoming insolvent or that a reportable "event" has, to the principal representative's knowledge, occurred or is believed to have occurred, to immediately notify the BMA and to make a report in writing to the BMA within 14 days of the prior notification setting out all the particulars of the case that are available to the principal representative.

Where there has been a significant loss which is reasonably likely to cause the insurer to fail to comply with its enhanced capital requirement (in respect of its general business, as described in more detail below), the principal representative must also furnish the BMA with a capital and solvency return reflecting an enhanced capital requirement prepared using post-loss data. The principal representative must provide this within 45 days of notifying the BMA regarding the loss.

Furthermore, where a notification has been made to the BMA regarding a material change to an insurer's business or structure (including a merger or amalgamation), the principal representative has 30 days from the date of such notification

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to furnish the BMA with unaudited interim statutory financial statements in relation to such period if so requested by the BMA, together with a general business solvency certificate in respect of those statements.

Approved Independent Auditor. All insurers must appoint an independent auditor who annually audits and reports on the insurer's financial statements prepared under generally accepted accounting principles ("GAAP") or international financial reporting standards ("IFRS") and statutory financial statements and the statutory financial return of the insurer, all of which, in the case of Arch Re Bermuda, are required to be filed annually with the BMA. The independent auditor must be approved by the BMA.

Approved Actuary. As a Class C insurer, Arch Re Bermuda is required to submit an annual actuary's certificate when filing its statutory financial returns. The actuary, who is normally a qualified life actuary, must be approved by the BMA.

Approved Loss Reserve Specialist. As a Class 4 insurer, Arch Re Bermuda is required to submit an opinion of its approved loss reserve specialist with its statutory financial return in respect of its loss and loss expense provisions. The loss reserve specialist, who will normally be a qualified casualty actuary, must be approved by the BMA.

Annual Financial Statements, Annual Statutory Financial Return and Annual Capital and Solvency Return. Arch Re Bermuda must prepare annual statutory financial statements as prescribed in the Insurance Act with respect to both its general business and its long-term business. The statutory financial statements are distinct from the annual GAAP basis financial statements referred to below. The statutory financial return for a Class 4 insurer shall include a report of the approved independent auditor on the statutory financial statement of such insurer, solvency certificates, the statutory financial statements for the general business, the opinion of the loss reserve specialist and a schedule of reinsurance ceded. The statutory financial return for a Class C insurer shall include a report of the approved independent auditor on the statutory financial statements of such insurer, the statutory financial statements related to the long-term business, a declaration of the statutory ratios, the long-term business solvency certificate and a certificate from the approved actuary. Arch Re Bermuda is also required to file audited GAAP basis annual financial statements, which must be available to the public. In addition, Arch Re Bermuda is required to file a capital and solvency return in respect of its general business and long-term business. The capital and solvency return includes its relevant regulatory risk-based capital model, a schedule of fixed income investments by ratings categories, a schedule of net reserves for losses and loss expense provisions by line of business, a schedule of premiums written by line of business, a schedule of risk management and a schedule of fixed income securities, a schedule of commercial insurer's solvency self assessment, a schedule of catastrophe risk return, a schedule of loss triangles or reconciliation of net loss reserves and a schedule of eligible capital.

Minimum Solvency Margins. Arch Re Bermuda, as a Class 4 insurer, must ensure that the value of its general business assets exceeds the amount of its general business liabilities by an amount greater than the prescribed minimum solvency margin (and enhanced capital requirement pertaining to its general business. Accordingly, Arch Re Bermuda is required, with respect to its general business, to maintain a minimum solvency margin equal to the greatest of (i) $100 million, (ii) 50% of net premiums written (being gross premiums written less any premiums ceded by Arch Re Bermuda, but Arch Re Bermuda may not deduct more than 25% of gross premiums when computing net premiums written), (iii) 15% of net discounted aggregate losses and loss expense provisions and other insurance reserves and (iv) 25% of its enhanced capital requirement. As a long-term insurer, Arch Re Bermuda is also required, with respect to its long-term business, to maintain a minimum solvency margin equal to the greater of $500,000 or 1.5% of its assets. For the purpose of this calculation, assets are defined as the total assets pertaining to its long-term business reported on the balance sheet in the relevant year less the amounts held in a segregated account.

Enhanced Capital Requirement. As a Class 4 insurer, Arch Re Bermuda is required to maintain available statutory capital and surplus pertaining to its general business at a level equal to or in excess of its enhanced capital requirement which is established by reference to either the Bermuda Solvency Capital Requirement model ("BSCR") or an approved internal capital model. The BSCR is a risk-based capital model which provides a method for determining an insurer's capital requirements (statutory capital and surplus) by taking into account the risk characteristics of different aspects of the insurer's business. The BSCR model is a risk-based capital model which provides a method for determining an insurer's capital requirements (statutory capital and surplus) by taking into account the risk characteristics of different aspects of the insurer's business. While not specifically referred to in the Insurance Act, the BMA has also established a target capital level for each Class 4 insurer equal to 120% of its enhanced capital requirement. While a Class 4 insurer is not currently required to maintain its statutory capital and surplus at this level, the target capital level serves as an early warning tool for the BMA, and failure to maintain statutory capital at least equal to the target capital level will likely result in increased regulatory oversight. As a Class C insurer, Arch Re Bermuda is also required to maintain available statutory capital and

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surplus in respect of its long-term business at a level equal to or in excess of its long-term enhanced capital requirement which is established by reference to either the Class C BSCR model or an approved internal capital model. The long-term enhanced capital requirement is being phased in and shall be 50%, 75% and 100% of the calculated amount determined by the long-term BSCR model for financial years 2013, 2014 and 2015, respectively.

Eligible Capital. To enable the BMA to better assess the quality of the insurer's capital resources, as a Class 4 insurer, Arch Re Bermuda is required to disclose the makeup of its capital in accordance with a 3-tiered capital system. Under this system, all of the insurer's capital instruments will be classified as either basic or ancillary capital, which in turn will be classified into one of three tiers based on their "loss absorbency" characteristics. Highest quality capital will be classified Tier 1 Capital, lesser quality capital will be classified as either Tier 2 Capital or Tier 3 Capital. A minimum threshold of Tier 1 and maximum thresholds of Tier 2 and Tier 3 Capital used to support Arch Re Bermuda's minimum solvency margin and enhanced capital requirement are specified under the rules. Tier 1, Tier 2 and Tier 3 Capital may, until January 1, 2024, include capital instruments that do not satisfy the requirement that the instrument be non-redeemable or settled only with the issuance of an instrument of equal or higher quality upon a breach, or if it would cause a breach, of the enhanced capital requirement. Where the BMA approved the use of certain instruments for capital purposes prior to the implementation of the eligible capital rules, the BMA's consent must be obtained if such instruments are to remain eligible for use in satisfying the minimum solvency margin pertaining to its general business and its enhanced capital requirement.

Minimum Liquidity Ratio. Arch Re Bermuda is required to maintain a minimum liquidity ratio for general business equal to the value of its relevant assets at not less than 75% of the amount of its relevant liabilities. Relevant assets include cash and time deposits, quoted investments, unquoted bonds and debentures, first liens on real estate, investment income due and accrued, accounts and premiums receivable and reinsurance balances receivable. The relevant liabilities are total general business insurance reserves and total other liabilities less deferred income tax and sundry liabilities (by interpretation, those not specifically defined).

Restrictions on Dividends and Distributions. Arch Re Bermuda is prohibited from declaring or paying any dividends during any financial year if it is in breach of its enhanced capital requirement or its general business or long-term solvency margins or its minimum liquidity ratio or if the declaration or payment of such dividends would cause such a breach. If it has failed to meet its minimum solvency margins or minimum liquidity ratio on the last day of any financial year, Arch Re Bermuda will be prohibited, without the approval of the BMA, from declaring or paying any dividends during the next financial year. In addition, Arch Re Bermuda is prohibited from declaring or paying in any financial year dividends of more than 25% of its total statutory capital and surplus (as shown on its previous financial year's statutory balance sheet) unless it files (at least seven days before payment of such dividends) with the BMA an affidavit stating that it will continue to meet the required margins.

Reduction of Capital. Without the approval of the BMA, Arch Re Bermuda is prohibited from reducing by 15% or more its total statutory capital as set out in its previous year's financial statements and any application for such approval must include an affidavit stating that it will continue to meet the required margins.

Long-Term Business Fund. An insurer carrying on long-term business is required to keep its accounts in respect of its long-term business separate from any accounts kept in respect of any other business. All receipts of its long-term business form part of its long-term business fund. No payment may be made directly or indirectly from an insurer's long-term business fund for any purpose other than a purpose related to the insurer's long-term business, unless such payment can be made out of any surplus certified by the insurer's approved actuary to be available for distribution otherwise than to policyholders. Arch Re Bermuda may not declare or pay a dividend to any person other than a policyholder unless the value of the assets in its long-term business fund, as certified by its approved actuary, exceeds the extent (as so certified) of the liabilities of the insurer's long-term business. In addition, the amount of such dividend shall not exceed the aggregate of that excess and any other funds properly available for payment of dividends, being funds arising out of business of the insurer other than its long-term business.

Restrictions on Transfer of Business and Winding-Up. As a long-term insurer, Arch Re Bermuda may only transfer long-term business, other than long-term business that is reinsurance business, with the sanction of the applicable Bermuda court. A long-term insurer may only be wound-up or liquidated by order of the applicable Bermuda court.

Fit and Proper Controllers. The BMA maintains supervision over the controllers of all registered insurers in Bermuda. A controller includes: (i) the managing director of the registered insurer or its parent company; (ii) the chief executive of the registered insurer or of its parent company; (iii) a shareholder controller; and (iv) any person in accordance with whose

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directions or instructions the directors of the registered insurer or of its parent company are accustomed to act. The definition of shareholder controller is set out in the Insurance Act, but generally refers to (i) a shareholder who holds 10% or more of the shares carrying rights to vote at a shareholders' meeting of the registered insurer or its parent company, or (ii) a shareholder who is entitled to exercise 10% or more of the voting power at any shareholders' meeting of such registered insurer or its parent company, or (iii) a shareholder who is able to exercise significant influence over the management of the registered insurer or its parent company by virtue of its shareholding or its entitlement to exercise, or control the exercise of, the voting power at any shareholders' meeting. A shareholder controller that owns 10% or more but less than 20% of the shares as described above is defined as a 10% shareholder controller; a shareholder controller that owns 20% or more but less than 33% of the shares as described above is defined as a 20% shareholder controller; a shareholder controller that owns 33% or more but less than 50% of the shares as described above is defined as a 33% shareholder controller; and a shareholder controller that owns 50% or more of the shares as described above is defined as a 50% shareholder controller.

Where the shares of the shareholder of a registered insurer, or the shares of its parent company, are traded on a recognized stock exchange, and such shareholder becomes a 10%, 20%, 33% or 50% shareholder controller of the insurer, that shareholder shall, within 45 days, notify the BMA in writing that such shareholder has become such a controller. Any person or entity who contravenes the Insurance Act by failing to give notice or knowingly becoming a shareholder controller before the required 45 days has elapsed is guilty of an offense and liable to a fine.

The BMA may file a notice of objection to any shareholder who has become a controller of any description where it appears that such shareholder is, or is no longer, a fit and proper shareholder to be a controller of the registered insurer. Any person who continues to be a controller of any description after having received a notice of objection shall be guilty of an offense.

Notification by Registered Person of Change of Controllers and Officers. All registered insurers are required to give written notice to the BMA of the fact that a person has become, or ceased to be, a controller or officer of the registered insurer within 45 days of becoming aware of such fact. An officer in relation to a registered insurer means a director, chief executive or senior executive performing duties of underwriting, actuarial, risk management, compliance, internal audit, finance or investment matters.

Notification of Material Changes. All registered insurers are required to give notice to the BMA of their intention to effect a material change within the meaning of the Insurance Act. For the purposes of the Insurance Act, the following changes are material: (i) the transfer or acquisition of insurance business being part of a scheme falling under section 25 of the Insurance Act or section 99 of the Companies Act; (ii) the amalgamation with or acquisition of another firm; (iii) engaging in unrelated business that is retail business, (iv) the acquisition of a controlling interest in an undertaking that is engaged in non-insurance business which offers services and products to persons who are not affiliates of the insurer, (v) outsourcing all or substantially all of the company's actuarial, risk management and internal audit functions, (vi) outsourcing all or a material part of an insurer's underwriting activity, (vii) the transfer other than by way of reinsurance of all or substantially all of a line of business, and (viii) the expansion into a material new line of business.

No registered insurer shall take any steps to give effect to a material change unless it has first served notice on the BMA that it intends to effect such material change and before the end of 14 days, either the BMA has notified such company in writing that it has no objection to such change or that period has lapsed without the BMA having issued a notice of objection. Any insurer who fails to give the required notice or which effects a material change, or allows such material change to be effected, before the prescribed period has elapsed or after having received a notice of objection from the BMA shall be guilty of an offense.

Insurance Code of Conduct. Arch Re Bermuda is subject to the Insurance Code of Conduct (the "Insurance Code"), which establishes duties and standards which must be complied with to ensure it implements sound corporate governance, risk management and internal controls. Failure to comply with the requirements under the Insurance Code will be a factor taken into account by the BMA in determining whether an insurer is conducting its business in a sound and prudent manner as prescribed by the Insurance Act. Failure to comply with the requirements of the Insurance Code could result in the BMA exercising its powers of intervention and will be a factor in calculating the operational risk charge applicable in accordance with that insurer's risk based capital model.

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Cancellation of Insurer's Registration. An insurer's registration may be canceled by the BMA on certain grounds specified in the Insurance Act, including failure of the insurer to comply with its obligations under the Insurance Act or if, in the opinion of the BMA, the insurer has not been carrying on business in accordance with sound insurance principles.

Group Supervision. The BMA acts as group supervisor of our group of insurance and reinsurance companies ("Group") and has designated Arch Re Bermuda as the designated insurer ("Designated Insurer"). Pursuant to its powers under the Insurance Act, the BMA maintains a register of particulars for the Group detailing, among other things, the names and addresses of the Designated Insurer; each member company of the Group falling within the scope of supervision; the principal representative of the Group in Bermuda; other competent authorities supervising other member companies of the Group; and the Group auditors. The Designated Insurer must notify the BMA of any changes to the above details entered on the register of the Group.

As Group supervisor, the BMA performs a number of supervisory functions including (i) coordinating the gathering and dissemination of information which is of importance for the supervisory task of other competent authorities; (ii) carrying out a supervisory review and assessment of the Group; (iii) carrying out an assessment of the Group's compliance with the rules on solvency, risk concentration, intra-Group transactions and good governance procedures; (iv) planning and coordinating, with other competent authorities, supervisory activities in respect of the Group, both as a going concern and in emergency situations; (v) coordinating any enforcement action that may need to be taken against the Group or any of its members; and (vi) planning and coordinating meetings of colleges of supervisors (consisting of insurance regulators) in order to facilitate the carrying out of the functions described above.

In carrying out its functions, the BMA makes rules for (i) assessing the financial situation and the solvency position of the Group and/or its members and (ii) regulating intra-Group transactions, risk concentration, governance procedures, risk management and regulatory reporting and disclosure.

Group Solvency and Group Supervision. The current supervision and solvency rules (together, "Group Rules") apply to our Group so long as the BMA remains our group supervisor. The BMA has implemented and imposed many of the additional requirements described in this section as part of its efforts to gain equivalence under Solvency II. Due to the delays in the implementation of Solvency II in Europe, it is not expected that the European Commission will take a final decision on whether or not it will recognize the regime in Bermuda to be equivalent to that laid down in Solvency II until the latter part of 2014, at the earliest. If the European Commission does not recognize the regime in Bermuda, this could mean that Arch Re Bermuda and its European Union-regulated affiliates may be subject to group supervision in Bermuda and the European Union, respectively. In addition, through the Group Rules, the BMA may take action which affects ACGL. A summary of the Group Rules is set forth below.

Annual Group Financial Statements. The Group is required to prepare and submit, on an annual basis, financial statements prepared in accordance with either IFRS or GAAP, together with statutory financial statements. The financial statements must be audited annually by the Group's approved auditor who is required to prepare an auditor's report thereon in accordance with generally accepted auditing standards. In addition, the Group must prepare statutory financial statements (which include, in statutory form, a balance sheet, an income statement, a statement of capital and surplus, and notes thereto). The Designated Insurer is required to file with the BMA the statutory financial statements and the audited GAAP financial statements for the Group with the BMA within five months from the end of the relevant financial year (unless specifically extended).

Annual Group Statutory Financial Return and Annual Capital and Solvency Return. The Group is required to prepare an annual statutory financial return which shall include, among other things, a report of the approved auditor (for the GAAP financial statements only), a business solvency certificate, the opinion of an actuary (exempt for 2013 filing), a capital and solvency certificate (and a declaration signed by two directors of the parent company, one of which may be the chief executive) and either the chief risk or chief financial officer of the parent company declaring that the return fairly represents the financial condition of the Group in all material respects). Both the annual statutory financial return and the capital and solvency return must be submitted to the BMA by the Designated Insurer within five months after its financial year end (unless specifically extended).

Quarterly Group Financial Statements. The Designated Insurer is required to file quarterly financial returns for the Group with the BMA on or before the last day of the months May, August and November of each year. The quarterly

Group financial returns consist of (i) quarterly unaudited (consolidated) financial statements for each financial quarter (which must minimally include a balance sheet and income statement and must also be recent and not reflect a financial position

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that exceeds two months) and (ii) a list and details of material intra-Group transactions and risk concentrations, details surrounding all intra-Group reinsurance and retrocession arrangements and details of the top ten counterparties and any other counterparty exposures exceeding 10% of Group's statutory capital and surplus.

Group Solvency Self Assessment ("GSSA"). The Group Rules require the board of directors of the parent company of the insurance group (the "Parent Board") to establish solvency self assessment procedures for the group that factors in all the foreseeable reasonably material risks. Such procedures should be carried out at least annually and assess the quality and quantity of the capital required to adequately cover the risks to which the insurance group is exposed. Such procedures must also be an integral part of the group's risk management framework and be reviewed and evaluated on a regular basis by the Parent Board. In particular, the GSSA should, among other things, demonstrate consideration of the relationship between risk management, the quality and quantity of capital resources, the impact of risk mitigation techniques and diversification and correlation effects between material risks; a description of the group's risk appetite; be forward-looking; include appropriate stress and scenario testing and appropriately reflect all assets and liabilities, material off-balance sheet arrangements, material intra group transactions, relevant managerial practices, systems and controls and a valuation basis that is aligned with the risk characteristics and business model of the group.

Group Minimum Solvency Margin ("Group MSM") and Group Enhanced Capital Requirement ("Group ECR"). Effective January 1, 2013, the Designated Insurer must ensure that the value of the Group's assets exceeds the amount of the Group's liabilities by the aggregate minimum margin of solvency of each qualifying member of the Group. A member is a qualifying member of the Group if it is subject to solvency requirements in the jurisdiction in which it is registered. Where the parent company exercises control in relation to any member of the group, the minimum margin of solvency of such member shall be its individual minimum solvency margin. Where the parent company exercises significant influence on any member of the Group, the minimum margin of solvency applicable to that member for purposes of calculating the Group MSM shall be an amount equal to the parent company's percentage shareholding in the member multiplied by that member's minimum margin of solvency. "Control" and "significant influence" shall be determined in accordance with either the IFRS or GAAP used to prepare the Group's IFRS or GAAP financial statements. The Group is required to maintain available group capital and surplus at a level equal to 50% of the Group ECR and this requirement will increase by increments of 10% in each of the following five years until 100% is required in 2018. This phasing in schedule is conditioned upon the BMA making further adjustments that would be either needed or appropriate once the effective date of Solvency II capital requirements is finalized.

Group Eligible Capital. To enable the BMA to better assess the quality of the group's capital resources, the Designated Insurer is required to disclose the makeup of the Group's capital in accordance with a 3-tiered capital system. Under the eligible capital requirements, all of the Group's capital instruments will be classified as either basic or ancillary capital which in turn will be classified into one of 3 tiers based on their "loss absorbency" characteristics. Highest quality capital will be classified Tier 1 Capital, lesser quality capital will be classified as either Tier 2 Capital or Tier 3 Capital. A minimum threshold of Tier 1 and maximum thresholds of Tier 2 and Tier 3 Capital used to satisfy the Group MSM and Group ECR requirements are specified under the rules. Tier 1, Tier 2 and Tier 3 Capital may, until January 1 2024, include capital instruments that do not satisfy the requirement that the instrument be non-redeemable or settled only with the issuance of an instrument of equal or higher quality upon a breach, or if redemption would cause a breach, of the Group ECR.

Group Governance. The Group Rules require the Parent Board to establish and effectively implement corporate governance policies and procedures, which it must be periodically review to ensure they continue to support the overall organizational strategy of the group. In particular, the Parent Board must:

- ensure that operational and oversight responsibilities of the group are clearly defined and documented and that the reporting of material deficiencies and fraudulent activities are transparent and devoid of conflicts of interest;
- establish systems for identifying on a risk sensitive basis those policies and procedures that must be reviewed annually and those policies and procedures that must be reviewed at other regular intervals;
- establish a risk management and internal controls framework and ensure that it is assessed regularly and such assessment is reported to the Parent Board and the chief and senior executives;
- establish and maintain sound accounting and financial reporting procedures and practices for the group; and

- establish and keep under review group functions relating to actuarial, compliance, internal audit and risk management functions which must address certain specific requirements as set out in the Group Rules.

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Designated Insurer Notification Obligations. The Designated Insurer must notify the BMA upon reaching a view that there is a likelihood of the Group or any member of the Group becoming insolvent or that a reportable "event" has, to the Designated Insurer's knowledge, occurred or is believed to have occurred. Examples of a reportable "event" include a failure by the Group or any member of the Group to comply substantially with a requirement imposed upon it under the Group Rules relating to its solvency position, governance and risk management or supervisory reporting and disclosures; failure by the Designated Insurer to comply with a direction given to it under the Insurance Act in respect of the group or any of its members; a criminal conviction imposed upon any member of the Group whether in Bermuda or abroad; material breaches of any statutory requirements by any member of the Group located outside of Bermuda that could lead to supervisory or enforcement action by a competent authority; or a significant loss that is reasonably likely to cause the Group to be unable to comply with its Group ECR. Within 30 days of such notification to the BMA, the Designated Insurer must furnish the BMA with a written report setting out all the particulars of the case that are available to it and within 45 days it must furnish a Group capital and solvency return that reflects the Group ECR that has been prepared using post-loss data and unaudited financial statements for such period as the BMA shall require together with a declaration of solvency in respect thereof. The Designated Insurer must also notify the BMA in writing within 14 days of becoming aware that a requirement of the Group Rules conflicts with the laws of another jurisdiction where a member of the Group operates.

The following events constitute material changes that must be notified to the BMA: (i) the amalgamation with or acquisition of another firm, (ii) engaging in unrelated business that is retail business, (iii) the acquisition of a controlling interest in an undertaking that is engaged in non-insurance business which offers services and products to persons who are not affiliates, (iv) outsourcing all or substantially all of the actuarial, risk management and internal audit functions, (v) outsourcing all or a material part of underwriting activities, (vi) the transfer other than by way of reinsurance of all or substantially all of a line of business, and (vii) the expansion into a material new line of business.

The Designated Insurer is required to give written notice to the BMA of the fact that a person has become, or ceased to be, a controller or officer of the parent company of the Group within 45 days of becoming aware of such fact. An officer in relation to the parent company of the Group means a director, chief executive or senior executive performing duties of underwriting, actuarial, risk management, compliance, internal audit, finance or investment matters.

If it appears to the BMA that the Designated Insurer is in breach of any provision of the Insurance Act or the Group Rules, the BMA may give the Designated Insurer such directions as appear to the BMA to be desirable for safeguarding the interests of policyholders and potential policyholders of the Group.

BMA's Powers of Intervention, Obtaining Information, Reports and Documents and Providing Information to other Regulatory Authorities. The BMA may, by notice in writing served on a registered person or a Designated Insurer, require the registered person or a Designated Insurer to provide such information and/or documentation as the BMA may reasonably require with respect to matters that are likely to be material to the performance of its supervisory functions under the Insurance Act. In addition, it may require such person's auditor, underwriter, accountant or any other person with relevant professional skill to prepare a report on any aspect pertaining thereto. In the case of a report, the person so appointed shall immediately give the BMA written notice of any fact or matter of which he becomes aware or which indicates to him that any condition attaching to his registration under the Insurance Act is not or has not or may not be or may not have been fulfilled and that such matters are likely to be material to the performance of its functions under the Insurance Act. If it appears to the BMA to be desirable in the interests of the clients of a registered person or relevant insurance group, the BMA may also exercise these powers in relation to subsidiaries, parent companies and other affiliates of the registered person or designated insurer.

If the BMA deems it necessary to protect the interests of the policyholders or potential policyholders of an insurer or insurance group, it may appoint one or more competent persons to investigate and report on the nature, conduct or state of the insurer's or the insurance group's business, or any aspect thereof, or the ownership or control of the insurer or insurance group. If the person so appointed thinks it necessary for the purposes of his investigation, he may also investigate the business of any person who is or has been at any relevant time, a member of the insurance group or of a partnership of which the person being investigated is a member. In this regard, it shall be the duty of every person who is or was a controller, officer, employee, agent, banker, auditor, accountant, barrister and attorney or insurance manager to produce to the person appointed such documentation as he may reasonably require for purposes of his investigation, and to attend and answer questions relevant to the investigation and to otherwise provide such assistance as may be necessary in connection therewith.

Where the BMA suspects that a person has failed to properly register under the Insurance Act or that a registered person or designated insurer has failed to comply with a requirement of the Insurance Act or that a person is not, or is no longer, a fit and proper person to perform functions in relation to a regulated activity, it may, by notice in writing, carry out an investigation into such person (or any other person connected thereto). In connection therewith, the BMA may require every person who is or was a controller, officer, employee, agent, banker, auditor, accountant, barrister and attorney or insurance manager to make a report and produce such documents in his care, custody and control and to attend before the BMA to answer questions relevant to the BMA's investigation and to take such actions as the BMA may direct. The BMA may also enter any premises for the purposes of carrying out its investigation and may petition the court for a warrant if it believes a person has failed to comply with a notice served on him or there are reasonable grounds for suspecting the completeness of any information or documentation produced in response to such notice or that its directions will not be complied with or that any relevant documents would be removed, tampered with or destroyed.

The BMA has the power to assist other regulatory authorities, including foreign insurance regulatory authorities, with their investigations involving insurance and reinsurance companies in Bermuda if it is satisfied that the assistance being requested is in connection with the discharge of regulatory responsibilities and that such cooperation is in the public interest. The grounds for disclosure by the BMA to a foreign regulatory authority without consent of the insurer are limited and the Insurance Act provides for sanctions for breach of the statutory duty of confidentiality.

Certain Other Bermuda Law Considerations

ACGL and Arch Re Bermuda are incorporated in Bermuda as "exempted companies." As a result, they are exempt from Bermuda laws restricting the percentage of share capital that may be held by non-Bermudians, but they may not participate in certain business transactions, including (i) the acquisition or holding of land in Bermuda (except that required for their business and held by way of lease or tenancy for terms of not more than 50 years) without the express authorization of the Bermuda legislature, (ii) the taking of mortgages on land in Bermuda to secure an amount in excess of $50,000 without the consent of the Minister of Finance, (iii) the acquisition of any bonds or debentures secured by any land in Bermuda, other than certain types of Bermuda government securities or (iv) the carrying on of business of any kind in Bermuda, except in furtherance of their business carried on outside Bermuda or under license granted by the Minister of Finance. While an insurer is permitted to reinsure risks undertaken by any company incorporated in Bermuda and permitted to engage in the insurance and reinsurance business, generally it is not permitted without a special license granted by the Minister of Finance to insure Bermuda domestic risks or risks of persons of, in or based in Bermuda.

ACGL and Arch Re Bermuda also need to comply with the provisions of The Bermuda Companies Act 1981, as amended (the "Companies Act") regulating the payment of dividends and making distributions from contributed surplus. A company shall not declare or pay a dividend, or make a distribution out of contributed surplus, if there are reasonable grounds for believing that: (i) the company is, or would after the payment be, unable to pay its liabilities as they become due; or (ii) the realizable value of the company's assets would thereby be less than its liabilities. See "Management's Discussion and Analysis of Financial Condition and Results of Operations—Financial Condition, Liquidity and Capital Resources—Liquidity and Capital Resources" and note 20, "Statutory Information," of the notes accompanying our financial statements.

Under Bermuda law, only persons who are Bermudians, spouses of Bermudians, holders of a permanent resident's certificate, holders of a working resident's certificate or persons who are exempt pursuant to the Incentives for Job Makers Act 2011, as amended ("exempted persons") may engage in gainful occupation in Bermuda without an appropriate governmental work permit. Our success may depend in part upon the continued services of key employees in Bermuda. Certain of our current key employees are not exempted persons and, as such, require specific approval to work for us in Bermuda. A work permit may be granted or extended upon showing that, after proper public advertisement, no exempted person is available who meets the minimum standards reasonably required by the employer.

U.S. Insurance Regulation

General. In common with other insurers, our U.S. based subsidiaries are subject to extensive governmental regulation and supervision in the various states and jurisdictions in which they are domiciled and licensed and/or approved to conduct business. The laws and regulations of the state of domicile have the most significant impact on operations. This regulation and supervision is designed to protect policyholders rather than investors. Generally, regulatory authorities have broad regulatory powers over such matters as licenses, standards of solvency, premium rates, policy forms, marketing practices, claims practices, investments, security deposits, methods of accounting, form and content of financial statements, reserves

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and provisions for unearned premiums, unpaid losses and loss adjustment expenses, reinsurance, minimum capital and surplus requirements, dividends and other distributions to shareholders, periodic examinations and annual and other report filings. In addition, transactions among affiliates, including reinsurance agreements or arrangements, as well as certain third party transactions, require prior regulatory approval from, or prior notice to and no disapproval by, the applicable regulator under certain circumstances. Certain insurance regulatory requirements are highlighted below. In addition, regulatory authorities conduct periodic financial, claims and market conduct examinations. Arch Insurance Company Europe is also subject to certain governmental regulation and supervision in the states where it writes excess and surplus lines insurance.

In addition to regulation applicable generally to U.S. insurance and reinsurance companies, our U.S. mortgage insurance operations are affected by federal and state regulation relating to mortgage insurers, mortgage lenders, and the origination, purchase and sale of residential mortgages. The private mortgage insurance industry is, and likely will continue to be, subject to substantial federal and state regulation, which has increased in recent years as a result of the deterioration of the housing and mortgage markets in the U.S. Increased federal or state regulatory scrutiny could lead to new legal precedents, new regulations, new practices, or regulatory actions or investigations, which could adversely affect our financial condition and operating results.

Credit for Reinsurance. Arch Re U.S. is subject to insurance regulation and supervision that is similar to the regulation of licensed primary insurers. However, except for certain mandated provisions that must be included in order for a ceding company to obtain credit for reinsurance ceded, the terms and conditions of reinsurance agreements generally are not subject to regulation by any governmental authority. This contrasts with admitted primary insurance policies and agreements, the rates and terms of which generally are regulated by state insurance regulators. As a practical matter, however, the rates charged by primary insurers do have an effect on the rates that can be charged by reinsurers.

Certain provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the “Dodd-Frank Act”), which became effective on July 21, 2011, provide that only the state in which a primary insurer is domiciled may regulate the financial statement credit for reinsurance taken by that primary insurer; other states will no longer be able to impose their own credit for reinsurance laws on primary insurers that are only licensed in such other states.

A primary insurer ordinarily will enter into a reinsurance agreement only if it can obtain credit for the reinsurance ceded on its U.S. statutory-basis financial statements. In general, credit for reinsurance is allowed in the following circumstances:

- if the reinsurer is licensed in the state in which the primary insurer is domiciled;
- if the reinsurer is an “accredited” or otherwise approved reinsurer in the state in which the primary insurer is domiciled;
- in some instances, if the reinsurer (a) is domiciled in a state that is deemed to have substantially similar credit for reinsurance standards as the state in which the primary insurer is domiciled and (b) meets certain financial requirements; or
- if none of the above applies, to the extent that the reinsurance obligations of the reinsurer are collateralized appropriately, typically through the posting of a letter of credit for the benefit of the primary insurer or the deposit of assets into a trust fund established for the benefit of the primary insurer.

Some states have adopted provisions of the National Association of Insurance Commissioners (“NAIC”) adopted amendments to its Credit for Reinsurance Model Law and Regulation (the “NAIC Credit for Reinsurance Model Act”) that allow full credit to U.S. ceding insurers for reinsurance ceded to qualified non-U.S. reinsurers (called “certified reinsurers”) based upon less than 100% collateralization. Under those provisions, collateral requirements may be reduced for international reinsurers meeting certain criteria as to financial strength and reliability that are domiciled in countries that are found to have strong systems of domestic insurance regulation. Applicants for “certified reinsurer” designation must agree to certain financial reporting, consent to jurisdiction and consent to provide collateral for the full amount of their assumed liabilities in specified circumstances. Arch Re Bermuda is approved in Florida and New York to post reduced collateral and may apply to be designated as a “certified reinsurer” in other U.S. states.

As a result of the requirements relating to the provision of credit for reinsurance, Arch Re U.S. and Arch Re Bermuda are indirectly subject to certain regulatory requirements imposed by jurisdictions in which ceding companies are domiciled.

Arch Re U.S. is licensed or is an accredited or otherwise approved reinsurer in 50 states and the District of Columbia. Arch Insurance is licensed as an insurer in 50 states, the District of Columbia, Puerto Rico, the U.S. Virgin Islands and

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Guam with a branch office in Canada (authorized to underwrite until December 31, 2012). Arch Specialty is licensed in one state and approved as an excess and surplus lines insurer in 49 states, the District of Columbia, Puerto Rico and the U.S. Virgin Islands. Arch E&S is licensed in one state and approved as an excess and surplus lines insurer in 47 states and the District of Columbia. Arch Indemnity is licensed as an insurer in 49 states and the District of Columbia. Arch Insurance Company Europe is eligible to write excess and surplus lines insurance in 50 states, the District of Columbia, the U.S. Virgin Islands, Guam, the Northern Mariana Islands and American Samoa by virtue of its listing on the NAIC International Insurers Department's Quarterly Listing of Alien Insurers pursuant to the Nonadmitted and Reinsurance Reform Act of 2010. Neither Arch Re Bermuda nor Arch Re Europe expects to become licensed, accredited or so approved in any U.S. jurisdiction.

Certain state regulatory agencies as well are conducting investigations of insurance and reinsurance companies' compliance with various federal and state laws. On June 25, 2013, the New York Department of Financial Services sent a letter to non-U.S. reinsurers approved to post reduced collateral (see "Regulation-U.S. Insurance Regulation-Credit for Reinsurance"), including Arch Re Bermuda, seeking information concerning such reinsurers' compliance with the Iran Freedom and Counter-Proliferation Act of 2012. We cannot predict the effect or outcome of these investigations on the insurance or reinsurance industry, the regulatory framework, or our business, financial condition and results of operations.

Holding Company Acts. All states have enacted legislation that regulates insurance holding company systems. These regulations generally provide that each insurance company in the system is required to register with the insurance department of its state of domicile and furnish information concerning the operations of companies within the holding company system which may materially affect the operations, management or financial condition of the insurers within the system. All transactions within a holding company system affecting insurers must be fair and reasonable. Notice to the state insurance departments is required prior to the consummation of certain material transactions between an insurer and any entity in its holding company system. In addition, certain of such transactions cannot be consummated without the applicable insurance department's prior approval, or its failure to disapprove after receiving notice. The holding company acts also prohibit any person from directly or indirectly acquiring control of a U.S. insurance company unless that person has filed an application with specified information with the insurance company's domiciliary commissioner and has obtained the commissioner's prior approval. Under most states' statutes, including Missouri and Nebraska, acquiring 10% or more of the voting securities of an insurance company or its parent company is presumptively considered an acquisition of control of the insurance company, although such presumption may be rebutted. Accordingly, any person or entity that acquires, directly or indirectly, 10% or more of the voting securities of ACGL without the prior approval of the commissioner will be in violation of these laws and may be subject to injunctive action requiring the disposition or seizure of those securities by the commissioner or prohibiting the voting of those securities, or to other actions that may be taken by the commissioner. In 2010, the NAIC adopted amendments to the Insurance Holding Company System Regulatory Act and Regulation, which, among other changes, introduce the concept of "enterprise risk" within an insurance holding company system. If and when the amendments are adopted by a particular state, the amended Insurance Holding Company System Regulatory Act and Regulation would impose more extensive informational requirements on parents and other affiliates of licensed insurers or reinsurers with the purpose of protecting them from enterprise risk, including requiring an annual enterprise risk report by the ultimate controlling person identifying the material risks within the insurance holding company system that could pose enterprise risk to the licensed companies. The amended Insurance Holding Company System Regulatory Act also requires any controlling person of a U.S. insurance company seeking to divest its controlling interest in the insurance company to file with the commissioner a confidential notice of the proposed divestiture at least 30 days prior to the cessation of control; after receipt of the notice, the commissioner shall determine those instances in which the parties seeking to divest or to acquire a controlling interest will be required to file for or obtain approval of the transaction. The amended Insurance Holding Company System Regulatory Act and Regulation must be adopted by the individual states for the new requirements to apply to U.S. domestic insurers and reinsurers. To date, only 24 states, including states in which our U.S.-based insurance subsidiaries are domiciled or licensed, have enacted legislation adopting the amended Insurance Holding Company System Regulatory Act in some form.

