HCC INSURANCE HOLDINGS INC/DE/
Form 10-K
March 02, 2009

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UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 10-K

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

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

For the fiscal year ended December 31, 2008

Commission file number 001-13790

HCC Insurance Holdings, Inc.
(Exact name of registrant as specified in its charter)

Delaware *(State or other jurisdiction of incorporation or organization)*	**76-0336636** *(IRS Employer Identification No.)*
13403 Northwest Freeway, Houston, Texas *(Address of principal executive offices)*	**77040-6094** *(Zip Code)*

(713) 690-7300

(Registrant s telephone number, including area code)

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

Title of each class:	**Name of each exchange on which registered:**
Common Stock, $1.00 par Value	New York Stock Exchange

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

Indicate by check mark if the registrant is a well-known seasoned issuer as defined in Rule 405 of the Securities Act. Yes þ 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 þ

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days. Yes þ 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, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer þ	Accelerated filer o
Non-accelerated filer o (Do not check if a smaller reporting company)	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 **þ**

The aggregate market value on June 30, 2008 (the last business day of the registrant s most recently completed second fiscal quarter) of the voting stock held by non-affiliates of the registrant was approximately $2.4 billion. For purposes of the determination of the above-stated amount, only Directors and executive officers are presumed to be affiliates, but neither the registrant nor any such person concede that they are affiliates of the registrant.

The number of shares outstanding of the registrant s Common Stock, $1.00 par value, at February 20, 2009 was 113.6 million.

DOCUMENTS INCORPORATED BY REFERENCE:

Information called for in Part III of this Form 10-K is incorporated by reference to the registrant s definitive Proxy Statement to be filed within 120 days of the close of the registrant s fiscal year in connection with the registrant s annual meeting of shareholders.

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FORWARD-LOOKING STATEMENTS

This report on Form 10-K contains certain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934, which are intended to be covered by the safe harbors created by those laws. We have based these forward-looking statements on our current expectations and projections about future events. These forward-looking statements include information about possible or assumed future results of our operations. All statements, other than statements of historical facts, included or incorporated by reference in this report that address activities, events or developments that we expect or anticipate may occur in the future, including such things as growth of our business and operations, business strategy, competitive strengths, goals, plans, future capital expenditures and references to future successes may be considered forward-looking statements. Also, when we use words such as anticipate, believe, estimate, expect, intend, plan, probably c expressions, we are making forward-looking statements.

Many risks and uncertainties may impact the matters addressed in these forward-looking statements, which could affect our future financial results and performance, including, among other things:

- *the effects of catastrophic losses;*
- *the cyclical nature of the insurance business;*
- *inherent uncertainties in the loss estimation process, which can adversely impact the adequacy of loss reserves;*
- *the effects of emerging claim and coverage issues;*
- *the effects of extensive governmental regulation of the insurance industry;*
- *potential credit risk with brokers;*
- *our assessment of underwriting risk;*
- *our retention of risk, which could expose us to potential losses;*
- *the adequacy of reinsurance protection;*
- *the ability or willingness of reinsurers to pay balances due us;*
- *the occurrence of terrorist activities;*
- *our ability to maintain our competitive position;*
- *changes in our assigned financial strength ratings;*
- *our ability to raise capital and funds for liquidity in the future;*
- *attraction and retention of qualified employees;*
- *fluctuations in securities markets, which may reduce the value of our investment assets, reduce investment income or generate realized investment losses;*

our ability to successfully expand our business through the acquisition of insurance-related companies;

impairment of goodwill;

the ability of our insurance company subsidiaries to pay dividends in needed amounts;

fluctuations in foreign exchange rates;

failures of our information technology systems

potential changes to the country s health care delivery system; and

change of control.

We describe these risks and uncertainties in greater detail in Item 1A, Risk Factors.

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These events or factors could cause our results or performance to differ materially from those we express in our forward-looking statements. Although we believe that the assumptions underlying our forward-looking statements are reasonable, any of these assumptions, and, therefore, also the forward-looking statements based on these assumptions, could themselves prove to be inaccurate. In light of the significant uncertainties inherent in the forward-looking statements that are included in this Report, our inclusion of this information is not a representation by us or any other person that our objectives and plans will be achieved.

Our forward-looking statements speak only at the date made, and we will not update these forward-looking statements unless the securities laws require us to do so. In light of these risks, uncertainties and assumptions, any forward-looking events discussed in this Report may not occur.

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PART I

Item 1. *Business*

Business Overview

HCC Insurance Holdings, Inc. is a Delaware corporation, which was formed in 1991. Its predecessor corporation was formed in 1974. Our principal executive offices are located at 13403 Northwest Freeway, Houston, Texas 77040, and our telephone number is (713) 690-7300. We maintain an Internet website at *www.hcc.com.* The reference to our Internet website address in this Report does not constitute the incorporation by reference of the information contained at the website in this Report. We will make available, free of charge through publication on our Internet website, a copy of our Annual Report on Form 10-K and quarterly reports on Form 10-Q and any current reports on Form 8-K or amendments to those reports, filed with or furnished to the Securities and Exchange Commission (SEC) as soon as reasonably practicable after we have filed or furnished such materials with the SEC.

As used in this report, unless otherwise required by the context, the terms we, us and our refer to HCC Insurance Holdings, Inc. and its consolidated subsidiaries and the term HCC refers only to HCC Insurance Holdings, Inc. All trade names or trademarks appearing in this report are the property of their respective holders.

We provide specialized property and casualty, surety, and group life, accident and health insurance coverages and related agency and reinsurance brokerage services to commercial customers and individuals. We concentrate our activities in selected, narrowly defined, specialty lines of business. We operate primarily in the United States, the United Kingdom, Spain, Bermuda and Ireland. Some of our operations have a broader international scope. We underwrite on both a direct basis, where we insure a risk in exchange for a premium, and on a reinsurance (assumed) basis, where we insure all or a portion of another, or ceding, insurance company s risk in exchange for all or a portion of the ceding insurance company s premium for the risk. We market our products both directly to customers and through a network of independent and affiliated brokers, producers, agents and third party administrators.

Since our founding, we have been consistently profitable, generally reporting annual increases in total revenue and shareholders equity. During the period 2004 through 2008, we had an average statutory combined ratio of 87.4% versus the less favorable 98.4% (source: A.M. Best Company, Inc.) recorded by the U.S. property and casualty insurance industry overall. During the period 2004 through 2008, our gross written premium increased from $2.0 billion to $2.5 billion, an increase of 27%, while net written premium increased 86% from $1.1 billion to $2.1 billion. During this period, our revenue increased from $1.3 billion to $2.3 billion, an increase of 77%. During the period December 31, 2004 through December 31, 2008, our shareholders equity increased 99% from $1.3 billion to $2.6 billion and our assets increased 41% from $5.9 billion to $8.3 billion.

Our insurance companies are risk-bearing and focus their underwriting activities on providing insurance and/or reinsurance in the following lines of business:

- Diversified financial products
- Group life, accident and health
- Aviation
- London market account
- Other specialty lines

Our domestic operating insurance companies are rated AA (Very Strong) (3rd of 23 ratings) by Standard & Poor s Corporation and AA (Very Strong) by Fitch Ratings (3rd of 21 ratings). Our international operating insurance companies are rated AA (Very Strong) by Standard & Poor s Corporation. Avemco Insurance Company, HCC Life Insurance Company, Houston Casualty Company and U.S. Specialty Insurance Company are rated A+ (Superior) (2nd of 16 ratings) by A.M. Best Company, Inc. American Contractors

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Indemnity Company, Perico Life Insurance Company, United States Surety Company and HCC Insurance Company are rated A (Excellent) (3rd of 16 ratings) by A.M. Best Company, Inc. Standard & Poor s, Fitch Ratings and A.M. Best are internationally recognized independent rating agencies. These financial strength ratings are intended to provide an independent opinion of an insurer s ability to meet its obligations to policyholders and are not evaluations directed at investors.

Our underwriting agencies underwrite on behalf of our insurance companies and in certain situations for other unaffiliated insurance companies. They receive fees for these services and do not bear any of the insurance risk of the companies for which they underwrite. Our underwriting agencies generate revenues based on fee income and profit commissions. The agencies specialize in the following types of business: contingency (including contest indemnification, event cancellation and weather coverages); directors and officers liability; individual disability (for athletes and other high profile individuals); kidnap and ransom; employment practices liability; marine; professional indemnity; public entity; various financial products; short-term medical; fidelity, difference in conditions (earthquake) and other specialty business. Our principal underwriting agencies are Covenant Underwriters, G.B. Kenrick & Associates, HCC Global Financial Products, HCC Indemnity Guaranty Agency, HCC Specialty Underwriters, MultiNational Underwriters, LLC, Professional Indemnity Agency and RA&MCO Insurance Services.