Enterprise Risk. The NAIC has increased its focus on risks within an insurer’s holding company system that may pose enterprise risk to the insurer. “Enterprise risk” is defined as any activity, circumstance, event or series of events involving one or more affiliates of an insurer that, if not remedied promptly, is likely to have a material adverse effect upon the financial condition or the liquidity of the insurer or its insurance holding company system as a whole. As noted above, the NAIC recently adopted amendments to its Model Insurance Holding Company System Regulatory Act and Regulation, which include, among other amendments, a requirement for the ultimate controlling person to file an enterprise risk report. In 2012, the NAIC adopted the Risk Management and Own Risk and Solvency Assessment (“ORSA”) Model Act, which requires domestic insurers to maintain a risk management framework and establishes a legal requirement for domestic insurers to conduct an ORSA in accordance with the NAIC's ORSA Guidance Manual. The ORSA Model Act provides that domestic insurers, or their insurance group, must regularly conduct an ORSA consistent with a process comparable to the ORSA Guidance Manual process. The ORSA Model Act also provides that, no more than once a year, an insurer's domiciliary regulator may request that an insurer submit an ORSA summary report, or any combination of reports that together contain the information described in the ORSA Guidance Manual, with respect to the insurer and/or the insurance group of which it is a member. If and when the ORSA Model Act is adopted by a particular state, the ORSA Model Act would impose more extensive filing requirements on parents and other affiliates of domestic insurers.

Regulation of Dividends and Other Payments from Insurance Subsidiaries. The ability of an insurer to pay dividends or make other distributions is subject to insurance regulatory limitations of the insurance company's state of domicile. Generally, such laws limit the payment of dividends or other distributions above a specified level. Dividends or other distributions in excess of such thresholds are "extraordinary" and are subject to prior regulatory approval. Such dividends or distributions may be subject to applicable withholding or other taxes. See "Management's Discussion and Analysis of Financial Condition and Results of Operations—Financial Condition, Liquidity and Capital Resources—Liquidity and Capital Resources" and note 20, "Statutory Information," of the notes accompanying our financial statements.

Insurance Regulatory Information System Ratios. The NAIC Insurance Regulatory Information System ("IRIS") was developed by a committee of state insurance regulators and is intended primarily to assist state insurance departments in executing their statutory mandates to oversee the financial condition of insurance companies operating in their respective states. IRIS identifies 13 industry ratios (referred to as "IRIS ratios") and specifies "usual values" for each ratio. Departure from the usual values of the IRIS ratios can lead to inquiries from individual state insurance commissioners as to certain aspects of an insurer's business. Certain of our U.S.-based subsidiaries generate IRIS ratios that are outside of the usual values. To date, none of these subsidiaries has received any notice of regulatory review regarding the IRIS ratios but there is no assurance that we may not be notified in the future.

Accreditation. The NAIC has instituted its Financial Regulation Accreditation Standards Program ("FRASP") in response to federal initiatives to regulate the business of insurance. FRASP provides a set of standards designed to establish effective state regulation of the financial condition of insurance companies. Under FRASP, a state must adopt certain laws and regulations, institute required regulatory practices and procedures, and have adequate personnel to enforce such items in order to become an "accredited" state. If a state is not accredited, other states may not accept certain financial examination reports of insurers prepared solely by the regulatory agency in such unaccredited state. The respective states in which our insurance and reinsurance subsidiaries are domiciled are accredited states.

Risk-Based Capital Requirements. In order to enhance the regulation of insurer solvency, the NAIC adopted in December 1993 a formula and model law to implement risk-based capital requirements for property and casualty insurance companies. These risk-based capital requirements are designed to assess capital adequacy and to raise the level of protection that statutory surplus provides for policyholder obligations. The risk-based capital model for property and casualty insurance companies measures three major areas of risk facing property and casualty insurers:

- underwriting, which encompasses the risk of adverse loss developments and inadequate pricing;
- declines in asset values arising from credit risk; and
- declines in asset values arising from investment risks.

An insurer will be subject to varying degrees of regulatory action depending on how its statutory surplus compares to its risk-based capital calculation. For equity investments in an insurance company affiliate, the risk-based capital requirements for the equity securities of such affiliate would generally be our U.S.-based subsidiaries' proportionate share of the affiliate's risk-based capital requirement.

Under the approved formula, an insurer's total adjusted capital is compared to its authorized control level risk-based capital. If this ratio is above a minimum threshold, no company or regulatory action is necessary. Below this threshold are four distinct action levels at which a regulator can intervene with increasing degrees of authority over an insurer as the ratio of surplus to risk-based capital requirement decreases. The four action levels include:

- insurer is required to submit a plan for corrective action;
- insurer is subject to examination, analysis and specific corrective action;

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- regulators may place insurer under regulatory control; and
- regulators are required to place insurer under regulatory control.

Each of our U.S. subsidiaries' surplus (as calculated for statutory purposes) is above the risk-based capital thresholds that would require either company or regulatory action.

Guaranty Funds and Assigned Risk Plans. Most states require all admitted insurance companies to participate in their respective guaranty funds which cover certain claims against insolvent insurers. Solvent insurers licensed in these states are required to cover the losses paid on behalf of insolvent insurers by the guaranty funds and are generally subject to annual assessments in the states by the guaranty funds to cover these losses. Participation in state-assigned risk plans may take the form of reinsuring a portion of a pool of policies or the direct issuance of policies to insureds. The calculation of an insurer's participation in these plans is usually based on the amount of premium for that type of coverage that was written by the insurer on a voluntary basis. Assigned risk pools tend to produce losses which result in assessments to insurers writing the same lines on a voluntary basis.

Federal Regulation. Although state regulation is the dominant form of regulation for insurance and reinsurance business, the federal government in recent years has shown some concern over the adequacy of state regulation. It is not possible to predict the future impact of any potential federal regulations or other possible laws or regulations on our U.S. based subsidiaries' capital and operations, and such laws or regulations could materially adversely affect their business. In addition, a number of federal laws affect and apply to the insurance industry, including various privacy laws and the economic and trade sanctions implemented by the Office of Foreign Assets Control ("OFAC"). OFAC maintains and enforces economic sanctions against certain foreign countries and groups and prohibits U.S. persons from engaging in certain transactions with certain persons or entities. OFAC has imposed civil penalties on persons, including insurance and reinsurance companies, arising from violations of its economic sanctions program.

Certain federal laws, such as the Real Estate Settlement Procedures Act of 1974 ("RESPA") and the Homeowners Protection Act of 1998 ("HOPA"), directly impact mortgage insurers. Other federal law and regulation relating to mortgage lenders and servicers, the GSEs, the Federal Housing Admistration ("FHA") and the U.S. Department of Veterans Affairs ("VA") may also affect mortgage insurers and the demand for private mortgage insurance. Such laws include the Equal Credit Opportunity Act, the Fair Housing Act, the Truth In Lending Act ("TILA"), the Fair Credit Reporting Act of 1970 ("FCRA"), and the Fair Debt Collection Practices Act. Among other things, these laws and their implementing regulations prohibit payments for referrals of settlement service business, require fairness and non-discrimination in granting or facilitating the granting of credit, govern the circumstances under which companies may obtain and use consumer credit information, define the manner in which companies may pursue collection activities, and require disclosures of the cost of credit and provide for other consumer protections.

The Dodd-Frank Wall Street Reform and Consumer Protection Act. The Dodd-Frank Act created the Federal Insurance Office ("FIO") within the Department of Treasury, which is not a federal regulator or supervisor of insurance, but monitors the insurance industry for systemic risk, administers the Terrorism Risk Insurance Program Reauthorization Act of 2007 ("TRIPRA"), consults with the states regarding insurance matters and develops federal policy on aspects of international insurance matters. In 2013, the FIO issued two reports relating to the insurance industry, one on modernization of the insurance regulatory system and one on the impact of Part II of the Nonadmitted and Reinsurance Reform Act of 2010. In its December 2013 report on modernization of the insurance regulatory system, the FIO recommended that federal standards and oversight for mortgage insurers be developed and implemented. The FIO has sought comment from the insurance industry in connection with a further report on the global reinsurance market and the regulation of reinsurance, which has not yet been released. The impact that these reports will have on the regulation of insurance, if any, is yet to be determined. The Dodd-Frank Act also created a uniform system for non-admitted insurance premium tax payments based on the home state of the policyholder and provides for single state regulation for financial solvency and credit for reinsurance as discussed above.

The Dodd-Frank Act established the Consumer Finance Protection Bureau ("CFPB") to regulate the offering and provision of consumer financial products and services under federal law, including residential mortgages. Pursuant to the Dodd-Frank Act, the CFPB is charged with rulemaking and enforcement with respect to enumerated consumer laws, including RESPA, TILA, HOPA, the SAFE Act and FCRA. The Dodd-Frank Act also granted to the CFPB certain supervisory powers with respect to "covered persons" and "service providers," as defined by the Act. The CFPB recently published residential mortgage servicing rules pursuant to TILA and RESPA. The CFPB has issued Civil Investigative

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Demands to several other mortgage insurers and in 2013 the United States District Court for the Southern District of Florida approved consent orders issued by the CFPB against four other mortgage insurers relating to captive reinsurers.

Under the Dodd-Frank Act, the CFPB is authorized to issue regulations governing a loan originator's determination that, at the time a loan is originated, the consumer has a reasonable ability to repay the loan (“ATR”). The CFPB issued final ATR regulations in 2013 containing detailed requirements on how lenders must verify a borrower's ability to repay a covered mortgage loan. The ATR rule became effective in January 2014. The Dodd-Frank Act provides for a statutory presumption that a borrower will have the ability to repay a loan if the loan has characteristics satisfying the definition of “qualified mortgage,” or QM, as contained in the CFPB’s ATR regulations. Creditors who violate the ATR rule can be liable for interest and fees paid by the borrower as well as actual and statutory damages. A borrower may assert such a violation as a defense by recoupment or set off in a foreclosure action.

Under the CFPB’s ATR rule, a loan is deemed to be a QM if it meets certain requirements, including:

- the term of the mortgage is 30 years or less;
- there is no negative amortization, interest only or balloon features;
- the lender documents the loan in accordance with requirements;
- the total "points and fees" do not exceed certain thresholds, generally 3%; and
- the total debt-to-income ratio does not exceed 43%.

The QM definition provides a "safe harbor" for QM loans with annual percentage rates, or APRs, below the threshold of 150 basis points over the Average Prime Offer Rate and a "rebuttable presumption" of compliance with ATR requirements for QM loans with an APR above that threshold.

The ATR rule also provides for a second, temporary category that allows for more flexible underwriting requirements. To qualify under the temporary QM definition, a mortgage must meet the general product feature requirements and be eligible to be purchased or guaranteed by the GSEs while they remain under conservatorship, FHA, VA, the Department of Agriculture or the Rural Housing Service. This temporary QM category expires on January 10, 2021, or earlier to the extent that the conservatorship of the Federal Housing Finance Agency (“FHFA”) ends or federal agencies issue their own qualified mortgage rules. In May 2013, the FHFA directed the GSEs to limit purchases after January 10, 2014 to loans that meet certain QM criteria. On September 30, 2013, HUD proposed a separate definition of a qualified mortgage for loans insured by the FHA. To the extent that government agencies adopt their own definitions of a qualified mortgage and those definitions are more favorable to lenders than those applicable to the market in which private mortgage insurers participate, our business may be adversely affected.

Under the QM Rule, mortgage insurance premiums that are payable by the consumer at or prior to consummation of the loan are includible in the calculation of points and fees unless, and to the extent that, they are less than or equal to those charged by FHA and are automatically refundable on a pro rata basis upon satisfaction of the loan.

Borrower-paid single premium products, both refundable and non-refundable, may be included within the points and fees calculation under the QM Rule. Because inclusion of mortgage insurance premiums in the calculation of points and fees will reduce the capacity for other points and fees in order for lenders to comply with the QM Rule, mortgage originators may be less likely to use those mortgage insurance products. The treatment of mortgage insurance premiums as a component of the points and fees calculation, or the potential indirect impact of mortgage insurance premiums on the total points and fees, may be factors as to whether a loan is in the safe harbor, receives a rebuttable presumption of ability to repay, or receives no presumption.

Because of the QM evidentiary standard that gives presumption of compliance, we anticipate that most newly-originated mortgages will be QMs. As a result, we believe that the QM regulations will have an impact on the size of the residential mortgage market. Our operating results could be adversely impacted if the QM regulations reduce the size of the origination market, reduce the willingness of lenders to extend low down payment credit, favor alternatives to private mortgage insurance such as government mortgage insurance programs, or change the mix of mortgage insurance business in ways that may be unfavorable to us.

The Dodd-Frank Act generally requires an issuer of an asset-backed security or initiator of an asset-backed transaction (a "securitizer") to retain at least 5% of the risk associated with securitized mortgage loans, although in some cases the retained risk may be allocated between the securitizer and the mortgage originator. This risk-retention requirement does not

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apply to a mortgage loan that is a "qualified residential mortgage," or "QRM," or that is insured or guaranteed by FHA or certain other federal agencies. In March 2011, federal regulators issued a proposed risk-retention rule that included a definition of QRM and an alternative definition. In August 2013, federal regulators made public a revised proposed risk retention rule and QRM definition (the "Revised Proposal"). The Revised Proposal generally defines QRM as a mortgage meeting the requirements of a QM. In addition, an alternative QRM definition, "QM-plus," that was considered but ultimately not selected as the preferred approach, was also proposed for comment. In addition to adopting certain QM criteria, QM-plus incorporates a maximum LTV standard of 70% and other restrictions to reduce the risk of default. Under the QM-plus alternative, significantly fewer loans likely would qualify as a QRM and, therefore, be exempt from risk retention.

Under the original and the Revised Proposal, lenders that originate loans that are sold to the GSEs while they are in conservatorship will not be required to retain risk associated with those loans. Changes in the conservatorship status of the GSEs or capital support provided to the GSEs by the U.S. government could impact the manner in which the credit risk retention rules apply to the GSEs.

If the final rules treat all QM loans as QRMs, low down payment loans with private mortgage insurance that do not meet the requirements of the QM rule can only be securitized with a risk retention requirement, which may further deter their origination and adversely affect our business. If the final definition includes a substantial down payment requirement, as in QM-plus, without recognition of private mortgage insurance to meet the definition, loans with LTVs in excess of the final requirement that are not guaranteed by the GSEs cannot be securitized without risk retention, which may deter their origination and adversely affect our business. Neither definition of QRM in the Revised Proposal incorporates the use of private mortgage insurance. The final timing of the adoption of any risk retention regulation and the definition of QRM remains uncertain.

The Dodd-Frank Act amended and expanded mortgage servicing requirements under TILA and RESPA. The CFPB published final regulations implementing these mortgage servicing requirements which became effective in January 2014. New loss mitigation procedures include the prohibition of commencement of foreclosure by the loan holder or servicer until 120 days after the borrower's delinquency. This and other loss mitigation requirements could cause delays in default servicing, cause the servicing of mortgage loans to become more costly, and could have an adverse impact on the timely resolution of mortgage insurance claims.

The Homeowners Protection Act of 1998. HOPA provides for the automatic termination, or cancellation upon a borrower's request, of private mortgage insurance upon satisfaction of certain conditions. HOPA requires that lenders give borrowers certain notices with regard to the automatic termination or cancellation of mortgage insurance. These provisions apply to borrower-paid mortgage insurance for purchase money, refinance and construction loans secured by the borrower's principal dwelling. FHA and VA loans are not covered by HOPA. Under HOPA, automatic termination of mortgage insurance generally occurs when the mortgage is first scheduled to reach an LTV of 78% of the home's original value, assuming that the borrower is current on the required mortgage payments. A borrower who has a "good payment history," as defined by HOPA, may generally request cancellation of mortgage insurance when the LTV is first scheduled to reach 80% of the home's original value or when actual payments reduce the loan balance to 80% of the home's original value.

Real Estate Settlement Procedures Act of 1974. Subject to limited exceptions, RESPA prohibits persons from giving or accepting anything of value in connection with the referral of a settlement service. Mortgage insurance generally has been considered to be a "settlement service" for purposes of RESPA. RESPA authorizes the CFPB, the Department of Justice, state attorneys general and state insurance commissioners to bring civil enforcement actions, and also provides for criminal penalties and private rights of action. In the past, a number of lawsuits have challenged the actions of private mortgage insurers under RESPA, alleging that the insurers violated the referral fee prohibition by entering into captive reinsurance arrangements or providing products or services to mortgage lenders at improperly reduced prices in return for the referral of mortgage insurance, including the provision of contract underwriting services. In addition to these private lawsuits, in April 2013, the United States District Court for the Southern District of Florida approved consent orders issued by the CFPB against four other private mortgage insurers relating to captive reinsurance. Under the settlements, the mortgage insurers will end the challenged practices, pay monetary penalties, and be subject to monitoring by the CFPB and required to make reports to the CFPB in order to ensure their compliance with the provisions of the orders.

Home Mortgage Disclosure Act of 1975. The Home Mortgage Disclosure Act of 1975 (“HMDA”) requires most mortgage originators to collect and report to the CFPB data relating to a mortgage loan applicant's race, nationality, gender, marital status, and census tract. Mortgage insurers are not required pursuant to law or regulation to report HMDA data, although, under the laws of several states, mortgage insurers are currently prohibited from discriminating on the basis of certain classifications. Mortgage insurers have, through an industry trade group, voluntarily reported the same data on loans submitted for insurance as is required for most mortgage lenders under HMDA.

Secure and Fair Enforcement for Mortgage Licensing Act. The Secure and Fair Enforcement for Mortgage Licensing Act ("SAFE Act") requires mortgage loan originators to be licensed or registered with the Nationwide Mortgage Licensing System and Registry, a database established by the Conference of State Bank Supervisors and the American Association of Residential Mortgage Regulators. We do not believe that the SAFE Act applies to Arch MI U.S. employees or contractors who review loan files in connection with underwriting mortgage insurance applications for the purpose of making mortgage insurance decisions. If the SAFE Act is interpreted to apply to our underwriters or other employees or contractors, we would take steps to comply with the Act, which could increase our costs.

Fair Credit Reporting Act. The Fair Credit Reporting Act ("FCRA") imposes restrictions on the permissible use of credit report information. FCRA has been interpreted by some FTC staff and federal courts to require mortgage insurance companies to provide "adverse action" notices to consumers in the event an application for mortgage insurance is declined or offered at less than the best available rate for the loan program applied for on the basis of a review of the consumer's credit. Arch MI U.S. provides notices as required. Although Arch MI U.S. has not been involved, there has been class action litigation over FCRA adverse action notices involving the mortgage industry, including court-approved settlements.

Terrorism Risk Insurance Program Reauthorization Act of 2007. The Terrorism Risk Insurance Act of 2002 was amended and extended by the Terrorism Risk Insurance Extension Act of 2005 and amended and extended again by TRIPRA through December 31, 2014. TRIPRA provides a federal backstop for insurance related losses resulting from any act of terrorism on U.S. soil or against certain U.S. air carriers, vessels or foreign missions. Under TRIPRA, all U.S. based property and casualty insurers are required to make terrorism insurance coverage available in specified commercial property and casualty insurance lines. Under TRIPRA, the federal government will pay 85% of covered losses after an insurer's losses exceed a deductible determined by a statutorily prescribed formula, up to a combined annual aggregate limit for the federal government and all insurers of $100 billion. If an act (or acts) of terrorism result in covered losses exceeding the $100 billion annual limit, insurers with losses exceeding their deductibles will not be responsible for additional losses. An insurer's deductible for each year is based on the insurer's direct commercial earned premiums for property and casualty insurance, excluding certain lines of business such as commercial auto, surety, professional liability and earthquake lines of business, for the prior calendar year multiplied by a specified percentage. The specified percentages for prior periods were 15% for 2005, 17.5% for 2006 and 20% for 2007 through 2013 and will be 20% for 2014.

Our U.S.-based property and casualty insurers, Arch Insurance, Arch Specialty, Arch E&S and Arch Indemnity, are subject to TRIPRA. TRIPRA specifically excludes reinsurance business and, accordingly, does not apply to our reinsurance operations. Our insurance group's deductible for 2013 was approximately $239 million (i.e., 20.0% of direct earned premiums). Based on 2013 direct commercial earned premiums, our insurance group's deductible for 2014 will be approximately $258 million (i.e., 20.0% of such direct earned premiums). It is possible that TRIPRA, which is currently scheduled to expire on December 31, 2014, will not be removed, or that coverage currently provided under TRIPRA will be significantly different after 2014.

The Gramm-Leach-Bliley Act. The Gramm-Leach-Bliley Act of 1999 ("GLBA"), which implements fundamental changes in the regulation of the financial services industry in the United States, was enacted on November 12, 1999. The GLBA permits mergers that combine commercial banks, insurers and securities firms under one holding company, a "financial holding company." Bank holding companies and other entities that qualify and elect to be treated as financial holding companies may engage in activities, and acquire companies engaged in activities, that are "financial" in nature or "incidental" or "complementary" to such financial activities. Such financial activities include acting as principal, agent or broker in the underwriting and sale of life, property, casualty and other forms of insurance and annuities.

Until the passage of the GLBA, the Glass-Steagall Act of 1933 had limited the ability of banks to engage in securities-related businesses, and the Bank Holding Company Act of 1956 had restricted banks from being affiliated with insurers. Since passage of the GLBA, among other things, bank holding companies may acquire insurers, and insurance holding companies may acquire banks. The ability of banks to affiliate with insurers may affect our U.S. subsidiaries' product lines by substantially increasing the number, size and financial strength of potential competitors. The GLBA also imposes privacy requirements on financial institutions, including obligations to protect and safeguard consumers' nonpublic personal information and records, and limitations on the re-use of such information. Federal

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regulatory agencies have issued Interagency Guidelines Establishing Information Security Standards, or "Security Guidelines," and interagency regulations regarding financial privacy, or "Privacy Rule," implementing sections of GLBA. The Security Guidelines establish standards relating to administrative, technical, and physical safeguards to ensure the security, confidentiality, integrity, and the proper disposal of consumer information. The Privacy Rule limits a financial institution's disclosure of nonpublic personal information to unaffiliated third parties unless certain notice requirements are met and the consumer does not elect to prevent or "opt out" of the disclosure. The Privacy Rule also requires that privacy notices provided to customers and consumers describe the financial institutions' policies and practices to protect the confidentiality and security of the information. With respect to mortgage insurers, GLBA is enforced by the U.S. Federal Trade Commission, or FTC, and state insurance regulators. Many states have enacted legislation implementing GLBA and establishing information security regulation. Many states have enacted privacy and data security laws which impose compliance obligations beyond GLBA, including obligations to protect social security numbers and provide notification in the event that a security breach results in a reasonable belief that unauthorized persons may have obtained access to consumer nonpublic information.

GSE Qualified Mortgage Insurer Requirements. Pursuant to their charters, the GSEs purchase low down payment loans insured by MIs that they determine to be qualified. Fannie Mae and Freddie Mac have each published comprehensive requirements to become and remain a qualified mortgage insurer (the “Eligibility Requirements”). Both Fannie Mae and Freddie Mac are in the process of revising their Eligibility Requirements and issued new draft eligibility requirements in 2010. Freddie Mac issued further draft requirements in 2011. FHFA, regulator and conservator of the GSEs, has announced its intention to complete the revision process. We expect new requirements to include a substantially revised capital adequacy framework with minimum capital requirements.

Arch MI U.S. is currently approved by the GSEs as an eligible mortgage insurer. In addition to the Eligibility Requirements, the GSEs imposed conditions in connection with their approvals of Arch MI U.S. as a qualified mortgage insurer. These conditions require, among other things, that Arch MI U.S.:

- maintain, through December 31, 2016, minimum capital funding of $400 million which may consist of statutory capital (policyholders’ surplus plus contingency reserves) of no less than $200 million, dedicated reinsurance trust assets for any primary business reinsured and the value of purchased technology assets;
- maintain minimum statutory capital (defined as policyholders’ surplus plus contingency reserves) of no less than $260 million;
- maintain a risk-to-capital ratio of no greater than 18 to 1;
- refrain from paying dividends to affiliates for three years commencing February 2014;
- insure only (i) GSE-eligible loans, (ii) loans that are GSE-eligible, other than as related to loan amount, (iii) loans originated under a state housing finance agency program, (iv) loans that meet the requirements of a “Qualified Mortgage” under federal regulation, or (v) other loans not included in (i) through (iv) provided that such loans in aggregate not constitute more than 2% of Arch MI U.S.’s total outstanding risk in force with a coverage effective date on or after December 31, 2003;
- obtain prior written approval to enter into transactions involving the issuance of insurance on other than an individual loan “flow” basis;
- not enter into reinsurance or other risk share arrangements without prior written approval; and
- re-domicile from Wisconsin to another state if requested by Fannie Mae.

Arch MI U.S.’s GSE approvals include additional conditions with respect to affiliate expense sharing arrangements, requirements to obtain a financial strength rating, provision of ancillary services (i.e., non-insurance) to customers, changes of ownership, and provisions regarding underwriting policies and claims processing.

In 2013, the GSEs also mandated minimum standards for mortgage insurer master policies, including standards relating to limitations of a mortgage insurer's rescission rights. We have developed a new master policy that conforms to these minimum standards and expect that policy to be implemented in 2014, subject to approval by state insurance regulators.

State Insurance Regulation of Mortgage Insurers. Arch MI U.S. is subject to detailed regulation both by its domiciliary and primary regulator, the Wisconsin Office of the Commissioner of Insurance (“Wisconsin OCI”) and by state

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insurance departments in each state in which it is licensed. As mandated by state insurance laws, mortgage insurers are generally mono-line companies restricted to writing a single type of insurance business, such as mortgage insurance business. Arch MI U.S. is subject to Wisconsin statutory requirements as to payment of dividends. The maximum amount of dividends that Arch MI U.S. may pay in any 12-month period without regulatory approval by the Wisconsin OCI is the lesser of adjusted statutory net income or 10% of statutory policyholders' surplus as of the preceding calendar year end. Adjusted statutory net income is defined for this purpose to be the greater of:

- net income for the calendar year preceding the date of the dividend, minus realized capital gains for that calendar year; or
- aggregate net income for the 3 calendar years preceding the date of the dividend, less realized capital gains for those calendar years and less dividends paid or credited and distributions made within the first 2 of the preceding 3 calendar years.

Generally, Wisconsin law precludes any dividend before giving at least 30 days' notice to the Wisconsin OCI and prohibits paying any dividend unless it is fair and reasonable to do so. In addition to Wisconsin, the GSEs and other states limit or restrict Arch MI U.S.'s ability to pay stockholder dividends.

Mortgage insurance companies licensed in Wisconsin are required to establish contingency loss reserves for purposes of statutory accounting in an amount equal to at least 50% of net earned premiums. These amounts generally cannot be withdrawn for a period of 10 years. However, with prior regulatory approval, a mortgage insurance company may make early withdrawals from the contingency reserve when incurred losses exceed 35% of net premiums earned in a calendar year.

Under Wisconsin law, as well as that of 15 other states, a mortgage insurer must maintain a minimum amount of statutory capital relative to its risk in force in order for the mortgage insurer to continue to write new business. While formulations of minimum capital vary in certain jurisdictions, the most common measure applied allows for a maximum risk-to-capital ratio of 25 to 1. Wisconsin requires a mortgage insurer to maintain a "minimum policyholder position" calculated in accordance with regulations. Policyholders' position consists primarily of statutory policyholders' surplus plus the statutory contingency reserve. While the statutory contingency reserve is reported as a liability on the statutory balance sheet, for risk-to-capital ratio calculations, it is included as capital for purposes of statutory capital.

The NAIC has established a Mortgage Guaranty Insurance Working Group ("Working Group") to make recommendations to the NAIC's Financial Condition Committee regarding changes to the NAIC's Mortgage Guaranty Insurance Model Act. The Working Group has released a draft Model Act which includes proposed changes to minimum statutory capital requirements and changes to the extent to which, and period for which, mortgage insurers must establish and hold contingency reserves. If the NAIC revises the Model Act, some state legislatures are likely to enact and implement part or all of the revised provisions.

Mortgage insurance premium rates are also subject to review and approval by state regulators. Any increase in premium rates must be justified, generally on the basis of the insurer's loss and default experience, expenses and future trend analysis. Arch MI U.S. has approved premium rates for credit union originated mortgage loans in all 50 states and approved premium rates for mortgage banking originated mortgage loans in 48 states.

Legislative and Regulatory Proposals. From time to time various regulatory and legislative changes have been proposed in the insurance and reinsurance industry. Among the proposals that have in the past been or are at present being considered are the possible introduction of federal regulation in addition to, or in lieu of, the current system of state regulation of insurers and the NAIC. In addition, there are a variety of proposals being considered by various state legislatures. Two ongoing areas of work at the NAIC are model rules relating to corporate governance and consideration of enhanced methods of group supervision.

Since the GSEs were placed into the conservatorship of FHFA in 2008, there has been debate regarding the roles of the GSEs, the federal government and private capital in the U.S. housing finance system. The federal government currently plays a dominant role in the U.S. housing finance system through the GSEs and the FHA, VA and Ginnie Mae. There is broad policy consensus toward the need for private capital to play a larger role and government credit risk to be reduced. However, to date there has been a lack of consensus with regard to the specific changes necessary to return a larger role for private capital and reduce the role of government. The size, complexity and centrality of the

GSEs to the current housing

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finance system and the importance of housing to the economy make the transition to any new housing finance system difficult.

GSE and secondary market reform proposals put forward since 2008 include the nearly complete privatization and elimination of the role of the GSEs, recapitalization of the GSEs, and a number of alternatives that combine a federal role with private capital, some of which eliminate the GSEs and others of which envision an on-going role for the GSES. In February 2011, the U.S. Department of the Treasury released a proposal to reform the U.S. housing finance market. While Treasury's proposal did not provide a particular timeline for GSE reform, it included the substantial reduction of government's footprint in housing finance. With respect to long-term reform, Treasury's proposal outlined three options for a future housing finance system, each of which differs in both the structure and scale of the federal government's future role:

Option 1: Privatized system of housing finance with the federal government's role limited to providing assistance for narrowly targeted groups of borrowers, leaving the vast majority of the mortgage market to the private sector;

Option 2: Similar to Option 1, but with the ability for the federal government to scale up to a larger share of the market if private capital withdraws in times of financial stress; and

Option 3: Similar to Option 2, but with assistance to low- and moderate-income borrowers and with the federal government providing catastrophic reinsurance behind private capital for securities of a targeted range of mortgages.

In August 2013, President Obama issued a set of core principles for housing finance reform which endorsed Option 3 and intended to ensure widespread and consistent access to 30-year fixed rate mortgages while phasing out the role of the GSEs in the housing finance system. The Obama Administration also endorsed intermediate steps to transition to a new housing finance system, including reducing the government's credit risk exposure at the GSEs through: (i) a capital markets approach in which private investors take on the risk of the portfolio's first losses, and (ii) an insurance approach in which well capitalized and regulated private institutions insure a portfolio of mortgages against default and collect insurance premiums.

Several reform proposals have been and are currently being considered by Congress. On July 24, 2012, the House Financial Services Committee passed H.R. 2767, "The Protecting American Taxpayers and Homeowners Act of 2013" (the "PATH Act"), a comprehensive secondary market reform plan similar to Option 1 including a very limited risk-bearing role for government and winding down of the GSEs, as well as extensive reforms to the FHA. Legislation in the Senate is likely to be influenced by, among other things, proposed bipartisan legislation co-authored by Senators Bob Corker (R-TN) and Mark Warner (D-VA), titled S. 1217, "The Housing Finance Reform and Taxpayer Protection Act" (the "Corker-Warner Bill"). The Corker-Warner Bill sets a framework for GSE and secondary market reform that includes winding down the GSEs over a five year period and the creation of a new entity, the Federal Mortgage Insurance Corporation, or FMIC, as a successor to FHFA with responsibility for running a catastrophic government insurance fund for certain mortgage-backed securities and regulating the operation of the secondary market. Among its provisions, properly underwritten mortgages meeting certain conditions, including private mortgage insurance on loans with LTVs in excess of 80%, will be eligible to be securitized with the catastrophic government guarantee provided by FMIC. The prospects for passage of housing finance and GSE reform legislation remain uncertain in both the House and Senate.

New federal legislation could reduce the level of private mortgage insurance coverage used by the GSEs as credit enhancement, eliminate the GSE charter requirement altogether or otherwise alter or eliminate the role of the GSEs, and thereby materially affect Arch MI U.S.’s ability to compete and the demand for its products.

As the regulator and conservator of the GSEs, FHFA has the authority to establish the priorities of the GSEs and to control and direct their operations. FHFA has made changes to the business and operations of the GSEs, in part under the direction of an FHFA-developed strategic plan for the conservatorship of the GSEs. This strategic plan called for the contraction of the role of the GSEs and expansion of the role of private capital through a number of actions, including shrinking the portfolios of the GSEs, raising guaranty fees and consideration of expanded use of credit risk sharing with private market participants, including private mortgage insurance and capital markets. On January 6, 2014, U.S. Representative Melvin Watt was sworn in as Director of FHFA. It is unknown how or to what extent FHFA’s strategic plan for the GSEs will change under its new director.

Arch MI U.S. competes with the single-family mortgage insurance programs of FHA, which is part of HUD. Congress is considering legislation to reform FHA. In 2012, an FHA reform bill, H.R. 4264 "The FHA Emergency Fiscal

Solvency Act of 2012," passed the House of Representatives. In July 2013, the House Financial Services Committee passed the PATH Act, which contains among its provisions extensive reforms to FHA. Also in July 2013, the Senate Banking Committee passed the S. 1376 "The FHA Solvency Act of 2013." Despite areas of similarity, there are significant differences between the PATH Act and the FHA Solvency Act of 2013. The prospects for passage of FHA reform legislation in either the House or Senate, and how differences in proposed reforms between the House and Senate might be resolved in any final legislation, are uncertain. If FHA reform were to raise FHA premiums, tighten FHA credit guidelines, make other changes which make lender use of the FHA less attractive, or implement credit risk sharing between the FHA and private mortgage insurers, these changes may be beneficial to Arch MI U.S. However, there can be no assurance that any FHA reform legislation will be enacted into law, and what provisions may be contained in any final legislation, if any.

We are unable to predict whether any of these proposed laws and regulations will be adopted, the form in which any such laws and regulations would be adopted, or the effect, if any, these developments would have on our operations and financial condition. See "—U.S. Insurance Regulation—General."

Basel III. In 1988, the Basel Committee on Banking Supervision developed the Basel Capital Accord ("Basel I"), which set out international benchmarks for assessing banks' capital adequacy requirements. In 2005, the Basel Committee issued an update to Basel I ("Basel II"), which, among other things, governs the capital treatment of mortgage insurance purchased by domestic and international banks in respect of their origination and securitization activities. In November 2010, the U.S. agreed to a new capital framework known as Basel III. This new capital framework is replacing the Basel II capital rules, which have not yet been implemented for U.S. depository institutions or holding companies. The Basel III framework applies to the 10 to 12 largest U.S. banking organizations, as well as to banking companies. It may also be imposed on non-banking financial companies that are determined by the relevant regulators to present systemic risks to the U.S. financial system. The Basel III framework refines the Basel II risk-based structure by requiring the use of highly stressed scenarios in determining the appropriate levels of risk undertaken by banks, and it also increases the required minimum capital ratios. The Basel III framework restricts the instruments that can count toward meeting the capital requirements, placing greater emphasis on common equity and retained earnings. Finally, Basel III will impose a new minimum liquidity standard on banking organizations.

The phase in period for the Basel III regime for larger banking organizations began on January 1, 2014 and for community banks will begin on January 1, 2015. The final regulations increase the amount of capital and the quality of the capital required to be held by banks. In addition, the capital rules continue to risk-weight assets based on internal models that use inputs such as the probability of default and the bank's expected loss given a default. The final regulations continue the current risk weighting of residential mortgage assets and the treatment of mortgage insurance as reducing the risk weighting on mortgages where the borrower has made a down payment of less than 10% of the value of the residential property. Draft Basel III regulations proposed by the regulators in 2012 would have increased the risk weightings of residential mortgage assets and did not require that mortgage insurance be factored into the calculation of the risk weightings. In addition, the final regulations increase the risk weighting for mortgage servicing assets held by banks and require the mortgage servicing assets above certain levels be deducted from the calculation of Tier I equity. Since most low down payment mortgages originated today are either sold to the GSEs or insured by the FHA or guaranteed by the VA, we cannot predict what, if any, impact to the mortgage insurance industry the Basel III regulations will have. Since a significant percentage of the mortgages insured by the mortgage insurance industry are serviced by banks or bank-owned mortgage companies, the changes in risk weighting for mortgage servicing assets and the deductions from Tier I equity capital for mortgage servicing assets above certain levels could cause shifts in the amounts of mortgages serviced by banks and bank affiliates or subsidiaries relative to non-banking organizations. It is difficult to predict the impact these shifts may have on the quality of the servicing of insured mortgages or the ultimate impact on the mortgage insurance industry.

United Kingdom Insurance Regulation

General. The Financial Services Authority (the "FSA"), which on April 1, 2013 was replaced by the Prudential Regulatory Authority ("PRA") and the Financial Conduct Authority ("FCA"), regulated insurance and reinsurance companies and firms carrying on insurance mediation activities operating in the U.K. under the Financial Services and Markets Act 2000 (the "FSMA"). In May 2004, Arch Insurance Company Europe was licensed and authorized by the

FSA. It holds the relevant permissions for the classes of insurance business which it underwrites in the U.K. In 2009, AUAL was licensed and authorized by the FSA and the Lloyd's Franchise Board. AUAL holds the relevant permissions for the classes of insurance business which are underwritten in the U.K. by Arch Syndicate 2012. Arch Syndicate 2012 has one member, Arch Syndicate Investments Ltd. Arch Risk Partners was licensed and authorized by the FSA in February 2012 to conduct insurance mediation activities. All U.K. companies are also subject to a range of statutory provisions, including the laws and regulations of the Companies Acts 2006 (as amended) (the “U.K. Companies Acts”).

The primary statutory goals of the FSA were to maintain and promote confidence in the U.K. financial system, secure the appropriate degree of protection for consumers and reduce financial crime. The FSA regulatory regime imposed risk management, solvency and capital requirements on U.K. insurance companies. The FSA had broad authority to supervise and regulate insurance companies and firms carrying on insurance mediation which extended to enforcement of the provisions of the FSMA and intervention in the operations of an insurance company. The FSA regime was based on principles from which all of its rules and guidance derived. Among these principles, the FSA increasingly emphasized a “culture of compliance” in those firms it regulated. The FSA carried out regular Advanced Risk Responsive Operating Framework (“ARROW”) assessments of regulated firms to ensure compliance with its rules and guidance. The FSA conducted risk assessments of Arch Insurance Company Europe in 2006 and 2008 and of Arch Insurance Company Europe and AUAL in 2011. The assessments provided the FSA’s views on Arch Insurance Company Europe’s and AUAL’s risk profile and regulatory capital requirements. In some cases, the FSA could have required remedial action or adjustments to a company’s management, operations, capital requirements, claims management or business plan.

The objectives of the PRA are to promote the safety and soundness of all firms it supervises and to secure an appropriate degree of protection for policyholders. The objectives of the FCA are to ensure customers receive financial services and products that meet their needs, to promote sound financial systems and markets and to ensure that firms are stable and resilient with transparent pricing information and which compete effectively and have the interests of their customers and the integrity of the market at the heart of how they run their business. The responsibilities of the FSA were split so that the PRA assumed responsibility for prudential regulation of banks and insurers, while the FCA assumed responsibility for the conduct of business regulation in the wholesale and retail markets. The ARROW assessment has been replaced, and the PRA and FCA adopted separate methods of assessing regulated firms. Arch Insurance Company Europe and AUAL are subject to regulation by both the PRA and FCA. Arch Risk Partners is subject to regulation by the FCA only.

Lloyd’s Supervision. The operations of AUAL and related Arch Syndicate 2012 and its corporate member, Arch Syndicate Investments Ltd (“ASIL”), are subject to the byelaws and regulations made by (or on behalf of) the Council of Lloyd’s, and requirements made under those byelaws. The Council of Lloyd’s, established in 1982 by Lloyd’s Act 1982, has overall responsibility and control of Lloyd’s. Those byelaws, regulations and requirements provide a framework for the regulation of the Lloyd’s market, including specifying conditions in relation to underwriting and claims operations of Lloyd’s participants. Lloyd’s is also subject to the provisions of the FSMA and was itself authorized and regulated as an insurer by the FSA. As of April 1, 2013, Lloyd's is authorized by the PRA and regulated by the PRA and FCA. Those entities acting within the Lloyd’s market are required to comply with the requirements of the FSMA and provisions of the PRA’s or FCA's rules, although the PRA has delegated certain of its powers, including some of those relating to prudential requirements, to Lloyd’s. ASIL, as a member of Lloyd’s, is required to contribute 0.5% of Arch Syndicate 2012’s premium income limit for each year of account to the Lloyd’s central fund. The Lloyd’s central fund is available if members of Lloyd’s assets are not sufficient to meet claims for which the member is liable. As a member of Lloyd’s, ASIL may also be required to contribute to the central fund by way of a supplement to a callable layer of up to 3% of Arch Syndicate 2012’s premium income limit for the relevant year of account. In addition, AUAL, on behalf of Arch Syndicate 2012, is approved to underwrite excess and surplus lines insurance in most states in the U.S. through Lloyd’s licenses. Such activities must be in compliance with the Lloyd’s requirements.

Financial Resources. Arch Insurance Company Europe, AUAL (on behalf of itself, Arch Syndicate 2012 and ASIL) and Arch Risk Partners were each required to demonstrate to the FSA that each had adequate financial assets to meet the financial resources requirement for its category. However, since the FSA split into the PRA and FCA, Arch Insurance Company Europe and AUAL (on behalf of itself, Arch Syndicate 2012 and ASIL) are now each be required to demonstrate the adequacy of its financial assets to the PRA, while Arch Risk Partners is required to demonstrate the adequacy of its financial assets to the FCA. On a periodic basis, Arch Insurance Europe was required to provide the FSA and Lloyd’s with its own risk-based assessment of its capital needs, taking into account comprehensive risk factors, including market, credit, operational, liquidity and group risks to generate a revised calculation of its expected liabilities which, in turn, enabled the FSA and Lloyd’s to provide individual capital guidance and requirements to Arch Insurance Europe. Following the split of the FSA into the PRA and FCA, similar requirements from the PRA have taken effect. Arch Insurance Europe’s surplus is above the risk-based capital threshold allowed by the FSA’s (now PRA's) individual capital assessment of Arch Insurance Europe. The FSA required, and now the PRA requires, that Arch Insurance Europe maintain a margin of solvency calculation based on the classes of business for which it is authorized and within its premium income projections applied to its worldwide general business.

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Reporting Requirements. Like all U.K. companies, Arch Insurance Europe and Arch Risk Partners must file and submit their annual audited financial statements in accordance with IFRS and related reports to the Registrar of Companies under the U.K. Companies Acts together with an annual return of certain core corporate information and changes from the prior year. This requirement is in addition to the regulatory returns required to be filed annually with the FSA (now the PRA or the FCA, as applicable) for Arch Insurance Company Europe, AUAL and Arch Risk Partners and, in the case of AUAL and ASIL, Lloyd’s.

Financial Services Compensation Scheme. The Financial Services Compensation Scheme (“FSCS”) is a scheme established under FSMA to compensate eligible policyholders of insurance companies who may become insolvent. FSCS is funded by levies it has the power to impose on all insurers. Arch Insurance Europe and/or Arch Risk Partners could be required to pay levies to FSCS.

Restrictions on Acquisition of Control. Under FSMA, the prior consent of the FSA was required, and now the PRA or FCA, as applicable, is required, before any person can become a controller or increase its control over any regulated company, including Arch Insurance Company Europe, AUAL and Arch Risk Partners, or over the parent undertaking of any regulated company. Therefore, the FSA’s prior consent was required, and now the PRA's or FCA's prior consent, as applicable, is required before any person can become a controller of ACGL. Prior consent is also required from Lloyd’s before any person can become a controller or increase its control over a corporate member or a managing agent or a parent undertaking of a corporate member or managing agent. A controller is defined for these purposes as a person who holds (either alone or in concert with others) 10% or more of the shares or voting power in the relevant company or its parent undertaking.

Restrictions on Payment of Dividends. Under English law, all companies are restricted from declaring a dividend to their shareholders unless they have “profits available for distribution.” The calculation as to whether a company has sufficient profits is based on its accumulated realized profits minus its accumulated realized losses. U.K. insurance regulatory laws do not prohibit the payment of dividends, but the FSA required, and now the PRA or FCA, as applicable, requires that insurance companies and insurance intermediaries maintain certain solvency margins and may restrict the payment of a dividend by Arch Insurance Company Europe, AUAL, ASIL or Arch Risk Partners. See “Management’s Discussion and Analysis of Financial Condition and Results of Operations—Financial Condition, Liquidity and Capital Resources— Liquidity and Capital Resources” and note 20, “Statutory Information,” of the notes accompanying our financial statements.

European Union Considerations. Through their respective authorizations in the U.K., a Member State of the European Union (“EU”), Arch Insurance Company Europe’s, AUAL’s and Arch Risk Partners’ authorizations are recognized throughout the European Economic Area (“EEA”), subject only to certain notification and application requirements. This authorization enables Arch Insurance Company Europe, AUAL and Arch Risk Partners to establish a branch in any other Member State of the EU, where such entity will be subject to the insurance regulations of each such Member State with respect to the conduct of its business in such Member State, but remain subject only to the financial and operational supervision by the FSA. The framework for the establishment of branches in Member States of the EU other than the U.K. was generally set forth, and remains subject to, directives adopted by the European Council, the legislative body of the EU, which directives are then implemented in each Member State. Arch Insurance Company Europe currently has branches in Denmark, Germany, Italy, Spain and Sweden and may establish branches in other Member States of the EU in the future. Further, through its authorizations in an EU Member State, Arch Risk Partners, Arch Insurance Company Europe and AUAL have the freedom to provide insurance services anywhere in the EEA subject to compliance with certain rules governing such provision, including notification to the FSA (now the PRA or FCA, as applicable).

On November 25, 2009, the EU adopted a new directive directed at insurance and reinsurance companies known as Solvency II. Solvency II is a new regulatory regime which will impose economic risk-based solvency requirements across all EU Member States and consists of three pillars: (1) Pillar I—quantitative capital requirements, based on a valuation of the entire balance sheet; (2) Pillar II—qualitative regulatory review, which includes governance, internal controls, enterprise risk management and supervisory review process; and (3) Pillar III—market discipline, which is accomplished through reporting of the insurer’s financial condition to regulators and the public. Secondary legislation under Solvency II is currently being discussed by the European Parliament and Council and by the European

Commission, and the directive will then have to be implemented in the U.K. by the U.K. Government, the PRA and the FCA (and in all other EU jurisdictions by their respective governments and insurance supervisors). The Solvency II directive is currently due to be transposed into national law by EU Member States on March 31, 2015 and due to apply to firms as of January 1, 2016. In the meantime, and as a result of the delays in enacting the so-called Omnibus II Directive (a directive intended to amend in

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part the existing solvency regime), the European Insurance and Occupational Pensions Authority ("EIOPA") has published guidelines ("EIOPA Guidelines") on the interim measures national supervisors should be taking before Solvency II comes into force, with such measures to be implemented through phasing-in provisions as of January 1, 2014. Arch Insurance Company Europe, AUAL and Syndicate 2012 will be required to comply with Solvency II requirements.

Canada Insurance Regulation

Arch Insurance Canada, which commenced underwriting on January 1, 2013, is subject to federal, as well as provincial and territorial, regulation in Canada. The Office of the Superintendent of Financial Institutions ("OSFI") is the federal regulatory body that, under the Insurance Companies Act (Canada), regulates federal Canadian and non-Canadian insurance companies operating in Canada. The primary goal of OSFI is to supervise the safety and soundness of insurance companies with the aim of securing the appropriate level of protection of insureds by imposing risk management, solvency and capital requirements on such companies. Arch Insurance Canada is subject to regulation in the provinces and territories in which it underwrites insurance, and the primary goal of insurance regulation at the provincial and territorial levels is to govern the market conduct of insurance companies. Arch Insurance Canada is licensed to carry on insurance business by OSFI and in each province and territory.

Under the Insurance Companies Act (Canada), Arch Insurance Canada is required to maintain an adequate amount of capital in Canada, calculated in accordance with a test promulgated by OSFI called the Minimum Capital Test ("MCT"). Arch Insurance Canada is required to file financial information with OSFI on an ongoing basis, including annual audited financial statements in accordance with IFRS. The appointed actuary of our Canadian operations must report annually on the adequacy of their reserves. OSFI's continuing supervision includes analysis of this information and periodic examinations of Arch Insurance Canada. OSFI has implemented a risk-based methodology for assessing insurance companies operating in Canada known as its "Supervisory Framework." In applying the Supervisory Framework, OSFI considers the inherent risks of the business and the quality of risk management for each significant activity of operating entity.

Ireland Insurance and Reinsurance Regulation

General. The Central Bank of Ireland ("CBOI") regulates insurance and reinsurance companies authorized in Ireland. We have two Irish operating subsidiaries: Arch Re Europe and Arch MI Europe. Arch Re Europe was licensed and authorized by the CBOI as a non-life reinsurer in October 2008 and as a life reinsurer in November 2009. Arch MI Europe was licensed and authorized by the CBOI as a non-life insurer in December 2011.

Both Arch Re Europe and Arch MI Europe are subject to the regulation and supervision of the CBOI. Arch Re Europe must comply with the European Communities (Reinsurance) Regulations, 2006, rules made thereunder and, insofar as relevant to reinsurance, the Irish Insurance Acts 1909 to 2009, regulations promulgated there under, regulations relating to reinsurance business promulgated under the European Communities Act 1972, the Irish Central Bank Acts 1942 to 2013 as amended, regulations promulgated there under and directions, guidelines and codes of conduct issued by the CBOI, including from January 1, 2014, the CBOI Guidelines of Preparing for Solvency II issued by EIOPA on September 27, 2013. Irish authorized reinsurers, such as Arch Re Europe, are also subject to the general body of Irish laws and regulations including the provisions of the Companies Acts 1963-2013. Arch MI Europe must comply with the Irish Insurance Acts 1909 to 2009, regulations promulgated thereunder, regulations relating to insurance business promulgated under the European Communities Act 1972, the Irish Central Bank Acts 1942 to 2013, as amended, regulations promulgated thereunder and directions and guidelines and codes of conduct issued by the CBOI, including from January 1, 2014, the CBOI Guidelines of Preparing for Solvency II.

Financial Resources. Both Arch Re Europe and Arch MI Europe are required to maintain reserves, particularly in respect of underwriting liabilities and a solvency margin as provided for in the Irish insurance acts and regulations mentioned above. Arch Re Europe must maintain assets constituting statutory reserves which must comply with principles including obligations to secure sufficiency, liquidity, security, quality, profitability and currency matching of investments. An appointed actuary must opine on the adequacy of the statutory reserves of both Arch Re Europe and Arch MI Europe annually.

Reporting Requirements. Like most Irish companies, Arch Re Europe and Arch MI Europe must file and submit their annual audited financial statements in accordance with Irish generally accepted accounting principles and related reports to the Registrar of Companies ("Registrar") under the Companies Acts 1963-2013 together with an annual return of certain core corporate information. Changes to core corporate information during the year must also be notified to the Registrar. These requirements are in addition to the regulatory returns required to be filed annually with the CBOI.

Restrictions on Payment of Dividends. Under Irish company law, Arch Re Europe and Arch MI Europe are permitted to make distributions only out of profits available for distribution. A company's profits available for distribution are its accumulated, realized profits, so far as not previously utilized by distribution or capitalization, less its accumulated, realized losses, so far as not previously written off in a reduction or reorganization of capital duly made. Further, the CBOI has powers to intervene if a dividend payment were to lead to a breach of regulatory capital requirements. See "Management's Discussion and Analysis of Financial Condition and Results of Operations—Financial Condition, Liquidity and Capital Resources—Liquidity and Capital Resources" and note 20, "Statutory Information," of the notes accompanying our financial statements.

European Union Considerations. As a reinsurance company authorized in Ireland, a Member State of the EU, Arch Re Europe's authorization is recognized throughout the EEA, subject only to any notification requirements imposed by other EU Member States. This authorization enables Arch Re Europe to provide reinsurance services, or to establish a branch, in any other Member State of the EEA. Although, in doing so, it may be subject to the laws of such Member States with respect to the conduct of its business in such Member State, company law registrations and other matters, it will remain subject to financial and operational supervision by the CBOI only. Arch Re Europe has a branch in Denmark, Arch Re Accident & Health ApS ("Arch Re Denmark"), which is an underwriting agency underwriting accident and health business for Arch Re Europe. Arch Re Europe also has a branch in the U.K., which underwrites non-life reinsurance risk for Arch Re Europe. Finally, Arch Re Europe also has a branch outside the EEA, Arch Reinsurance Europe Underwriting Limited, Dublin (Ireland), Zurich Branch ("Arch Re Europe Swiss Branch").

As an insurance company authorized in Ireland, a Member State of the EU, Arch MI Europe's authorization is recognized throughout the EEA, subject to certain notifications requirements imposed under the European Directives and there being no objection from the CBOI and the Member States concerned, and it may establish branches and provide insurance services in all EEA Member States.

Switzerland Reinsurance Regulation

In November 2006, Arch Re Bermuda opened Arch Reinsurance Ltd., Hamilton (Bermuda), European Branch Zurich ("Arch Re Bermuda Swiss Branch"). In December 2008, Arch Re Europe opened Arch Re Europe Swiss Branch as a branch office. Upon the opening of this branch in the fourth quarter of 2008, the operations of Arch Re Bermuda Swiss Branch were transferred to Arch Re Europe Swiss Branch. Arch Re Bermuda Swiss Branch was formally de-registered from the commercial register of the Canton of Zurich in early 2009. As both Arch Re Europe and Arch Re Bermuda are domiciled outside of Switzerland and their activities were and are limited to reinsurance, their respective branches in Switzerland were and are not required to be licensed by the Swiss insurance regulatory authorities.

European Union Insurance and Reinsurance Regulation

The single system established in the EU for regulation and supervision of the general insurance sector and its single passport regime had until 2007 applied only to direct insurance, and there was no common regulation of reinsurance in the EU. However, direct insurers established in a Member State of the EEA who were also authorized by their domestic regulatory authorities to transact reinsurance have had freedom to establish branches in and provide insurance services to all EEA states and that freedom has in practice been extended to their reinsurance activities. In December 2005, the EU published the Reinsurance Directive (the "Directive") as a first step in harmonization of reinsurance regulation in the single market. Member States of the EU and the EEA were required to implement the Directive by December 2007. Pure reinsurers established in a Member State of the EU now have freedom to establish branches in and provide services to all EEA states under a regime comparable to that enjoyed by direct insurers, and they will be subject to similar rules in relation to licensing and financial supervision.

Arch Insurance Company Europe, AUAL and Arch Risk Partners, being established in the U.K. and authorized by the FSA (now the PRA and FCA), are able, subject to regulatory notifications and there being no objection from the relevant U.K. regulator, and the Member States concerned, to establish branches and provide insurance and reinsurance services in all EEA Member States. Arch Re Europe, being established in Ireland and authorized by the CBOI to write reinsurance, is able, subject to similar regulatory notifications and there being no objection from the

CBOI and the Member States concerned, to establish branches and provide reinsurance services in those EEA states which have implemented the

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Directive. The Directive itself does not prohibit EEA insurers from obtaining reinsurance from reinsurers licensed outside the EEA, such as Arch Re Bermuda. As such, and subject to the specific rules in particular Member States, Arch Re Bermuda may do business from Bermuda with insurers in EEA Member States, but it may not directly operate its reinsurance business within the EEA. Unless agreement is reached between the European Commission and Bermuda to accord Bermuda based reinsurers with market access on the basis of the equivalent nature of Bermuda regulation, each individual EEA Member State may impose conditions on reinsurance provided by Bermuda based reinsurers which could restrict their future provision of reinsurance to the EEA Member State concerned. A number of EEA Member States currently restrict the extent to which Bermudian reinsurers may promote their services in those Member States, and a few have certain prohibitions on the purchase of insurance from reinsurers not authorized in the EEA. The Directive is scheduled to be repealed and replaced by new provisions under Solvency II on January 1, 2016. However, this may change depending on whether the implementation date for Solvency II is extended again from January 1, 2016.

Article 172 of Solvency II will, when it comes into force, provide that reinsurance contracts concluded by insurance undertakings in the EEA with reinsurers having their head office in a country whose solvency regime has been determined to be equivalent to Solvency II shall be treated in the same manner as reinsurance contracts with undertakings in the EEA authorized under Solvency II. The European Commission is considering whether the solvency regime in Bermuda is equivalent to that laid down in Solvency II. In October 2011, EIOPA, which is established under European Law as an independent advisory body to the European Parliament, the European Council and the European Commission and specifically to assist in preparing equivalence decisions, advised that Bermuda meets the criteria set out in EIOPA’s methodology for equivalence assessments under Solvency II subject to certain caveats set out in EIOPA’s report. EIOPA will revisit its assessment of the equivalence of the solvency regime in Bermuda when implementation measures for Solvency II have been agreed.

On September 27, 2013, EIOPA published the EIOPA Guidelines, which are intended to ensure that national EEA supervisors, insurance and reinsurance companies and groups take active steps towards implementing key areas of Solvency II in a consistent and convergent way. The EIOPA Guidelines, which are addressed to national EEA supervisors and require local implementation, are applicable on a phased basis from January 1, 2014 and cover the Solvency II areas of systems of governance, forward-looking assessment of “own risks,” submission of information to national supervisors and pre-application of internal models.

TAX MATTERS

The following summary of the taxation of ACGL and the taxation of our shareholders is based upon current law and is for general information only. Legislative, judicial or administrative changes may be forthcoming that could affect this summary.

The following legal discussion (including and subject to the matters and qualifications set forth in such summary) of certain tax considerations (a) under “—Taxation of ACGL—Bermuda” and “—Taxation of Shareholders—Bermuda Taxation” based upon the advice of Conyers Dill & Pearman Limited, Hamilton, Bermuda and (b) under “—Taxation of ACGL—United States,” “—Taxation of Shareholders—United States Taxation,” “—Taxation of Our U.S. Shareholders” and “ States Taxation of Non-U.S. Shareholders” is based upon the advice of Cahill Gordon & Reindel LLP, New York, New York (the advice of such firms does not include accounting matters, determinations or conclusions relating to the business or activities of ACGL). The summary is based upon current law and is for general information only. The tax treatment of a holder of our shares (common shares or series C non-cumulative preferred shares), or of a person treated as a holder of our shares for U.S. federal income, state, local or non-U.S. tax purposes, may vary depending on the holder’s particular tax situation. Legislative, judicial or administrative changes or interpretations may be forthcoming that could be retroactive and could affect the tax consequences to us or to holders of our shares.

Taxation of ACGL

Bermuda

Under current Bermuda law, ACGL is not subject to tax on income or profits, withholding, capital gains or capital transfers. ACGL has obtained from the Minister of Finance under the Exempted Undertakings Tax Protection Act 1966 an assurance that, in the event that Bermuda enacts legislation imposing tax computed on profits, income, any capital asset, gain or appreciation, or any tax in the nature of estate duty or inheritance, the imposition of any such tax shall not be applicable to ACGL or to any of our operations or our shares, debentures or other obligations until March 31, 2035. We

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could be subject to taxes in Bermuda after that date. This assurance will be subject to the proviso that it is not to be construed so as to prevent the application of any tax or duty to such persons as are ordinarily resident in Bermuda (we are not so currently affected) or to prevent the application of any tax payable in accordance with the provisions of the Land Tax Act 1967 or otherwise payable in relation to any property leased to us or our insurance subsidiary. We pay annual Bermuda government fees, and our Bermuda insurance and reinsurance subsidiary pays annual insurance license fees. In addition, all entities employing individuals in Bermuda are required to pay a payroll tax and other sundry taxes payable, directly or indirectly, to the Bermuda government.

United States

ACGL and its non-U.S. subsidiaries intend to conduct their operations in a manner that will not cause them to be treated as engaged in a trade or business in the United States and, therefore, will not be required to pay U.S. federal income taxes (other than U.S. excise taxes on insurance and reinsurance premium and withholding taxes on dividends and certain other U.S. source investment income). However, because definitive identification of activities which constitute being engaged in a trade or business in the U.S. is not provided by the Internal Revenue Code of 1986, as amended (the "Code"), or regulations or court decisions, there can be no assurance that the U.S. Internal Revenue Service will not contend successfully that ACGL or its non-U.S. subsidiaries are or have been engaged in a trade or business in the United States. A foreign corporation deemed to be so engaged would be subject to U.S. income tax, as well as the branch profits tax, on its income, which is treated as effectively connected with the conduct of that trade or business unless the corporation is entitled to relief under the permanent establishment provisions of a tax treaty. Such income tax, if imposed, would be based on effectively connected income computed in a manner generally analogous to that applied to the income of a domestic corporation, except that deductions and credits generally are not permitted unless the foreign corporation has timely filed a U.S. federal income tax return in accordance with applicable regulations. Penalties may be assessed for failure to file tax returns. The 30% branch profits tax is imposed on net income after subtracting the regular corporate tax and making certain other adjustments.

Under the income tax treaty between Bermuda and the United States (the "Treaty"), ACGL's Bermuda insurance subsidiaries will be subject to U.S. income tax on any insurance premium income found to be effectively connected with a U.S. trade or business only if that trade or business is conducted through a permanent establishment in the United States. No regulations interpreting the Treaty have been issued. While there can be no assurances, ACGL does not believe that any of its Bermuda insurance subsidiaries has a permanent establishment in the United States. Such subsidiaries would not be entitled to the benefits of the Treaty if (i) less than 50% of ACGL's shares were beneficially owned, directly or indirectly, by Bermuda residents or U.S. citizens or residents, or (ii) any such subsidiary's income were used in substantial part to make disproportionate distributions to, or to meet certain liabilities to, persons who are not Bermuda residents or U.S. citizens or residents. While there can be no assurances, ACGL believes that its Bermuda insurance subsidiaries are eligible for Treaty benefits.

The Treaty clearly applies to premium income, but may be construed as not protecting investment income. If ACGL’s Bermuda insurance subsidiaries were considered to be engaged in a U.S. trade or business and were entitled to the benefits of the Treaty in general, but the Treaty were not found to protect investment income, a portion of such subsidiaries’ investment income could be subject to U.S. federal income tax.

Non-U.S. insurance companies carrying on an insurance business within the United States have a certain minimum amount of effectively connected net investment income, determined in accordance with a formula that depends, in part, on the amount of U.S. risk insured or reinsured by such companies. If any of ACGL's non-U.S. insurance subsidiaries is considered to be engaged in the conduct of an insurance business in the United States, a significant portion of such company's investment income could be subject to U.S. income tax.

Non-U.S. corporations not engaged in a trade or business in the United States are nonetheless subject to U.S. income tax on certain "fixed or determinable annual or periodic gains, profits and income" derived from sources within the United States as enumerated in Section 881(a) of the Code (such as dividends and certain interest on investments), subject to exemption under the Code or reduction by applicable treaties.

The United States also imposes an excise tax on insurance and reinsurance premiums paid to non-U.S. insurers or reinsurers with respect to risks located in the United States. The rates of tax, unless reduced by an applicable U.S. tax treaty, are 4% for non-life insurance premiums and 1% for life insurance and all reinsurance premiums.

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United Kingdom

Our U.K. subsidiaries are companies incorporated and have their central management and control in the U.K., and are therefore resident in the U.K. for corporation tax purposes. As a result, they will be subject to U.K. corporate tax on their respective worldwide profits. The main rate of U.K. corporation tax for the financial year starting April 1, 2013 is 23% on profits, but progressive decreases in the rate have been announced to take effect on April 1, 2014 through 2015 from 21% to 20%.

Canada

In January 2005, Arch Insurance received its federal license to commence underwriting in Canada and began writing business in the first quarter of 2005 through its branch operation. Effective January 1, 2013, the branch operation was domesticated into Arch Insurance Canada, a Canadian federal insurance company subsidiary of Arch Insurance. Arch Insurance Canada is taxed on its worldwide income. The general federal corporate income tax rate in Canada is currently 15%. Provincial and territorial corporate income tax rates are added to the general federal corporate income tax rate and generally vary between 10% and 16%.

Ireland

Arch Re Europe was licensed and authorized by the CBOI as a non-life reinsurer in October 2008 and as a life reinsurer in November 2009. Arch MI Europe was licensed and authorized by the CBOI as a non-life insurer in 2011. Each of Arch Re Europe and Arch MI Europe is incorporated and resident in Ireland for corporation tax purposes and will be subject to Irish corporate tax on its worldwide profits, including the profits of Arch Re Europe Swiss Branch and its U.K. branch. Any creditable foreign tax (i.e., Swiss or U.K.) payable will be creditable against Arch Re Europe's Irish corporate tax liability on the results of Arch Re Europe's Swiss and U.K. branches. The current rate of Irish corporation tax applicable to such profits is 12.5%.

Switzerland

Arch Re Europe Swiss Branch is subject to Swiss corporation tax on the profit which is allocated to the branch. The effective tax rate is approximately 21.17% for Swiss federal, cantonal and communal corporation taxes on the profit. The effective tax rate of the annual cantonal and communal capital taxes on the equity which is allocated to Arch Re Europe Swiss Branch is approximately 0.172%.

Denmark

Arch Re Denmark, established as a subsidiary of Arch Re Bermuda, is subject to Danish corporation taxes on its profits at a rate of 25% for 2013 and the preceding years. For 2014, the corporate tax rate has been reduced to 24.5%, for 2015 to 23.5% and for 2016 and onwards to 22%.

Taxation of Shareholders

The following summary sets forth certain United States federal income tax considerations related to the purchase, ownership and disposition of our common shares and our series C non-cumulative preferred shares ("preferred shares"). Unless otherwise stated, this summary deals only with shareholders ("U.S. Holders") that are United States Persons (as defined below) who hold their common shares and preferred shares as capital assets and as beneficial owners. The following discussion is only a general summary of the United States federal income tax matters described herein and does not purport to address all of the United States federal income tax consequences that may be relevant to a particular shareholder in light of such shareholder's specific circumstances. In addition, the following summary does not describe the United States federal income tax consequences that may be relevant to certain types of shareholders, such as banks, insurance companies, regulated investment companies, real estate investment trusts, financial asset securitization investment trusts, dealers in securities or traders that adopt a mark-to-market method of tax accounting, tax exempt organizations, expatriates or persons who hold the common shares or preferred shares as part of a hedging or conversion transaction or as part of a straddle, who may be subject to special rules or treatment under the Code. This discussion is based upon the Code, the Treasury regulations promulgated there under and any relevant administrative rulings or pronouncements or judicial decisions, all as in effect on the date of this annual report and as currently interpreted, and does not take into account possible changes in such tax laws or interpretations thereof, which may apply retroactively. This discussion does not include any description of the tax laws of any state or local governments within the United States, or of

any foreign government, that may be applicable to our common shares or preferred shares or the shareholders. Persons considering making an investment in the common shares or preferred shares should consult their own tax advisors concerning the application of the United States federal tax laws to their particular situations as well as any tax consequences arising under the laws of any state, local or foreign taxing jurisdiction prior to making such investment.
If a partnership holds our common shares or preferred shares, the tax treatment of a partner will generally depend upon the status of the partner and the activities of the partnership. If you are a partner of a partnership holding our common shares or preferred shares, you should consult your tax advisor.
For purposes of this discussion, the term "United States Person" means:

- a citizen or resident of the United States,
- a corporation or entity treated as a corporation created or organized in or under the laws of the United States, any state thereof, or the District of Columbia,
- an estate the income of which is subject to United States federal income taxation regardless of its source,
- a trust if either (x) a court within the United States is able to exercise primary supervision over the administration of such trust and one or more United States persons have the authority to control all substantial decisions of such trust or (y) the trust has a valid election in effect to be treated as a United States person for U.S. federal income tax purposes or
- any other person or entity that is treated for U.S. federal income tax purposes as if it were one of the foregoing.

Bermuda Taxation
Currently, there is no Bermuda withholding tax on dividends paid by us.
United States Taxation
Taxation of Dividends. The preferred shares should be properly classified as equity rather than debt for U.S. federal income tax purposes. Subject to the discussions below relating to the potential application of the CFC, "related person insurance income" ("RPII") and PFIC rules, as defined below, cash distributions, if any, made with respect to our common shares or preferred shares will constitute dividends for U.S. federal income tax purposes to the extent paid out of our current or accumulated earnings and profits (as computed using U.S. tax principles). If a U.S. Holder of our common shares or our preferred shares is an individual or other non-corporate holder, dividends paid, if any, to that holder that constitute qualified dividend income will be taxable at the rate applicable for long-term capital gains (generally up to 20%), provided that such person meets a holding period requirement. Generally in order to meet the holding period requirement, the United States Person must hold the common shares for more than 60 days during the 121-day period beginning 60 days before the ex-dividend date and must hold preferred shares for more than 90 days during the 181-day period beginning 90 days before the ex-dividend date. Dividends paid, if any, with respect to common shares or preferred shares generally will be qualified dividend income, provided the common shares or preferred shares are readily tradable on an established securities market in the U.S. in the year in which the shareholder receives the dividend (which should be the case for shares that are listed on the NASDAQ Stock Market or the New York Stock Exchange) and ACGL is not considered to be a passive foreign investment company in either the year of the distribution or the preceding taxable year. No assurance can be given that the preferred shares will be considered readily tradable on an established securities market in the United States. See "—Taxation of Our U.S. Shareholders" below.
A U.S. Holder that is an individual, estate or a trust that does not fall into a special class of trusts that is exempt from such tax, will be subject to a 3.8% tax on the lesser of (1) the U.S. Holder's "net investment income" for the relevant taxable year and (2) the excess of the U.S. Holder's modified adjusted gross income for the taxable year over a certain threshold (which in the case of individual will be between $125,000 and $250,000, depending on the individual's circumstances). A U.S. Holder's net investment income will generally include its dividend income and its net gains from the disposition of our common shares and preferred shares, unless such dividend income or net gains are derived in the ordinary course of the conduct of a trade or business (other than a trade or business that consists of certain passive or trading activities).
Distributions with respect to the common shares and the preferred shares will not be eligible for the dividends received deduction allowed to U.S. corporations under the Code. To the extent distributions on our common shares and

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preferred shares exceed our earnings and profits, they will be treated first as a return of the U.S. Holder's basis in our common shares and our preferred shares to the extent thereof, and then as gain from the sale of a capital asset.

Sale, Exchange or Other Disposition. Subject to the discussions below relating to the potential application of the CFC, RPII and PFIC rules, holders of common shares and preferred shares generally will recognize capital gain or loss for U.S. federal income tax purposes on the sale, exchange or disposition of common shares or preferred shares, as applicable.

Redemption of Preferred Shares. A redemption of the preferred shares will be treated under section 302 of the Code as a dividend if we have sufficient earnings and profits, unless the redemption satisfies one of the tests set forth in section 302(b) of the Code enabling the redemption to be treated as a sale or exchange, subject to the discussion herein relating to the potential application of the CFC, RPII and PFIC rules. Under the relevant Code section 302(b) tests, the redemption should be treated as a sale or exchange only if it (1) is substantially disproportionate, (2) constitutes a complete termination of the holder's stock interest in us or (3) is "not essentially equivalent to a dividend." In determining whether any of these tests are met, shares considered to be owned by the holder by reason of certain constructive ownership rules set forth in the Code, as well as shares actually owned, must generally be taken into account. It may be more difficult for a United States Person who owns, actually or constructively by operation of the attribution rules, any of our other shares to satisfy any of the above requirements. The determination as to whether any of the alternative tests of section 302(b) of the Code is satisfied with respect to a particular holder of the preference shares depends on the facts and circumstances as of the time the determination is made.

Taxation of Our U.S. Shareholders

Controlled Foreign Corporation Rules

Under our bye-laws, the 9.9% voting restriction applicable to the Controlled Shares of a U.S. Person (as defined in our bye-laws) generally does not apply to certain of our investors. Depending upon the ownership of these investors and as a result of certain attribution rules, we and our foreign subsidiaries could be controlled foreign corporations (“CFCs”). That status as a CFC would not cause us or any of our subsidiaries to be subject to U.S. federal income tax. Such status also would have no adverse U.S. federal income tax consequences for any U.S. Holder that is considered to own less than 10% of the total combined voting power of our shares or those of our foreign subsidiaries. Only U.S. Holders that are considered to own 10% or more of the total combined voting power of our shares or those of our foreign subsidiaries (taking into account shares actually owned by such U.S. Holder as well as shares attributed to such U.S. Holder under the Code or the regulations there under) (a “10% U.S. Voting Shareholder”) would be affected by our status as a CFC. The preferred shares generally should not be considered voting stock for purposes of determining whether a United States Person would be a "10% U.S. Voting Shareholder." The shares may, however, become entitled to vote (as a class along with any other class of preferred shares of ACGL then outstanding) for the election of two additional members of the board of directors of ACGL if ACGL does not declare and pay dividends for the equivalent of six or more dividend periods. In such case, the preferred shares should be treated as voting stock for as long as such voting rights continue. Our bye-laws are intended to prevent any U.S. Holder from being considered a 10% U.S. Voting Shareholder by limiting the votes conferred by the Controlled Shares (as defined in our bye-laws) of any U.S. Person to 9.9% of the total voting power of all our shares entitled to vote. However, because under our bye-laws certain funds associated with Warburg Pincus LLC and Hellman & Friedman LLC generally are entitled to vote their directly owned common shares in full, a U.S. Holder that is attributed (under the Code or the regulations there under) common shares owned by such funds may be considered a 10% U.S. Voting Shareholder. If we are a CFC, a U.S. Holder that is considered a 10% U.S. Voting Shareholder would be subject to current U.S. federal income taxation (at ordinary income tax rates) to the extent of all or a portion of the undistributed earnings and profits of ACGL and our subsidiaries attributable to “subpart F income” (including certain insurance premium income and investment income) and may be taxable at ordinary income tax rates on any gain realized on a sale or other disposition (including by way of repurchase or liquidation) of our shares to the extent of the current and accumulated earnings and profits attributable to such shares.

While our bye-laws are intended to prevent any member from being considered a 10% U.S. Voting Shareholder (except as described above), there can be no assurance that a U.S. Holder will not be treated as a 10% U.S. Voting Shareholder, by attribution or otherwise, under the Code or any applicable regulations there under.

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Related Person Insurance Income Rules

Generally, we do not expect the gross RPII (related person insurance income) of any of our non-U.S. subsidiaries to equal or exceed 20% of its gross insurance income in any taxable year for the foreseeable future and do not expect the direct or indirect insureds (and related persons) of any such subsidiary to directly or indirectly own 20% or more of either the voting power or value of our stock. Consequently, we do not expect any U.S. person owning common shares or preferred shares to be required to include in gross income for U.S. federal income tax purposes RPII income, but there can be no assurance that this will be the case.