Our brokers provide reinsurance and insurance brokerage services for our insurance companies, agencies and our clients and receive fees for their services. A reinsurance broker structures and arranges reinsurance between insurers seeking to cede insurance risks and reinsurers willing to assume such risks. Reinsurance brokers do not bear any of the insurance risks of their client companies. They earn commission income, and to a lesser extent, fees for certain services, generally paid by the insurance and reinsurance companies with whom the business is placed. Insurance broker operations consist of consulting with retail and wholesale clients by providing information about insurance coverage and marketing, placing and negotiating particular insurance risks. Our brokers specialize in placing insurance and reinsurance for group life, accident and health, aviation, surety, marine, and property and casualty lines of business. Our brokers are Continental Underwriters and Rattner Mackenzie.

Our Strategy

Our business philosophy is to maximize underwriting profits and produce non-risk-bearing fee and commission income while limiting risk in order to preserve shareholders equity and maximize earnings. We concentrate our insurance writings in selected, narrowly defined, specialty lines of business in which we believe we can achieve an underwriting profit. We also rely on our experienced underwriting personnel and our access to and expertise in the reinsurance marketplace to achieve our strategic objectives. We market our insurance products both directly to customers and through affiliated and independent brokers, agents, producers and third party administrators.

The property and casualty insurance industry and individual lines of business within the industry are cyclical. There are times, particularly when there is excess capital in the industry or underwriting results have been good, when a large number of companies offer insurance on certain lines of business, causing premium rates and premiums written by companies to trend downward. During other times, insurance companies limit their writings in certain lines of business due to lack of capital or following periods of excessive losses. This results in an increase in premium rates and premiums for those companies that continue to write insurance in those lines of business.

In our insurance company operations, we believe our operational flexibility, which permits us to shift the focus of our insurance underwriting activity among our various lines of business, allows us to implement a strategy of emphasizing more profitable lines of business during periods of increased premium rates and de-emphasizing less profitable lines of business during periods of increased competition. In addition, we believe that our underwriting agencies and brokers complement our insurance underwriting activities. Our ability to utilize affiliated insurers, underwriting agencies and reinsurance brokers permits us to retain a greater portion of the gross revenue derived from our written premium.

Following a period in which premium rates rose substantially, premium rates in several of our lines of business became more competitive during the past five years. The rate decreases were more gradual than the prior rate increases; thus, our underwriting activities remain profitable. During the past several years, we expanded our underwriting activities and increased our retentions in response to these market conditions, to the increased spread provided by our overall book of business, and to our increased capital strength. During 2005 and 2006, we increased our retentions on certain of our lines of business that were not generally exposed to catastrophe risk and where profit margins were usually more predictable. These higher retention levels increased our net written and earned premium and have resulted in additional underwriting profits, investment income and net earnings.

Through reinsurance, our insurance companies transfer or cede all or part of the risk we have underwritten to a reinsurance company in exchange for all or part of the premium we receive in connection with the risk. We purchase reinsurance to limit the net loss to our insurance companies from both individual and catastrophic risks. The amount of reinsurance we purchase varies depending on, among other things, the particular risks inherent in the policies underwritten, the pricing of reinsurance and the competitive conditions within the relevant line of business.

When we decide to retain more underwriting risk in a particular line of business, we do so with the intention of retaining a greater portion of any underwriting profits without increasing our exposure to severe or catastrophe losses. In this regard, we may purchase less proportional or quota share reinsurance applicable to that line, thus accepting more of the risk but possibly replacing it with specific excess of loss reinsurance, in which we transfer to reinsurers both premium and losses on a non-proportional basis for individual and catastrophic risks above a retention point. Additionally, we may obtain facultative reinsurance protection on individual risks. In some cases, we may choose not to purchase reinsurance in a line of business in which we believe there has been a favorable loss history, our policy limits are relatively low or we determine there is a low likelihood of catastrophe exposure.

We also acquire or make strategic investments in companies that present an opportunity for future profits or for the enhancement of our business. We expect to continue to acquire complementary businesses. We believe that we can enhance acquired businesses through the synergies created by our underwriting capabilities and our other operations.

Our business plan is shaped by our underlying business philosophy, which is to maximize underwriting profit and net earnings while preserving and achieving long-term growth of shareholders equity. As a result, our primary objective is to increase net earnings rather than market share or gross written premium.

In our ongoing operations, we will continue to:

- emphasize the underwriting of lines of business in which there is an anticipation of underwriting profits based on various factors including premium rates, the availability and cost of reinsurance, policy terms and conditions, and market conditions,

- limit our insurance companies aggregate net loss exposure from a catastrophic loss through the use of reinsurance for those lines of business exposed to such losses and diversification into lines of business not exposed to such losses, and

- consider the potential acquisition of specialty insurance operations and other strategic investments.

Industry Segment and Geographic Information

Financial information concerning our operations by industry segment and geographic data is included in the Consolidated Financial Statements and Notes thereto.

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Acquisitions

We have made a series of acquisitions that have furthered our overall business strategy. Our major transactions during the last three years are described below:

On July 1, 2006, we acquired G.B. Kenrick & Associates, Inc., an underwriting agency located in Auburn Hills, Michigan, recognized as a premier underwriter of public entity insurance. Kenrick operates as a subsidiary of Professional Indemnity Agency.

On October 2, 2006, we acquired the assets of the Health Products Division of Allianz Life Insurance Company of North America (the Health Products Division) for cash consideration of $140.0 million and assumed the outstanding loss reserves. The Health Products Division s operations include medical stop-loss insurance for self-insured corporations and groups; medical excess insurance for HMOs; provider excess insurance for integrated delivery systems; excess medical reinsurance to small and regional insurance carriers; and LifeTrac, a network for providing organ and bone marrow transplants. We integrated the Health Products Division s operations into HCC Life Insurance Company.

On January 2, 2008, we acquired MultiNational Underwriters, LLC, an underwriting agency located in Indianapolis, Indiana for cash consideration of $42.7 million and possible additional cash consideration depending upon future underwriting profit levels. This agency writes domestic and international short-term medical insurance. We formed Syndicate 4141 at Lloyd s of London to write the international business.

In the fourth quarter of 2008, we acquired four underwriting agencies for total consideration of $29.9 million. On October 1, 2008 we acquired the Criminal Justice division of U.S. Risk Insurance Brokers. Rebranded Pinnacle Underwriting Partners, this newly established underwriting agency, located in Scottsdale, Arizona, serves the private detention and security industry. On November 1, 2008, we acquired Cox Insurance Group, a medical stop-loss managing general underwriter covering the Midwestern United States. On December 1, 2008, we acquired Arrowhead Public Risk, a division of Arrowhead General Insurance Agency, Inc., a managing general agency based in Richmond, Virginia, specializing in risk management for the public entity sector. On December 31, 2008, we acquired VMGU Insurance Agency, a leading underwriter of the lumber, building materials, forest products and woodworking industries, based in Waltham, Massachusetts.

On December 3, 2008, we announced that the Company had executed an agreement to acquire Surety Company of the Pacific, a leading writer of license and permit bonds headquartered in Encino, California. This transaction closed on February 28, 2009.

We continue to evaluate acquisition opportunities, and we may complete additional acquisitions during 2009. Any future acquisitions will be designed to expand and strengthen our existing lines of business or to provide access to additional specialty sectors, which we expect to contribute to our overall growth.

Insurance Company Operations

Lines of Business

This table shows our insurance companies total premium written, otherwise known as gross written premium, by line of business and the percentage of each line to total gross written premium (dollars in thousands):

	2008	2007	2006

Diversified financial products	$	1,051,722	42%	$	963,355	39%	$	956,057	43%
Group life, accident and health		829,903	33		798,684	33		621,639	28
Aviation		185,786	8		195,809	8		216,208	10
London market account		175,561	7		213,716	9		234,868	10
Other specialty lines		251,021	10		280,040	11		205,651	9
Discontinued lines of business		4,770			(425)			1,225	
Total gross written premium	$	2,498,763	100%	$	2,451,179	100%	$	2,235,648	100%

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This table shows our insurance companies actual premium retained, otherwise known as net written premium, by line of business and the percentage of each line to total net written premium (dollars in thousands):

	2008		2007		2006	
Diversified financial products	$ 872,007	42%	$ 771,648	39%	$ 794,232	44%
Group life, accident and health	789,479	38	759,207	38	590,811	33
Aviation	136,019	7	145,761	7	166,258	9
London market account	107,234	5	118,241	6	127,748	7
Other specialty lines	151,120	8	191,151	10	133,481	7
Discontinued lines of business	4,759		(399)		22	
Total net written premium	$ 2,060,618	100%	$ 1,985,609	100%	$ 1,812,552	100%

This table shows our insurance companies net written premium as a percentage of gross written premium, otherwise referred to as percentage retained, for our continuing lines of business:

	2008	2007	2006
Diversified financial products	83%	80%	83%
Group life, accident and health	95	95	95
Aviation	73	74	77
London market account	61	55	54
Other specialty lines	60	68	65
Consolidated percentage retained	82%	81%	81%

Underwriting

We underwrite business produced through affiliated underwriting agencies, through independent and affiliated brokers, producers and third party administrators, and by direct marketing efforts. We also write facultative or individual account reinsurance, as well as some treaty reinsurance business.

Diversified Financial Products

We underwrite a variety of financial insurance risks in our diversified financial products line of business. These risks include:

- directors and officers liability
- employment practices liability
- professional indemnity
- surety and credit
- fidelity
- various financial products

We began to underwrite this line of business through a predecessor company in 1977. Our insurance companies started participating in this business in 2001. We have substantially increased our level of business through the acquisition of a number of agencies and insurance companies that operate in this line of business, both domestically and internationally. Each of the acquired entities has significant experience in its respective specialty within this line of business. We have also formed entities developed around teams of experienced underwriters that offer these products.

In 2002 and 2003, following several years of insurance industry losses, significant rate increases were experienced throughout our diversified financial products line of business, particularly directors and officers liability, which we began underwriting in 2002. We benefited greatly from these improved conditions despite the fact that we had not been involved in the past losses. Rates softened between 2004 and 2008 for some of the products in this line and increased for other products in 2008, but our underwriting margins are still very profitable. There is also considerable investment income derived from diversified financial products due to the extended periods involved in claims resolution. Although individual losses in the directors and officers public company liability business may have potential severity, the remainder of the diversified financial products business is less volatile with relatively low limits.

Group Life, Accident and Health

We write medical stop-loss business through HCC Life Insurance Company and, since its December 2005 acquisition, Perico Life Insurance Company. Our medical stop-loss insurance provides coverages to companies, associations and public entities that elect to self-insure their employees medical coverage for losses within specified levels, allowing them to manage the risk of excessive health insurance exposure by limiting aggregate and specific losses to a predetermined amount. We first began writing this business through a predecessor company in 1980. Our insurance companies started participating in this business in 1997. This line of business has grown both organically and through acquisitions. We are considered a market leader in medical stop-loss insurance. We also underwrite a small program of group life insurance, offered to our insureds as a complement to our medical stop-loss products.

Premium rates for medical stop-loss business rose substantially beginning in 2000 and, although competition has increased in recent years and the amount of premium rate increases has decreased, underwriting results have remained profitable. Premium rate increases together with deductible increases are still adequate to cover medical cost trends. Medical stop-loss business has relatively low limits, a low level of catastrophe exposure, a generally predictable result and a short time span between the writing of premium, the reporting of claims and the payment of claims. We currently buy no reinsurance for this line of business.

Our risk management business is composed of provider excess, HMO and medical excess risks. This business has relatively lower limits and a low level of catastrophe exposure. The business is competitive, but remains profitable.

We began writing alternative workers compensation and occupational accident insurance in 1996. This business is currently written through U.S. Specialty Insurance Company. These products have relatively low limits, a relatively low level of catastrophe exposure and a generally predictable result.

With the acquisition of MultiNational Underwriters, LLC, we began writing short-term domestic and international medical insurance that covers individuals when there is a lapse in coverage or when traveling internationally. This business has relatively low limits and the term is generally of short duration. This business is primarily produced on an internet platform.

Aviation

We are a market leader in the general aviation insurance industry insuring aviation risks, both domestically and internationally. Types of aviation business we insure include:

- antique and vintage military aircraft
- cargo operators
- commuter airlines
- corporate aircraft
- fixed base operations
- military law enforcement aircraft
- private aircraft owners
- rotor wing aircraft

We offer coverages that include hulls, engines, avionics and other systems, liabilities, cargo and other ancillary coverages. We generally do not insure major airlines, major manufacturers, products or satellites. Insurance claims related to general aviation business tend to be seasonal, with the majority of the claims being incurred during warm weather months.

We have been underwriting aviation risks through Houston Casualty Company since 1981 and Avemco Insurance Company and U.S. Specialty Insurance Company, which were acquired in 1997, have written this business since 1959. We are one of the largest writers of personal aircraft insurance in the United States. Our aviation gross premium has remained relatively stable since 1998, but it has decreased slightly in 2007 and 2008 due to competition and decreasing rates, principally in the domestic business. We have generally increase our retentions since 1998 as this business is predominantly written with small limits and has generally

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predictable results. The market related to international risks is very competitive and has seen rate decreases over the last few years, but is now showing signs of stabilizing.

London Market Account

Our London market account business consists of marine, energy, property, and accident and health business and has been primarily underwritten by Houston Casualty Company s London branch office. During 2006, we began to utilize HCC International Insurance Company to underwrite the non-U.S. based risks for this line of business. This line includes most of our catastrophe exposures. We have underwritten these risks for more than 15 years, increasing or decreasing our premium volume depending on market conditions, which can be very volatile in this line. The following table presents the details of net premium written within the London market account line of business (in thousands):

	2008	2007	2006
Marine	$ 14,413	$ 30,685	$ 26,664
Energy	44,554	45,962	57,619
Property	28,827	19,856	18,049
Accident and health	19,440	21,738	25,416
Total London market account net written premium	$ 107,234	$ 118,241	$ 127,748

We underwrite marine risks for ocean-going vessels including hull, protection and indemnity, liabilities and cargo. We have underwritten marine risks since 1984 in varying amounts depending on market conditions.

In our energy business, we underwrite physical damage, business interruption and other ancillary coverages. We have been underwriting both onshore and offshore energy risks since 1988. This business includes but is not limited to:

- drilling rigs
- gas production and gathering platforms
- natural gas facilities
- petrochemical plants
- pipelines
- refineries

Rates were relatively low for an extended period of time, reaching levels where underwriting profitability was difficult to achieve. As a result, we have underwritten energy risks on a very selective basis, striving for quality rather than quantity. Underwriting profitability was adversely impacted by hurricane activity that occurred in 2004 and 2005, but this resulted in 2006 rates increasing substantially and policy conditions becoming more stringent. Competitive pressures increased in 2007, adversely affecting prices, causing us to write less of this business. The business was very profitable in 2006 and 2007 because there were no catastrophe losses. The business was adversely affected by two hurricanes in 2008 but the business was still profitable principally as a result of our reinsurance coverage in force. We continue to reinsure much of our catastrophe exposure, buying substantial amounts of reinsurance on an excess of loss basis.

We underwrite property business specializing in risks of large, often multinational, corporations, covering a variety of commercial properties, which include but are not limited to:

- factories
- hotels
- industrial plants
- office buildings
- retail locations
- utilities

We have written property business since 1986, including business interruption, physical damage and catastrophe risks, such as flood and earthquake. Rates increased significantly following September 11, 2001, but trended downward by 2005 despite the hurricane activity in 2004. Massive losses from hurricanes in 2005 resulted in substantial rate increases, but due to over capacity, policy conditions have remained unchanged, unlike energy risks. Accordingly, we substantially reduced our involvement in policies with exposures in the Florida and U.S. Gulf Coast regions. We continue to buy substantial catastrophe reinsurance, unlike many industry participants, which was shown to be adequate during 2004 and 2005 when large amounts of industry capital were lost. While the hurricane activity seriously affected our earnings in the third quarters of 2004 and 2005, we still were able to produce record annual earnings in those years. This business was profitable in 2006 and 2007 as there were no significant catastrophe losses, and in 2008 despite the losses from two hurricanes.