Section 953(c)(7) of the Code generally provides that Section 1248 of the Code (which generally would require a U.S. Holder to treat certain gains attributable to the sale, exchange or disposition of common shares or preferred shares as a dividend) will apply to the sale or exchange by a U.S. shareholder of shares in a foreign corporation that is characterized as a CFC under the RPII rules if the foreign corporation would be taxed as an insurance company if it were a domestic corporation, regardless of whether the U.S. shareholder is a 10% U.S. Voting Shareholder or whether the corporation qualifies for either the RPII 20% ownership exception or the RPII 20% gross income exception. Although existing Treasury Department regulations do not address the question, proposed Treasury regulations issued in April 1991 create some ambiguity as to whether Section 1248 and the requirement to file Form 5471 would apply when the foreign corporation has a foreign insurance subsidiary that is a CFC for RPII purposes and that would be taxed as an insurance company if it were a domestic corporation. We believe that Section 1248 and the requirement to file Form 5471 will not apply to a less than 10% U.S. Shareholder because ACGL is not directly engaged in the insurance business. There can be no assurance, however, that the U.S. Internal Revenue Service will interpret the proposed regulations in this manner or that the Treasury Department will not take the position that Section 1248 and the requirement to file Form 5471 will apply to dispositions of our common shares or our preferred shares.

If the U.S. Internal Revenue Service or U.S. Treasury Department were to make Section 1248 and the Form 5471 filing requirement applicable to the sale of our shares, we would notify shareholders that Section 1248 of the Code and the requirement to file Form 5471 will apply to dispositions of our shares. Thereafter, we would send a notice after the end of each calendar year to all persons who were shareholders during the year notifying them that Section 1248 and the requirement to file Form 5471 apply to dispositions of our shares by U.S. Holders. We would attach to this notice a copy of Form 5471 completed with all our information and instructions for completing the shareholder information.

Tax-Exempt Shareholders

Tax-exempt entities may be required to treat certain Subpart F insurance income, including RPII, that is includible in income by the tax-exempt entity as unrelated business taxable income. Prospective investors that are tax exempt entities are urged to consult their tax advisors as to the potential impact of the unrelated business taxable income provisions of the Code.

Passive Foreign Investment Companies

Sections 1291 through 1298 of the Code contain special rules applicable with respect to foreign corporations that are "passive foreign investment companies" ("PFICs"). In general, a foreign corporation will be a PFIC if 75% or more of its income constitutes "passive income" or 50% or more of its assets produce passive income. If we were to be characterized as a PFIC, U.S. Holders would be subject to a penalty tax at the time of their sale of (or receipt of an "excess distribution" with respect to) their common shares or preferred shares. In general, a shareholder receives an "excess distribution" if the amount of the distribution is more than 125% of the average distribution with respect to the shares during the three preceding taxable years (or shorter period during which the taxpayer held the stock). In general, the penalty tax is equivalent to an interest charge on taxes that are deemed due during the period the shareholder owned the shares, computed by assuming that the excess distribution or gain (in the case of a sale) with respect to the shares was taxable in equal portions throughout the holder's period of ownership. The interest charge is equal to the applicable rate imposed on underpayments of U.S. federal income tax for such period. A U.S. shareholder may avoid some of the adverse tax consequences of owning shares in a PFIC by making a qualified electing fund ("QEF") election. A QEF election is revocable only with the consent of the IRS and has the following consequences to a shareholder:

- For any year in which ACGL is not a PFIC, no income tax consequences would result.

- For any year in which ACGL is a PFIC, the shareholder would include in its taxable income a proportionate share of the net ordinary income and net capital gains of ACGL and certain of its non-U.S. subsidiaries.

The PFIC statutory provisions contain an express exception for income "derived in the active conduct of an insurance business by a corporation which is predominantly engaged in an insurance business…" This exception is intended to ensure that income derived by a bona fide insurance company is not treated as passive income, except to the extent such income is attributable to financial reserves in excess of the reasonable needs of the insurance business. The PFIC statutory provisions contain a look-through rule that states that, for purposes of determining whether a foreign corporation is a PFIC, such foreign corporation shall be treated as if it "received directly its proportionate share of the income" and as if it "held its proportionate share of the assets" of any other corporation in which it owns at least 25% of the stock. We believe that we are not a PFIC, and we will use reasonable best efforts to cause us and each of our majority owned non-U.S. insurance subsidiaries not to constitute a PFIC.

No regulations interpreting the substantive PFIC provisions have yet been issued. Each U.S. Holder should consult his tax advisor as to the effects of these rules.

Proposed Legislation

On November 19, 2013, Senate Finance Committee then-Chairman Max Baucus (D-MT) released a tax reform discussion draft on international tax issues. A provision in the discussion draft would change the definition of a U.S. shareholder for CFC purposes and overhaul the PFIC rules, including eliminating the PFIC exception for certain insurance companies. On February 26, 2014, the House Ways and Means Committee Chairman Dave Camp published a tax reform proposal titled "Tax Reform Act of 2014." The tax form proposal contains a provision that would significantly modify the PFIC exception for certain insurance companies.

Prospective investors should consult their own tax advisor regarding the likelihood that the provisions in these discussion drafts and tax reform proposal are enacted and any effect of such provisions.

United States Taxation of Non-U.S. Shareholders

Taxation of Dividends

Cash distributions, if any, made with respect to common shares or preferred shares held by shareholders who are not United States Persons ("Non-U.S. holders") generally will not be subject to United States withholding tax.

Sale, Exchange or Other Disposition

Non-U.S. holders of common shares or preferred shares generally will not be subject to U.S. federal income tax with respect to gain realized upon the sale, exchange or other disposition of such shares unless such gain is effectively connected with a U.S. trade or business of the Non-U.S. holder in the United States or such person is present in the United States for 183 days or more in the taxable year the gain is realized and certain other requirements are satisfied.

Information Reporting and Backup Withholding

Non-U.S. holders of common shares or preferred shares will not be subject to U.S. information reporting or backup withholding with respect to dispositions of common shares effected through a non-U.S. office of a broker, unless the broker has certain connections to the United States or is a United States person. No U.S. backup withholding will apply to payments of dividends, if any, on our common shares or our preferred shares.

Sections 1471 through 1474 to the Code, known as the Foreign Account Tax Compliance Act ("FATCA"), impose a withholding tax of 30% on (i) U.S.-source interest, dividends and certain other types of income, and (ii) the gross proceeds from the sale or disposition of assets which produce such types of income, which are received by a foreign financial institution ("FFI"), unless such FFI enters into an agreement with the IRS to obtain certain information as to the identity of the direct and indirect owners of accounts in such institution. In addition, a 30% withholding tax may be imposed on the above payments to certain non-financial foreign entities which do not (i) certify to each respective withholding agent that they have no "substantial U.S. owners" (i.e., a U.S. 10% direct or indirect shareholder), or (ii) provide such withholding agent with the certain information as to the identity of such substantial U.S. owners. The United States is in the process of negotiating intergovernmental agreements to implement FATCA ("IGAs") with a number of jurisdictions. Bermuda has signed an IGA with the United States. Different rules than those described above may apply under such an IGA.

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Withholding on U.S.-source interest, dividends and certain other types of income will apply beginning on July 1, 2014, and withholding on gross proceeds will apply beginning on January 1, 2017. Prospective investors are urged to consult their own tax advisors as to the filing and information requirements that may be imposed on them in respect of their ownership of our common share or preferred shares.

Other Tax Laws

Shareholders should consult their own tax advisors with respect to the applicability to them of the tax laws of other jurisdictions.

ITEM 1A. RISK FACTORS

Set forth below are risk factors relating to our business. You should also refer to the other information provided in this report, including our "Management's Discussion and Analysis of Financial Condition and Results of Operations" and our accompanying consolidated financial statements, as well as the information under the heading "Cautionary Note Regarding Forward-Looking Statements."

Risks Relating to Our Industry

We operate in a highly competitive environment, and we may not be able to compete successfully in our industry.

Insurance and Reinsurance

The insurance and reinsurance industry is highly competitive. We compete with major U.S. and non-U.S. insurers and reinsurers, many of which have greater financial, marketing and management resources than we do, as well as other potential providers of capital willing to assume insurance and/or reinsurance risk. We also compete with new companies that continue to be formed to enter the insurance and reinsurance markets. In addition, continued consolidation within the insurance and reinsurance industry will further enhance the already competitive underwriting environment. These consolidated entities may use their enhanced market power and broader capital base to negotiate price reductions for products and services that compete with ours, and we may experience rate declines and possibly write less business. In our insurance business, we compete with insurers that provide specialty property and casualty lines of insurance, including ACE Limited, Alleghany Corporation, Allied World Assurance Company, Ltd., American International Group, Inc., AXIS Capital Holdings Limited, Berkshire Hathaway, Inc., Chubb Corporation, CNA, Endurance Specialty Holdings Ltd., The Hartford Financial Services Group, Inc., HCC Insurance Holdings, Inc., Ironshore Inc., Liberty Mutual Insurance, Lloyd's, Markel Insurance Company, RLI Corp., The Travelers Companies, W.R. Berkley Corp., XL Group plc and Zurich Insurance Group. In our reinsurance business, we compete with reinsurers that provide property and casualty lines of reinsurance, including ACE Limited, Alleghany Corporation, Argo International Holdings, Ltd., AXIS Capital Holdings Limited, Berkshire Hathaway, Inc., Endurance Specialty Holdings Ltd., Everest Re Group Ltd., Hannover Rückversicherung AG, Lloyd's, Markel Global Reinsurance, Montpelier Re Holdings Ltd., Munich Re Group, PartnerRe Ltd., Platinum Underwriters Holdings, Ltd., RenaissanceRe Holdings Ltd., Swiss Reinsurance Company, Third Point Reinsurance Ltd., Validus Holdings Ltd and XL Group plc. We do not believe that we have a significant market share in any of our markets.

Financial institutions and other capital markets participants also offer alternative products and services similar to our own or alternative products that compete with insurance and reinsurance products, such as insurance/risk-linked securities, catastrophe bonds and derivatives. In recent years, capital market participants have been increasingly active in the reinsurance market and markets for related risks. Certain of the new companies entering the insurance and reinsurance markets are pursuing more aggressive investment strategies than do we and other traditional reinsurers, which may result in further downward pressure on premium rates. In this regard, we are co-sponsoring, along with Highbridge Principal Strategies, L.L.C. (a JP MorganChase company) ("Highbridge"), Watford Re Ltd. ("Watford"), a new property and casualty reinsurer for which we will perform underwriting services and Highbridge will manage the investments, seeking higher yields and potentially assuming more risk than in our investment portfolio. If the investment and/or insurance underwriting strategy are not successful, we may be exposed to a risk of loss on our investment and in respect of the reinsurance cessions. In addition, we may not be aware of other companies that may be planning to enter the segments of the insurance and reinsurance market in which we operate.

Our competitive position is based on many factors, including our perceived overall financial strength, ratings assigned by independent rating agencies, geographic scope of business, client and broker relationships, premiums charged, contract

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terms and conditions, products and services offered (including the ability to design customized programs), appropriate and timely claim payments, reputation, experience and qualifications of employees and local presence. We may not be successful in competing with others on any of these bases, and the intensity of competition in our industry may erode profitability and result in less favorable policy terms and conditions for insurance and reinsurance companies generally, including us.

Mortgage Insurance

The private mortgage insurance industry is highly competitive. The principal sources of our U.S. competition are other private mortgage insurers, the Federal Housing Administration ("FHA") and other alternatives to private mortgage insurance. We compete with other private mortgage insurers on the basis of pricing, terms and conditions, underwriting guidelines, loss mitigation practices, financial strength, reputation, customer relationships, technology, service and other factors. One or more private mortgage insurers may seek increased market share by reducing pricing, or loosening their underwriting guidelines or practices, which could adversely affect our mortgage insurance operations. Competition within the private mortgage insurance industry could result in the loss of customers, lower premiums, riskier credit guidelines and other changes that could lower our revenues or increase our expenses.

The mortgage insurance industry's business has been limited as a result of competition with FHA, which substantially increased its market share beginning in 2008. Factors that could cause FHA to maintain or increase its share of the mortgage insurance market include:

- a reduction in the premiums charged for government mortgage insurance or a loosening of underwriting guidelines;
- imposition of additional loan level fees by the government sponsored entities ("GSEs"), Fannie Mae and Freddie Mac, on loans that require mortgage insurance;
- increases in GSE guaranty fees and the difference in the spread between Fannie Mae mortgage-backed securities ("MBS") and Ginnie Mae MBS; and
- the implementation of new regulations under the Dodd-Frank Act and the Basel III Rules.

If the FHA or other government-sponsored mortgage insurance programs maintain or increase their share of the mortgage insurance market, our mortgage insurance business could be adversely affected.

In addition to FHA and other federal mortgage insurance programs, lenders and investors may select other alternatives to private mortgage insurance, including:

- state-supported mortgage insurance funds in several states;
- lenders and other investors holding mortgages in portfolio and self-insuring;
- investors using credit enhancements other than mortgage insurance, using other credit enhancements in conjunction with reduced levels of mortgage insurance coverage, or accepting credit risk without credit enhancement; and
- lenders originating mortgages using "piggy-back" structures to avoid mortgage insurance, such as a first mortgage with an 80% LTV and a second mortgage with a 10%, 15% or 20% LTV (referred to as 80-10-10, 80-15-5 or 80-20 loans, respectively) rather than a first mortgage with a 90%, 95% or 100% LTV that has mortgage insurance.

Any alternatives to private mortgage insurance that develop could adversely affect our operations. Any failure by us to effectively compete within and outside the mortgage insurance industry could adversely affect our financial condition and results of operations.

The insurance and reinsurance industry is highly cyclical, and we expect to continue to experience periods characterized by excess underwriting capacity and unfavorable premium rates.

Historically, insurers and reinsurers have experienced significant fluctuations in operating results due to competition, frequency of occurrence or severity of catastrophic events, levels of capacity, general economic conditions, changes in equity, debt and other investment markets, changes in legislation, case law and prevailing concepts of liability and other factors. In particular, demand for reinsurance is influenced significantly by the underwriting results of primary insurers and prevailing general economic conditions. The supply of insurance and reinsurance is related to prevailing prices and levels of surplus capacity that, in turn, may fluctuate in response to changes in rates of return being realized in the insurance and reinsurance industry on both underwriting and investment sides. As a result, the insurance and reinsurance business historically has been a cyclical industry characterized by periods of intense price competition due to excessive underwriting capacity as well as periods when shortages of capacity permitted favorable premium levels and changes in terms and conditions. The supply of insurance and reinsurance has increased over the past several years and may increase further, either as a result of capital provided by new entrants or by the commitment of additional capital by existing insurers or reinsurers. Continued increases in the supply of insurance and reinsurance may have consequences for us, including fewer contracts written, lower premium rates, increased expenses for customer acquisition and retention, and less favorable policy terms and conditions.

Claims for catastrophic events could cause large losses and substantial volatility in our results of operations and could have a material adverse effect on our financial position and results of operations. As a result, the value of our securities, including our common shares and preferred shares, may fluctuate widely.

We have large aggregate exposures to natural and man-made catastrophic events. Catastrophes can be caused by various events, including hurricanes, floods, windstorms, earthquakes, hailstorms, tornados, explosions, severe winter weather, fires, droughts and other natural disasters. Catastrophes can also cause losses in non-property business such as workers' compensation or general liability. In addition to the nature of the property business, we believe that economic and geographic trends affecting insured property, including inflation, property value appreciation and geographic concentration tend to generally increase the size of losses from catastrophic events over time. Actual losses from future catastrophic events may vary materially from estimates due to the inherent uncertainties in making such determinations resulting from several factors, including the potential inaccuracies and inadequacies in the data provided by clients, brokers and ceding companies, the modeling techniques and the application of such techniques, the contingent nature of business interruption exposures, the effects of any resultant demand surge on claims activity and attendant coverage issues.

In addition, over the past several years, changing weather patterns and climatic conditions, such as global warming, have added to the unpredictability and frequency of natural disasters in certain parts of the world and created additional uncertainty as to future trends and exposures. Although the loss experience of catastrophe insurers and reinsurers has historically been characterized as low frequency, there is a growing consensus today that climate change increases the frequency and severity of extreme weather events and, in recent years, the frequency of major catastrophes appears to have increased. Claims for catastrophic events, or an unusual frequency of smaller losses in a particular period, could expose us to large losses and cause substantial volatility in our results of operations, which could have a material adverse effect on our ability to write new business and cause the value of our securities, including our common shares and preferred shares, to fluctuate widely.

We could face unanticipated losses from war, terrorism and political instability, and these or other unanticipated losses could have a material adverse effect on our financial condition and results of operations.

We have substantial exposure to unexpected, large losses resulting from future man-made catastrophic events, such as acts of war, acts of terrorism and political instability. These risks are inherently unpredictable. It is difficult to predict the timing of such events with statistical certainty or estimate the amount of loss any given occurrence will generate. In certain instances, we specifically insure and reinsure risks resulting from acts of terrorism. Even in cases where we attempt to exclude losses from terrorism and certain other similar risks from some coverages written by us, we may not be successful in doing so. Moreover, irrespective of the clarity and inclusiveness of policy language, there can be no assurance that a court or arbitration panel will not limit enforceability of policy language or otherwise issue a ruling adverse to us. Accordingly, while we believe our reinsurance programs, together with the coverage provided under TRIPRA, are sufficient to reasonably limit our net losses relating to potential future terrorist attacks, we can offer no assurance that our available capital will be adequate to cover losses when they materialize. To the extent that an act of terrorism is certified by the Secretary of the Treasury, our U.S. insurance operations may be covered under TRIPRA for up to 85% of its losses for 2013 and future years, in each case subject to a mandatory deductible of 20% of our prior year’s direct earned premium for covered property and liability coverages for 2013 through 2014. If an act (or acts) of terrorism result in covered losses exceeding the $100 billion annual limit, insurers with losses exceeding their deductibles will not be responsible for additional losses. In addition, TRIPRA expires on December 31, 2014, and there can be no assurance that Congress will extend TRIPRA or will not make significant changes to the law. It is not possible to completely eliminate our exposure to unforecasted or unpredictable events, and to the extent that losses from such risks occur, or TRIPRA is not extended, our financial condition and results of operations could be materially adversely affected.

The insurance and reinsurance industry is subject to regulatory and legislative initiatives or proposals from time to time which could adversely affect our business.

From time to time, various regulatory and legislative changes have been proposed in the insurance and reinsurance industry. Among the proposals that are at present being considered are the possible introduction of global regulatory standards for the amount of capital that insurance groups must maintain across the group.

The extreme turmoil in the financial markets has increased the likelihood of changes in the way the financial services industry is regulated. Governmental authorities in the U.S. and worldwide have become increasingly interested in potential risks posed by the insurance industry as a whole, and to commercial and financial systems in general. While we cannot predict the exact nature, timing or scope of possible governmental initiatives, there may be increased regulatory intervention in our industry in the future. For example, the U.S. federal government has increased its scrutiny of the insurance regulatory framework in recent years, and some state legislators have considered or enacted laws that will alter and likely increase state regulation of insurance and reinsurance companies and holding companies. Moreover, the NAIC, which is an association of the insurance commissioners of all 50 states and the District of Columbia, regularly reexamines existing laws and regulations. There are also a variety of proposals being considered by various state legislatures.

Solvency II, the EU regulatory regime which was enacted in November 2009, imposes new solvency and governance requirements across all EU Member States. Although Solvency II was originally supposed to have become effective by November 1, 2012, a proposed Omnibus II directive was to set revised dates for transposition and implementation of Solvency II by the EU Member States. However, there have been a series of delays in the European Parliament vote to approve the Omnibus II directive. To avoid legal uncertainty, the EU Commission successively enacted two short directives which amend Solvency II with regard to the dates of its transposition and implementation by EU Member States. The current proposed date for transposition of Solvency II by EU Member States, as set out in the most recent amending directive, is March 31, 2015 with the implementation of Solvency II by January 1, 2016. Further delay in the implementation of Solvency II is possible, but the extent and nature of the delay is uncertain.

The detail of the Solvency II project will be set out in “delegated acts” and binding technical standards which will be issued by the European Commission and will be legally binding. The European Commission plans to publish drafts for any of these measures in the Spring of 2014. Solvency II imposes significant requirements for our EU-based regulated companies which require substantial documentation and implementation effort. Regulators in Bermuda and other jurisdictions in which we operate are also considering various proposals for financial and regulatory reform. The BMA has implemented and imposed additional requirements on the companies it regulates, such as Arch Re Bermuda, as part of its efforts to achieve equivalence under Solvency II. While the BMA regulates Arch Re Bermuda as a long-term and general business insurer under the Insurance Act in Bermuda, the impact of the Group Rules may have an adverse effect on ACGL and our operations. The future impact of such initiatives, if any, on our results of operations or our financial condition cannot be determined at this time. We are unable to predict whether any of these laws and regulations will be adopted, the form in which any such laws and regulations would be adopted, or the effect, if any, these developments would have on our operations and financial condition, including the capital we are required to hold. In light of the delays in implementation of Solvency II, it is unclear when the European Commission will take a final decision on whether or not it will recognize the solvency regime in Bermuda to be equivalent to that laid down in Solvency II. If the European Commission does not recognize the regime in Bermuda to be equivalent, this could have an adverse effect on our operations.

The U.S. mortgage insurance industry is subject to substantial federal and state regulation, which has increased in recent years. The U.S. mortgage insurance industry is also subject to increased federal and state regulatory scrutiny (including by state insurance regulatory authorities), which could generate new regulations, regulatory actions or investigations. Failure to comply with federal and state regulations promulgated by federal consumer protection authorities and state insurance regulatory authorities could lead to enforcement or disciplinary action, including the imposition of penalties and the revocation of our authorization to operate.

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Underwriting risks and reserving for losses are based on probabilities and related modeling, which are subject to inherent uncertainties.

Our success is dependent upon our ability to assess accurately the risks associated with the businesses that we insure and reinsure. We establish reserves for losses and loss adjustment expenses which represent estimates involving actuarial and statistical projections, at a given point in time, of our expectations of the ultimate settlement and administration costs of losses incurred. We utilize actuarial models as well as available historical insurance industry loss ratio experience and loss development patterns to assist in the establishment of loss reserves. Most or all of these factors are not directly quantifiable, particularly on a prospective basis, and the effects of these and unforeseen factors could negatively impact our ability to accurately assess the risks of the policies that we write. Changes in the assumptions used by these models or by management could lead to an increase in our estimate of ultimate losses in the future. In addition, there may be significant reporting lags between the occurrence of the insured event and the time it is actually reported to the insurer and additional lags between the time of reporting and final settlement of claims. Unfavorable development in any of these factors could cause the level of reserves to be inadequate. In addition, the estimation of loss reserves is also more difficult during times of adverse economic and market conditions due to unexpected changes in behavior of claimants and policyholders, including an increase in fraudulent reporting of exposures and/or losses, reduced maintenance of insured properties or increased frequency of small claims. Changes in the level of inflation also result in an increased level of uncertainty in our estimation of loss reserves. As a result, actual losses and loss adjustment expenses paid will deviate, perhaps substantially, from the reserve estimates reflected in our financial statements.

If our loss reserves are determined to be inadequate, we will be required to increase loss reserves at the time of such determination with a corresponding reduction in our net income in the period in which the deficiency becomes known. It is possible that claims in respect of events that have occurred could exceed our claim reserves and have a material adverse effect on our results of operations, in a particular period, or our financial condition in general. As a compounding factor, although most insurance contracts have policy limits, the nature of property and casualty insurance and reinsurance is such that losses can exceed policy limits for a variety of reasons and could significantly exceed the premiums received on the underlying policies, thereby further adversely affecting our financial condition.

As of December 31, 2013, our reserves for unpaid losses and loss adjustment expenses, net of unpaid losses and loss adjustment expenses recoverable, were approximately $7.1 billion. Such reserves were established in accordance with applicable insurance laws and GAAP. Loss reserves are inherently subject to uncertainty. In establishing the reserves for losses and loss adjustment expenses, we have made various assumptions relating to the pricing of our reinsurance contracts and insurance policies and have also considered available historical industry experience and current industry conditions. Any estimates and assumptions made as part of the reserving process could prove to be inaccurate due to several factors, including the fact that relatively limited historical information has been reported to us through December 31, 2013.

In accordance with mortgage insurance industry practice, we only establish loss reserves for loans in our existing default inventory. Because our mortgage insurance reserving process does not take account of the impact of future losses from loans that are not in default, mortgage insurance loss reserves are not intended to be an estimate of total future losses. Our expectation of total future losses under our mortgage insurance policies in force at any period end is not reflected in our financial statements. In addition to establishing loss reserves for loans in default, under GAAP, we are required to establish a premium deficiency reserve for our mortgage insurance products if the amount of expected future losses for a particular product and maintenance costs for such product exceeds expected future premiums, existing reserves and the anticipated investment income for such product. We evaluate whether a premium deficiency exists quarterly. There can be no assurance that premium deficiency reserves will not be required in future periods. If this were to occur, our results of operations and financial condition could be adversely affected.

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The failure of any of the loss limitation methods we employ could have a material adverse effect on our financial condition or results of operations.

We have large aggregate exposures to natural and man-made catastrophic events. These risks are inherently unpredictable. It is difficult to predict the timing of such events with statistical certainty or estimate the amount of loss any given occurrence will generate. It is not possible to completely eliminate our exposure to unforecasted or unpredictable events and, to the extent that losses from such risks occur, our financial condition and results of operations could be materially adversely affected. Therefore, claims for natural and man-made catastrophic events could expose us to large losses and cause substantial volatility in our results of operations, which could cause the value of our common shares to fluctuate widely. In certain instances, we specifically insure and reinsure risks resulting from terrorism. Even in cases where we attempt to exclude losses from terrorism and certain other similar risks from some coverages written by us, we may not be successful in doing so. Moreover, irrespective of the clarity and inclusiveness of policy language, there can be no assurance that a court or arbitration panel will limit enforceability of policy language or otherwise issue a ruling adverse to us.

We seek to limit our loss exposure by writing a number of our reinsurance contracts on an excess of loss basis, adhering to maximum limitations on reinsurance written in defined geographical zones, limiting program size for each client and prudent underwriting of each program written. In the case of proportional treaties, we may seek per occurrence limitations or loss ratio caps to limit the impact of losses from any one or series of events. In our insurance operations, we seek to limit our exposure through the purchase of reinsurance. We cannot be certain that any of these loss limitation methods will be effective. We also seek to limit our loss exposure by geographic diversification. Geographic zone limitations involve significant underwriting judgments, including the determination of the area of the zones and the inclusion of a particular policy within a particular zone's limits. There can be no assurance that various provisions of our policies, such as limitations or exclusions from coverage or choice of forum, will be enforceable in the manner we intend as it is possible that a court or regulatory authority could nullify or void an exclusion or limitation, or legislation could be enacted modifying or barring the use of these exclusions and limitations. Disputes relating to coverage and choice of legal forum may also arise. Underwriting is inherently a matter of judgment, involving important assumptions about matters that are inherently unpredictable and beyond our control, and for which historical experience and probability analysis may not provide sufficient guidance. One or more catastrophic or other events could result in claims that substantially exceed our expectations, or the protections set forth in our policies could be voided, which, in either case, could have a material adverse effect on our financial condition or our results of operations, possibly to the extent of eliminating our shareholders' equity.

For our natural catastrophe exposed business, we seek to limit the amount of exposure we will assume from any one insured or reinsured and the amount of the exposure to catastrophe losses from a single event in any geographic zone. We monitor our exposure to catastrophic events, including earthquake and wind, and periodically reevaluate the estimated probable maximum pre-tax loss for such exposures. Our estimated probable maximum pre-tax loss is determined through the use of modeling techniques, but such estimate does not represent our total potential loss for such exposures. Our models employ both proprietary and vendor-based systems and include cross-line correlations for property, marine, offshore energy, aviation, workers compensation and personal accident. We seek to limit the probable maximum pre-tax loss to a specific level for severe catastrophic events. Currently, we seek to limit our 1-in-250 year return period net probable maximum loss from a severe catastrophic event in any geographic zone to approximately 25% of total shareholders' equity. We reserve the right to change this threshold at any time. Net probable maximum loss estimates are net of expected reinsurance recoveries, before income tax and before excess reinsurance reinstatement premiums. Loss estimates are reflective of the zone indicated and not the entire portfolio. Since hurricanes and windstorms can affect more than one zone and make multiple landfalls, our loss estimates include clash estimates from other zones. Our loss estimates do not represent our maximum exposures and it is highly likely that our actual incurred losses would vary materially from the modeled estimates. There can be no assurances that we will not suffer pre-tax losses greater than 25% of our total shareholders' equity from one or more catastrophic events due to several factors, including the inherent uncertainties in estimating the frequency and severity of such events and the margin of error in making such determinations resulting from potential inaccuracies and inadequacies in the data provided by clients and brokers, the modeling techniques and the application of such techniques or as a result of a decision to change the percentage of shareholders' equity exposed to a single catastrophic event. Catastrophe modeling is a relatively new discipline that utilizes a mix of historical data, scientific theory and mathematical methods. We believe that there is considerable uncertainty in the data and parameter inputs for insurance industry catastrophe models. In that regard, there is no universal standard in the preparation of insured data for use in the models and the running of modeling software. In our view, the accuracy of the models depends heavily on the availability of detailed insured loss data from actual recent large catastrophes. Due to the limited number of events, there is

significant potential for substantial differences between the modeled loss estimate and actual company experience for a single large catastrophic event. This potential difference could be even greater for perils with less modeled annual frequency, such as U.S. earthquake, or less modeled annual severity, such as European windstorm. We are also reliant upon third-party estimates of industry insured exposures and there is significant variation possible around the relationship between our loss and that of the industry following a catastrophic event. In addition, actual losses may increase if our reinsurers fail to meet their obligations to us or the reinsurance protections purchased by us are exhausted or are otherwise unavailable. See “Risk Factors—Risk Relating to Our Industry” and “Management’s Discussion and Analysis of Financial Condition and Results of Operations—Natural and Man-Made Catastrophic Events.”
Depending on business opportunities and the mix of business that may comprise our insurance and reinsurance portfolio, we may seek to adjust our self-imposed limitations on probable maximum pre-tax loss for catastrophe exposed business.

The risk associated with underwriting treaty reinsurance business could adversely affect us.

Like other reinsurers, our reinsurance group does not separately evaluate each of the individual risks assumed under reinsurance treaties. Therefore, we are largely dependent on the original underwriting decisions made by ceding companies. We are subject to the risk that the ceding companies may not have adequately evaluated the risks to be reinsured and that the premiums ceded may not adequately compensate us for the risks we assume.

While reinsurance and retrocessional coverage will be used to limit our exposure to risks, the availability of such arrangements may be limited, and counterparty credit and other risks associated with our reinsurance arrangements may result in losses which could adversely affect our financial condition and results of operations.

For the purposes of managing risk, we use reinsurance and also may use retrocessional arrangements. In the normal course of business, our insurance subsidiaries cede a portion of their premiums through pro rata, excess of loss and facultative reinsurance agreements. Our reinsurance subsidiaries purchase a limited amount of retrocessional coverage as part of their aggregate risk management program. In addition, our reinsurance subsidiaries participate in "common account" retrocessional arrangements for certain pro rata treaties. Such arrangements reduce the effect of individual or aggregate losses to all companies participating on such treaties, including the reinsurers, such as our reinsurance subsidiaries, and the ceding company. The availability and cost of reinsurance and retrocessional protection is subject to market conditions, which are beyond our control. As a result of such market conditions and other factors, we may not be able to successfully mitigate risk through reinsurance and retrocessional arrangements.

Further, we are subject to credit risk with respect to our reinsurance and retrocessions because the ceding of risk to reinsurers and retrocessionaires does not relieve us of our liability to the clients or companies we insure or reinsure. We monitor the financial condition of our reinsurers and attempt to place coverages only with carriers we view as substantial and financially sound. Although we have not experienced any material credit losses to date, an inability of our reinsurers or retrocessionnaires to meet their obligations to us could have a material adverse effect on our financial condition and results of operations. Our losses for a given event or occurrence may increase if our reinsurers or retrocessionaires dispute or fail to meet their obligations to us or the reinsurance or retrocessional protections purchased by us are exhausted or are otherwise unavailable for any reason. Our failure to establish adequate reinsurance or retrocessional arrangements or the failure of our existing reinsurance or retrocessional arrangements to protect us from overly concentrated risk exposure could adversely affect our financial condition and results of operations.

Our reliance on brokers subjects us to their credit risk.

In accordance with industry practice, we generally pay amounts owed on claims under our insurance and reinsurance contracts to brokers, and these brokers, in turn, pay these amounts to the clients that have purchased insurance or reinsurance from us. In some jurisdictions, if a broker fails to make such payment, we may remain liable to the insured or ceding insurer for the deficiency. Likewise, in certain jurisdictions, when the insured or ceding company pays the premiums for these contracts to brokers for payment to us, these premiums are considered to have been paid and the insured or ceding company will no longer be liable to us for those amounts, whether or not we have actually received the premiums from the broker. Consequently, we assume a degree of credit risk associated with our brokers. To date, we have not experienced any losses related to this credit risk.

Unexpected political legislative or judicial developments related to coverage may adverse affect us.

The effects of emerging claims and coverage issues are uncertain. The insurance industry is also affected by political, judicial and legal developments which have in the past resulted in new or expanded theories of liability. These or other changes could impose new financial obligations on us by extending coverage beyond our underwriting intent or otherwise require us to make unplanned modifications to the products and services that we provide, or cause the delay or cancellation of products and services that we provide. In some instances, these changes may not become apparent until sometime after we have issued insurance or reinsurance contracts that are affected by the changes. As a result, the full extent of liability under our insurance or reinsurance contracts may not be known for many years after a contract is issued. The effects of unforeseen developments or substantial government intervention could adversely impact our ability to achieve our goals.

The insurance businesses in which we operate may be subject to periodic negative publicity which may negatively impact our financial results.

Our products and services are ultimately distributed to individual and business customers. From time to time, consumer advocacy groups or the media may focus attention on insurance products and services, thereby subjecting the industry to periodic negative publicity. We also may be negatively impacted if competitors in one or more of our markets engage in practices resulting in increased public attention to our business. These factors may further increase our costs of doing business and adversely affect our profitability by impeding our ability to market our products and services, requiring us to change our products or services or by increasing the regulatory burdens under which we operate.

Changes in current accounting practices and future pronouncements may materially impact our reported financial results.

Developments in accounting practices, for example a convergence of U.S. GAAP with IFRS, may require considerable additional expense to comply with, particularly if we are required to prepare information relating to prior periods for comparable purposes or to apply the new requirements retroactively. The impact of changes in current accounting practices and future pronouncements cannot be predicted, but may affect the results of our operations, including among other things, the calculation of net income.

Risks Relating to Our Company

Our success will depend on our ability to maintain and enhance effective operating procedures and internal controls and our ERM program.

Operational risk and losses can result from, among other things, fraud, errors, failure to document transactions properly or to obtain proper internal authorization, failure to comply with regulatory requirements, information technology failures, failure to appropriately transition new hires or external events. We continue to enhance our operating procedures and internal controls (including information technology initiatives and controls over financial reporting) to effectively support our business and our regulatory and reporting requirements. Our management does not expect that our disclosure controls or our internal controls will prevent all errors and all fraud. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. As a result of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the company have been detected. These inherent limitations include the realities that judgments in decision making can be faulty, and that breakdowns can occur because of simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons or by collusion of two or more people. The design of any system of controls also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions; over time, controls may become inadequate because of changes in conditions, or the degree of compliance with the policies or procedures may deteriorate. As a result of the inherent limitations in a cost-effective control system, misstatement due to error or fraud may occur and not be detected. Accordingly, our disclosure controls and procedures are designed to provide reasonable, not absolute, assurance that the disclosure controls and procedures are met. Any ineffectiveness in our controls or procedures could have a material adverse effect on our business.

The NAIC has increased its focus on risks within an insurer's holding company system that may pose enterprise risk to the insurer. The NAIC recently adopted amendments to its Model Insurance Holding Company System Regulatory

Act and Regulation, which include, among other amendments, a requirement for the ultimate controlling person to file an enterprise risk report. In 2012, the NAIC adopted the ORSA Model Act, which requires domestic insurers to maintain a risk management framework and establishes a legal requirement for domestic insurers to conduct an ORSA in accordance with the NAIC’s ORSA Guidance Manual. The ORSA Model Act also provides that, no more than once a year, an insurer’s domiciliary regulator may request that an insurer submit an ORSA summary report, or any combination of reports that together contain the information described in the ORSA Guidance Manual, applicable to the insurer and/or the insurance group of which it is a member. We operate within an ERM framework designed to assess and monitor our risks. However, there can be no assurance that we can effectively review and monitor all risks or that all of our employees will operate within the ERM framework. There can be no assurance that our ERM framework will result in us accurately identifying all risks and accurately limiting our exposures based on our assessments.

A downgrade in our ratings or our inability to obtain a rating for our operating insurance and reinsurance subsidiaries may adversely affect our relationships with clients and brokers and negatively impact sales of our products.