We began writing London market accident and health risks in 1996, including trip accident, medical and disability. Due to past experience and other market factors, we significantly decreased premiums starting in 2004, although our business is now much more stable and profitable.

Our London market account is reinsured principally on an excess of loss basis. We closely monitor catastrophe exposure and purchase reinsurance to limit our net exposure to a level such that any loss is not expected to impact our capital or exceed our net earnings in the affected quarter. Previous net catastrophe losses from Hurricane Andrew in 1992, the Northridge Earthquake in 1994, the terrorist attacks on September 11, 2001, and the hurricanes of 2004, 2005 and 2008 did not exceed our net earnings in the quarter when each occurred.

Other Specialty Lines

In addition to the above, we underwrite various other specialty lines of business, including different types of property and liability business, such as event cancellation, contingency, film completion, public entity and U.K. liability. We had an assumed quota share contract for surplus lines business that expired in March 2008. Individual premiums by type of business are not material to the Other Specialty Lines line of business.

Insurance Companies

Houston Casualty Company

Houston Casualty Company is our largest insurance company subsidiary. It is domiciled in Texas and insures risks worldwide. Houston Casualty Company underwrites business produced by independent agents and brokers, affiliated underwriting agencies, reinsurance brokers, and other insurance and reinsurance companies. Houston Casualty Company writes diversified financial products, aviation, London market account and other specialty lines of business. Houston Casualty Company s 2008 gross written premium, including Houston Casualty Company-London, was $586.4 million.

Houston Casualty Company-London

Houston Casualty Company operates a branch office in London, England, in order to more closely align its underwriting operations with the London market, a historical focal point for some of the business that it underwrites. In 2006, we focused the underwriting activities of Houston Casualty Company-London s office on risks based in the United States but written in the London market. We began to use HCC International Insurance Company as a platform for much of the European and other international risks previously underwritten by Houston Casualty Company-London.

HCC International Insurance Company

HCC International Insurance Company PLC writes diversified financial products business, primarily surety, credit and professional indemnity products, and non-United States based London market account risks. HCC International Insurance Company has been in operation since 1982 and is domiciled in the United Kingdom. HCC International Insurance Company s 2008 gross written premium was $233.9 million. We intend to continue to expand the underwriting activities of HCC International Insurance Company and to use it as an integral part of a European platform for our international insurance operations.

U.S. Specialty Insurance Company

U.S. Specialty Insurance Company is a Texas-domiciled property and casualty insurance company. It primarily writes diversified financial products, aviation and accident and health business. U.S. Specialty Insurance Company acts as an issuing carrier for certain business underwritten by our underwriting agencies. U.S. Specialty Insurance Company s gross written premium in 2008 was $555.6 million.

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HCC Life Insurance Company

HCC Life Insurance Company is an Indiana-domiciled life insurance company. It operates as primarily a larger group life, accident and health insurer. Its primary products are medical stop-loss and medical excess business. This business is produced by unaffiliated agents, brokers and third party administrators. In 2006, the Health Products Division was acquired and integrated into HCC Life Insurance Company. HCC Life Insurance Company s gross written premium in 2008 was $692.1 million.

Avemco Insurance Company

Avemco Insurance Company is a Maryland-domiciled property and casualty insurer and operates as a direct market underwriter of general aviation business. It has also been an issuing carrier for accident and health business and some other lines of business underwritten by our underwriting agencies and an affiliated underwriting agency. Avemco Insurance Company s gross written premium in 2008 was $48.5 million.

American Contractors Indemnity Company

American Contractors Indemnity Company is a California-domiciled surety company. It writes court, specialty contract, license and permit, and bail bonds. American Contractors Indemnity Company has been in operation since 1990 and operates as a part of our HCC Surety Group. American Contractors Indemnity Company s 2008 gross written premium was $87.5 million.

HCC Europe

Houston Casualty Company Europe, Seguros y Reaseguros, S.A. is a Spanish insurer. It underwrites diversified financial products business. HCC Europe is also an issuing carrier for diversified financial products business underwritten by an affiliated underwriting agencies and has been in operation since 1978. HCC Europe s gross written premium in 2008 was $129.4 million.

HCC Reinsurance Company

HCC Reinsurance Company Limited is a Bermuda-domiciled reinsurance company that writes assumed reinsurance from our insurance companies and a limited amount of direct insurance. HCC Reinsurance Company is an issuing carrier for diversified financial products business underwritten by our underwriting agency, HCC Indemnity Guaranty. HCC Reinsurance Company also reinsures our proportional interests in Lloyd s of London Syndicates 4040 and 4141. HCC Reinsurance Company s gross written premium in 2008 was $135.0 million.

HCC Specialty Insurance Company

HCC Specialty Insurance Company is an Oklahoma-domiciled property and casualty insurance company in operation since 2002. It writes diversified financial products and other specialty lines of business produced by affiliated underwriting. HCC Specialty Insurance Company s gross written premium in 2008 was $21.5 million and was 100% ceded to Houston Casualty Company.

United States Surety Company

United States Surety Company is a Maryland-domiciled surety company that has been in operation since 1996. It writes contract bonds and operates as a part of our HCC Surety Group. United States Surety Company s 2008 gross written premium was $24.7 million.

Perico Life Insurance Company

Perico Life Insurance Company was a previously dormant company acquired in December 2005 and is a Delaware-domiciled life insurance company. Perico Life Insurance Company now operates as primarily a small group life, accident and health insurer. Its principal product is medical stop-loss business. In 2006, we consolidated the operations of Perico Ltd. into Perico Life Insurance Company. Perico Life Insurance Company s 2008 gross written premium was $52.3 million.

HCC Insurance Company

HCC Insurance Company is an Indiana-domiciled property and casualty insurance company. It writes business included in our other specialty lines of business that is produced by one of our underwriting agencies. HCC Insurance Company s gross written premium in 2008 was $13.5 million and was 100% ceded to Houston Casualty Company.

Lloyd s of London Syndicates

We currently have an 87% participation in Lloyd s of London Syndicate 4040, which writes business included in our other specialty lines of business, and a 100% participation in recently formed Lloyd s of London Syndicate 4141, which writes business in our group life, accident and health line of business. These syndicates are managed by HCC Underwriting Agency, Ltd. (UK). Our participation in these syndicates is reinsured by HCC Reinsurance Company. We expect to use our Lloyd s of London platform and the licenses it affords us to write business that is unique to Lloyd s of London and to write business in countries where our other insurance companies are not currently licensed.

Pioneer General Insurance Company

Pioneer General Insurance Company, which was acquired in 2007, primarily writes a small amount of bail bond business in Colorado.

Underwriting Agency Operations

Historically, we have acquired underwriting agencies with seasoned books of business and experienced underwriters. These agencies control the distribution of their business. After we acquire an agency, we generally begin to write some or all of its business through our insurance companies, and, in some cases, the insurance companies reinsure some of the business with unaffiliated insurance companies. Over time, we retain greater percentages of this business, reducing the revenues of our underwriting agencies, but increasing our underwriting profits. We have also consolidated certain of our underwriting agencies with our insurance companies when our retention of their business approached 100%. We plan to continue this process into the future.

Our underwriting agencies act on behalf of affiliated and unaffiliated insurance companies and provide insurance underwriting management and claims administration services. Our underwriting agencies do not assume any insurance or reinsurance risk themselves and generate revenues based entirely on fee income and profit commissions. These subsidiaries are in a position to direct and control business they produce. Our insurance companies serve as policy issuing companies for the majority of the business written by our underwriting agencies. If an unaffiliated insurance company serves as the policy issuing company, our insurance companies may reinsure the business written by our underwriting agencies. Our underwriting agencies generated total revenue in 2008 of $162.1 million.

Professional Indemnity Agency

Professional Indemnity Agency, Inc., based in Mount Kisco, New York and with operations in San Francisco, California, Concord, California, and Auburn Hills, Michigan, acts as an underwriting manager for diversified financial products specializing in directors and officers liability and professional indemnity, kidnap and ransom, employment practice liability, public entity, fidelity, difference in conditions (earthquake) and other specialty lines of business on behalf of affiliated and unaffiliated insurance companies. It has been in operation since 1977.