Our operating insurance and reinsurance subsidiaries are rated by ratings agencies. Brokers negotiate contracts of insurance between insured and insurer on behalf of the insured and intermediaries negotiate contracts of reinsurance between a primary insurer and reinsurer, on behalf of the primary insurer. Third-party rating agencies, such as A.M. Best, assess and rate the financial strength of insurers and reinsurers based upon criteria established by the rating agencies, which criteria are subject to change. Ratings are an important factor in establishing the competitive position of insurance and reinsurance companies. Insureds, insurers, ceding insurers and intermediaries use these ratings as one measure by which to assess the financial strength and quality of insurers and reinsurers. These ratings are often an important factor in the decision by an insured, ceding insurer, broker or intermediary of whether to place business with a particular insurance or reinsurance provider. Our financial strength ratings are subject to periodic review as rating agencies evaluate us to confirm that we continue to meet their criteria for ratings assigned to us by them. Such ratings may be revised downward or revoked at the sole discretion of such ratings agencies in response to a variety of factors, including a minimum capital adequacy ratio, management, earnings, capitalization and risk profile. We can offer no assurances that our ratings will remain at their current levels. A ratings downgrade or the potential for such a downgrade, or failure to obtain a necessary rating, could adversely affect our relationships with agents, brokers, wholesalers, intermediaries, clients and other distributors of our existing products and services, as well as new sales of our products and services. In addition, under certain of the reinsurance agreements assumed by our reinsurance operations, upon the occurrence of a ratings downgrade or other specified triggering event with respect to our reinsurance operations, such as a reduction in surplus by specified amounts during specified periods, our ceding company clients may be provided with certain rights, including, among other things, the right to terminate the subject reinsurance agreement and/or to require that our reinsurance operations post additional collateral. Any ratings downgrade or failure to obtain a necessary rating could adversely affect our ability to compete in our markets, could cause our premiums and earnings to decrease and have a material adverse impact on our financial condition and results of operations. In addition, a downgrade in ratings of certain of our operating subsidiaries would in certain cases constitute an event of default under our credit facilities. See “Management’s Discussion and Analysis of Financial Condition and Results of Operations—Contractual Obligations and Commercial Commitments—Letter of Credit and Revolving Credit Facilities” for a discussion of our credit facilities.

In light of the difficulties experienced recently by many financial institutions, including our competitors in the insurance industry, we believe it is possible that rating agencies may heighten the level of scrutiny they apply when analyzing companies in our industry, may increase the frequency and scope of their reviews, may request additional information from the companies that they rate (including additional information regarding the valuation of investment securities held), and may adjust upward the capital and other requirements employed in their models for maintenance of certain rating levels.

The loss of our key employees or our inability to retain them could negatively impact our business.

Our success has been, and will continue to be, dependent on our ability to retain the services of our existing key executive officers and to attract and retain additional qualified personnel in the future. The pool of talent from which we actively recruit is limited. Although, to date, we have not experienced difficulties in attracting and retaining key personnel, the inability to attract and retain qualified personnel could have a material adverse effect on our financial condition and results of operations. In addition, our underwriting staff is critical to our success in the production of business. While we do not consider any of our key executive officers or underwriters to be irreplaceable, the loss of the services of our key executive officers or underwriters or the inability to hire and retain other highly qualified personnel in the future could delay or prevent us from fully implementing our business strategy which could affect our financial performance.

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Technology breaches or failures, including, but not limited to, those resulting from a malicious cyber attack on us or our business partners and service providers, could disrupt or otherwise negatively impact our business.

We rely on information technology systems to process, transmit, store and protect the electronic information, financial data and proprietary models that are critical to our business. Furthermore, a significant portion of the communications between our employees and our business partners and service providers depends on information technology and electronic information exchange. Like all companies, our information technology systems are vulnerable to data breaches, interruptions or failures due to events that may be beyond our control, including, but not limited to, natural disasters, theft, terrorist attacks, computer viruses, hackers and general technology failures. Additionally, our employees and vendors may use portable computers or mobile devices that can be stolen, lost or damaged.

We believe that we have established and implemented appropriate security measures, controls and procedures to safeguard our information technology systems and to prevent unauthorized access to such systems and any data processed and/or stored in such systems, and we periodically employ third parties to evaluate and test the adequacy of such systems, controls and procedures. In addition, we have established a comprehensive business continuity plan which is designed to ensure that we are able to maintain all aspects of our key business processes functioning in the midst of certain disruptive events, including any disruptions to or breaches of our information technology systems. Our business continuity plan is routinely tested and evaluated for adequacy. Despite these safeguards, disruptions to and breaches of our information technology systems are possible and may negatively impact our business.

It is possible that insurance policies we have in place with third parties would not entirely protect us in the event that we experienced a breach, interruption or widespread failure of our information technology systems. Furthermore, we have not secured any insurance coverage designed to specifically protect us from the result of such events. Although we have experienced no known or threatened cases involving unauthorized access to our information technology systems and data or unauthorized appropriation of such data to date, we have no assurance that such technology breaches will not occur in the future.

The preparation of our financial statements requires us to make many estimates and judgments, which are even more difficult than those made in a mature company since relatively limited historical information has been reported to us through December 31, 2013.

The preparation of consolidated financial statements requires us to make many estimates and judgments that affect the reported amounts of assets, liabilities (including reserves), revenues and expenses, and related disclosures of contingent liabilities. On an ongoing basis, we evaluate our estimates, including those related to revenue recognition, insurance and other reserves, reinsurance recoverables, investment valuations, intangible assets, bad debts, income taxes, contingencies and litigation. We base our estimates on historical experience, where possible, and on various other assumptions that we believe to be reasonable under the circumstances, which form the basis for our judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Estimates and judgments for a relatively new insurance and reinsurance company, like our company, are even more difficult to make than those made in a mature company since relatively limited historical information has been reported to us through December 31, 2013. Instead, our current loss reserves are primarily based on estimates of exposures on reported claims and estimates involving actuarial and statistical projections of our expectations of the ultimate settlement and administration costs of claims incurred but not yet reported. We utilize actuarial models as well as historical insurance industry loss development patterns to establish our initial loss reserves. Over time, other common reserving methodologies have begun to be employed. Actual claims and claim expenses paid may deviate, perhaps substantially, from the reserve estimates reflected in our financial statements.

The price of our common shares may be volatile.

There has been significant volatility in the market for equity securities. During 2013 and 2012, the price of our common shares fluctuated from a low of $44.00 to a high of $59.78 and from a low of $35.49 to a high of $45.16, respectively. On February 24, 2014, our common shares closed at a price of $55.23. The price of our common shares may not remain at or exceed current levels. The following factors, in addition to those described in other risk factors above, may have an adverse impact on the market price of our common stock:

- actual or anticipated variations in our quarterly results, including as a result of catastrophes or our investment performance;

- our share repurchase program;

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- changes in market valuation of companies in the insurance and reinsurance industry;
- changes in expectations of future financial performance or changes in estimates of securities analysts;
- fluctuations in stock market processes and volumes;
- issuances or sales of common shares or other securities in the future;
- the addition or departure of key personnel; and
- announcements by us or our competitors of acquisitions, investments or strategic alliances.

Stock markets in the U.S. continue to experience volatile price and volume fluctuations. Such fluctuations, as well as general political conditions, the current poor economic conditions or interest rate or currency rate fluctuations, could adversely affect the market price of our stock.

Adverse developments in the financial markets could have a material adverse effect on our results of operations, financial position and our businesses, and may also limit our access to capital; our policyholders, reinsurers and retrocessionaires may also be affected by such developments, which could adversely affect their ability to meet their obligations to us.

Adverse developments in the financial markets, such as disruptions, uncertainty or volatility in the capital and credit markets, may result in realized and unrealized capital losses that could have a material adverse effect on our results of operations, financial position and our businesses, and may also limit our access to capital required to operate our business. Depending on market conditions, we could incur additional realized and unrealized losses on our investment portfolio in future periods, which could have a material adverse effect on our results of operations, financial condition and business. Current economic conditions could also have a material impact on the frequency and severity of claims and therefore could negatively impact our underwriting returns. In addition, our policyholders, reinsurers and retrocessionaires may be affected by such developments in the financial markets, which could adversely affect their ability to meet their obligations to us. The volatility in the financial markets could continue to significantly affect our investment returns, reported results and shareholders' equity.

Our business is dependent upon insurance and reinsurance brokers and intermediaries, and the loss of important broker relationships could materially adversely affect our ability to market our products and services.

We market our insurance and reinsurance products primarily through brokers and intermediaries. We derive a significant portion of our business from a limited number of brokers. During 2013, approximately 16.0% and 17.0% of our gross premiums written were generated from or placed by Aon Corporation and its subsidiaries and Marsh & McLennan Companies and its subsidiaries, respectively. No other broker and no one insured or reinsured accounted for more than 10% of gross premiums written for 2013. Some of our competitors have higher financial strength ratings, offer a larger variety of products, set lower prices for insurance coverage, offer higher commissions and/or have had longer term relationships with the brokers we use than we have. This may adversely impact our ability to attract and retain brokers to sell our insurance products or brokers may increasingly promote products offered by other companies. The failure or inability of brokers to market our insurance products successfully, or loss of all or a substantial portion of the business provided by these brokers could have a material adverse impact on our business, financial condition and results of operations.

We could be materially adversely affected to the extent that managing general agents, general agents and other producers exceed their underwriting authorities or if our agents, our insureds or other third parties commit fraud or otherwise breach obligations owed to us.

For certain business conducted by our insurance group, following our underwriting, financial, claims and information technology due diligence reviews, we authorize managing general agents, general agents and other producers to write business on our behalf within underwriting authorities prescribed by us. In addition, Arch MI U.S. delegates the underwriting of a significant percentage of its primary new insurance written to certain mortgage lenders. Under this delegated underwriting program, the approved customer may determine whether mortgage loans meet our mortgage insurance program guidelines and commit us to issue mortgage insurance. We rely on the underwriting controls of these agents to write business within the underwriting authorities provided by us. Although we monitor such business on an ongoing basis, our monitoring efforts may not be adequate or our agents may exceed their underwriting authorities or otherwise breach obligations owed to us. In addition, our agents, our insureds or other third parties may commit fraud or otherwise breach their obligations to us. To the extent that our agents, our insureds or other third parties exceed their

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underwriting authorities, commit fraud or otherwise breach obligations owed to us in the future, our financial condition and results of operations could be materially adversely affected.

We are exposed to credit risk in certain of our business operations.

In addition to exposure to credit risk related to our investment portfolio, reinsurance recoverables and reliance on brokers and other agents (each discussed elsewhere in this section), we are exposed to credit risk in other areas of our business related to policyholders. We are exposed to credit risk in our insurance group's surety unit where we guarantee to a third party that our policyholder will satisfy certain performance or financial obligations. If our policyholder defaults, we may suffer losses and be unable to be reimbursed by our policyholder. We are exposed to credit risk in our insurance group's construction and national accounts units where we write large deductible insurance policies. Under these policies, we are typically obligated to pay the claimant the full amount of the claim (shown as "contractholder payables" on our consolidated balance sheets). We are subsequently reimbursed by the policyholder for the deductible amount (shown as "contractholder receivables" on our consolidated balance sheets), which can be a set amount per claim and/or an aggregate amount for all covered claims. As such, we are exposed to credit risk from the policyholder. Additionally, we write retrospectively rated policies (i.e., policies in which premiums are adjusted after the policy period based on the actual loss experience of the policyholder during the policy period). In this instance, we are exposed to credit risk to the extent the adjusted premium is greater than the original premium. While we generally seek to mitigate this risk through collateral agreements that require the posting of collateral in such forms as cash and letters of credit from banks, our efforts to mitigate the credit risk that we have to our policyholders may not be successful. Although we have not experienced any material credit losses to date, an increased inability of our policyholders to meet their obligations to us could have a material adverse effect on our financial condition and results of operations.

Our investment performance may affect our financial results and ability to conduct business.

Our operating results depend in part on the performance of our investment portfolio. A significant portion of our cash and invested assets consists of fixed maturities (72.1% as of December 31, 2013). Although our current investment guidelines and approach stress preservation of capital, market liquidity and diversification of risk, our investments are subject to market-wide risks and fluctuations. In addition, we are subject to risks inherent in particular securities or types of securities, as well as sector concentrations. Changing market conditions could materially affect the future valuation of securities in our investment portfolio, which could cause us to impair some portion of those securities. We may not be able to realize our investment objectives, which could have a material adverse effect on our financial results. In the event that we are unsuccessful in correlating our investment portfolio with our expected insurance and reinsurance liabilities, we may be forced to liquidate our investments at times and prices that are not optimal, which could have a material adverse effect on our financial results and ability to conduct our business.

We may be adversely affected by changes in economic conditions, including interest rate changes, as well as legislative changes.

Our operating results are affected by, and we are exposed to, significant financial and capital markets risk, including changes in interest rates, real estate values, foreign currency exchange rates, market volatility, the performance of the economy in general, the performance of our investment portfolio and other factors outside our control.

In addition, our investment portfolio includes residential MBS. As of December 31, 2013, MBS constituted approximately 8.4% of our cash and invested assets. As with other fixed income investments, the fair value of these securities fluctuates depending on market and other general economic conditions and the interest rate environment. Changes in interest rates can expose us to changes in the prepayment rate on these investments. In periods of declining interest rates, mortgage prepayments generally increase and MBS are prepaid more quickly, requiring us to reinvest the proceeds at the then current market rates. Conversely, in periods of rising rates, mortgage prepayments generally fall, preventing us from taking full advantage of the higher level of rates. However, current economic conditions may curtail prepayment activity as refinancing becomes more difficult, thus limiting prepayments on MBS.

Interest rates are highly sensitive to many factors, including the fiscal and monetary policies of the U.S. and other major economies, inflation, economic and political conditions and other factors beyond our control. Although we attempt to take measures to manage the risks of investing in changing interest rate environments, we may not be able to mitigate interest rate sensitivity effectively. Despite our mitigation efforts, an increase in interest rates could have a material adverse effect on our book value.

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The residential mortgage market in the U.S has experienced a variety of difficulties in certain underwriting periods and is only recently recovering from a period of severe home price depreciation. It is uncertain whether this recovery will continue. Delinquencies and losses with respect to residential mortgage loans generally increased for such periods and may continue to increase, particularly in the subprime sector. In addition, residential property values in many states have declined or remained stable after extended periods during which those values appreciated. A continued decline or an extended flattening in those values may result in additional increases in delinquencies and losses on residential mortgage loans generally, especially with respect to second homes and investment properties, and with respect to any residential mortgage loans where the aggregate loan amounts (including any subordinate loans) are close to or greater than the related property values. These developments may have a significant adverse effect on the prices of loans and securities, including those in our investment portfolio. The situation continues to have wide ranging consequences, including downward pressure on economic growth and the potential for increased insurance and reinsurance exposures, which could have an adverse impact on our results of operations, financial condition, business and operations. Our portfolio includes commercial mortgage backed securities ("CMBS"). At December 31, 2013, CMBS constituted approximately 7.6% of our cash and invested assets. The commercial real estate market may experience price deterioration, which could lead to delinquencies and losses on commercial real estate mortgages.

Mortgage insurance losses result when a borrower becomes unable to continue to make mortgage payments and the home of such borrower cannot be sold for an amount that covers unpaid principal and interest and the expenses of the sale. Deteriorating economic conditions increase the likelihood that borrowers will have insufficient income to pay their mortgages and can adversely affect housing values. In addition, natural disasters or other catastrophic events could result in increased claims if such events adversely affected the employment and income of borrowers and the value of homes. Any of these events or deteriorating economic conditions could cause our mortgage insurance losses to increase and adversely affect our results of operations and financial condition.

Also, in each year, a significant portion of our mortgage insurance premiums will be from mortgage insurance written in prior years. Accordingly, the length of time insurance remains in force, referred to as persistency, is a significant driver of mortgage insurance revenues. Factors affecting persistency include:

- current mortgage interest rates compared to those rates on our insurance in force, which affects the likelihood of the insurance in force to be subject to borrower refinance;
- the amount of home equity, as homeowners with more equity in their homes can generally more readily move to a new residence or refinance their existing mortgage; and
- Mortgage insurance cancellation policies of mortgage investors and the cancellation of borrower-paid mortgage insurance, either upon request of the borrower or as required by law based upon the amortization schedule of the loan.

If these or other factors cause the length of time our mortgage insurance policies remain in force to decline, our mortgage insurance revenues could be adversely affected.

Significant, continued volatility, changes in interest rates, a lack of pricing transparency, market liquidity, declines in equity prices and the strengthening or weakening of foreign currencies against the U.S. Dollar, individually or in tandem, could have a material adverse effect on our results of operations, financial condition or cash flows through realized losses, impairments and changes in unrealized positions

Market developments and government actions regarding the sovereign debt crisis in Europe, particularly in Portugal, Ireland, Italy, Greece and Spain, could have a material adverse effect on our business, financial condition, results of operations and liquidity.

The global recession and disruption of the financial markets has led to concerns over access to capital markets and the solvency of EU Member States, including Portugal, Ireland, Italy, Greece and Spain, and of financial institutions that have significant direct or indirect exposure to debt issued by, or the economies of, these countries. As of December 31, 2013, our investment portfolio does not contain significant investments in government bonds issued by Portugal, Ireland, Italy, Greece and Spain and in financial institutions that have significant direct or indirect exposure to debt issued by, or the economies of, those countries (see "Management's Discussion and Analysis of Financial Condition and Results of Operations— Financial Condition, Liquidity and Capital Resources—Financial Condition—Investable Assets"). The continued uncertainty over the outcome of international financial support programs and the possibility that EU Member

States may experience similar financial troubles could further disrupt global markets. Recent rating agency downgrades on certain European sovereign debt, as well as downgrades on certain European financial institutions, and growing concern of the potential default of government issuers or of a possible withdrawal by one or more EU Member States from the Eurozone and/or a break-up of the EU has further contributed to this uncertainty. The negative impact of these events on economic conditions and global markets could have an adverse effect on our business, financial condition and liquidity. For example, this crisis may cause the value of the European currencies, including the Euro, to further depreciate against the U.S. Dollar, which in turn could materially adversely impact Euro-denominated assets held in our investment portfolio or our European book of business. In addition, the applicable legal framework and the terms of our Euro-denominated insurance policies and reinsurance agreements generally do not address withdrawal by a member state from the Eurozone or a break-up of the EU, which could create uncertainty in our payment obligations and rights under those policies and agreements in the event that such a withdrawal or break-up does occur. Additionally, a contagion effect of a possible default of one or more EU Member States and/or their withdrawal from the Eurozone, or the failure of financial institutions, on the global economy, including other EU Member States and our counterparties located in those countries, or a break-up of the EU could have a material adverse effect on our business, financial condition, results of operations and liquidity.

Certain of our investments are illiquid and are difficult to sell, or to sell in significant amounts at acceptable prices, to generate cash to meet our needs.

Our investments in certain securities, including certain fixed income and structured securities, investments in funds accounted for using the equity method, other investments and our investment in Gulf Re (joint venture) may be illiquid due to contractual provisions or investment market conditions. If we require significant amounts of cash on short notice in excess of anticipated cash requirements, then we may have difficulty selling these investments in a timely manner or may be forced to sell or terminate them at unfavorable values.

The determination of the amount of allowances and impairments taken on our investments is highly subjective and could materially impact our results of operations or financial position.

On a quarterly basis, we perform reviews of our investments to determine whether declines in fair value below the cost basis are considered other-than-temporary in accordance with applicable accounting guidance regarding the recognition and presentation of other-than-temporary impairments. The process of determining whether a security is other-than-temporarily impaired requires judgment and involves analyzing many factors. These factors include (i) an analysis of the liquidity, business prospects and overall financial condition of the issuer, (ii) the time period in which there was a significant decline in value, (iii) the significance of the decline, and (iv) the analysis of specific credit events. We evaluate the unrealized losses of our equity securities by issuer and determine if we can forecast a reasonable period of time by which the fair value of the securities would increase and we would recover our cost. If we are unable to forecast a reasonable period of time in which to recover the cost of our equity securities, we record a net impairment loss in earnings equivalent to the entire unrealized loss. There can be no assurance that our management has accurately assessed the level of impairments taken and allowances reflected in our financial statements. Furthermore, additional impairments may need to be taken or allowances provided for in the future. Historical trends may not be indicative of future impairments or allowances.

We may require additional capital in the future, which may not be available or only available on unfavorable terms.

We monitor our capital adequacy on a regular basis. The capital requirements of our business depend on many factors, including regulatory requirements, our ability to write new business successfully and to establish premium rates and reserves at levels sufficient to cover losses. Our ability to underwrite is largely dependent upon the quality of our claims paying and financial strength ratings as evaluated by independent rating agencies. To the extent that our existing capital is insufficient to fund our future operating requirements and/or cover claim losses, we may need to raise additional funds through financings or limit our growth. Any equity or debt financing, if available at all, may be on terms that are unfavorable to us. In the case of equity financings, dilution to our shareholders could result, and, in any case, such securities may have rights, preferences and privileges that are senior to those of our outstanding securities. Disruptions, uncertainty or volatility in the capital and credit markets may also limit our access to capital required to operate our business. Such market conditions may limit our ability to access the capital necessary to develop our business and replace, in a timely manner, our letters of credit facilities upon maturity. As such, we may be forced to delay raising capital or bear an unattractive cost of capital which could decrease our profitability and significantly reduce our financial flexibility. If we are not able to obtain adequate capital, our business, results of operations and financial condition could be adversely

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affected. See “Management’s Discussion and Analysis of Financial Condition and Results of Operations—Financial Condition, Liquidity and Capital Resources— Liquidity and Capital Resources.”

If we are unable to timely implement our U.S. mortgage insurance strategy, our financial results could be adversely affected.

On January 30, 2014, our U.S.-based subsidiaries completed the acquisition of CMG Mortgage Insurance Company (renamed “Arch MI U.S.” subject to receipt of applicable state approvals). Prior to the acquisition, CMG Mortgage Insurance Company had been a GSE-approved mortgage insurance company limited to only credit union customers. Our strategy is to broaden Arch MI U.S.’s customer base to national and regional mortgage banks and originators, while maintaining and increasing Arch MI U.S.’s share of the mortgage insurance credit union market. Our success will depend upon, among other factors, our ability to:

- develop business relationships with national and regional mortgage banks and originators and obtain their approvals as an authorized mortgage insurance provider;
- develop and implement necessary e-commerce connectivity with new customers’ mortgage origination systems;
- maintain and expand business relationships with existing credit union customers;
- integrate various technology systems of Arch MI U.S. into our existing operating and technology systems; and
- retain and attract talent at Arch MI U.S. necessary to implement our U.S. mortgage insurance strategy.

Because of these factors, economic conditions and competitive dynamics, the extent to which we will be successful implementing our U.S. mortgage insurance strategy, and the timing of implementation, are uncertain. If we are unable to timely attract new, and retain existing, customers and process business efficiently and reliably, our results of operations and financial condition could be adversely affected.

Our acquisition of CMG Mortgage Insurance Company may expose us to unknown liabilities.

In the acquisition, we purchased all of the outstanding equity interests of CMG Mortgage Insurance Company and three other mortgage insurers as well as certain information technology and other assets of PMI (the “Acquired Mortgage Operations”). We will generally be subject to all liabilities associated with the Acquired Mortgage Operations, other than certain excluded liabilities as set forth in the purchase agreements. If there are unknown liabilities or other obligations, including contingent liabilities, our business could be materially affected. We may learn additional information about the Acquired Mortgage Operations that adversely affects us, such as unknown liabilities, issues that could affect our ability to comply with the Sarbanes-Oxley Act or issues that could affect our ability to comply with other applicable laws.

We may fail to realize the growth prospects and other benefits anticipated from the Acquired Mortgage Operations.

The success of the acquisition will depend, in part, on our ability to realize the anticipated business opportunities and growth prospects from acquiring the Acquired Mortgage Operations. We may never realize these business opportunities and growth prospects. Integrating the Acquired Mortgage Operations will require significant efforts and expenditures. Our management might have its attention diverted while trying to integrate operations and corporate and administrative infrastructures and the cost of integration may exceed our expectations. We may also be required to make unanticipated capital expenditures or investments in order to maintain, improve or sustain the acquired operations or take write offs or impairment charges and may be subject to unanticipated or unknown liabilities relating to the Acquired Mortgage Operations. We might experience increased competition that limits our ability to expand our business, and we might not be able to capitalize on expected business opportunities. If any of these factors limit our ability to integrate the Acquired Mortgage Operations successfully or on a timely basis, the expectations of future results of operations following the acquisition might not be met.

We will incur significant transaction and acquisition-related integration costs in connection with the Acquired Mortgage Operations.

We are currently integrating the Acquired Mortgage Operations into our operations. Although we anticipate achieving synergies in connection with the acquisition, we also expect to incur costs to implement such cost savings measures. We cannot at this time identify the timing, nature and amount of all such charges. The significant acquisition-related integration costs could materially adversely affect our results of operations in the period in which such charges are recorded or our

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cash flow in the period in which any related costs are actually paid. Although we believe that the elimination of duplicative costs, as well as the realization of other efficiencies related to the integration of the Acquired Mortgage Operations, will offset incremental transaction and acquisition-related costs over time, this net benefit may not be achieved in the near term, or at all. We have identified some, but not all, of the actions necessary to achieve our anticipated cost and operational savings. Accordingly, the cost and operational savings may not be achievable in our anticipated amount or time frame or at all. Investors should not place undue reliance on the anticipated benefits of the acquisition in making their investment decision.

The ultimate performance of the mortgage insurance portfolio we acquired in connection with our acquisition of the Acquired Mortgage Operations remains uncertain.

CMG Mortgage Insurance Company incurred significant losses during the period 2008 to 2012. At the closing of the acquisition, CMG Mortgage Insurance Company had insurance in force of approximately $21.5 billion. The ultimate performance of the portfolio we acquired remains uncertain and subject to factors outside of our control, including, among others, changes in unemployment, home prices and interest rates in the U.S. Deteriorating economic conditions in the U.S. would adversely affect the performance of our acquired U.S. mortgage insurance portfolio and could adversely affect our results of operations and financial condition. Pursuant to the Purchase Agreement, we may pay additional consideration to the former owners of CMG Mortgage Insurance Company based on the actual results of CMG Mortgage Insurance Company's pre-closing portfolio over an agreed upon period.

The costs savings we expect to realize from our services agreement with PMI may fail to materialize and the provision of services to PMI could hinder our ability to execute our U.S. mortgage insurance business plan and strategy.

We have entered into a multi-year services agreement with PMI (the "Services Agreement") pursuant to which we will perform or assist with many of PMI's run-off operations. We will provide run-off services to PMI "at cost" as determined by reference to operational metrics specified in the Services Agreement. We believe that this arrangement with PMI will allow us to leverage our own operations and reduce certain of our fixed costs associated with our information technology systems and other mortgage insurance operations. The services that we are required to provide PMI cover many aspects of PMI's run-off operations, including policy reporting and servicing, and financial, actuarial, HR and legal services. If the time and resources necessary to provide the services are greater than anticipated, and we are therefore unable to provide such services with existing personnel, we may not fully achieve the expense reductions anticipated. If the level of services required is less than anticipated or the Services Agreement is terminated earlier than we expect, we may charge PMI a lower than anticipated portion of our own fixed costs and we may not achieve the expense reductions anticipated. In addition, the performance of its obligations under the Services Agreement could distract our management from the execution of our U.S. mortgage insurance business plan and strategy. If we fail to perform required services or perform services in a manner that does not meet specified performance standards, PMI may terminate the Services Agreement and could exercise other remedies against us, including, under certain circumstances, seeking damages and the release to PMI of source code relating to our technology systems. If any of these events were to occur, our financial condition and results of operations could be adversely affected.

The information technology systems from the Acquired Mortgage Operations may not perform as expected, may be unable to meet the demands of customers, may become outmoded, or may be temporarily interrupted or fail.

In connection with the Acquired Mortgage Operations, we acquired the technology and operating systems of PMI. We will use these systems to service our U.S. mortgage insurance portfolios. Accordingly, our U.S. mortgage insurance business is highly dependent on the effective operation of these newly acquired systems. While we believe that the acquired systems are adequate to service our U.S. mortgage insurance portfolios, there can be no assurance that they will operate in all manners in which we intend or exhibit the functionality and performance we expected or possess all of the functionality required by customers currently or in the future.

Mortgage insurance customers require that we conduct our business in a secure manner, electronically via the Internet or via electronic data transmission. We must continually invest significant resources in establishing and maintaining electronic connectivity with customers. In order to integrate electronically with new customers, we require electronic connections between our systems and those of the industry's largest mortgage servicing systems and leading loan origination systems. Arch MI U.S. currently possesses connectivity with certain of these external systems, but there is no assurance that such connectivity is sufficient and we are undertaking new electronic integration efforts with third-party loan servicing and origination systems. Such efforts could significantly delay entry into certain markets or customers as the

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electronic integration process requires time and effort to complete. Our business, financial condition and operating results may be adversely affected if we do not possess or timely acquire the requisite set of electronic integrations necessary to keep pace with the technological demands of customers.

Our mortgage insurance systems are vulnerable to damage or interruption from power outages, computer and telecommunications failures, computer viruses, cyber-attacks, security breaches, catastrophic events and errors in usage. Although we have disaster recovery and business continuity plans in place, we may not be able to adequately execute these plans in a timely fashion. Because we rely on our technology systems for many critical functions, including connecting with our customers, if such systems were to fail or become outmoded, we may experience a significant disruption in our operations and in the business we receive and process, which could adversely affect our results of operations and financial condition.

Any future acquisitions, growth of our operations through the addition of new lines of insurance or reinsurance business through our existing subsidiaries or through the formation of new subsidiaries, expansion into new geographic regions and/or joint ventures or partnerships may expose us to risks.

We may in the future make strategic acquisitions either of other companies or selected blocks of business, expand our business lines or enter into joint ventures. Any future acquisitions may expose us to challenges and risks, including:

- integrating financial and operational reporting systems and establishing satisfactory budgetary and other financial controls;
- funding increased capital needs, overhead expenses or cash flow shortages that may occur if anticipated sales and revenues are not realized or are delayed, whether by general economic or market conditions or unforeseen internal difficulties;
- obtaining management personnel required for expanded operations;
- obtaining necessary regulatory permissions;
- the value of assets acquired may be lower than expected or may diminish due to credit defaults or changes in interest rates and liabilities assumed may be greater than expected;
- the assets and liabilities we may acquire may be subject to foreign currency exchange rate fluctuation; and
- financial exposures in the event that the sellers of the entities we acquire are unable or unwilling to meet their indemnification, reinsurance and other obligations to us.

Our failure to manage successfully these operational challenges and risks may impact our results of operations. In addition, if the reserves established by us, as they relate to any acquired book of business, prove to be inadequate, then subject to whatever recourse we may have against the seller or reinsurers, we may be responsible for adverse development in such reserves.

If the volume of low down payment mortgage originations declines, the amount of mortgage insurance we write in the U.S. could decline, which would reduce our mortgage insurance revenues.

The size of the U.S. mortgage insurance market depends in large part upon the volume of low down payment home mortgage originations. Factors affecting the volume of low down payment mortgage originations include, among others:

- restrictions on mortgage credit due to stringent underwriting standards and liquidity issues affecting lenders;
- changes in mortgage interest rates and home prices, and other economic conditions in the U.S. and regional economies;
- population trends, including the rate of household formation; and
- U.S. government housing policy.

A decline in the volume of low down payment home mortgage originations could decrease demand for mortgage insurance, decrease our new insurance written and reduce mortgage insurance revenues.

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If the role of the GSEs in the U.S. housing market changes, or if the GSEs change other policies or practices, the amount of insurance that we write could decrease.

The GSEs are the beneficiaries of a significant portion of the insurance policies we issue as a result of their purchases, statutorily required or otherwise, of qualifying mortgage loans from lenders or investors. Accordingly, changes in the following or other GSE policies could significantly affect our U.S. mortgage insurance operations:

- the amount of loans purchased by the GSEs that require mortgage insurance;
- the level of private mortgage insurance coverage lenders select when private mortgage insurance is used as the required credit enhancement on low down payment mortgages;
- GSE pricing, including the amount of loan level fees that the GSEs assess on loans that require mortgage insurance, which could reduce the demand for our products;
- loan eligibility standards for loans purchased by the GSEs, which impact the conforming mortgage loan origination market, including loan quality and availability;
- terms on which mortgage insurance coverage can be canceled before reaching the cancellation thresholds required by law;
- purchases by the GSEs of credit enhancements other than mortgage insurance;
- whether the GSEs influence mortgage lenders' selection of mortgage insurers providing coverage; and
- the size of loans that are eligible for purchase or guaranty by the GSEs.

The charters of the GSEs require credit enhancement for low down payment mortgages in order for such loans to be eligible for purchase or guarantee by the GSEs. Lenders have typically used mortgage insurance to satisfy GSE charter credit enhancement requirements. If the charters of the GSEs were amended to change or eliminate the acceptability of private mortgage insurance, our new mortgage insurance business could decline significantly.

The GSEs are operating under the conservatorship of the Federal Housing Finance Agency. In conservatorship, the GSEs could change their practices with respect to mortgage insurance or individual mortgage insurers, which could affect mortgage insurance coverage required by the GSEs on mortgage loans or Arch MI U.S.'s status as an eligible mortgage insurer. The GSEs practices also may be impacted by legislative or regulatory changes. The U.S. Congress is examining the role of the GSEs in the U.S. housing market and may implement structural and other changes to the GSEs. Since 2011, a number of legislative proposals have been introduced with regard to the future role of the GSEs, the structure of the secondary market and the role of the Federal government within the mortgage market. We cannot predict whether any of these proposals will become law or the impact any future legislation will have on our U.S. mortgage insurance operations.

As a result of the foregoing issues, it is uncertain what role the GSEs and the mortgage insurance industry will play in the housing finance system in the future or the impact of any such changes on Arch MI U.S. Changes in the GSEs' roles or practices could have a material adverse effect on our U.S. mortgage insurance business.

The premiums we charge for mortgage insurance on insured loans and the associated investment income may not be adequate to compensate for future losses from these loans.

We set premiums at the time a policy is issued based upon our expectations regarding likely performance over the life of insurance coverage. We generally cannot cancel mortgage insurance coverage or adjust renewal premiums during the life of a mortgage insurance policy. As a result, losses from higher than anticipated claims generally cannot be offset by premium increases on policies in force or mitigated by non-renewal or cancellation of insurance coverage. The premiums we charge on our insurance in force and the associated investment income may not be adequate to compensate us for the risks and costs associated with the insurance coverage provided to customers.

Our mortgage insurance portfolio includes loans with loan to value ("LTV") ratios exceeding 95%, adjustable rate mortgages, or ARMs, reduced documentation loans and less than A-quality loans. We expect higher default and claim rates for high-LTV loans, ARMs, reduced documentation loans, less-than-A quality loans. Although we attempt to incorporate the higher default and claim rates associated with these loans into our underwriting and pricing models, there can be no assurance that the premiums earned and the associated investment income will adequately compensate us for future losses from these loans.

Geographic concentration of our U.S. mortgage insurance insurance in force could increase losses and harm our financial performance.
We are affected by economic downturns and other events in specific regions of the United States where a large portion of our U.S. mortgage insurance business is concentrated. As of December 31, 2013, 5.1% of CMG Mortgage Insurance Company's primary risk-in-force was located in Florida and 8.8% was located in California. Historically, CMG Mortgage Insurance Company has experienced higher levels of losses in those states. Continued elevated loss experience with respect to risk-in-force in these states could adversely affect our results of operations.
Existing or new GSE requirements under eligibility requirements for mortgage insurers could reduce our operating flexibility or require us to contribute additional capital to Arch MI U.S.
Fannie Mae and Freddie Mac have each established approval requirements for eligible mortgage insurers relating to most areas of Arch MI U.S.'s operations. The GSEs may revise their eligibility requirements at any time. The GSEs are currently developing revisions to their eligibility guidelines that we believe will include greater limitations and restrictions on mortgage insurers. Although the GSEs have not publicly disclosed the substance of the revisions, we expect the revised rules will include new minimum capital requirements. The revisions could adversely affect our ability to write mortgage insurance, to generate the returns we anticipate from our mortgage insurance operations, or to compete with providers of alternatives to mortgage insurance.
The GSEs could revise existing eligibility requirements to require mortgage insurers to acquire additional capital or further limit certain activities and practices in order to remain an eligible mortgage insurer with them. Such limitations could include, among other things, maximum risk-to-capital ratios and limitations on our ability to pay dividends or make other payments, which could limit our operating flexibility. In order to become an eligible mortgage insurer, Arch MI U.S. agreed to certain requirements and conditions in addition to the GSEs' established approval requirements.
As a condition to its approval from Freddie Mac, Arch MI U.S. is required to maintain statutory capital (policyholders' surplus plus contingency reserves) of no less than $200 million and a risk-to-capital ratio of no greater than 18 to 1. As a condition of its approval from Fannie Mae, Arch MI U.S. is required to maintain statutory capital (defined as policyholders' surplus plus contingency reserves) of no less than $260 million and a risk-to-capital ratio of no greater than 18 to 1. If Arch MI U.S. were to fail to meet GSE or state regulatory capital requirements, it could be required to suspend writing business in some or all states.
While we intend to adhere to these requirements, there can be no assurance that the GSEs will continue to treat Arch MI U.S. as an eligible mortgage insurer. The GSEs, as major purchasers of conventional mortgage loans in the United States, are the primary beneficiaries of Arch MI U.S.'s mortgage insurance coverage. If either or both of the GSEs were to cease to consider Arch MI U.S. an eligible mortgage insurer and, therefore, cease accepting our mortgage insurance products, our results of operations and financial condition would be adversely affected.
State regulation of mortgage insurers could in the future cause Arch MI U.S. to need additional capital to fund its operations or expand its business and, if we are unable or unwilling to provide it with such capital, it may be unable to operate or expand, which could adversely affect our financial condition or results of operations.
Arch MI U.S. may require additional capital to support its growth and comply with regulatory and GSE requirements. Arch MI U.S.'s principal regulator is the Wisconsin OCI. Under Wisconsin law, as well as that of 15 other states, a mortgage insurer must maintain minimum statutory capital relative to its risk-in-force in order for the mortgage insurer to continue to write new business. While formulations of minimum capital vary by jurisdiction, the most common measure applied allows for a maximum permitted risk to capital ratio of 25 to 1. Wisconsin and certain other states, including California and Illinois, apply a substantially similar requirement referred to as minimum policyholders position.
Potential changes to state mortgage insurance regulations could reduce Arch MI U.S.'s profitability and its ability to compete with credit enhancement alternatives to mortgage insurance.
The NAIC, which reviews state insurance laws and regulations, has established a Mortgage Guaranty Insurance Working Group ("Working Group") to make recommendations to the NAIC's Financial Condition Committee regarding changes to the NAIC's Mortgage Guaranty Insurance Model Act. The Working Group has released a draft Model Act which includes proposed changes to minimum statutory capital requirements and changes to the extent to which, and

period for which, mortgage insurers must establish and hold contingency reserves.