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HCC Specialty Underwriters

HCC Specialty Underwriters Inc., with its home office in Wakefield, Massachusetts and with branch offices in London, England, Los Angeles, California and New York, New York, acts as an underwriting manager for sports disability, contingency, film completion and other group life, accident and health and specialty lines of business on behalf of affiliated and unaffiliated insurance companies. It has been in operation since 1982.

HCC Global Financial Products

HCC Global Financial Products, LLC acts as an underwriting manager for diversified financial products, specializing in directors and officers liability business on behalf of affiliated insurance companies. It has been in operation since 1999, underwriting domestic business from Farmington, Connecticut, Jersey City, New Jersey and Houston, Texas and international business from Barcelona, Spain, London, England, and Miami, Florida.

Covenant Underwriters

Covenant Underwriters, Ltd. is an underwriting agency based in Covington, Louisiana with an office in New York, New York, specializing in commercial marine insurance underwritten on behalf of affiliated and unaffiliated insurance companies. It has been in operation through predecessor entities since 1993.

HCC Indemnity Guaranty Agency

HCC Indemnity Guaranty Agency, Inc. is an underwriting agency based in New York, New York, specializing in writing insurance and reinsurance related to various financial products. It writes on behalf of affiliated insurance companies. It has been in operation since 2004.

HCC Underwriting Agency, Ltd. (UK)

HCC Underwriting Agency, Ltd. (UK) is a managing agent for two Lloyd s of London syndicates, Syndicates 4040 and 4141, which specialize in United Kingdom third party liability, employers liability, and short-term medical risks. One of our insurance companies is a participant in these syndicates, with current participation of 87% in Syndicate 4040 and 100% in Syndicate 4141. We plan to use HCC Underwriting Agency, Ltd. (UK) and its managed syndicates as a platform for expanding our operations within the Lloyd s of London market. HCC Underwriting Agency, Ltd. (UK) has been in operation since 2004.

MultiNational Underwriters, LLC

MultiNational Underwriters, LLC, based in Indianapolis, Indiana, is an underwriting agency specializing in domestic and international short-term medical insurance, which is written principally through an internet platform. The domestic business is written on behalf of one of our domestic insurance companies and the international business is written by Lloyd s of London Syndicate 4141, which is managed by one of our subsidiaries and in which we have a 100% participation.

Reinsurance and Insurance Broker Operations

Our reinsurance and insurance brokers provide a variety of services, including marketing, placing, consulting on and servicing insurance risks for their clients, which include medium to large corporations, unaffiliated and affiliated insurance and reinsurance companies, and other risk-taking entities. The brokers earn commission income and, to a lesser extent, fees for certain services, which are generally paid by the underwriters with whom the business is placed.

Some of these risks may be initially underwritten by our insurance companies, and they may retain a portion of the risk. Total revenue generated by our brokers in 2008 amounted to $26.3 million.

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Rattner Mackenzie

Rattner Mackenzie Limited is a reinsurance broker based in London, England. Rattner Mackenzie specializes in group life, accident and health reinsurance and some specialty property and casualty lines of business. It operates as a Lloyd s of London broker for insurance and reinsurance business placed on behalf of unaffiliated and affiliated insurance companies, reinsurance companies and underwriting agencies and has been in operation since 1989.

Continental Underwriters

Continental Underwriters Ltd. is an insurance broker based in Covington, Louisiana, specializing in commercial marine insurance and has been in operation since 1970.

Other Operations

Other operating income consists of the following:

- equity in the earnings of mainly insurance-related companies in which we invest,
- dividends and interest from certain other insurance-related strategic investments and gains or losses from the disposition of these investments,
- income related to two mortgage impairment insurance contracts which, while written as insurance policies, receive accounting treatment as derivative financial instruments,
- income related to a mortgage guaranty reinsurance contract which is accounted for utilizing deposit accounting,
- the profit or loss from a portfolio of trading securities, and
- other miscellaneous income.

Other operating income was $9.6 million in 2008 and $43.5 million in 2007, and can vary considerably from period to period depending on the amount of investment or disposition activity. In the fourth quarter of 2006, we began liquidating our trading portfolio, a process that was completed in 2007 with the exception of two investment positions which were sold in 2008. We invested the proceeds primarily in fixed income securities.

Operating Ratios

Premium to Surplus Ratio

This table shows the ratio of statutory gross written premium and net written premium to statutory policyholders surplus for our property and casualty insurance companies (dollars in thousands):

	2008	2007	2006	2005	2004
Gross written premium	$ 2,510,612	$ 2,460,498	$ 2,243,843	$ 2,049,116	$ 1,992,361
Net written premium	2,064,091	1,985,641	1,812,896	1,495,931	1,121,343
Policyholders surplus	1,852,684	1,744,889	1,342,054	1,110,268	844,851

Gross written premium ratio	135.5%	141.0%	167.2%	184.6%	235.8%
Gross written premium industry average(1)	*	160.7%	171.0%	192.7%	201.6%
Net written premium ratio	111.4%	113.8%	135.1%	134.7%	132.7%
Net written premium industry average(1)	90.0%**	84.2%	90.4%	99.8%	108.5%

(1) Source: A.M. Best Company, Inc.
* Not available
** Estimated by A.M. Best Company, Inc.

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While there is no statutory requirement regarding a permissible premium to policyholders surplus ratio, guidelines established by the National Association of Insurance Commissioners provide that a property and casualty insurer s annual statutory gross written premium should not exceed 900% and net written premium should not exceed 300% of its policyholders surplus. However, industry and rating agency guidelines place these ratios at 300% and 200%, respectively. Our property and casualty insurance companies have maintained ratios lower than such guidelines.

Combined Ratio GAAP

The underwriting experience of a property and casualty insurance company is indicated by its combined ratio. The GAAP combined ratio is a combination of the loss ratio (the ratio of incurred losses and loss adjustment expenses to net earned premium) and the expense ratio (the ratio of policy acquisition costs and other underwriting expenses, net of ceding commissions, to net earned premium). We calculate the GAAP combined ratio using financial data derived from our consolidated financial statements reported under accounting principles generally accepted in the United States of America (generally accepted accounting principles). Our insurance companies GAAP loss ratios, expense ratios and combined ratios are shown in the following table:

	2008	2007	2006	2005	2004
Loss ratio	60.4%	59.6%	59.2%	67.1%	63.8%
Expense ratio	25.0	23.8	25.0	26.1	26.7
Combined ratio GAAP	85.4%	83.4%	84.2%	93.2%	90.5%

Combined Ratio Statutory

The statutory combined ratio is a combination of the loss ratio (the ratio of incurred losses and loss adjustment expenses to net earned premium) and the expense ratio (the ratio of policy acquisition costs and other underwriting expenses, net of ceding commissions, to net written premium). We calculate the statutory combined ratio using financial data derived from the combined financial statements of our insurance company subsidiaries reported in accordance with statutory accounting principles. Our insurance companies statutory loss ratios, expense ratios and combined ratios are shown in the following table:

	2008	2007	2006	2005	2004
Loss ratio	60.8%	60.6%	60.0%	67.1%	64.3%
Expense ratio	24.3	23.9	24.0	25.5	26.7
Combined ratio Statutory	85.1%	84.5%	84.0%	92.6%	91.0%
Industry average	104.7*	95.7	92.5%	100.7%	98.3%

* Estimated by A. M. Best Company, Inc.

The statutory ratio data is not intended to be a substitute for results of operations in accordance with generally accepted accounting principles. We believe including this information is useful to allow a comparison of our operating results with those of other companies in the insurance industry. The source of the industry average is A.M. Best Company, Inc. A.M. Best Company, Inc. reports insurer performance based on statutory financial data to provide more standardized comparisons among individual companies and to provide overall industry performance. This data is not an evaluation directed at investors.

Reserves

Our net loss and loss adjustment expense reserves are composed of reserves for reported losses and reserves for incurred but not reported losses (which include provisions for potential movement in reported losses, as well as for claims that have occurred but have not yet been reported to us), less a reduction for

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reinsurance recoverables related to those reserves. Reserves are recorded by product line and are undiscounted, except for reserves related to acquisitions.

The process of estimating our loss and loss adjustment expense reserves involves a considerable degree of judgment by management and is inherently uncertain. The recorded reserves represent management s best estimate of unpaid loss and loss adjustment expense by line of business. Because we provide insurance coverage in specialized lines of business that often lack statistical stability, management considers many factors and not just actuarial point estimates in determining ultimate expected losses and the level of net reserves required and recorded.

To record reserves on our lines of business, we utilize expected loss ratios, which management selects based on the following:

- information used to price the applicable policies,
- historical loss information where available,
- any public industry data for that line or similar lines of business,
- an assessment of current market conditions, and
- a claim-by-claim review by management, where actuarial homogenous data is unavailable.

Management also considers the point estimates and ranges calculated by our actuaries, together with input from our experienced underwriting and claims personnel. Because of the nature and complexities of the specialized types of business we insure, management may give greater weight to the expectations of our underwriting and claims personnel, who often perform a claim by claim review, rather than to the actuarial estimates. However, we utilize the actuarial point and range estimates to monitor the adequacy and reasonableness of our recorded reserves.

Each quarter, management compares recorded reserves to the most recent actuarial point estimate and range for each line of business. If the recorded reserves vary significantly from the actuarial point estimate, management determines the reasons for the variances and may adjust the reserves up or down to an amount that, in management s judgment, is adequate based on all of the facts and circumstances considered, including the actuarial point estimates. We consistently maintain total consolidated net reserves above the total actuarial point estimate but within the actuarial range.

Our actuaries utilize standard actuarial techniques in making their actuarial point estimates. These techniques require a high degree of judgment, and changing conditions can cause fluctuations in the reserve estimates. We believe that our review process is effective, such that any required changes are recognized in the period of change as soon as the need for the change is evident. Reinsurance recoverables offset our gross reserves based upon the contractual terms of our reinsurance agreements.

With the exception of 2004, our net reserves historically have shown favorable development except for the effects of losses from commutations, which we have completed in the past and may negotiate in the future. Commutations can produce adverse prior year development since, under generally accepted accounting principles, any excess of undiscounted reserves assumed over assets received must be recorded as a loss at the time the commutation is completed. Economically, the loss generally represents the discount for the time value of money that will be earned over the payout of the reserves; thus, the loss may be recouped as investment income is earned on the assets received. Based on our reserving techniques and our past results, we believe that our net reserves are adequate.

The reserving process is intended to reflect the impact of inflation and other factors affecting loss payments by taking into account changes in historical payment patterns and perceived trends. There is no precise method for the subsequent evaluation of the adequacy of the consideration given to inflation, or to any other specific factor, or to the way one factor may impact another.

We underwrite risks that are denominated in a number of foreign currencies and, therefore, maintain loss reserves with respect to these policies in the respective currencies. These reserves are subject to exchange rate

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fluctuations, which may have an effect on our net earnings. Generally, we match the reserves denominated in foreign currencies with assets denominated in the same currency resulting in a natural hedge that mitigates the effects of exchange rate fluctuation.

The loss development triangles show changes in our reserves in subsequent years from the prior loss estimates, based on experience at the end of each succeeding year, on the basis of generally accepted accounting principles. The estimate is increased or decreased as more information becomes known about the frequency and severity of losses for individual years. A redundancy means the original estimate was higher than the current estimate; a deficiency means that the current estimate is higher than the original estimate.

The first line of each loss development triangle presents, for the years indicated, our gross or net reserve liability, including the reserve for incurred but not reported losses. The first section of each table shows, by year, the cumulative amounts of loss and loss adjustment expense paid at the end of each succeeding year. The second section sets forth the re-estimates in later years of incurred losses, including payments, for the years indicated. The cumulative redundancy (deficiency) represents, at the date indicated, the difference between the latest re-estimated liability and the reserves as originally estimated.

This loss development triangle shows development in loss reserves on a gross basis (in thousands):

8	2007	2006	2005	2004	2003	2002	2001	2000
5,230	$ 3,227,080	$ 3,097,051	$ 2,813,720	$ 2,089,199	$ 1,525,313	$ 1,158,915	$ 1,132,258	$ 944,117
	32,131	28,348	15,427	3,368		5,587		(66,571)
5,230	3,259,211	3,125,399	2,829,147	2,092,567	1,525,313	1,164,502	1,132,258	877,546
	902,352	797,217	689,126	511,766	396,077	418,809	390,232	400,279
		1,260,672	1,077,954	780,130	587,349	548,941	612,129	537,354
			1,385,011	993,655	772,095	659,568	726,805	667,326
				1,144,350	866,025	823,760	803,152	720,656
					1,002,058	886,458	921,920	758,126
						1,003,780	1,009,049	835,994
							1,101,393	924,803
								964,763
5,230	3,259,211	3,125,399	2,829,147	2,092,567	1,525,313	1,164,502	1,132,258	877,546
	3,187,167	3,034,778	2,825,846	2,121,839	1,641,426	1,287,003	1,109,098	922,080
		2,918,269	2,714,374	2,115,671	1,666,931	1,393,143	1,241,261	925,922
			2,631,477	2,028,501	1,690,729	1,464,448	1,384,608	1,099,657

			2,002,477	1,619,744	1,506,360	1,455,046	1,102,636
				1,639,621	1,453,674	1,480,193	1,135,143
					1,467,540	1,433,630	1,137,652
						1,462,481	1,079,353
							1,113,971
$ 72,044	$ 207,130	$ 197,670	$ 90,090	$ (114,308)	$ (303,038)	$ (330,223)	$ (236,425)

The gross redundancies reflected in the above table for 2004 through 2007 resulted primarily from the following activity:

Excluding certain runoff business described below, during 2008, we recorded favorable development of $106.2 million. Most of this was from our diversified financial products line of business on the 2005 and prior underwriting years, our London market account for the 2005 and prior accident years, and an assumed quota share program reported in our other specialty lines for the 2005 and prior accident years. These changes primarily affected the 2003 through 2006 accident years.

Excluding certain runoff business described below, during 2007, we recorded favorable development of $44.1 million. Most of this was from the 2003 and 2004 underwriting years in our diversified financial products line of business, which affected 2003 through 2005 accident years.

During 2008, we recorded adverse development of $34.1 million on certain run-off assumed accident and health reinsurance business reported in our discontinued lines of business due to our continuing evaluation of reserves, primarily on the 2000 accident year. During 2007, we recorded favorable development of $46.5 million on the same run-off accident and health business. The combined effect of these entries was favorable development of $12.4 million.

The gross deficiencies reflected in the above table for 1999 through 2003 resulted from the following:

During 2005, 2004 and 2003, we recorded $49.8 million, $127.7 million and $132.9 million, respectively, in gross losses on certain run-off assumed accident and health reinsurance business reported in our discontinued lines of business, due to our processing of additional information received and our continuing evaluation of reserves on this business. Collectively, these transactions primarily affected the 1999, 2000 and 2001 accident years.

The 2000 and 1999 years in the table were also adversely affected by late reporting loss information received during 2001 for certain other discontinued business.

The gross reserves in the discontinued lines of business, particularly with respect to run-off assumed accident and health reinsurance business, produced substantial adverse development from 2003 through 2005. This assumed accident and health reinsurance is primarily excess coverage for large losses related to workers compensation policies. Losses tend to develop and affect excess covers considerably after the original loss was incurred. Additionally, certain primary insurance companies that we reinsured have experienced financial difficulty and some of them are in liquidation, with guaranty funds now responsible for administering the business. Losses related to this business are historically late reporting. While we attempt to anticipate these conditions in setting our gross reserves, we have only been partially successful to date, and there could be additional adverse development in these reserves in the future. The gross losses that have developed adversely have been substantially reinsured and, therefore, the net effects have been much less.

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The following table provides a reconciliation of the gross liability for loss and loss adjustment expense payable on the basis of generally accepted accounting principles (in thousands):

	2008	2007	2006
Gross reserves for loss and loss adjustment expense payable at beginning of year	$ 3,227,080	$ 3,097,051	$ 2,813,720
Gross reserve additions from acquired businesses	32,131	826	146,811
Foreign currency adjustment	(102,777)	34,202	46,422
Incurred loss and loss adjustment expense:			
Provision for loss and loss adjustment expense for claims occurring in current year	1,707,538	1,443,031	1,222,139
Increase (decrease) in estimated loss and loss adjustment expense for claims occurring in prior years*	(72,044)	(90,621)	(3,301)
Incurred loss and loss adjustment expense	1,635,494	1,352,410	1,218,838
Loss and loss adjustment expense payments for claims occurring during:			
Current year	474,346	460,192	439,614
Prior years	902,352	797,217	689,126
Loss and loss adjustment expense payments	1,376,698	1,257,409	1,128,740
Gross reserves for loss and loss adjustment expense payable at end of year	$ 3,415,230	$ 3,227,080	$ 3,097,051

* Changes in loss and loss adjustment expense reserves for losses occurring in prior years reflect the gross effect of the resolution of losses for other than the reserve value and the subsequent adjustments of loss reserves.