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If the NAIC revises the Model Act, some state legislatures are likely to enact and implement part or all of the revised provisions. While we cannot predict the effect that any NAIC recommendations or future legislation may have on Arch MI U.S., such changes could reduce Arch MI U.S.'s profitability and its ability to compete with credit enhancement alternatives to mortgage insurance, which could harm our financial condition or results of operations.

Our mortgage insurance business is dependent on maintaining and expanding our customer base.

The success of our U.S. mortgage insurance operations is highly dependent on our ability to attract and retain non-credit union customers and, particularly, the large lenders that originate a significant majority of low down payment mortgages in the U.S. To insure loans originated by these originators, we must obtain their respective approvals as an authorized mortgage insurer and establish connectivity with their mortgage origination systems. The process of obtaining lender approvals and integrating our systems can be time-consuming and requires the coordination of significant lender resources. There is no assurance we will receive approvals from these lenders or establish system connectivity with them in a timely manner or at all. If we cannot timely obtain such approvals, or fail to obtain and retain approvals, Arch MI U.S.'s business, financial condition and operating results could be adversely affected. The loss of a significant customer could reduce our mortgage insurance revenue and, if not replaced, adversely affect our financial condition and results of operations.

Increasing consolidation among mortgage lenders, including recent mergers in the U.S. banking indsutry, will continue to result in significant customer concentration for U.S. mortgage insurers. As a result of this significant concentration, Fannie Mae, Freddie Mac and the largest mortgage lenders possess substantial market power, which enables them to influence our business and the mortgage insurance industry in general. A deterioration in any of these relationships, or the loss of business from our key customers, could have an adverse effect on our financial condition and results of operations.

If servicers fail to adhere to appropriate servicing standards or experience disruptions to their businesses, our mortgage insurance operations could be adversely affected.

Our mortgage insurance policies require our customers and their servicers to timely submit premium and reports and utilize commercially reasonable efforts to limit and mitigate loss when a loan is in default. If one or more servicers failed to adhere to these requirements, our financial results could be adversely affected. Without reliable servicing, we may be unable to process new mortgage insurance business or service existing insured loans.

Arch MI U.S. could be adversely affected if, and to the extent that, the Consumer Financial Protection Bureau's ("CFPB") final rule defining a qualified mortgage reduces the size of the origination market or private mortgage insurance market.

The Dodd-Frank Act authorized the CFPB to issue regulations governing a loan originator's determination that, at the time a loan is originated, the consumer has a reasonable ability to repay the loan ("ATR"). The CFPB's ATR regulations became effective for residential mortgage loan applications received on January 10, 2014. The Dodd-Frank Act provides a statutory presumption that a borrower will have the ability to repay a loan if the loan meets the definition of "qualified mortgage," ("QM"), contained in the CFPB ATR regulations. Because the statutory presumption may allow lenders to mitigate liability risk under the Truth in Lending Act, lenders may be reluctant to make loans that do not qualify as QMs. Under the ATR regulations, if the lender requires the borrower to purchase mortgage insurance, the mortgage insurance premiums are included in monthly mortgage costs in determining the borrower's ability to repay the loan. The demand for mortgage insurance may decrease if monthly mortgage insurance premiums make it less likely that a loan will qualify for QM status. In addition, under the ATR regulations, mortgage insurance premiums payable at or prior to consummation of the loan are under certain circumstances included in points and fees. The QM rule includes a limitation on points and fees in excess of 3% of the total loan amount. Mortgage originators may be less likely to purchase single premium mortgage insurance products to the extent that the associated premiums are deemed to be points and fees. We cannot predict how origination practices will change as a result of the ATR regulations. To the extent changes reduce the size of the origination market or the private mortgage insurance market, Arch MI U.S.'s business could be adversely affected.

Federal regulation relating to minimum credit risk-retention requirements in residential mortgage loan securitizations could reduce the number of low down payment loans available to be insured.

The Dodd-Frank Act requires certain federal regulators to promulgate regulations providing for minimum credit risk-retention requirements in securitizations of residential mortgage loans that do not meet the definition of "qualified residential mortgages" ("QRM"). In 2011, federal regulators issued a proposed credit risk retention rule, which the

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regulators re-proposed with revisions on in 2013. The initial proposed rule suggested maximum LTV ratios and did not give consideration to mortgage insurance in computing LTVs. The re-proposed rule did not include the maximum LTV requirements. Instead, the federal regulators proposed that if a mortgage loan meets the CFPB’s definition of a “qualified mortgage,” the loan would be considered a QRM loan. The re-proposal also presented an alternative approach to defining QRM, referred to as “QM plus.” Under this alternative, to be eligible for QRM status, the loan’s LTV could not exceed 70% (exclusive of any credit insurance). If the federal regulators adopt a final QRM rule that is similar to the QM plus proposal and such final rule does not give consideration to mortgage insurance in computing LTV, Arch MI U.S.’s business could be adversely affected. The impact of the re-proposed QRM rule on the mortgage insurance industry is uncertain and depends on, among other things, the final definition of QRM and whether the final definition will affect the size of the high-LTV mortgage market. If the final QRM rule adopted by the federal regulators materially reduces the size of the high-LTV mortgage market, Arch MI U.S.’s business could be adversely affected.
While the GSEs are not now subject to the Dodd-Frank Act credit risk retention requirements, changes in their conservatorship status or the capital support provided to the GSEs by the U.S. government could impact the manner in which the credit risk retention rules apply to them. If the GSEs become subject to the credit risk retention requirements, or if the portion of the mortgage market that the GSEs either purchase or securitize diminishes, Arch MI U.S.’s business could be adversely affected.

The implementation of the Basel III Capital Accord may adversely affect the use of mortgage insurance by certain banks.

In 1988, the Basel Committee on Banking Supervision developed the Basel Capital Accord, “Basel I,” which set out international benchmarks for assessing banks' capital adequacy requirements. In 2005, the Basel Committee issued “Basel II” which, among other things, governs the capital treatment of mortgage insurance purchased and held on balance sheet by banks in respect of their origination and securitization activities. In July 2013, federal agencies approved publication of final regulatory capital rules, called the “Basel III Rules.” With certain exceptions, the Basel III Rules became effective on January 1, 2014. If implementation of the Basel III Rules increases the capital requirements of banking organizations with respect to the residential mortgages we insure or does not provide sufficiently favorable treatment for the use of mortgage insurance, it could adversely affect the demand for mortgage insurance.

We sold our prior reinsurance operations in May 2000 and may have liability to the purchaser and continuing liability from those reinsurance operations if the purchaser should fail to make payments on the reinsurance liabilities it assumed.

On May 5, 2000, we sold our prior reinsurance operations to Sirius America Reinsurance Company (“Sirius America”), formerly known as White Mountains Reinsurance Company of America. The Sirius America transaction was structured as a transfer and assumption agreement (and not reinsurance), and, accordingly, the loss reserves (and any related reinsurance recoverables) relating to the transferred business are not included as assets or liabilities on our balance sheet. In addition, in connection with that asset sale, we made extensive representations and warranties about us and our reinsurance operations, some of which survived the closing of the asset sale. Breach of these representations and warranties could result in liability for us. In the event that Sirius America refuses or is unable to make payment for reserved losses transferred to it by us in the May 2000 sale and the notice given to reinsureds is found not to be an effective release by such reinsureds, we would be liable for such claims. A.M. Best has assigned an “A” (Excellent) financial strength rating to Sirius America. Sirius America reported $528 million of regulatory capital at December 31, 2012.

Some of the provisions of our bye-laws and our shareholders agreement may have the effect of hindering, delaying or preventing third party takeovers or changes in management initiated by shareholders. These provisions may also prevent our shareholders from receiving premium prices for their shares in an unsolicited takeover.

Some provisions of our bye-laws could have the effect of discouraging unsolicited takeover bids from third parties or changes in management initiated by shareholders. These provisions may encourage companies interested in acquiring us to negotiate in advance with our board of directors, since the board has the authority to overrule the operation of several of the limitations.

Among other things, our bye-laws provide:

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for a classified board of directors, in which the directors of the class elected at each annual general meeting holds office for a term of three years, with the term of each class expiring at successive annual general meetings of shareholders;

- that the number of directors is determined by the board from time to time by a vote of the majority of our board;
- that directors may only be removed for cause, and cause removal shall be deemed to exist only if the director whose removal is proposed has been convicted of a felony or been found by a court to be liable for gross negligence or misconduct in the performance of his or her duties;
- that our board has the right to fill vacancies, including vacancies created by an expansion of the board; and
- for limitations on shareholders' right to raise proposals or nominate directors at general meetings.

Our bye-laws provide that certain provisions which may have anti-takeover effects may be repealed or altered only with prior board approval and upon the affirmative vote of holders of shares representing at least 65% of the total voting power of our shares entitled generally to vote at an election of directors.

The bye-laws also contain a provision limiting the rights of any U.S. person (as defined in section 7701(a)(30) of the Internal Revenue Code of 1986, as amended (the "Code")) that owns shares of ACGL, directly, indirectly or constructively (within the meaning of section 958 of the Code), representing more than 9.9% of the voting power of all shares entitled to vote generally at an election of directors. The votes conferred by such shares of such U.S. person will be reduced by whatever amount is necessary so that after any such reduction the votes conferred by the shares of such person will constitute 9.9% of the total voting power of all shares entitled to vote generally at an election of directors. Notwithstanding this provision, the board may make such final adjustments to the aggregate number of votes conferred by the shares of any U.S. person that the board considers fair and reasonable in all circumstances to ensure that such votes represent 9.9% of the aggregate voting power of the votes conferred by all shares of ACGL entitled to vote generally at an election of directors. ACGL will assume that all shareholders (other than specified persons) are U.S. persons unless we receive assurance satisfactory to us that they are not U.S. persons.

Moreover, most states, including states in which our subsidiaries are domiciled, have laws and regulations that require regulatory approval of a change in control of an insurer or an insurer's holding company. Where such laws apply to us and our subsidiaries, there can be no effective change in our control unless the person seeking to acquire control has filed a statement with the regulators and has obtained prior approval for the proposed change from such regulators. The usual measure for a presumptive change in control pursuant to these laws is the acquisition of 10% or more of the voting power of the insurance company or its parent, although this presumption is rebuttable. Consequently, a person may not acquire 10% or more of our common shares without the prior approval of insurance regulators in the state in which our subsidiaries are domiciled.

The bye-laws also provide that the affirmative vote of at least 66 2/3% of the outstanding voting power of our shares (excluding shares owned by any person (and such person’s affiliates and associates) that is the owner of 15% or more (a “15% Holder”) of our outstanding voting shares) shall be required for various corporate actions, including:

- merger or consolidation of the company into a 15% Holder;
- sale of any or all of our assets to a 15% Holder;
- the issuance of voting securities to a 15% Holder; or
- amendment of these provisions;

provided, however, the supermajority vote will not apply to any transaction approved by the board.

The provisions described above may have the effect of making more difficult or discouraging unsolicited takeover bids from third parties. To the extent that these effects occur, shareholders could be deprived of opportunities to realize takeover premiums for their shares and the market price of their shares could be depressed. In addition, these provisions could also result in the entrenchment of incumbent management.

Our operating insurance and reinsurance subsidiaries are subject to regulation in various jurisdictions, and material changes in the regulation of their operations could adversely affect us.

Our insurance and reinsurance subsidiaries are subject to government regulation in each of the jurisdictions in which they are licensed or authorized to do business. Governmental agencies have broad administrative power to regulate many aspects of the insurance business, which may include trade and claim practices, accounting methods, premium rates, marketing practices, claims practices, advertising, policy forms, and capital adequacy. These agencies are concerned

primarily with the protection of policyholders rather than shareholders. Moreover, insurance laws and regulations, among other things:

- establish solvency requirements, including minimum reserves and capital and surplus requirements;
- limit the amount of dividends, tax distributions, intercompany loans and other payments our insurance subsidiaries can make without prior regulatory approval;
- impose restrictions on the amount and type of investments we may hold;
- require assessments through guaranty funds to pay claims of insolvent insurance companies; and
- require participation in state-assigned risk plans which may take the form of reinsuring a portion of a pool of policies or the direct issuance of policies to insureds.

The NAIC continuously examines existing laws and regulations in the U.S. We cannot predict the effect that any NAIC recommendations or proposed or future legislation or rule making in the U.S. or elsewhere may have on our financial condition or operations.

Our Bermuda insurance and reinsurance subsidiary, Arch Re Bermuda, conducts its business from its offices in Bermuda and is not licensed or admitted to do business in any jurisdiction except Bermuda. However, Arch Re Bermuda has been approved as a “certified reinsurer” in certain U.S. states that allow reduced collateral for reinsurance ceded to such insurers; such “certified reinsurers” are subject to certain insurance laws in the U.S. states where they are certified. Recent scrutiny of the insurance and reinsurance industry in the U.S. and other countries could subject Arch Re Bermuda to additional regulation. Our U.S. insurance and reinsurance subsidiaries write insurance and reinsurance in the U.S. These subsidiaries are subject to extensive regulation under state statutes which delegate regulatory, supervisory and administrative powers to state insurance commissioners. Such regulation generally is designed to protect policyholders rather than investors. Arch Insurance Canada writes insurance and reinsurance in Canada and is subject to federal, as well as provincial and territorial, regulation in Canada.

Arch Insurance Europe conducts its business from London and branch offices in certain EU countries and is subject to the insurance regulations of the U.K. Arch Risk Partners is also based in the U.K. and subject to U.K. regulations. Arch Re Europe and Arch MI Europe, our subsidiaries in Ireland, conduct their business from Ireland and are subject to the regulations in Ireland. Arch Re Europe also conducts business from branch offices in Switzerland and U.K., as well as in Denmark. Arch Insurance Europe, Arch Re Europe, Arch Risk Partners and Arch MI Europe are also subject to the EU regulations and regulations of the respective EU Member States where they have established branches or in which they conduct business with respect to the conduct of their business in such EU Member State, but each company remains subject only to the financial and operational supervision by the PRA or FCA (as applicable), in the case of Arch Insurance Europe and Arch Risk Partners, and the CBOI, in the case of Arch Re Europe. Arch Insurance Europe, Arch MI Europe, Arch Risk Partners and Arch Re Europe have the freedom to provide their respective insurance and reinsurance services anywhere in the EEA subject to compliance with certain rules governing such provision, including notification to the PRA or FCA (as applicable) and the CBOI, respectively. Arch Insurance Company Europe is eligible to write excess and surplus lines insurance in all 50 states, the District of Columbia, the U.S. Virgin Islands, Guam the Northern Mariana Islands and American Samoa by virtue of its listing on the NAIC International Insurers Department’s Quarterly listing of Alien Insurers pursuant to the Nonadmitted and Reinsurance Reform Act of 2010. In addition, AUAL, on behalf of Arch Syndicate 2012, is approved to underwrite excess and surplus lines insurance in most states in the U.S. through Lloyd’s licenses.

Our U.S., Bermuda, Canada, U.K. and Ireland subsidiaries are required to maintain minimum capital and surplus as mandated by their respective jurisdictions of incorporation and, in some cases, by the jurisdictions in which those subsidiaries write business. Arch Insurance Company Europe is required to maintain minimum capital surplus as mandated by the NAIC and where it is eligible to write excess and surplus lines insurance. All of our subsidiaries are currently in compliance with these capital and surplus requirements.

In addition, virtually all U.S. states require insurers licensed to do business therein to bear a portion of contingent and incurred claim handling expenses and the unfunded amount of “covered” claim and unearned premium obligations of impaired or insolvent insurance companies, either up to the policy's limit, the applicable guaranty fund covered claim obligation cap, or 100% of statutorily defined workers' compensation benefits, subject to applicable deductibles. These obligations are funded by assessments, made on a retrospective, prospective or prefunded basis, which are levied by guaranty associations within the state, up to prescribed limits (typically 2% of “net direct written premium”), on all member insurers in the state on the basis of the proportionate share of the premiums written by member insurers in certain covered lines of business in which the impaired, insolvent or failed insurer was engaged. Accordingly, the total amount of assessments levied on us by the states in which we are licensed to write insurance may increase as we increase our premiums written. In addition, as a condition to the ability to conduct business in certain states (and within the jurisdiction of some local governments), insurance companies are subject to or required to participate in various premium or loss based insurance-related assessments, including mandatory (a/k/a “involuntary”) insurance pools, underwriting associations, workers' compensation second-injury funds, reinsurance funds and other state insurance facilities. Although we may be entitled to take premium tax credit (or offsets), recover policy surcharges or include assessments in future premium rate structures for payments we make under these facilities, the effect of these assessments and insurance-related arrangements, or changes in them, could reduce our profitability in any given period or limit our ability to grow our business.

We periodically review our corporate structure so that we can optimally deploy our capital. Changes in that structure require regulatory approval. Delays or failure in obtaining any of these approvals could limit the amount of insurance that we can write in the U.S.

If ACGL or any of our subsidiaries were to become subject to the laws of a new jurisdiction in which such entity is not presently admitted, ACGL or such subsidiary may not be in compliance with the laws of the new jurisdiction. In addition, we could, at any time and in any jurisdiction, face individual, group and class action lawsuits by our policyholders and others for alleged violations of applicable laws and regulations. Any such litigation or failure to comply with applicable laws could result in the imposition of significant restrictions on our ability to do business, and could also result in suspensions, injunctions, monetary damages, fines or other sanctions, any or all of which could adversely affect our financial condition and results of operations.

Our business is subject to risks related to litigation.

We may from time to time be subject to a variety of legal actions relating to our current and past business operations, including, but not limited to, disputes over coverage or claims adjudication, including claims alleging that we have acted in bad faith in the administration of claims by our policyholders, disputes with our agents, producers or network providers over compensation and termination of contracts and related claims and disputes relating to certain businesses acquired or disposed of by us.

Multi-party or class action claims may present additional exposure to substantial economic, non–economic or punitive damage awards. The loss of even one of these claims, if it resulted in a significant damage award or a judicial ruling that was otherwise detrimental, could create a precedent in the industry that could have a material adverse effect on our results of operations and financial condition. This risk of potential liability may make reasonable settlements of claims more difficult to obtain. We cannot determine with any certainty what new theories of recovery may evolve or what their impact may be on our business.

Mortgage insurers have been involved in litigation alleging violations of the Real Estate Settlement Procedures Act of 1974 (“RESPA”) and the Fair Credit Reporting Act (“FCRA”). RESPA generally precludes Arch MI U.S. from providing services or products to mortgage lenders free of charge, charging fees for services that are lower than their reasonable or fair market value, and paying fees for services that others provide that are higher than their reasonable or fair market value, in exchange for the referral of settlement services. Violations of the referral fee limitations of RESPA may be enforced by the federal agencies, state attorneys general and state insurance commissioners, as well as by private litigants in class actions. A number of lawsuits have challenged the actions of mortgage insurers other than Arch MI U.S., alleging that the insurers violated RESPA by entering into captive reinsurance arrangements or providing products or services, including contract underwriting, to mortgage lenders at improperly reduced prices in return for the referral of mortgage insurance. Other mortgage insurance companies have received Civil Investigative Demands from the CFPB as part of its investigation to determine whether mortgage lenders’ and mortgage insurance providers’ captive mortgage insurance arrangements violated federal law. We cannot predict whether additional actions of these types, or other actions, will be brought against us or other mortgage insurers. Any such proceedings could adversely affect our financial condition and results of operations.

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If our Bermuda principal operating subsidiary becomes subject to insurance statutes and regulations in jurisdictions other than Bermuda or if there is a change in Bermuda law or regulations or the application of Bermuda law or regulations, there could be a significant and negative impact on our business.

Arch Re Bermuda, our Bermuda insurance and reinsurance subsidiary, is a registered Bermuda Class 4 general business insurer and as a Class C long-term business insurer and has been designated as the Designated Insurer for group supervision purposes. As such, it is subject to regulation and supervision in Bermuda. Bermuda insurance statutes and the regulations and policies of the BMA require Arch Re Bermuda to, among other things:

- maintain a minimum level of capital and surplus on both an individual and group basis;
- maintain an individual (for its general business) enhanced capital requirement, general and long-term business solvency margins on an individual and group basis and a minimum liquidity ratio (for its general business);
- restrict dividends and distributions;
- obtain prior approval regarding the ownership and transfer of shares;
- maintain a principal office and appoint and maintain a principal representative in Bermuda;
- file annual financial statements, an annual statutory financial return and an annual capital and solvency return; and
- allow for the performance of certain period examinations of Arch Re Bermuda and its financial condition and that of the group insurance companies.

These statutes and regulations may restrict our ability to write insurance and reinsurance policies, distribute funds and pursue our investment strategy. We do not presently intend for Arch Re Bermuda to be admitted to do business in the U.S., U.K. or any jurisdiction other than Bermuda, although Arch Re Bermuda has been approved as a “certified reinsurer” in certain U.S. states that allow reduced collateral for reinsurance ceded to such reinsurers. We cannot assure you that insurance regulators in the U.S., U.K. or elsewhere will not review the activities or Arch Re Bermuda or its subsidiaries or agents and assert that Arch Re Bermuda is subject to such jurisdiction’s licensing requirements, or impose restrictions on Arch Re Bermuda as a condition for its being approved as a “certified reinsurer.”

Generally, Bermuda insurance statutes and regulations applicable to Arch Re Bermuda are less restrictive than those that would be applicable if they were governed by the laws of any states in the U.S. If in the future we become subject to any insurance laws of the U.S. or any state thereof or of any other jurisdiction, we cannot assure you that we would be in compliance with such laws or that complying with such laws would not have a significant and negative effect on our business.

The process of obtaining licenses is very time consuming and costly, and Arch Re Bermuda may not be able to become licensed in jurisdictions other than Bermuda should we choose to do so. The modification of the conduct of our business that would result if we were required or chose to become licensed in certain jurisdictions could significantly and negatively affect our financial condition and results of operations. In addition, our inability to comply with insurance statutes and regulations could significantly and adversely affect our financial condition and results of operations by limiting our ability to conduct business as well as subject us to penalties and fines.

Because Arch Re Bermuda is a Bermuda company, it is subject to changes in Bermuda law and regulation that may have an adverse impact on our operations, including through the imposition of tax liability or increased regulatory supervision. In addition, Arch Re Bermuda will be exposed to any changes in the political environment in Bermuda. The Bermuda insurance and reinsurance regulatory framework recently has become subject to increased scrutiny in many jurisdictions, including the U.K. As a result of the delay in implementation of Solvency II, it is unclear when the European Commission will take a final decision on whether or not it will recognize the solvency regime in Bermuda to be equivalent to that laid down in Solvency II. While we cannot predict the future impact on our operations of changes in the laws and regulation to which we are or may become subject, any such changes could have a material adverse effect on our business, financial condition and results of operations.

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ACGL is a holding company and is dependent on dividends and other payments from its operating subsidiaries, which are subject to dividend restrictions, to make payments, including the payment of debt service obligations and operating expenses we may incur and any payments of dividends, redemption amounts or liquidation amounts with respect to our preferred shares and common shares.

ACGL is a holding company whose assets primarily consist of the shares in our subsidiaries. Generally, ACGL depends on its available cash resources, liquid investments and dividends or other distributions from subsidiaries to make payments, including the payment of debt service obligations and operating expenses it may incur and any payments of dividends, redemption amounts or liquidation amounts with respect to our preferred shares and common shares, and to fund the share repurchase program. The ability of our regulated insurance and reinsurance subsidiaries to pay dividends or make distributions is dependent on their ability to meet applicable regulatory standards. In addition, the ability of our insurance and reinsurance subsidiaries to pay dividends to ACGL and to intermediate parent companies owned by ACGL could be constrained by our dependence on financial strength ratings from independent rating agencies. Our ratings from these agencies depend to a large extent on the capitalization levels of our insurance and reinsurance subsidiaries. We believe that ACGL has sufficient cash resources and available dividend capacity to service its indebtedness and other current outstanding obligations. See "Management's Discussion and Analysis of Financial Condition and Results of Operations—Financial Condition, Liquidity and Capital Resources—Liquidity and Capital Resources."

If our Bermuda reinsurance subsidiary is unable to provide collateral to ceding companies, its ability to conduct business could be significantly and negatively affected.

Arch Re Bermuda is a registered Bermuda insurance company and is not licensed or admitted as an insurer in any jurisdiction in the U.S., although Arch Re Bermuda has been approved as a "certified reinsurer" in certain U.S. state that allow reduced collateral for reinsurance ceded to such reinsurers. Insurance regulations in the U.S. do not uniformly permit insurance companies to take credit for reinsurance obtained from unlicensed or non-admitted insurers on their statutory financial statements unless security is posted, and Arch Re Bermuda's contracts generally require it to post a letter of credit or provide other security, even in U.S. states where it has been approved for reduced collateral. Although, to date, Arch Re Bermuda has not experienced any difficulties in providing collateral when required, if we are unable to post security in the form of letters of credit or trust funds when required, the operations of Arch Re Bermuda could be significantly and negatively affected.

Foreign currency exchange rate fluctuation may adversely affect our financial results.

We write business on a worldwide basis, and our results of operations may be affected by fluctuations in the value of currencies other than the U.S. Dollar. The primary foreign currencies in which we operate are the Euro, the British Pound Sterling and the Canadian Dollar. Changes in foreign currency exchange rates can reduce our revenues, increase our liabilities and costs and cause fluctuations in the valuation of our investment portfolio. We may therefore suffer losses solely as a result of exchange rate fluctuations. In order to mitigate our exposure to foreign currency fluctuations in our net insurance liabilities, we have invested and expect to continue to invest in securities denominated in currencies other than the U.S. Dollar. In addition, we may replicate investment positions in foreign currencies using derivative financial instruments. Net foreign exchange losses, recorded in the statement of income, were $12.3 million for 2013, compared to losses of $29.0 million for 2012 and gains of $17.4 million for 2011. Changes in the value of investments due to foreign currency rate movements are reflected as a direct increase or decrease to shareholders' equity and are not included in the statement of income. We have chosen not to hedge certain currency risks on capital contributed to certain subsidiaries, including to Arch Insurance Europe held in British Pounds Sterling, and may continue to choose not to hedge our currency risks. There can be no assurances that arrangements to match projected liabilities in foreign currencies with investments in the same currencies or derivative financial instruments will mitigate the negative impact of exchange rate fluctuations, and we may suffer losses solely as a result of exchange rate fluctuations.

Certain employees of our Bermuda operations are required to obtain work permits before engaging in a gainful occupation in Bermuda. Required work permits may not be granted or may not remain in effect.

Under Bermuda law, only persons who are Bermudians, spouses of Bermudians, holders of a permanent resident's certificate, holders of a working resident's certificate or persons who are exempt pursuant to the Incentives for Job

Makers Act 2011, as amended ("exempted persons") may engage in gainful occupation in Bermuda without an appropriate governmental work permit. Our success may depend in part on the continued services of key employees in Bermuda. Save for the CEO and other ‘chief’ officer positions (where the advertising requirement is automatically waived), a work permit

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will only be granted or renewed upon showing that, after proper public advertisement, no exempted person is available who meets the minimum standards reasonably required by the employer. A work permit is issued with an expiry date (up to ten years) and no assurances can be given that any work permit will be issued or, if issued, renewed upon the expiration of the relevant term (although, based on current policy, it is unlikely that renewal applications in respect of persons holding 'chief' officer positions will be denied). We consider our key officers in Bermuda who require work permits to be Constantine Iordanou, our Chairman, President and Chief Executive Officer (work permit expires November 2014), Mark D. Lyons, our Executive Vice President and Chief Financial Officer (work permit expires March 2018), Marc Grandisson, Chairman and Chief Executive Officer of Arch Worldwide Reinsurance Group (work permit expires May 2015), and Nicolas Papadopoulo, President and Chief Executive Officer of Arch Re Bermuda (work permit expires March 2015). We also have other key positions in Bermuda held by persons who hold work permits subject to renewal. If work permits are not obtained or renewed for our principal employees, we could lose their services, which could materially affect our business.

The enforcement of civil liabilities against us may be difficult.

We are a Bermuda company and some of our officers and directors are residents of various jurisdictions outside the U.S. All or a substantial portion of our assets and the assets of those persons may be located outside the U.S. As a result, it may be difficult for you to effect service of process within the U.S. upon those persons or to enforce in U.S. courts judgments obtained against those persons.

We have appointed National Registered Agents, Inc., New York, New York, as our agent for service of process with respect to actions based on offers and sales of securities made in the U.S. We have been advised by our special Bermuda legal counsel, Conyers Dill & Pearman Limited, that the U.S. and Bermuda do not currently have a treaty providing for reciprocal recognition and enforcement of judgments of U.S. courts in civil and commercial matters and that a final judgment for the payment of money rendered by a court in the U.S. based on civil liability, whether or not predicated solely upon the U.S. federal securities laws, would, therefore, not be automatically enforceable in Bermuda. We also have been advised by Conyers Dill & Pearman Limited that a final and conclusive judgment obtained in a court in the U.S. under which a sum of money is payable as compensatory damages (i.e., not being a sum claimed by a revenue authority for taxes or other charges of a similar nature by a governmental authority, or in respect of a fine or penalty or multiple or punitive damages) may be the subject of an action on a debt in the Supreme Court of Bermuda under the common law doctrine of obligation. Such an action should be successful upon proof that the sum of money is due and payable, and without having to prove the facts supporting the underlying judgment, as long as:

- the court which gave the judgment had proper jurisdiction over the parties to such judgment;
- such court did not contravene the rules of natural justice of Bermuda;
- such judgment was not obtained by fraud;
- the enforcement of the judgment would not be contrary to the public policy of Bermuda;
- no new admissible evidence relevant to the action is submitted prior to the rendering of the judgment by the courts of Bermuda; and
- there is due compliance with the correct procedures under Bermuda law.

A Bermuda court may impose civil liability on us or our directors or officers in a suit brought in the Supreme Court of Bermuda against us or such persons with respect to a violation of U.S. federal securities laws, provided that the facts surrounding such violation would constitute or give rise to a cause of action under Bermuda law.

Our international business is subject to applicable laws and regulations relating to sanctions and foreign corrupt practices, the violation of which could adversely affect our operations.

We must comply with all applicable economic sanctions and anti-bribery laws and regulations of the U.S. and other foreign jurisdictions where we operate, including the U.K. and the European Community. U.S. laws and regulations applicable to us include the economic trade sanctions laws and regulations administered by the United States Department of the Treasury's Office of Foreign Assets Control as well as certain laws administered by the United States Department of State. In addition, we are subject to the Foreign Corrupt Practices Act and other anti-bribery laws such as the U.K. Bribery Act that generally bar corrupt payments or unreasonable gifts to foreign governments or officials. Although we have policies and controls in place that are designed to ensure compliance with these laws and regulations, it is possible that an

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employee or intermediary could fail to comply with applicable laws and regulations. In such event, we could be exposed to civil penalties, criminal penalties and other sanctions, including fines or other punitive actions. In addition, such violations could damage our business and/or our reputation. Such criminal or civil sanctions, penalties, other sanctions, and damage to our business and/or reputation could have a material adverse effect on our financial condition and results of operations.

Risk Relating to Our Preferred Shares

General market conditions and unpredictable factors could adversely affect market prices for our outstanding preferred shares.

There can be no assurance about the market prices for any series of our preferred shares. Several factors, many of which are beyond our control, will influence the fair value of such series of preferred shares. Factors that might influence the fair value of any series of our preferred shares include, but are not limited to:

- whether dividends have been declared and are likely to be declared on any series of our preferred shares from time to time;
- our creditworthiness, financial condition, performance and prospects;
- whether the ratings on any series of our preferred shares provided by any ratings agency have changed;
- the market for similar securities; and
- economic, financial, geopolitical, regulatory or judicial events that affect us and/or the insurance or financial markets generally.

Dividends on our preferred shares are non-cumulative.

Dividends on our preferred shares are non-cumulative and payable only out of lawfully available funds of ACGL under Bermuda law. Consequently, if ACGL's board of directors (or a duly authorized committee of the board) does not authorize and declare a dividend for any dividend period with respect to any series of our preferred shares, holders of such preferred shares would not be entitled to receive any such dividend, and such unpaid dividend will not accrue and will never be payable. ACGL will have no obligation to pay dividends for a dividend period on or after the dividend payment date for such period if its board of directors (or a duly authorized committee of the board) has not declared such dividend before the related dividend payment date; if dividends on any series of our preferred shares are authorized and declared with respect to any subsequent dividend period, ACGL will be free to pay dividends on any other series of preferred shares and/or our common shares. In the past, we have not paid dividends on our common shares.

Our preferred shares are equity and are subordinate to our existing and future indebtedness.

Our preferred shares are equity interests and do not constitute indebtedness. As such, our preferred shares will rank junior to all of our indebtedness and other non-equity claims with respect to assets available to satisfy our claims, including in our liquidation. As of December 31, 2013, our total consolidated long-term debt was $900.0 million. We may incur additional debt in the future. Our existing and future indebtedness may restrict payments of dividends on our preferred shares. Additionally, unlike indebtedness, where principal and interest would customarily be payable on specified due dates, in the case of preferred shares like our preferred shares, (1) dividends are payable only if declared by the board of directors of ACGL (or a duly authorized committee of the board) and (2) as described under "Risks Relating to Our Company—ACGL is a holding company and is dependent on dividends and other payments from its operating subsidiaries, which are subject to dividend restrictions, to make payments, including the payment of debt service obligations and operating expenses we may incur and any payments of dividends, redemption amounts or liquidation amounts with respect to our preferred shares and common shares," we are subject to certain regulatory and other constraints affecting our ability to pay dividends and make other payments.

The voting rights of holders of our preferred shares are limited.

Holders of our preferred shares have no voting rights with respect to matters that generally require the approval of voting shareholders. The limited voting rights of holders of our preferred shares include the right to vote as a class on certain fundamental matters that affect the preference or special rights of our preferred shares as set forth in the certificate of designations relating to each series of preferred shares. In addition, if dividends on any series of our preferred shares have not been declared or paid for the equivalent of six dividend payments, whether or not for consecutive dividend

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periods, holders of the outstanding preferred shares of any series will be entitled to vote for the election of two additional directors to our board of directors subject to the terms and to the limited extent as set forth in the certificate of designations relating to such series of preferred shares.

There is no limitation on our issuance of securities that rank equally with or senior to our preferred shares.

We may issue additional securities that rank equally with or senior to our preferred shares without limitation. The issuance of securities ranking equally with or senior to our preferred shares may reduce the amount available for dividends and the amount recoverable by holders of such series in the event of a liquidation, dissolution or winding-up of ACGL.

We may be impacted by regulatory initiatives affecting our preferred shares.

Our preferred shares are intended to constitute Tier 2 capital in accordance with the group requirements of the BMA which came into force on January 1, 2013. In order for the preferred shares to qualify as Tier 2 capital, the terms of the preferred shares reflect the criteria contained in the Insurance (Group Supervision) Rules 2011 published by the BMA in January 2012. No assurance can be made that the BMA will deem that the preferred shares constitute Tier 2 capital under the group supervision rules. In the event that the BMA does not make such a determination, subject to the limitations of the preferred shares, which may require the consent of the preferred shareholders, we may be able to vary the terms of the preferred shares or exchange the preferred shares for new securities to achieve the desired regulatory capital treatment. We cannot predict how new regulatory changes in other jurisdictions may affect these rules, if at all, or whether we will be able to make any changes to the terms of the preferred shares to enable it to qualify as Tier 2 capital.

Risks Relating to Taxation

We and our non-U.S. subsidiaries may become subject to U.S. federal income taxation.

ACGL and its non-U.S. subsidiaries intend to operate their business in a manner that will not cause them to be treated as engaged in a trade or business in the U.S. and, thus, will not be required to pay U.S. federal income taxes (other than U.S. excise taxes on insurance and reinsurance premium and withholding taxes on certain U.S. source investment income) on their income. However, because there is uncertainty as to the activities which constitute being engaged in a trade or business in the U.S., there can be no assurances that the U.S. Internal Revenue Service (“IRS”) will not contend successfully that ACGL or its non-U.S. subsidiaries are engaged in a trade or business in the U.S. If ACGL or any of its non-U.S. subsidiaries were subject to U.S. income tax, our shareholders' equity and earnings could be adversely affected.