The favorable development for 2008 related primarily to reserve reductions in our diversified financial products line of business on the 2005 and prior underwriting years, our London market account for the 2005 and prior accident years, and an assumed quota share program reported in our other specialty lines for the 2005 and prior accident years. This was partially offset by reserve increases on certain run-off assumed accident and health business reported in our discontinued lines. The favorable development for 2007 was caused by decreasing reserves on the same run-off accident and health business, plus other reductions primarily from our diversified financial products line of business on the 2003 and 2004 underwriting years.

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This loss development triangle shows development in loss reserves on a net basis (in thousands):

08	2007	2006	2005	2004	2003	2002	2001	2000	1
6,271	$ 2,342,800	$ 2,108,961	$ 1,533,433	$ 1,059,283	$ 705,200	$ 458,702	$ 313,097	$ 249,872	$ 2
	29,053	25,730	14,218	3,168		5,587		(6,048)	
6,271	2,371,853	2,134,691	1,547,651	1,062,451	705,200	464,289	313,097	243,824	2
	687,675	556,096	222,336	172,224	141,677	115,669	126,019	102,244	1
		858,586	420,816	195,663	135,623	152,674	131,244	139,659	1
			588,659	337,330	124,522	115,214	163,808	118,894	1
				424,308	217,827	88,998	93,405	138,773	1
					313,315	155,708	59,936	158,935	1
						242,904	125,311	137,561	2
							186,224	194,517	1
								240,590	2
									2

6,271	2,371,853	2,134,691	1,547,651	1,062,451	705,200	464,289	313,097	243,824	2
	2,289,482	2,108,294	1,541,125	1,087,845	735,678	487,403	306,318	233,111	2
		1,997,867	1,514,632	1,087,123	770,497	500,897	338,194	222,330	2
			1,426,548	1,081,140	792,099	571,403	366,819	259,160	2
				1,040,333	808,261	585,741	418,781	267,651	2
					794,740	613,406	453,537	296,396	2
						597,666	462,157	305,841	2
							455,279	311,344	2
								307,262	2
									2
	$ 82,371	$ 136,824	$ 121,103	$ 22,118	$ (89,540)	$ (133,377)	$ (142,182)	$ (63,438)	$

The net redundancies reflected in the above table for 2005 through 2007 resulted primarily from the following:

Reserve reductions in 2008 from our diversified financial products line of business on the 2005 and prior underwriting years, our London market account for the 2005 and prior accident years, and an assumed quota share program reported in our other specialty lines for the 2005 and prior accident years. These changes primarily affected the 2003 through 2006 accident years.

Reserve reductions in 2007 from the 2003 and 2004 underwriting years in our diversified financial products line of business, which primarily affected the 2003 through 2005 accident years.

Reserve reductions in 2006 on prior year hurricanes and aviation, affecting primarily the 2004 and 2005 accident years.

The net deficiencies reflected in the above table for 1999 through 2004 resulted primarily from activity on certain run-off assumed accident and health business reported in our discontinued lines of business, as follows:

Commutation charges of $20.2 million, $26.0 million and $28.8 million recorded in 2006, 2005 and 2003, respectively.

Reserve strengthening of $27.3 million in 2004 to bring net reserves above our actuarial point estimate.

Collectively, these transactions primarily affected the 1999, 2000 and 2001 accident years.

The table below provides a reconciliation of the liability for loss and loss adjustment expense payable, net of reinsurance ceded, on the basis of generally accepted accounting principles (in thousands):

	2008	2007	2006
Net reserves for loss and loss adjustment expense payable at beginning of year	$ 2,342,800	$ 2,108,961	$ 1,533,433
Net reserve additions from acquired businesses	29,053	742	146,811
Foreign currency adjustment	(82,677)	27,304	36,957
Incurred loss and loss adjustment expense:			
Provision for loss and loss adjustment expense for claims occurring in current year	1,294,244	1,210,344	1,018,382
Increase (decrease) in estimated loss and loss adjustment expense for claims occurring in prior years*	(82,371)	(26,397)	(6,526)
Incurred loss and loss adjustment expense	1,211,873	1,183,947	1,011,856
Loss and loss adjustment expense payments for claims occurring during:			
Current year	397,103	422,058	397,760
Prior years	687,675	556,096	222,336
Loss and loss adjustment expense payments	1,084,778	978,154	620,096
Net reserves for loss and loss adjustment expense payable at end of year	$ 2,416,271	$ 2,342,800	$ 2,108,961

* Changes in loss and loss adjustment expense reserves for losses occurring in prior years reflect the net effect of the resolution of losses for other than the reserve value and the subsequent adjustments of loss reserves.

The favorable development for 2008 related primarily to reserve reductions in our diversified financial products line of business on the 2005 and prior underwriting years, our London market account for the 2005 and prior accident years, and an assumed quota share program reported in our other specialty lines for the 2005 and prior accident years. The favorable development for 2007 related primarily to reserve reductions in our diversified financial products line of business from the 2003 and 2004 underwriting years. The favorable development for 2006 related to a reduction in prior year hurricane reserves and a reduction in aviation reserves, mostly offset by another commutation charge on the run-off accident and health business.

Deficiencies and redundancies in the reserves occur as we continually review our loss reserves with our actuaries, increasing or reducing loss reserves as a result of such reviews and as losses are finally settled and claims exposures are reduced. We believe we have provided for all material net incurred losses.

We write directors and officers , professional indemnity and fiduciary liability coverage for public and private companies and not-for-profit organizations and continue to closely monitor our exposure to subprime and credit market related issues. We also write trade credit business and provide coverage for certain financial institutions, which have potential exposure to shareholder lawsuits as a result of the current economic environment. Based on our present knowledge, we believe our ultimate losses from these coverages will be contained within our current overall reserves for this business.

We have no material exposure to asbestos claims or environmental pollution losses. Our largest insurance company subsidiary only began writing business in 1981, and its policies normally contain pollution exclusion clauses that limit pollution coverage to sudden and accidental losses only, thus excluding intentional dumping and seepage claims. Policies issued by our other insurance company subsidiaries do not have significant environmental exposures because of the types of risks covered.

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Enterprise Risk Management

Our Enterprise Risk Management (ERM) process provides us with a structured process for identifying business opportunities as well as downside risks or threats. This process enables us to assess risks in a more transparent and consistent manner, resulting in improved recognition, management and monitoring of risk. With ERM, we are creating a risk awareness culture throughout the organization that will allow us to continue to achieve strong risk management practices. In support of our ERM initiative, a Corporate Vice President who reports to the President and her staff are responsible for the process. Our Internal Risk Committee, composed of senior operating management, oversees the process. Our Board of Directors has established an Enterprise Risk Oversight Committee that monitors the ERM process on behalf of the Board of Directors.

Regulation

The business of insurance is extensively regulated by the government. At this time, the insurance business in the United States is regulated primarily by the individual states. Additional federal regulation of the insurance industry may occur in the future.

Our business depends on our compliance with applicable laws and regulations and our ability to maintain valid licenses and approvals for our operations. We devote a significant effort to obtain and maintain our licenses and to comply with the diverse and complex regulatory structure. In all jurisdictions, the applicable laws and regulations are subject to amendment or interpretation by regulatory authorities. Generally, regulatory authorities are vested with broad discretion to grant, renew and revoke licenses and approvals and to implement regulations governing the business and operations of insurers, insurance agents, brokers and third party administrators.

Insurance Companies

Our insurance companies are subject to regulation and supervision by the states and by other jurisdictions in which they do business. Regulation by the states varies, but generally involves regulatory and supervisory powers exercised by a state insurance official. In the United States, the regulation and supervision of our insurance operations primarily entails:

- approval of policy forms and premium rates,
- licensing of insurers and their agents,
- periodic examinations of our operations and finances,
- prescription of the form and content of records of financial condition to be filed with the regulatory authority,
- required levels of deposits for the benefit of policyholders,
- requiring certain methods of accounting,
- requiring reserves for unearned premium, losses and other purposes,
- restrictions on the ability of our insurance companies to pay dividends,
- restrictions on the nature, quality and concentration of investments,

restrictions on transactions between insurance companies and their affiliates,

restrictions on the size of risks insurable under a single policy, and

standards of solvency, including risk-based capital measurement (which is a measure developed by the National Association of Insurance Commissioners and used by state insurance regulators to identify insurance companies that potentially are inadequately capitalized).