Congress has been considering legislation intended to eliminate certain perceived tax advantages of Bermuda and other non-U.S. insurance companies and U.S. insurance companies having Bermuda and other non-U.S. affiliates, including perceived tax benefits resulting principally from reinsurance between or among U.S. insurance companies and their Bermuda affiliates. Some U.S. insurance companies have also been lobbying Congress recently to pass such legislation. In this regard, the American Jobs Creation Act of 2004 (the “Jobs Act”) permits the IRS to re-allocate, re-characterize or adjust items of income, deduction or certain other items related to a reinsurance agreement between related parties to reflect the proper source, character and amount for each item (in contrast to prior law, which only covered source and character). The Jobs Act also eliminated the tax benefits available to a U.S. company that, after March 4, 2003, changed its legal domicile to a non-U.S. jurisdiction, a transaction commonly known as an inversion. We changed our legal domicile from the U.S. to Bermuda, but were not affected by the anti-inversion rule because our change in domicile occurred in November 2000. The American Infrastructure Investment and Improvement Act of 2008 as passed by the Senate Finance Committee would have made the Jobs Act anti-inversion rule applicable retroactively to inversions that occurred after March 20, 2002. Although this modification would not affect ACGL, no assurance can be given that if reintroduced in the current Congress the final bill will not make the Jobs Act anti-inversion rule applicable retroactively to inversions that occurred on an earlier date, in which case ACGL could be adversely affected. A recently reintroduced legislative proposal would treat certain foreign corporations as U.S. corporations if such corporation is primarily managed and controlled within the U.S. While we believe ACGL is not primarily managed and controlled within the U.S., there is no assurance that the proposal would not apply to ACGL. Another legislative proposal would treat a foreign corporation as a U.S. corporation if it is determined that the foreign corporation was formed or organized principally for the purpose of avoiding being treated as a U.S. corporation. It is uncertain whether this proposal would apply to ACGL, but it would adversely affect us if enacted and found to apply. Another legislative proposal has been introduced that would treat certain “tax haven CFCs” as U.S. corporations for federal income tax purposes. The term “tax haven CFC” would include a Bermuda corporation that is a controlled foreign corporation, but would exclude corporations that engage in the active

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conduct of a trade or business in Bermuda. It is not clear how this bill would apply to ACGL, which conducts its insurance and reinsurance businesses through its subsidiaries. Further, it is not clear whether this bill was intended to apply to a publicly traded company such as ACGL. There is no assurance that this legislative proposal, if enacted, would not apply to ACGL or any of its non-U.S. subsidiaries. In addition, Congress has conducted hearings relating to the tax treatment of reinsurance between affiliates and is reported to be considering legislation that would adversely affect reinsurance between U.S. and non-U.S. affiliates. One such proposal would increase the excise tax rate on reinsurance premiums paid to affiliated non-U.S. reinsurers. A legislative proposal in the House of Representatives as well as a prior Senate Finance Committee staff discussion draft and other prior proposals would limit deductions for premiums ceded to affiliated non-U.S. reinsurers above certain levels. The Administration's Fiscal Year 2014 Revenue Proposals contain a similar but more restrictive provision that would deny deductions for all premiums ceded to affiliated non-U.S. reinsurers, offset by an exclusion for any ceding commissions received or reinsurance recovered from such affiliates. Two legislative proposals (i.e., H.R. 3157 and S. 1963) introduced during the 112th Congress appeared to adopt the provision contained in the Administration's Fiscal Year 2014 Revenue Proposals. Enactment of such legislation or proposal as well as other changes in U.S. tax laws, regulations and interpretations thereof to address these issues could adversely affect us.

In November of 2013, the Senate Committee on Finance published two alternative Chairman's Staff Discussion Drafts on reforming international business taxation. The drafts contain legislative proposals that, if enacted, could adversely affect us. The drafts include a provision to limit deductions for premium ceded to affiliated non-U.S. reinsurers, which is similar to the provision in the Administration's Fiscal Year 2014 Revenue Proposals as described above. The drafts would repeal the portfolio interest exemption on U.S. corporate debt, which could significantly increase tax liabilities on our investment portfolio or cause us to increase investment in non-U.S. corporate debt. On February 26, 2014, the House Ways and Means Committee Chairman Dave Camp published a tax reform proposal titled "Tax Reform Act of 2014." The proposal contains several provisions that, if enacted, could adversely affect us. One provision is similar to the reinsurance premium disallowance provision contained in the Administration's Fiscal Year 2014 Revenue Proposals as described above. Other provisions in the proposal would modify certain tax rules applicable to U.S. and non-U.S. insurance companies, which could adversely affect our U.S. federal income tax liabilities.

Our non-U.S. companies may be subject to U.K. tax that may have a material adverse effect on our results of operations.

We intend to operate in such a manner so that none of our companies, other than our U.K. subsidiaries and branch operations (the "U.K. Group"), should be resident in the U.K. for tax purposes or carry on a trade, whether or not through a permanent establishment, in the U.K. Accordingly, we do not expect that of our other subsidiaries, other than the U.K. Group, should be subject to U.K. tax. Case law has held that whether or not a trade is being carried on in the U.K. is a matter of fact and emphasis is placed on where the operations take place from which the profits in substance arise. HM Revenue and Customs might contend successfully that one or more of our subsidiaries, in addition to the U.K. Group, is carrying on a trade in the U.K. For U.K. tax purposes, a non-U.K. tax resident company will be subject to U.K. corporation tax only if it carries on a trade through a permanent establishment in the U.K. However, that subsidiary may still be subject to U.K. income tax if it carries on a trade in the U.K., without a permanent establishment, unless it is entitled to the protection afforded by a double tax treaty between the U.K. and the jurisdiction in which that company is resident. If any of our subsidiaries is treated as resident, or carrying on a trade, in the U.K., whether or not through a permanent establishment, and, therefore, subject to U.K. tax, our results of operations could be materially adversely affected.

We may become subject to taxes in Bermuda after March 31, 2035, which may have a material adverse effect on our results of operations.

Under current Bermuda law, we are not subject to tax on income, profits, withholding, capital gains or capital transfers. Furthermore, we have obtained from the Minister of Finance of Bermuda under the Exempted Undertakings Tax Protection Act, 1966, an assurance that, in the event that Bermuda enacts legislation imposing tax computed on profits, income, any capital asset, gain or appreciation, or any tax in the nature of estate duty or inheritance tax, then the imposition of the tax will not be applicable to us or our operations until March 31, 2035. We could be subject to taxes in Bermuda after that date. This assurance does not, however, prevent the imposition of taxes on any person ordinarily resident in Bermuda or any company in respect of its ownership of real property or leasehold interests in Bermuda.

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The impact of Bermuda's letter of commitment to the OECD to eliminate harmful tax practices is uncertain and could adversely affect our tax status in Bermuda.

The Organization for Economic Cooperation and Development ("OECD") has published reports and launched a global initiative among member and non-member countries on measures to limit harmful tax competition. These measures are largely directed at counteracting the effects of tax havens and preferential tax regimes in countries around the world. Bermuda was not listed in the most recent report as an uncooperative tax haven jurisdiction because it had previously committed to eliminate harmful tax practices, to embrace international tax standards for transparency, to exchange information and to eliminate an environment that attracts business with no substantial domestic activity. We are not able predict what changes will arise from the commitment or whether such changes will subject us to additional taxes.

We may become subject to taxation on profits generated in Bermuda as a result of the OECD's plan on "Base erosion and profit shifting"

In 2013, the OECD published an “Action Plan on Base Erosion and Profit Shifting.” The plan proposes the development of rules to prevent Base Erosion and Profit Shifting which may drive fundamental changes in the perception of tax structuring and transfer pricing by tax authorities. The action plan includes adopting transfer pricing rules or special measures to ensure that returns will not accrue to an entity solely because it has contractually assumed risks or has provided capital. The action plan will likely put a much greater emphasis on the location of individuals and their contributions towards profit generation. This may result in a significant change to the existing transfer pricing rules and would potentially have a significant impact on the allocation of taxable profits throughout our subsidiaries. As a consequence, profits currently generated in Bermuda may become subject to taxation outside Bermuda.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

We lease a total of approximately 7,000 square feet in Bermuda for the operations of ACGL and our internal investment management group. Our reinsurance group leases approximately 102,000 square feet for offices in the U.S., Bermuda, Europe and Canada. The principal U.S. office of our insurance group support operations (excluding underwriting units) is in Jersey City, New Jersey where we lease approximately 107,000 square feet. Such lease expires in 2024. We lease approximately 71,000 square feet in New York City for the headquarters of the U.S. insurance group’s underwriting product lines and Northeast regional underwriting operations. Our insurance group also leases a total of approximately 246,000 square feet for its other primary U.S. offices and offices in Canada, Bermuda, Europe, South Africa and Australia.

Our rental expense, net of income from subleases, was approximately $18.7 million, $17.1 million and $16.4 million for 2013, 2012 and 2011, respectively. Our future minimum rental charges for the remaining terms of our existing leases, exclusive of escalation clauses and maintenance costs and net of rental income, will be approximately $140.4 million. We believe that the above described office space is adequate for our needs. However, as we continue to develop our business, we may open additional office locations during 2014.

ITEM 3. LEGAL PROCEEDINGS

We, in common with the insurance industry in general, are subject to litigation and arbitration in the normal course of our business. As of December 31, 2013, we were not a party to any litigation or arbitration which is expected by management to have a material adverse effect on our results of operations and financial condition and liquidity.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

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PART II

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

MARKET INFORMATION

Our common shares are traded on the NASDAQ Stock Market under the symbol "ACGL." For the periods presented below, the high and low sales prices and closing prices for our common shares as reported on the NASDAQ Stock Market were as follows:

	Three Months Ended			
	December 31, 2013	September 30, 2013	June 30, 2013	March 31, 2013
High	$59.78	$55.87	$54.64	$52.59
Low	$53.85	$51.00	$49.46	$44.00
Close	$59.69	$54.13	$51.41	$52.57
	Three Months Ended			
	December 31, 2012	September 30, 2012	June 30, 2012	March 31, 2012
High	$45.16	$41.71	$40.42	$38.60
Low	$41.71	$38.07	$36.80	$35.49
Close	$44.02	$41.64	$39.69	$37.24

On February 24, 2014, the high and low sales prices and the closing price for our common shares as reported on the NASDAQ Stock Market were $56.00, $55.23 and $55.23, respectively.

HOLDERS

As of February 24, 2014, and based on information provided to us by our transfer agent and proxy solicitor, there were 1,027 holders of record of our common shares and approximately 19,000 beneficial holders of our common shares.

DIVIDENDS

Any determination to pay dividends on ACGL's Series C non-cumulative preferred shares ("Series C preferred shares") or common shares will be at the discretion of ACGL's board of directors (or a duly authorized committee of the board of directors) and will be dependent upon its results of operations, financial condition and other factors deemed relevant by ACGL's board of directors. As a holding company, ACGL will depend on future dividends and other permitted payments from its subsidiaries to pay dividends to its shareholders. ACGL's subsidiaries' ability to pay dividends, as well as its ability to pay dividends, is subject to regulatory, contractual, rating agency and other constraints. So long as any Series C preferred shares remain outstanding for any dividend period, unless the full dividends for the latest completed dividend period on all outstanding Series C preferred shares and parity shares have been declared and paid (or declared and a sum sufficient for the payment thereof has been set aside), (a) no dividend may be paid or declared on ACGL's common shares or any of its other securities ranking junior to the Series C preferred shares (other than a dividend payable solely in common shares or in such other junior securities) and (b) no common shares or other junior shares may be purchased, redeemed or otherwise acquired for consideration by ACGL, directly or indirectly (other than (i) as a result of a reclassification of junior shares for or into other junior shares, or the exchange or conversion of one junior share for or into another junior share, (ii) through the use of the proceeds of a substantially contemporaneous sale of junior shares and (iii) as permitted by the bye-laws of ACGL in effect on the date of issuance of the Series C preferred shares).

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ISSUER PURCHASES OF EQUITY SECURITIES

The following table summarizes our purchases of our common shares for the 2013 fourth quarter:

Period	Issuer Purchases of Equity Securities Total Number of Shares Purchased (1)	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 Plan or Programs (2)
10/1/2013-10/31/2013	6,767	$55.62	—	$712,115
11/1/2013-11/30/2013	4,357	$58.34	—	$712,115
12/1/2013-12/31/2013	4,117	$58.11	—	$712,115
Total	15,241	$57.07	—	$712,115

(1) Includes repurchases by ACGL of shares, from time to time, from employees in order to facilitate the payment of withholding taxes on restricted shares granted and the exercise of stock appreciation rights. We purchased these shares at their fair market value, as determined by reference to the closing price of our common shares on the day the restricted shares vested or the stock appreciation rights were exercised.

(2) Remaining amount available at December 31, 2013 under ACGL's share repurchase authorization, under which repurchases may be effected from time to time in open market or privately negotiated transactions through December 2014.

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PERFORMANCE GRAPH

The following graph compares the cumulative total shareholder return on our common shares for each of the last five years through December 31, 2013 to the cumulative total return, assuming reinvestment of dividends, of (1) S&P 500 Composite Stock Index ("S&P 500 Index") and (2) the S&P 500 Property & Casualty Insurance Index. The share price performance presented below is not necessarily indicative of future results.

CUMULATIVE TOTAL SHAREHOLDER RETURN (1)(2)(3)

	Company Name/Index	Base Period 12/31/08	12/31/09	12/31/10	12/31/11	12/31/12	12/31/13
l	Arch Capital Group Ltd.	$100.00	$102.07	$125.61	$159.33	$188.39	$255.45
n	S&P 500 Index	$100.00	$126.46	$145.51	$148.59	$172.37	$228.19
p	S&P 500 Property & Casualty Insurance Index	$100.00	$112.35	$122.38	$122.08	$146.63	$202.78

(1) Stock price appreciation plus dividends.

(2) The above graph assumes that the value of the investment was $100 on December 31, 2008.

(3) This graph is not "soliciting material," is not deemed filed with the SEC and is not to be incorporated by reference in any filing by us under the Securities Act of 1933 or the Securities and Exchange Act of 1934, whether made before or after the date hereof and irrespective of any general incorporation language in any such filing.

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ITEM 6. SELECTED FINANCIAL DATA

The following tables set forth summary historical consolidated financial and operating data and should be read in conjunction with "Management's Discussion and Analysis of Financial Condition and Results of Operations" and our financial statements and the related notes.

(U.S. dollars in thousands except share data)	Year Ended December 31, 2013	2012	2011	2010	2009
Statement of Income Data:					
Revenues:					
Net premiums written	$3,351,367	$3,052,235	$2,673,326	$2,511,040	$2,763,112
Net premiums earned	3,145,952	2,935,140	2,631,815	2,552,483	2,842,745
Net investment income	267,219	294,895	338,198	364,878	390,131
Equity in net income (loss) of investment funds accounted for using the equity method	35,701	73,510	(9,605)	61,400	167,819
Net realized gains (losses)	74,018	194,228	110,646	252,751	143,582
Total revenues	3,526,157	3,482,381	3,063,307	3,244,067	3,501,622
Income before income taxes	742,505	589,387	426,370	850,401	890,802
Net Income	$709,731	$593,397	$436,163	$842,672	$872,006
Preferred dividends	(21,938)	(25,079)	(25,844)	(25,844)	(25,844)
Loss on repurchase of preferred shares	—	(10,612)	—	—	—
Net income available to common shareholders	$687,793	$557,706	$410,319	$816,828	$846,162
Diluted net income per share	$5.07	$4.03	$2.97	$5.18	$4.55
Cash dividends per share	—	—	—	—	—
After-tax operating income available to common shareholders (1)	$595,715	$350,640	$303,382	$491,158	$646,866
After-tax operating income available to common shareholders per share — diluted (1)	$4.39	$2.54	$2.19	$3.12	$3.48
After-tax operating return on average common equity (2)	11.7%	7.7%	7.2%	12.1%	18.4%
Weighted average common shares and common share equivalents outstanding — diluted	135,777,183	138,258,847	138,289,702	157,565,157	185,781,396

(1) After-tax operating income available to common shareholders is defined as net income available to common shareholders, excluding net realized gains or losses, net impairment losses included in earnings, equity in net income or loss of investment funds accounted for using the equity method, net foreign exchange gains or losses and loss on repurchase of preferred shares, net of income taxes. The presentation of after-tax operating income available to common shareholders is a "non-GAAP financial measure" as defined in Regulation G. See "Management's Discussion and Analysis—General—Comment on Non-GAAP Financial Measures" for further details.

(2) Equals after-tax operating income available to common shareholders divided by the average of beginning and ending common shareholders' equity for each period presented.

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(U.S. dollars in thousands except share data)	December 31, 2013	2012	2011	2010	2009
Balance Sheet Data:					
Total investable assets (1)	$14,049,525	$13,045,134	$12,316,205	$11,842,513	$11,375,902
Premiums receivable	753,924	688,873	501,563	503,434	595,030
Reinsurance recoverables on unpaid and paid losses and loss adjustment expenses	1,804,330	1,870,037	1,851,584	1,763,985	1,720,270
Total assets	19,566,094	17,816,762	17,105,357	16,243,011	15,761,123
Reserves for losses and loss adjustment expenses:					
Before unpaid losses and loss adjustment expenses recoverable	8,824,696	8,933,292	8,456,210	8,098,454	7,873,412
Net of unpaid losses and loss adjustment expenses recoverable	7,076,446	7,104,222	6,638,163	6,395,253	6,213,912
Unearned premiums:					
Before prepaid reinsurance premiums	1,896,365	1,647,978	1,411,872	1,370,075	1,433,331
Net of prepaid reinsurance premiums	1,568,022	1,349,494	1,146,176	1,106,627	1,155,346
Senior notes	800,000	300,000	300,000	300,000	300,000
Revolving credit agreement borrowings	100,000	100,000	100,000	100,000	100,000
Total liabilities	13,918,598	12,647,884	12,513,283	11,766,225	11,474,075
Common shareholders' equity	5,322,496	4,843,878	4,267,074	4,151,786	3,962,048
Preferred shareholders' equity	325,000	325,000	325,000	325,000	325,000
Total shareholders' equity	$5,647,496	$5,168,878	$4,592,074	$4,476,786	$4,287,048
Book value per common share (2)	$39.82	$36.19	$31.76	$29.73	$24.12
Common shares outstanding, net of treasury shares (3)	133,674.884	133,842.613	134,358.345	139,632.225	164,285.034

(1) In our securities lending transactions, we receive collateral in excess of the fair value of the fixed maturities and short-term investments pledged under securities lending agreements. For purposes of this table, we have excluded collateral received and reinvested and included “fixed maturities and short-term investments pledged under securities lending agreements, at fair value.”

(2) Excludes the effects of stock options and restricted stock units.

(3) Reflects the impact of our share repurchase program.

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ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion and analysis contains forward-looking statements which involve inherent risks and uncertainties. All statements other than statements of historical fact are forward-looking statements. These statements are based on our current assessment of risks and uncertainties. Actual results may differ materially from those expressed or implied in these statements and, therefore, undue reliance should not be placed on them. Important factors that could cause actual events or results to differ materially from those indicated in such statements are discussed in this report, including the sections entitled "Cautionary Note Regarding Forward-Looking Statements," and "Risk Factors."

This discussion and analysis should be read in conjunction with our audited consolidated financial statements and notes thereto presented under Item 8. Tabular amounts are in U.S. Dollars in thousands, except share amounts, unless otherwise noted.

GENERAL

Overview

Arch Capital Group Ltd. ("ACGL" and, together with its subsidiaries, "we" or "us") is a Bermuda public limited liability company with approximately $6.55 billion in capital at December 31, 2013 and, through operations in Bermuda, the United States, Europe and Canada, writes insurance and reinsurance on a worldwide basis. While we are positioned to provide a full range of property and casualty insurance and reinsurance lines, we focus on writing specialty lines of insurance and reinsurance. It is our belief that our underwriting platform, our experienced management team and our strong capital base that is unencumbered by significant pre-2002 risks have enabled us to establish a strong presence in the insurance and reinsurance markets.

The worldwide insurance and reinsurance industry is highly competitive and has traditionally been subject to an underwriting cycle in which a hard market (high premium rates, restrictive underwriting standards, as well as terms and conditions, and underwriting gains) is eventually followed by a soft market (low premium rates, relaxed underwriting standards, as well as broader terms and conditions, and underwriting losses). Insurance market conditions may affect, among other things, the demand for our products, our ability to increase premium rates, the terms and conditions of the insurance policies we write, changes in the products offered by us or changes in our business strategy.

The financial results of the insurance and reinsurance industry are influenced by factors such as the frequency and/or severity of claims and losses, including natural disasters or other catastrophic events, variations in interest rates and financial markets, changes in the legal, regulatory and judicial environments, inflationary pressures and general economic conditions. These factors influence, among other things, the demand for insurance or reinsurance, the supply of which is generally related to the total capital of competitors in the market.

Current Outlook

The broad market environment continues to be competitive with softening in terms and conditions in our reinsurance business, reflecting the increased capacity that has entered the market. In our insurance business, the best opportunities are in some sectors of the excess and surplus market and in the contract binding and program lines. In these areas, our insurance business is experiencing improved pricing and has increased exposure units. With the continued low interest rate environment, additional increases are needed in many lines in order for us to achieve our return requirements. Our underwriting teams continue to execute a disciplined strategy by emphasizing small and medium-sized accounts over large accounts and by focusing more on short-tail business. In addition, our reinsurance business entered into a number of large transactions during 2013 while our insurance operations continues to diversify into various lines of business such as contract binding and travel insurance.

On January 30, 2014, our U.S.-based subsidiaries completed the acquisition of CMG Mortgage Insurance Company and the mortgage insurance operating platform of PMI Mortgage Insurance Co. ("PMI"). CMG Mortgage Insurance Company has been renamed "Arch Mortgage Insurance Company" ("Arch MI U.S.") subject to receipt of applicable state approvals. As part of the transaction, Arch MI U.S. has obtained approval as an eligible mortgage insurer from Fannie Mae and Freddie Mac, subject to maintaining certain ongoing requirements. The completion of the transaction enables us to enter the U.S. mortgage insurance marketplace immediately and allows us to serve all lenders nationwide, including CMG Mortgage Insurance Company’s existing credit union customers. The acquisition provides us with mortgage insurance licenses across the U.S. and a comprehensive mortgage insurance operating platform. Arch MI U.S. is rated “BBB+” with a stable outlook by S&P. In addition, we entered into a distribution agreement with CMFG Life Insurance Company (CUNA Mutual) and a reinsurance agreement with an affiliate of CUNA Mutual. In addition to traditional mortgage insurance, affiliates of ACGL provide various risk sharing products to mortgage lenders as well as Fannie Mae and Freddie Mac.

Our objective is to achieve an average operating return on average equity of 15% or greater over the insurance cycle, which we believe to be an attractive return to our common shareholders given the risks we assume. We continue to look for opportunities to find acceptable books of business to underwrite without sacrificing underwriting discipline. We expect that catastrophe-exposed business will continue to represent a significant proportion of our overall book, which could increase the volatility of our operating results.

The current economic conditions could continue to have a material impact on the frequency and severity of claims and, therefore, could negatively impact our underwriting returns. In addition, volatility in the financial markets could continue to significantly affect our investment returns, reported results and shareholders’ equity. We consider the potential impact of economic trends in the estimation process for establishing unpaid losses and loss adjustment expenses and in determining our investment strategies.

In addition, the impact of the continuing weakness of the U.S., European countries and other key economies, projected budget deficits for the U.S., European countries and other governments and the consequences associated with possible additional downgrades of securities of the U.S., European countries and other governments by credit rating agencies is inherently unpredictable and could have a material adverse effect on financial markets and economic conditions in the U.S. and throughout the world. In turn, this could have a material adverse effect on our business, financial condition and results of operations and, in particular, this could have a material adverse effect on the value and liquidity of securities in our investment portfolio.

Natural Catastrophe Risk

We monitor our natural catastrophe risk globally for all perils and regions, in each case, where we believe there is significant exposure. Our models employ both proprietary and vendor-based systems and include cross-line correlations for property, marine, offshore energy, aviation, workers compensation and personal accident. Currently, we seek to limit our 1-in-250 year return period net probable maximum pre-tax loss from a severe catastrophic event in any geographic zone to approximately 25% of total shareholders’ equity. We reserve the right to change this threshold at any time. Based on in-force exposure estimated as of January 1, 2014, our modeled peak zone catastrophe exposure is a windstorm affecting the Northeastern U.S., with a net probable maximum pre-tax loss of $801 million, followed by windstorms affecting the Gulf of Mexico and Florida Tri-County with net probable maximum pre-tax losses of $670 million and $566 million, respectively. Our exposures to other perils, such as U.S. earthquake and international events, are less than the exposures arising from U.S. windstorms and hurricanes. As of January 1, 2014, our modeled peak zone earthquake exposure (New Madrid area earthquake) represented approximately 46% of our peak zone catastrophe exposure, and our modeled peak zone international exposure (Japan earthquake) is substantially less than both our peak zone windstorm and earthquake exposures. Net probable maximum pre-tax loss estimates are net of expected reinsurance recoveries, before income tax and before excess reinsurance reinstatement premiums. Loss estimates are reflective of the zone indicated and not the entire portfolio. Since hurricanes and windstorms can affect more than one zone and make multiple landfalls, our loss estimates include clash estimates from other zones.

The loss estimates shown above do not represent our maximum exposures and it is highly likely that our actual incurred losses would vary materially from the modeled estimates. There can be no assurances that we will not suffer a net loss greater than 25% of our total shareholders' equity from one or more catastrophic events due to several factors, including the inherent uncertainties in estimating the frequency and severity of such events and the margin of error in making such determinations resulting from potential inaccuracies and inadequacies in the data provided by clients and brokers, the modeling techniques and the application of such techniques or as a result of a decision to change the percentage of shareholders' equity exposed to a single catastrophic event. In addition, actual losses may increase if our reinsurers fail to meet their obligations to us or the reinsurance protections purchased by us are exhausted or are otherwise unavailable. See “Risk Factors—Risk Relating to Our Industry” and “Management’s Discussion and Analysis of Financial Condition and Results of Operations—Natural and Man-Made Catastrophic Events.”

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Financial Measures

Management uses the following three key financial indicators in evaluating our performance and measuring the overall growth in value generated for ACGL's common shareholders:

Book Value per Common Share

Book value per common share represents total common shareholders' equity divided by the number of common shares outstanding. Management uses growth in book value per common share as a key measure of the value generated for our common shareholders each period and believes that book value per common share is the key driver of ACGL's common share price over time. Book value per common share is impacted by, among other factors, our underwriting results, investment returns and share repurchase activity, which has an accretive or dilutive impact on book value per common share depending on the purchase price.

Book value per common share was $39.82 at December 31, 2013, a 10.0% increase from $36.19 at December 31, 2012. The growth in 2013 was primarily generated through underwriting returns.

After-Tax Operating Return on Average Common Equity

After-tax operating return on average common equity ("Operating ROAE") represents after-tax operating income available to common shareholders divided by the average of beginning and ending common shareholders' equity during the period. After-tax operating income available to common shareholders, a "non-GAAP measure" as defined in the SEC rules, represents net income available to common shareholders, excluding net realized gains or losses, net impairment losses recognized in earnings, equity in net income or loss of investment funds accounted for using the equity method, net foreign exchange gains or losses and loss on repurchase of preferred shares, net of income taxes. Management uses Operating ROAE as a key measure of the return generated to common shareholders and has set an objective to achieve an average Operating ROAE of 15% or greater over the insurance cycle, which it believes to be an attractive return to common shareholders given the risks we assume. See "Comment on Non-GAAP Financial Measures."

Our Operating ROAE was 11.7% for 2013, compared to 7.7% for 2012 and 7.2% for 2011. The Operating ROAE for 2013 reflects a lower amount of losses from catastrophic events than the comparable periods, somewhat offset by the impact of lower interest yields on the investment portfolio.

Total Return on Investments

Total return on investments includes net investment income, equity in net income or loss of investment funds accounted for using the equity method, net realized gains and losses and the change in unrealized gains and losses generated by our investment portfolio. Total return is calculated on a pre-tax basis and before investment expenses and includes the effect of financial market conditions along with foreign currency fluctuations. Management uses total return on investments as a key measure of the return generated to common shareholders on the capital held in the business, and compares the return generated by our investment portfolio against a benchmark return index.

The benchmark return index is a customized combination of indices intended to approximate a target portfolio by asset mix and average credit quality while also matching the approximate estimated duration and currency mix of our insurance and reinsurance liabilities. Although the estimated duration and average credit quality of this index will move as the duration and rating of its constituent securities change, generally we do not adjust the composition of the benchmark return index. The benchmark return index should not be interpreted as expressing a preference for or aversion to any particular sector or sector weight. The index is intended solely to provide, unlike many master indices that change based on the size of their constituent indices, a relatively stable basket of investable indices.

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At December 31, 2013, the benchmark return index had an average Moody's credit quality of "Aa1", an estimated duration of 3.66 years and included weightings to the following indices:

	Weighting	
The Bank of America Merrill Lynch 1-10 Year AA U.S. Corporate & Yankees Index	21.250	%
The Bank of America Merrill Lynch 5-10 Year U.S. Treasury Index	12.500	
The Bank of America Merrill Lynch U.S. Mortgage Backed Securities Index	11.875	
Barclays Capital CMBS, AAA Index	10.000	
The Bank of America Merrill Lynch 1-5 Year U.S. Treasury Index	7.500	
The Bank of America Merrill Lynch 1-10 Year U.S. Municipal Securities Index	7.125	
The Bank of America Merrill Lynch US Bullet Agency Securities 1-10 Years Index	5.000	
MSCI World Free Index	5.000	
The Bank of America Merrill Lynch 0-3 Month U.S. Treasury Bill Index	5.000	
The Bank of America Merrill Lynch 1-10 Year EMU Governments Index	4.000	
The Bank of America Merrill Lynch U.S. High Yield Constrained Index	2.750	
Barclays Capital U.S. High-Yield Corporate Loan Index	2.750	
The Bank of America Merrill Lynch 1-10 Year U.K. Gilt Index	2.750	
The Bank of America Merrill Lynch 1-5 Year CAD Governments Index	2.500	
Total	100.000	%

The following table summarizes the pre-tax total return (before investment expenses) of our investment portfolio compared to the benchmark return against which we measured our portfolio during the periods:

	Arch Portfolio (1)		Benchmark Return	
Pre-tax total return (before investment expenses):				
Year Ended December 31, 2013	1.28	%	0.85	%
Year Ended December 31, 2012	5.88	%	4.90	%
Year Ended December 31, 2011	3.81	%	4.80	%

(1) Our investment expenses were approximately 0.26%, 0.22% and 0.22%, respectively, of average invested assets in 2013, 2012 and 2011.

Total return for our investment portfolio outperformed that of the benchmark return index in 2013 and reflected strong returns on high-yield corporate bonds and bank loan investments, which augmented the return on our investment grade fixed income portfolio. Excluding foreign exchange, total return was 1.13% for 2013, compared to 5.59% for 2012 and 4.10% for 2011.

Comment on Non-GAAP Financial Measures

Throughout this filing, we present our operations in the way we believe will be the most meaningful and useful to investors, analysts, rating agencies and others who use our financial information in evaluating the performance of our company. This presentation includes the use of after-tax operating income available to common shareholders, which is defined as net income available to common shareholders, excluding net realized gains or losses, net impairment losses recognized in earnings, equity in net income or loss of investment funds accounted for using the equity method net foreign exchange gains or losses and loss on repurchase of preferred shares, net of income taxes. The presentation of after-tax operating income available to common shareholders is a "non-GAAP financial measure" as defined in Regulation G. The reconciliation of such measure to net income available to common shareholders (the most directly comparable GAAP financial measure) in accordance with Regulation G is included under "Results of Operations" below.

We believe that net realized gains or losses, net impairment losses recognized in earnings, equity in net income or loss of investment funds accounted for using the equity method, net foreign exchange gains or losses and loss on repurchase of preferred shares in any particular period are not indicative of the performance of, or trends in, our business. Although net realized gains or losses, net impairment losses recognized in earnings, equity in net income or loss of investment funds accounted for using the equity method and net foreign exchange gains or losses are an integral part of our operations, the decision to realize investment gains or losses, the recognition of net impairment losses, the recognition of equity in net income or loss of investment funds accounted for using the equity method and the recognition of foreign exchange gains or

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losses are independent of the insurance underwriting process and result, in large part, from general economic and financial market conditions. Furthermore, certain users of our financial information believe that, for many companies, the timing of the realization of investment gains or losses is largely opportunistic. In addition, net impairment losses recognized in earnings on our investments represent other-than-temporary declines in expected recovery values on securities without actual realization. The use of the equity method on certain of our investments in certain funds that invest in fixed maturity securities is driven by the ownership structure of such funds (either limited partnerships or limited liability companies). In applying the equity method, these investments are initially recorded at cost and are subsequently adjusted based on our proportionate share of the net income or loss of the funds (which include changes in the fair value of the underlying securities in the funds). This method of accounting is different from the way we account for our other fixed maturity securities and the timing of the recognition of equity in net income or loss of investment funds accounted for using the equity method may differ from gains or losses in the future upon sale or maturity of such investments. The loss on repurchase of preferred shares related to the redemption of the Series A and B preferred shares in April 2012 and had no impact on total shareholders' equity or cash flows. Due to these reasons, we exclude net realized gains or losses, net impairment losses recognized in earnings, equity in net income or loss of investment funds accounted for using the equity method, net foreign exchange gains or losses and loss on repurchase of preferred shares from the calculation of after-tax operating income available to common shareholders.

We believe that showing net income available to common shareholders exclusive of the items referred to above reflects the underlying fundamentals of our business since we evaluate the performance of and manage our underwriting to produce a profit. In addition to presenting net income available to common shareholders, we believe that this presentation enables investors and other users of our financial information to analyze our performance in a manner similar to how management analyzes performance. We also believe that this measure follows industry practice and, therefore, allows the users of financial information to compare our performance with our industry peer group. We believe that the equity analysts and certain rating agencies which follow us and the insurance industry as a whole generally exclude these items from their analyses for the same reasons.

RESULTS OF OPERATIONS

The following table summarizes, on an after-tax basis, our consolidated financial data, including a reconciliation of after-tax operating income available to common shareholders to net income available to common shareholders:

	Year Ended December 31,		
	2013	2012	2011
After-tax operating income available to common shareholders	$595,715	$350,640	$303,382
Net realized gains, net of tax	73,844	184,083	108,306
Net impairment losses recognized in earnings, net of tax	(3,786)	(11,388)	(9,062)
Equity in net income (loss) of investment funds accounted for using the equity method, net of tax	35,738	73,510	(9,605)
Net foreign exchange (losses) gains, net of tax	(13,718)	(28,527)	17,298
Loss on repurchase of preferred shares, net of tax	—	(10,612)	—
Net income available to common shareholders	$687,793	$557,706	$410,319

The higher level of after-tax operating income in 2013 than in 2012 and 2011 was primarily due to a lower amount of losses from catastrophic events and also reflected the impact of current insurance and reinsurance market conditions and the impact of lower interest yields on the investment portfolio.

Segment Information

For the periods presented, we classified our businesses into two underwriting segments — insurance and reinsurance — and corporate and other (non-underwriting). Accounting guidance regarding disclosures about segments of an enterprise and related information requires certain disclosures about operating segments in a manner that is consistent with how management evaluates the performance of the segment. For a description of our underwriting segments, refer to Note 3, "Segment Information," of the notes accompanying our consolidated financial statements. Management measures segment performance based on underwriting income or loss.

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Insurance Segment

The following table sets forth our insurance segment's underwriting results:

	Year Ended December 31,			Year Ended December 31,		
	2013	2012	% Change	2012	2011	% Change
Gross premiums written	$2,712,509	$2,593,959	4.6	$2,593,959	$2,444,485	6.1
Net premiums written	1,948,796	1,825,334	6.8	1,825,334	1,721,279	6.0
Net premiums earned	$1,876,014	$1,800,343	4.2	$1,800,343	$1,679,047	7.2
Other underwriting income	2,122	2,335		2,335	2,870	
Losses and loss adjustment expenses	(1,188,445)	(1,283,841)		(1,283,841)	(1,172,742)	
Acquisition expenses, net	(311,904)	(298,983)		(298,983)	(278,696)	
Other operating expenses	(315,387)	(307,489)		(307,489)	(307,797)	
Underwriting income (loss)	$62,400	$(87,635)	n/m	$(87,635)	$(77,318)	n/m

Underwriting Ratios			% Point Change			% Point Change
Loss ratio	63.3 %	71.3 %	(8.0)	71.3 %	69.8 %	1.5
Acquisition expense ratio (1)	16.5 %	16.5 %	—	16.5 %	16.4 %	0.1
Other operating expense ratio	16.8 %	17.1 %	(0.3)	17.1 %	18.3 %	(1.2)
Combined ratio	96.6 %	104.9 %	(8.3)	104.9 %	104.5 %	0.4

(1) The acquisition expense ratio is adjusted to include certain other underwriting income.

The components of the insurance segment's underwriting results are discussed below.

Premiums Written.

The following table sets forth our insurance segment's net premiums written by major line of business:

	Year Ended December 31,					
	2013		2012		2011	
	Amount	%	Amount	%	Amount	%
Programs	$419,673	22	$340,130	19	$290,378	17
Property, energy, marine and aviation	280,551	14	294,690	16	335,589	19
Professional liability	222,351	11	260,705	14	237,860	14
Executive assurance	213,727	11	250,904	14	231,405	13
Construction	161,877	8	130,201	7	120,405	7
Casualty	112,094	6	112,307	6	114,235	7
National accounts	109,233	6	80,929	4	80,973	5
Lenders products	101,576	5	99,724	5	94,301	5
Surety	64,911	3	53,271	3	42,475	2
Travel and accident	63,209	3	80,489	4	71,940	4
Healthcare	40,115	2	36,814	2	35,652	2
Other (1)	159,479	9	85,170	6	66,066	5
Total	$1,948,796	100	$1,825,334	100	$1,721,279	100

(1) Includes alternative markets, contract binding, accident and health and excess workers' compensation business.

2013 versus 2012: Net premiums written by the insurance segment were 6.8% higher in 2013 than in 2012. Increases in programs, contract binding, construction and national accounts were partially offset by reductions in professional liability, executive assurance and travel and accident business. The increase in program business was due to a combination of new business, underlying exposure growth and the impact of rate increases while the growth in construction and national accounts primarily resulted from new business and strong renewal retention. Contract binding, launched in early 2013, is an insurance facility that caters to smaller accounts written through the wholesale distribution channel. The reductions in professional liability and executive assurance business resulted from a continued strategic reduction in exposure to international business while the lower level of travel and accident business was due in part to a change in distribution strategy at the end of 2012.

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2012 versus 2011: Net premiums written by the insurance segment were 6.0% higher in 2012 than in 2012. Increases in programs, professional liability, executive assurance and accident and health business were partially offset by a reduction in onshore energy business. The increase in program business was primarily due to growth within existing programs and the impact of rate movements. Growth in professional liability primarily reflected new business written in small and medium sized accounts while the growth in executive assurance business primarily resulted from small and medium sized accounts in the U.K. and the U.S. The increase in accident and health business primarily resulted from new business. The reduction in onshore energy premiums reflected a strategic shift towards writing more on an excess basis and utilizing smaller capacity per account as well as an increased use of reinsurance.

Net Premiums Earned.

The following table sets forth our insurance segment's net premiums earned by major line of business:

	Year Ended December 31,					
	2013		2012		2011	
	Amount	%	Amount	%	Amount	%
Programs	$386,840	21	$318,740	18	$283,367	17
Property, energy, marine and aviation	304,294	16	313,081	17	322,510	19
Professional liability	231,014	12	258,401	14	252,037	15
Executive assurance	221,925	12	241,791	13	228,623	14
Construction	149,864	8	129,446	7	112,764	7
Casualty	103,152	5	113,597	6	111,654	7
National accounts	100,865	5	79,771	4	79,542	5
Lenders products	99,847	5	103,478	6	79,522	5
Surety	57,719	3	47,302	3	41,119	2
Travel and accident	59,987	3	78,050	4	69,945	4
Healthcare	38,852	2	36,779	2	35,906	2
Other (1)	121,655	8	79,907	6	62,058	3
Total	$1,876,014	100	$1,800,343	100	$1,679,047	100

(1) Includes alternative markets, contract binding, accident and health and excess workers' compensation business.

Net premiums earned by the insurance segment were 4.2% higher in 2013 than in 2012, reflecting changes in net premiums written over the previous five quarters. Net premiums earned by the insurance segment were 7.2% higher in 2012 than in 2011.

Losses and Loss Adjustment Expenses.

The table below shows the components of the insurance segment's loss ratio:

	Year Ended December 31,					
	2013		2012		2011	
Current year	65.7	%	73.0	%	72.9	%
Prior period reserve development	(2.4	)%	(1.7	)%	(3.1	)%
Loss ratio	63.3	%	71.3	%	69.8	%

Current Year Loss Ratio.

2013 versus 2012: The insurance segment's current year loss ratio was 7.3 points lower in 2013 than in 2012. The 2013 loss ratio included 1.2 points of current year catastrophic event activity, compared to 5.9 points in 2012. The 2013 loss ratio reflected estimated margin expansion along with a lower level of non-catastrophic large loss activity than in 2012.

2012 versus 2011: The insurance segment's current year loss ratio was 0.1 points higher in 2012 than in 2011. The 2012 loss ratio included 5.9 points of current year catastrophic event activity, compared to 6.3 points in 2011. Specific 2012 catastrophic events included Superstorm Sandy in the 2012 fourth quarter, Hurricane Isaac in the 2012 third quarter and various U.S. wind/rain events in the 2012 first quarter.

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Prior Period Reserve Development.
2013 prior period reserve development: The insurance segment’s net favorable development of $45.1 million, or 2.4 points of net earned premium, consisted of $67.0 million of net favorable development from short-tailed lines, partially offset by $21.9 million of net adverse development from medium-tailed and long-tailed lines. Favorable development in short-tailed lines predominantly consisted of $62.4 million of net favorable development in property lines from the 2008 to 2011 accident years, primarily due to varying levels of reported claims activity, with the balance emanating from lenders products, primarily from the 2011 and 2012 accident years, and travel and accident, primarily from the 2009 and 2010 accident years. Contained within this short tail release was favorable development of $15.9 million from 2005 to 2012 named catastrophic events. Net adverse development in medium-tailed and long-tailed lines of $21.9 million included a net increase of $28.0 million in specialty casualty reserves. Such development primarily stemmed from losses in two captive programs written by the insurance segment's Canadian operation, which was partially offset by favorable development in non-captive business, and from three large excess casualty claims in the insurance segment's U.S. operation, all of the above in the more recent accident years. In addition, the insurance segment experienced $26.2 million of net adverse development in program business, with nearly 90% of this development emanating from a single canceled program whose last inception year was 2011. Such amounts were partially offset by net favorable development spread across various lines and accident years.
2012 prior period reserve development: The insurance segment’s net favorable development of $31.2 million, or 1.7 points of net earned premium, consisted of $79.3 million of net favorable development from short-tailed lines, partially offset by $48.1 million of net adverse development from medium-tailed and long-tailed lines. Favorable development in short-tailed lines predominantly consisted of $69.0 million of net favorable development in property lines from the 2007 to 2011 accident years, primarily due to varying levels of reported claims activity, with the balance emanating from travel and accident and lender’s products, both primarily from the 2009 to 2011 accident years. Contained within this short tail release was favorable development of $19.1 million from 2005 to 2011 named catastrophic events. Net adverse development in medium-tailed and long-tailed lines of $48.1 million included a net increase of $38.9 million from the insurance segment’s U.K. underwriting operations for the 2007 to 2010 accident years, primarily due to an increase in Australian executive assurance reserves. In addition, U.S. primary specialty casualty reserves reflected a net increase of $23.0 million, primarily from the 2003 to 2005 accident years, and $19.8 million from U.S. professional liability in the two most recent accident years. Such amounts were partially offset by net favorable development spread across various lines and accident years.
2011 prior period reserve development: The insurance segment’s net favorable development of $52.1 million, or 3.1 points of net earned premium, consisted of $75.7 million of net favorable development from short-tailed lines, partially offset by $23.6 million of net adverse development from medium-tailed and long-tailed lines. Favorable development in short-tailed lines predominantly consisted of $68.5 million of net favorable development in property lines from the 2008 to 2010 accident years, primarily due to varying levels of reported claims activity, with the balance emanating from surety and lender’s products, both primarily from the 2008 to 2010 accident years. Contained within this short tail release was favorable development of $23.0 million from 2005 to 2010 named catastrophic events. Net adverse development in medium-tailed and long-tailed lines of $23.6 million included a net increase of $32.3 million in casualty reserves which consisted of $14.3 million of adverse development, primarily from the 2005 and 2007 accident years, on New York residential contractors business, $8.5 million of adverse development on a 2010 accident year energy casualty claim, and $9.5 million from other commercial claims. In addition, there was a net increase of $9.8 million in program business, primarily from the 2003 and 2004 accident years. Such amounts were partially offset by net favorable development spread across various lines and accident years.
Underwriting Expenses.
2013 versus 2012: The insurance segment’s underwriting expense ratio was 33.3% in 2013, compared to 33.6% in 2012. The acquisition expense ratio was 16.5% for 2013, compared to 16.5% for 2012. The acquisition expense ratio is influenced by, among other things, (1) the amount of ceding commissions received from reinsurers, (2) the amount of business written on a surplus lines (non-admitted) basis and (3) mix of business. The 2013 acquisition expense ratio reflected changes in the form of reinsurance ceded and mix of business. The insurance segment’s other operating expense ratio was 16.8% for 2013, compared to 17.1% for 2012, reflecting the benefits of continued expense

management and a higher level of net premiums earned.
2012 versus 2011: The insurance segment's underwriting expense ratio was 33.6% in 2012, compared to 34.7% in 2011. The acquisition expense ratio was 16.5% for 2012, compared to 16.4% for 2011. The 2012 acquisition expense ratio

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also reflected changes in the form of reinsurance ceded and mix of business while the 2011 acquisition expense ratio included 0.5 points related to favorable reserve development in prior accident years on certain contracts with variable commission structures. The insurance segment's other operating expense ratio was 17.1% for 2012, compared to 18.3% for 2011, reflecting the benefits of continued expense management and a higher level of net premiums earned.

Reinsurance Segment

The following table sets forth our reinsurance segment's underwriting results:

	Year Ended December 31,			Year Ended December 31,		
	2013	2012	% Change	2012	2011	% Change
Gross premiums written	$1,489,191	$1,282,000	16.2	$1,282,000	$998,520	28.4
Net premiums written	1,402,571	1,226,901	14.3	1,226,901	952,047	28.9
Net premiums earned	$1,269,938	$1,134,797	11.9	$1,134,797	$952,768	19.1
Other underwriting income	5,517	5,755		5,755	559	
Losses and loss adjustment expenses	(490,979)	(577,436)		(577,436)	(554,811)	
Acquisition expenses, net	(252,199)	(209,901)		(209,901)	(184,241)	
Other operating expense	(142,940)	(122,546)		(122,546)	(92,945)	
Underwriting income	$389,337	$230,669	68.8	$230,669	$121,330	90.1
Underwriting Ratios			% Point Change			% Point Change
Loss ratio	38.7%	50.9%	(12.2)	50.9%	58.2%	(7.3)
Acquisition expense ratio	19.9%	18.5%	1.4	18.5%	19.3%	(0.8)
Other operating expense ratio	11.3%	10.8%	0.5	10.8%	9.8%	1.0
Combined ratio	69.9%	80.2%	(10.3)	80.2%	87.3%	(7.1)

The components of the reinsurance segment's underwriting results are discussed below.

Premiums Written.

The following table sets forth our reinsurance segment's net premiums written by major line of business:

	Year Ended December 31,					
	2013		2012		2011	
	Amount	%	Amount	%	Amount	%
Other specialty (1)	$417,865	30	$308,104	25	$219,632	23
Casualty (2)	306,304	22	205,925	17	173,344	18
Property excluding property catastrophe (3)	292,536	21	265,783	22	226,013	24
Property catastrophe	220,749	16	283,677	23	246,793	26
Marine and aviation	64,380	5	84,649	7	77,309	8
Other (4)	100,737	6	78,763	6	8,956	1
Total	$1,402,571	100	$1,226,901	100	$952,047	100
Pro rata	$781,594	56	$598,874	49	$416,321	44
Excess of loss	620,977	44	628,027	51	535,726	56
Total	$1,402,571	100	$1,226,901	100	$952,047	100

(1) Includes U.K. motor, trade credit, surety, workers' compensation catastrophe, accident and health and other.
(2) Includes professional liability, executive assurance and healthcare business.
(3) Includes facultative business.
(4) Includes mortgage, life, casualty clash and other.

2013 versus 2012: Net premiums written in 2013 were 14.3% higher than in 2012. The growth in net premiums written primarily reflected increases in other specialty and casualty lines, partially offset by reductions in property catastrophe and marine business. The increase in other specialty business was primarily due to a multi-line quota share reinsurance agreement entered into in the 2013 third quarter which resulted in approximately $66 million of premiums written in 2013, including a $40 million unearned premium transfer. In addition, other specialty premiums reflected growth

in trade credit and crop hail business, partially offset by a continued reduction in U.K. motor business. Growth in casualty business was due, in part, to a professional liability quota share contract entered into in the 2013 fourth quarter which contributed $59 million of premiums written in 2013, including a $44 million unearned premium transfer, along with new casualty multi-line treaties written during 2013. The reduction in property catastrophe and marine business reflected market conditions, selected non-renewals and a higher usage of retrocessional coverage.
2012 versus 2011: Net premiums written in 2012 were 28.9% higher than in 2011. The growth in net premiums written reflected increases in all lines of business, primarily in U.K. motor and mortgage business. The reinsurance segment’s U.K. motor business was primarily due to new business written emanating from one significant client while the mortgage business primarily resulted from a reinsurance treaty written in the 2012 second quarter covering newly originated residential mortgages beginning in October 2011. Growth in property lines primarily resulted from new business written by the reinsurance segment’s treaty and facultative operations and also reflected $10.1 million of reinstatement premiums as a result of the 2012 fourth quarter catastrophic activity while the higher level of casualty business reflects a mix of new business and the impact of improving market conditions.
Net Premiums Earned.
The following table sets forth our reinsurance segment’s net premiums earned by major line of business:

	Year Ended December 31,					
	2013		2012		2011	
	Amount	%	Amount	%	Amount	%
Other specialty (1)	$387,630	31	$309,101	27	$195,855	21
Casualty (2)	241,774	19	188,963	17	189,608	20
Property excluding property catastrophe (3)	274,719	22	254,338	22	243,702	26
Property catastrophe	232,423	18	280,185	25	238,748	25
Marine and aviation	70,105	6	76,145	7	77,819	8
Other (4)	63,287	4	26,065	2	7,036	0
Total	$1,269,938	100	$1,134,797	100	$952,768	100
Pro rata	$659,852	52	$515,764	45	$435,311	46
Excess of loss	610,086	48	619,033	55	517,457	54
Total	$1,269,938	100	$1,134,797	100	$952,768	100

(1) Includes U.K. motor, trade credit, surety, workers' compensation catastrophe, accident and health and other.
(2) Includes professional liability, executive assurance and healthcare business.
(3) Includes facultative business.
(4) Includes mortgage, life, casualty clash and other.

Net premiums earned in 2013 were 11.9% higher than in 2012, reflecting changes in net premiums written over the previous five quarters, including the mix and type of business written. Net premiums earned in 2012 were 19.1% higher than in 2011. We completed the acquisition of the credit and surety reinsurance operations of Ariel Reinsurance Company Ltd. based in Zurich, Switzerland in April 2012. In the transaction, which was accounted for as a business combination under GAAP, we acquired approximately $84 million of net unearned premiums along with other insurance balances. Under applicable accounting rules for business combinations, the recording of such unearned premiums was not reflected as net premiums written but results in net premiums earned. The reinsurance segment’s net premiums earned in 2013 and 2012 included approximately $26 million and $50 million, respectively, related to the acquired net unearned premiums with a remaining unearned premium balance of $8 million at December 31, 2013. Such amount is expected to be substantially earned by the end of 2014.

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Losses and Loss Adjustment Expenses.
The table below shows the components of the reinsurance segment's loss ratio:

	Year Ended December 31,					
	2013		2012		2011	
Current year	55.9	%	67.7	%	82.6	%
Prior period reserve development	(17.2	)%	(16.8	)%	(24.4	)%
Loss ratio	38.7	%	50.9	%	58.2	%

Current Year Loss Ratio.
2013 versus 2012: The reinsurance segment's current year loss ratio was 11.8 points lower in 2013 than in 2012. The 2013 loss ratio included 5.2 points for current year catastrophic event activity, compared to 14.7 points in 2012. The 2013 loss ratio also reflected changes in the mix of business.
2012 versus 2011: The reinsurance segment's current year loss ratio was 14.9 points lower in 2012 than in 2011. The 2012 loss ratio included 14.7 points for current year catastrophic event activity, compared to 32.5 points in 2011. Specific 2012 catastrophic events included Superstorm Sandy in the 2012 fourth quarter, Hurricane Isaac in the 2012 third quarter and various U.S. wind/rain events in the 2012 first quarter.
Prior Period Reserve Development.
2013 prior period reserve development: The reinsurance segment's net favorable development of $218.9 million, or 17.2 points of net earned premium, consisted of $112.1 million from short-tailed lines and $106.8 million of net favorable development from medium-tailed and long-tailed lines. Favorable development in short-tailed lines included $110.1 million from property catastrophe and property other than property catastrophe reserves, primarily from the 2009 to 2012 underwriting years. Contained within this release was favorable development of $28.6 million from the 2005 to 2012 named catastrophic events. The net reduction of loss estimates for the reinsurance segment's short-tailed lines primarily resulted from varying levels of reported and paid claims activity than previously anticipated which led to decreases in certain loss ratio selections during 2013. Net favorable development of $106.8 million in medium-tailed and long-tailed lines included reductions in casualty reserves of $98.8 million, primarily from the 2003 to 2009 underwriting years, and marine and aviation reserves of $8.1 million, primarily from the 2007 and 2009 underwriting years. The balance of net favorable development was spread across various lines and underwriting years.
2012 prior period reserve development: The reinsurance segment's net favorable development of $190.3 million, or 16.8 points of net earned premium, consisted of $117.6 million from short-tailed lines and $72.7 million of net favorable development from medium-tailed and long-tailed lines. Favorable development in short-tailed lines included $92.1 million from property catastrophe and property other than property catastrophe reserves, primarily from the 2008 to 2011 underwriting years. Contained within this release was favorable development of $16.8 million from the 2005 to 2011 named catastrophic events. The net reduction of loss estimates for the reinsurance segment's short-tailed lines primarily resulted from varying levels of reported and paid claims activity than previously anticipated which led to decreases in certain loss ratio selections during 2012. Net favorable development of $72.7 million in medium-tailed and long-tailed lines included reductions in casualty reserves of $55.9 million, primarily from the 2003 to 2009 underwriting years, and marine and aviation reserves of $16.8 million, primarily from the 2008 to 2010 underwriting years. The balance of net favorable development was spread across various lines and underwriting years.
2011 prior period reserve development: The reinsurance segment's net favorable development of $232.9 million, or 24.4 points of net earned premium, consisted of $118.5 million from short-tailed lines and $114.4 million of net favorable development from medium-tailed and long-tailed lines. Favorable development in short-tailed lines included $97.6 million from property catastrophe and property other than property catastrophe reserves, primarily from the 2007 to 2010 underwriting years. Contained within this release was favorable development of $19.4 million from the 2005 to 2010 named catastrophic events. The net reduction of loss estimates for the reinsurance segment's short-tailed lines primarily resulted from varying levels of reported and paid claims activity than previously anticipated which led to decreases in certain loss ratio selections during 2011. Net favorable development of $114.4 million in medium-tailed and long-tailed lines included reductions in casualty reserves of $99.0 million, primarily from the 2002 to 2007 underwriting years, and

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marine and aviation reserves of $15.4 million, primarily from the 2006 to 2010 underwriting years. The balance of net favorable development was spread across various lines and underwriting years.

Underwriting Expenses.

2013 versus 2012: The underwriting expense ratio for the reinsurance segment was 31.2% in 2013, compared to 29.3% in 2012. The acquisition expense ratio for 2013 was 19.9%, compared to 18.5% for 2012. The comparison of the 2013 and 2012 acquisition expense ratios is influenced by, among other things, the mix and type of business written and earned and the level of ceding commission income. The operating expense ratio for 2013 of 11.3% was higher than the 2012 ratio of 10.8% primarily due to selected expansion of the reinsurance segment's operating platform, partially offset by the benefits of a higher level of net premiums earned.

2012 versus 2011: The underwriting expense ratio for the reinsurance segment was 29.3% in 2012, compared to 29.1% in 2011. The acquisition expense ratio for 2012 was 18.5%, compared to 19.3% for 2011. The comparison of the 2012 and 2011 acquisition expense ratios is influenced by, among other things, the mix and type of business written and earned and the level of ceding commission income. The operating expense ratio for 2012 of 10.8% was higher than the 2011 ratio primarily due to selected expansion of the reinsurance segment's operating platform, partially offset by the benefits of a higher level of net premiums earned.

Net Investment Income

The components of net investment income were derived from the following sources:

	Year Ended December 31,		
	2013	2012	2011
Fixed maturities	$249,833	$281,140	$331,469
Term loan investments	20,608	15,283	2,854
Equity securities	8,919	7,963	7,332
Short-term investments	1,259	1,980	2,174
Other (1)	19,710	14,196	19,152
Gross investment income	300,329	320,562	362,981
Investment expenses	(33,110)	(25,667)	(24,783)
Net investment income	$267,219	$294,895	$338,198

(1) Includes dividends on investment funds and other items.

The pre-tax investment income yield was 2.12% for 2013, compared to 2.51% for 2012 and 2.89% for 2011. The comparability of net investment income between the periods was influenced by our share repurchase program, as well as the decrease in the pre-tax investment income yield, due in part to the prevailing interest rate environment. The pre-tax investment income yields were calculated based on amortized cost. Yields on future investment income may vary based on financial market conditions, investment allocation decisions and other factors.

Equity in Net Income (Loss) of Investment Funds Accounted for Using the Equity Method

We recorded $35.7 million of equity in net income for 2013, compared to $73.5 million of equity in net income for 2012 and $9.6 million of equity in net losses for 2011. Such amounts resulted, in part, from investments in U.S. and Euro-denominated bank loan funds which use leverage to achieve a higher rate of return. While leverage presents opportunities for increasing the total return of such investments, it may increase losses as well. Accordingly, any event that adversely affects the value of the underlying securities held by such investments would be magnified to the extent leverage is used and our potential losses from such investments would be magnified.

Net Realized Gains (Losses)

We recorded net realized gains of $74.0 million, $194.2 million and $110.6 million, respectively, for 2013, 2012 and 2011. Currently, our portfolio is managed to maximize total return within certain guidelines. In assessing returns under this approach, we include net investment income, net realized gains and losses and the change in unrealized gains and losses generated by our investment portfolio. The effect of financial market movements on the investment portfolio will directly

impact net realized gains and losses as the portfolio is adjusted and rebalanced. See note 6, "Investment Information—Net Realized Gains (Losses)," of the notes accompanying our consolidated financial statements for additional information. Total return on our portfolio under management for 2013 was 1.28%, compared to 5.88% for 2012 and 3.81% for 2011. Excluding foreign exchange, total return was 1.13% for 2013, compared to 5.59% for 2012 and 4.10% for 2011. Total return is calculated on a pre-tax basis and before investment expenses.

Net Impairment Losses Recognized in Earnings

On a quarterly basis, we perform reviews of our available for sale investments to determine whether declines in fair value below the cost basis are considered other-than-temporary in accordance with applicable accounting guidance regarding the recognition and presentation of other-than-temporary impairments. The process of determining whether a security is other-than-temporarily impaired requires judgment and involves analyzing many factors. These factors include (i) an analysis of the liquidity, business prospects and overall financial condition of the issuer, (ii) the time period in which there was a significant decline in value, (iii) the significance of the decline, and (iv) the analysis of specific credit events. We evaluate the unrealized losses of our equity securities by issuer and determine if we can forecast a reasonable period of time by which the fair value of the securities would increase and we would recover our cost. If we are unable to forecast a reasonable period of time in which to recover the cost of our equity securities, we record a net impairment loss in earnings equivalent to the entire unrealized loss. For 2013, we recorded $3.8 million of credit related impairments in earnings, compared to $11.4 million in 2012 and $9.1 million in 2011. The other-than-temporary impairments ("OTTI") recorded in 2013, 2012 and 2011 primarily resulted from reductions in estimated recovery values on certain mortgage-backed and asset-backed securities following the review of such securities and on equity securities following a review of available positive and negative evidence. See note 6, "Investment Information—Other-Than-Temporary Impairments," of the notes accompanying our consolidated financial statements for additional information.

Other Expenses

Other expenses, which are included in our other operating expenses and part of corporate and other (non-underwriting), were $42.4 million for 2013, compared to $35.3 million for 2012 and $31.4 million for 2011. Such amounts primarily represent certain holding company costs necessary to support our worldwide insurance and reinsurance operations, share based compensation expense and costs associated with operating as a publicly traded company.

Net Foreign Exchange Gains or Losses

Net foreign exchange losses for 2013 of $12.3 million consisted of net unrealized gains of $0.7 million and net realized losses of $13.0 million, compared to net foreign exchange losses for 2012 of $29.0 million which consisted of net unrealized losses of $27.3 million and net realized losses of $1.6 million and net foreign exchange gains for 2011 of $17.4 million which consisted of net unrealized gains of $23.5 million and net realized losses of $6.1 million. Net unrealized foreign exchange gains or losses result from the effects of revaluing our net insurance liabilities required to be settled in foreign currencies at each balance sheet date. Historically, we have held investments in foreign currencies which are intended to mitigate our exposure to foreign currency fluctuations in our net insurance liabilities. However, changes in the value of such investments due to foreign currency rate movements are reflected as a direct increase or decrease to shareholders' equity and are not included in the consolidated statements of income. At times, we have chosen not to match portions of our projected liabilities in foreign currencies with investments in the same currencies and may not match such amounts in future periods, which could increase our exposure to foreign currency fluctuations and increase the volatility of our shareholders' equity.

Loss on Repurchase of Preferred Shares

Following the issuance of $325.0 million of 6.75% Series C preferred shares in April 2012, we redeemed all of our $200.0 million of 8.0% Series A preferred shares and $125.0 million of 7.875% Series B preferred shares at a redemption price equal to $25.00 per share in May 2012. In accordance with GAAP, upon issuance of the Series A and B preferred shares in 2006, costs of $10.6 million were recognized as a reduction of additional paid-in capital in shareholders' equity. Following the redemption of such shares, such issue costs were recorded as a "loss on repurchase of preferred shares" to remove the costs from additional paid-in capital. Such adjustment had no impact on total shareholders' equity or cash flows.

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Income Taxes

ACGL changed its legal domicile from the United States to Bermuda in November 2000. Under current Bermuda law, we are not obligated to pay any taxes in Bermuda based upon income or capital gains. We have received a written undertaking from the Minister of Finance in Bermuda under the Exempted Undertakings Tax Protection Act of 1966 that in the event legislation is enacted in Bermuda imposing tax computed on profits, income, gain or appreciation on any capital asset, or tax in the nature of estate duty or inheritance tax, such tax will not be applicable to us or our operations until March 31, 2035.

ACGL will be subject to U.S. federal income tax only to the extent that it derives U.S. source income that is subject to U.S. withholding tax or income that is effectively connected with the conduct of a trade or business within the U.S. and is not exempt from U.S. tax under an applicable income tax treaty. ACGL will be subject to a withholding tax on dividends from U.S. investments and interest from certain U.S. taxpayers. ACGL does not consider itself to be engaged in a trade or business within the U.S. and, consequently, does not expect to be subject to direct U.S. income taxation. However, because there is uncertainty as to the activities which constitute being engaged in a trade or business within the United States, there can be no assurances that the U.S. Internal Revenue Service will not contend successfully that ACGL or its non-U.S. subsidiaries are engaged in a trade or business in the United States. If ACGL or any of its non-U.S. subsidiaries were subject to U.S. income tax, ACGL's shareholders' equity and earnings could be materially adversely affected. ACGL has subsidiaries and branches that operate in various jurisdictions around the world that are subject to tax in the jurisdictions in which they operate. The significant jurisdictions in which ACGL's subsidiaries and branches are subject to tax include the United States, United Kingdom, Canada, Ireland, Switzerland and Denmark. See "Risk Factors—Risks Relating to Taxation" and "Business—Tax Matters."

The income tax provision on income before income taxes resulted in an expense of 4.4% for 2013, compared to a benefit of 0.7% for 2012 and a benefit of 2.3% for 2011. Our effective tax rate fluctuates from year to year consistent with the relative mix of income or loss reported by jurisdiction and the varying tax rates in each jurisdiction. See note 12, "Income Taxes," of the notes accompanying our consolidated financial statements for a reconciliation of the difference between the provision for income taxes and the expected tax provision at the weighted average statutory tax rate for 2013, 2012 and 2011.

CRITICAL ACCOUNTING POLICIES, ESTIMATES AND RECENT ACCOUNTING PRONOUNCEMENTS

The preparation of consolidated financial statements in accordance with GAAP requires us to make many estimates and judgments that affect the reported amounts of assets, liabilities (including reserves), revenues and expenses, and related disclosures of contingent liabilities. On an ongoing basis, we evaluate our estimates, including those related to revenue recognition, insurance and other reserves, reinsurance recoverables, allowance for doubtful accounts, investment valuations, intangible assets, bad debts, income taxes, contingencies and litigation. We base our estimates on historical experience, where possible, and on various other assumptions that we believe to be reasonable under the circumstances, which form the basis for our judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Estimates and judgments for a relatively new insurance and reinsurance company, like our company, are even more difficult to make than those made in a mature company since relatively limited historical information has been reported to us through December 31, 2013. Actual results will differ from these estimates and such differences may be material. We believe that the following critical accounting policies affect significant estimates used in the preparation of our consolidated financial statements.

Reserves for Losses and Loss Adjustment Expenses

We are required by applicable insurance laws and regulations and GAAP to establish reserves for losses and loss adjustment expenses ("Loss Reserves") that arise from the business we underwrite. Loss Reserves for our insurance and reinsurance operations are balance sheet liabilities representing estimates of future amounts required to pay losses and loss adjustment expenses for insured or reinsured events which have occurred at or before the balance sheet date. Loss Reserves do not reflect contingency reserve allowances to account for future loss occurrences. Losses arising from future events will be estimated and recognized at the time the losses are incurred and could be substantial.

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At December 31, 2013 and 2012, our Loss Reserves, net of unpaid losses and loss adjustment expenses recoverable, by type and by operating segment were as follows:

	December 31,	
	2013	2012
Insurance:		
Case reserves	$1,446,029	$1,438,575
IBNR reserves	3,037,755	2,979,344
Total net reserves	$4,483,784	$4,417,919
Reinsurance:		
Case reserves	$751,249	$781,894
Additional case reserves	113,331	195,033
IBNR reserves	1,728,082	1,709,376
Total net reserves	$2,592,662	$2,686,303
Total:		
Case reserves	$2,197,278	$2,220,469
Additional case reserves	113,331	195,033
IBNR reserves	4,765,837	4,688,720
Total net reserves	$7,076,446	$7,104,222

Insurance Operations

Loss Reserves for our insurance operations are comprised of (1) estimated amounts for claims reported ("case reserves") and (2) incurred but not reported ("IBNR") losses. For our insurance operations, generally, claims personnel determine whether to establish a case reserve for the estimated amount of the ultimate settlement of individual claims. The estimate reflects the judgment of claims personnel based on general corporate reserving practices, the experience and knowledge of such personnel regarding the nature and value of the specific type of claim and, where appropriate, advice of counsel. Our insurance operations also contract with a number of outside third party administrators in the claims process who, in certain cases, have limited authority to establish case reserves. The work of such administrators is reviewed and monitored by our claims personnel. Loss Reserves are also established to provide for loss adjustment expenses and represent the estimated expense of settling claims, including legal and other fees and the general expenses of administering the claims adjustment process. Periodically, adjustments to the reported or case reserves may be made as additional information regarding the claims is reported or payments are made. IBNR reserves are established to provide for incurred claims which have not yet been reported at the balance sheet date as well as to adjust for any projected variance in case reserving. Actuaries estimate ultimate losses and loss adjustment expenses using various generally accepted actuarial methods applied to known losses and other relevant information. Like case reserves, IBNR reserves are adjusted as additional information becomes known or payments are made. The process of estimating reserves involves a considerable degree of judgment by management and, as of any given date, is inherently uncertain.

Ultimate losses and loss adjustment expenses are generally determined by extrapolation of claim emergence and settlement patterns observed in the past that can reasonably be expected to persist into the future. In forecasting ultimate losses and loss adjustment expenses with respect to any line of business, past experience with respect to that line of business is the primary resource, developed through both industry and company experience, but cannot be relied upon in isolation. Uncertainties in estimating ultimate losses and loss adjustment expenses are magnified by the time lag between when a claim actually occurs and when it is reported and settled. This time lag is sometimes referred to as the "claim-tail". The claim-tail for most property coverages is typically short (usually several months up to a few years). The claim-tail for certain professional liability, executive assurance and healthcare coverages, which are generally written on a claims-made basis, is typically longer than property coverages but shorter than casualty lines. The claim-tail for liability/casualty coverages, such as general liability, products liability, multiple peril coverage, and workers' compensation, may be especially long as claims are often reported and ultimately paid or settled years, or even decades, after the related loss events occur. During the long claims reporting and settlement period, additional facts regarding coverages written in prior accident years, as well as about actual claims and trends, may become known and, as a result, our insurance operations may adjust their reserves. If management determines that an adjustment is appropriate, the adjustment is recorded in the accounting period in which such determination is made in accordance with GAAP. Accordingly, should Loss Reserves need to be increased or decreased in the future from amounts currently established, future results of operations would be negatively or positively impacted, respectively.

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In determining ultimate losses and loss adjustment expenses, the cost to indemnify claimants, provide needed legal defense and other services for insureds and administer the investigation and adjustment of claims are considered. These claim costs are influenced by many factors that change over time, such as expanded coverage definitions as a result of new court decisions, inflation in costs to repair or replace damaged property, inflation in the cost of medical services and legislated changes in statutory benefits, as well as by the particular, unique facts that pertain to each claim. As a result, the rate at which claims arose in the past and the costs to settle them may not always be representative of what will occur in the future. The factors influencing changes in claim costs are often difficult to isolate or quantify and developments in paid and incurred losses from historical trends are frequently subject to multiple and conflicting interpretations. Changes in coverage terms or claims handling practices may also cause future experience and/or development patterns to vary from the past. A key objective of actuaries in developing estimates of ultimate losses and loss adjustment expenses, and resulting IBNR reserves, is to identify aberrations and systemic changes occurring within historical experience and accurately adjust for them so that the future can be projected reliably. Because of the factors previously discussed, this process requires the substantial use of informed judgment and is inherently uncertain.

At December 31, 2013 and 2012, the insurance segment's Loss Reserves by major line of business, net of unpaid losses and loss adjustment expenses recoverable, were as follows:

	December 31,	
	2013	2012
Executive assurance	$803,021	$772,768
Casualty	669,078	663,703
Programs	644,689	592,235
Professional liability	597,612	598,638
Property, energy, marine and aviation	503,208	613,176
Construction	452,861	430,170
National accounts	241,860	207,551
Healthcare	124,727	135,227
Surety	82,999	95,139
Travel and accident	35,197	36,568
Lenders products	31,076	28,606
Other	297,456	244,138
Total net reserves	$4,483,784	$4,417,919

The initial reserving method for our insurance operations to date has been, to a large extent, the expected loss method, which is commonly applied when limited loss experience exists. Our insurance operations employ a number of different reserving methods depending on the line of business, the availability of historical loss experience and the stability of that loss experience. Over time, such techniques have been given more weight in the reserving process due to the continuing maturation of their Loss Reserves and the increased availability and credibility of the historical experience. Any estimates and assumptions made as part of the reserving process could prove to be inaccurate due to several factors, including the fact that relatively limited historical information has been reported to our insurance operations through December 31, 2013 in some lines of business. See below for a discussion of the key assumptions in our insurance operations' reserving process.

Although Loss Reserves are initially determined based on underwriting and pricing analyses, our insurance operations apply several generally accepted actuarial methods, as discussed below, on a quarterly basis to evaluate their Loss Reserves, in addition to the expected loss method, in particular for Loss Reserves from more mature accident years (the year in which a loss occurred). As noted below, our insurance operations give some weight to their own experience following reviews of open claims on lines of business written on a claims-made basis for which they developed a reasonable level of credible data. Each quarter, as part of the reserving process, actuaries at our insurance operations reaffirm that the assumptions used in the reserving process continue to form a sound basis for the projection of liabilities. If actual loss activity differs substantially from expectations based on historical information, an adjustment to loss reserves may be supported. Loss Reserves for more mature accident years are now based more on historical loss activity and patterns than on the initial assumptions based on pricing indications. More recent accident years rely more heavily on internal pricing assumptions. Our insurance operations place more or less reliance on a particular actuarial method based on the facts and circumstances at the time the estimates of Loss Reserves are made. These methods generally fall into one of the following categories or are hybrids of one or more of the following categories:

- Expected loss methods – these methods are based on the assumption that ultimate losses vary proportionately with premiums. Expected loss and loss adjustment expense ratios are typically developed based upon the information derived by underwriters and actuaries during the initial pricing of the business, supplemented by industry data available from organizations, such as statistical bureaus and consulting firms, where appropriate. These ratios consider, among other things, rate increases and changes in terms and conditions that have been observed in the market. Expected loss methods are useful for estimating ultimate losses and loss adjustment expenses in the early years of long-tailed lines of business, when little or no paid or incurred loss information is available, and is commonly applied when limited loss experience exists for a company.

- Historical incurred loss development methods – these methods assume that the ratio of losses in one period to losses in an earlier period will remain constant in the future. These methods use incurred losses (i.e., the sum of cumulative historical loss payments plus outstanding case reserves) over discrete periods of time to estimate future losses. Historical incurred loss development methods may be preferable to historical paid loss development methods because they explicitly take into account open cases and the claims adjusters' evaluations of the cost to settle all known claims. However, historical incurred loss development methods necessarily assume that case reserving practices are consistently applied over time. Therefore, when there have been significant changes in how case reserves are established, using incurred loss data to project ultimate losses may be less reliable than other methods.
- Historical paid loss development methods – these methods, like historical incurred loss development methods, assume that the ratio of losses in one period to losses in an earlier period will remain constant. These methods use historical loss payments over discrete periods of time to estimate future losses and necessarily assume that factors that have affected paid losses in the past, such as inflation or the effects of litigation, will remain constant in the future. Because historical paid loss development methods do not use incurred losses to estimate ultimate losses, they may be more reliable than the other methods that use incurred losses in situations where there are significant changes in how incurred losses are established by a company's claims adjusters. However, historical paid loss development methods are more leveraged (meaning that small changes in payments have a larger impact on estimates of ultimate losses) than actuarial methods that use incurred losses because cumulative loss payments take much longer to equal the expected ultimate losses than cumulative incurred amounts. In addition, and for similar reasons, historical paid loss development methods are often slow to react to situations when new or different factors arise than those that have affected paid losses in the past.
- Adjusted historical paid and incurred loss development methods – these methods take traditional historical paid and incurred loss development methods and adjust them for the estimated impact of changes from the past in factors such as inflation, the speed of claim payments or the adequacy of case reserves. Adjusted historical paid and incurred loss development methods are often more reliable methods of predicting ultimate losses in periods of significant change, provided the actuaries can develop methods to reasonably quantify the impact of changes. As such, these methods utilize more judgment than historical paid and incurred loss development methods.
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