In the United States, state insurance regulations are intended primarily for the protection of policyholders rather than shareholders. The state insurance departments monitor compliance with regulations through periodic reporting procedures and examinations. The quarterly and annual financial reports to the state insurance regulators utilize statutory accounting principles, which are different from the generally accepted accounting principles we use in our reports to shareholders. Statutory accounting principles, in keeping with the intent to assure the protection of policyholders, are generally based on a liquidation concept, while generally accepted accounting principles are based on a going-concern concept.

In the United States, state insurance regulators classify direct insurance companies and some individual lines of business as admitted (also known as licensed) insurance or non-admitted (also known as surplus lines) insurance. Surplus lines insurance is offered by non-admitted companies on risks that are not insured in the particular state by admitted companies. All surplus lines insurance is required to be written through licensed surplus lines insurance brokers, who are required to be knowledgeable of and to follow specific state laws prior to placing a risk with a surplus lines insurer. Our insurance companies offer products on both an admitted and surplus lines basis.

U.S. state insurance regulations also affect the payment of dividends and other distributions by insurance companies to their shareholders. Generally, insurance companies are limited by these regulations in the payment of dividends above a specified level. Dividends in excess of those thresholds are extraordinary dividends and are subject to prior regulatory approval. Many states require prior regulatory approval for all dividends.

In the United Kingdom, the Financial Services Authority supervises all securities, banking and insurance businesses, including Lloyd s of London. The Financial Services Authority oversees compliance with established periodic auditing and reporting requirements, risk assessment reviews, minimum solvency margins, dividend restrictions, restrictions governing the appointment of key officers, restrictions governing controlling ownership interests and various other requirements. All of our United Kingdom operations, including Houston Casualty Company-London, are authorized and regulated by the Financial Services Authority.

HCC Europe is domiciled in Spain and operates on the equivalent of an admitted basis throughout the European Union. HCC Europe s primary regulator is the Spanish General Directorate of Insurance and Pension Funds of the Ministry of the Economy and Treasury (Dirección General de Seguros y Fondos de Pensiones del Ministerio de Economía y Hacienda).

Underwriting Agencies and Reinsurance and Insurance Brokers

In addition to the regulation of insurance companies, the states impose licensing and other requirements on the underwriting agency and service operations of our other subsidiaries. These regulations relate primarily to:

- advertising and business practice rules,
- contractual requirements,
- financial security,
- licensing as agents, brokers, reinsurance brokers, managing general agents or third party administrators,
- limitations on authority, and
- recordkeeping requirements.

Statutory Accounting Principles

The principal differences between statutory accounting principles for our domestic insurance company subsidiaries and generally accepted accounting principles, the method by which we report our consolidated financial results to our shareholders, are as follows:

a liability is recorded for certain reinsurance recoverables under statutory accounting principles whereas, under generally accepted accounting principles, there is no such provision unless the recoverables are deemed to be doubtful of collection, certain assets that are considered non-admitted assets are eliminated from a balance sheet prepared in accordance with statutory accounting principles, but are included in a balance sheet prepared in accordance with generally accepted accounting principles,

only some of the deferred tax asset is recognized under statutory accounting principles,

fixed income investments classified as available for sale are recorded at market value for generally accepted accounting principles and at amortized cost under statutory accounting principles,

outstanding losses and unearned premium are reported on a gross basis under generally accepted accounting principles and on a net basis under statutory accounting principles, and

under statutory accounting principles, policy acquisition costs are expensed as incurred and, under generally accepted accounting principles, such costs are deferred and amortized to expense as the related premium is earned.

Our international insurance company subsidiaries accounting principles are prescribed by regulatory authorities in each country. The prescribed principles do not vary significantly from generally accepted accounting principles.

Insurance Holding Company Acts

Because we are an insurance holding company, we are subject to the insurance holding company system regulatory requirements of a number of states. Under these regulations, we are required to report information regarding our capital structure, financial condition and management. We are also required to provide prior notice to, or seek the prior approval of, insurance regulatory authorities of certain agreements and transactions between our affiliated companies. These agreements and transactions must satisfy certain regulatory requirements.

Assessments

Many states require insurers licensed to do business in the state to bear a portion of the loss suffered by some insureds as a result of the insolvency of other insurers or to bear a portion of the cost of insurance for high-risk or otherwise uninsured individuals. Depending upon state law, insurers can be assessed an amount that is generally limited to between 1% and 2% of premiums written for the relevant lines of insurance in that state. Part of these payments may be recoverable through premium rates, premium tax credits or policy surcharges. Significant increases in assessments could limit the ability of our insurance subsidiaries to recover such assessments through tax credits or other means. In addition, there have been some legislative efforts to limit policy surcharges or repeal the tax offset provisions. We cannot predict the extent to which such assessments may increase or whether there may be limits imposed on our ability to recover or offset such assessments.

Insurance Regulations Concerning Change of Control

Many state insurance regulatory laws contain provisions that require advance approval by state agencies of any change of control of an insurance company that is domiciled or, in some cases, has substantial business in that state. Control is generally presumed to exist through the ownership of 10% or more of the voting securities of a domestic insurance company or of any company that controls a domestic insurance company. HCC owns, directly or indirectly, all of the shares of stock of insurance companies domiciled in a number of states. Any purchaser of shares of common stock representing 10% or more of the voting power of our common stock will be presumed to have acquired control of our domestic insurance subsidiaries unless, following application by that purchaser, the relevant state insurance regulators determine otherwise. Any transactions that would constitute a change in control of any of our individual insurance subsidiaries would generally require prior approval by the insurance departments of the states in which the insurance subsidiary is domiciled. Also, one of our insurance subsidiaries is domiciled in the United Kingdom and another in Spain. Insurers in those countries are also subject to change of control restrictions under their individual regulatory frameworks. These requirements may deter or delay possible significant transactions in our common stock or the disposition of our insurance companies to third parties, including transactions which could be beneficial to our shareholders.

Risk-Based Capital

The National Association of Insurance Commissioners has developed a formula for analyzing insurance companies called risk-based capital. The risk-based capital formula is intended to establish minimum capital thresholds that vary with the size and mix of an insurance company s business and assets. It is designed to identify companies with capital levels that may require regulatory attention. At December 31, 2008, each of our domestic insurance companies total adjusted capital was significantly in excess of the authorized control level risk-based capital.

Insurance Regulatory Information System

The National Association of Insurance Commissioners has developed a rating system, the Insurance Regulatory Information System, primarily intended to assist state insurance departments in overseeing the financial condition of all insurance companies operating within their respective states. The Insurance Regulatory Information System consists of eleven key financial ratios that address various aspects of each insurer s financial condition and stability. Our insurance companies Insurance Regulatory Information System ratios generally fall within the usual prescribed ranges.

Terrorism Risk Insurance Act

The Federal Terrorism Risk Insurance Act (TRIA) was initially enacted in 2002 for the purpose of ensuring the availability of insurance coverage for certain acts of terrorism, as defined in the TRIA. The Terrorism Risk Insurance Extension Act of 2005 extended TRIA through December 31, 2007. On December 26, 2007, the President signed into law the Terrorism Risk Insurance Program Reauthorization Act of 2007 (Reauthorization Act). The Reauthorization Act extends the program through December 31, 2014. A major provision of the Reauthorization Act is the revision of the definition of Act of Terrorism to remove the requirement that the act of terrorism be committed by an individual acting on behalf of any foreign person or foreign interest in order to be certified under the Reauthorization Act. The Reauthorization Act sets the Federal share of compensation (subject to a $100.0 million program trigger) for program years 2008 2014 at 85%, excess of our retention level, up to the maximum annual liability cap of $100.0 billion.

Under the Reauthorization Act, we are required to offer terrorism coverage to our commercial policyholders in certain lines of business, for which we may, when warranted, charge an additional premium. The policyholders may or may not accept such coverage. The Reauthorization Act also established a deductible that each insurer would have to meet before Federal reimbursement would occur. For 2009, our deductible is approximately $100.7 million.

Legislative Initiatives

In recent years, state legislatures have considered or enacted laws that modify and, in many cases, increase state authority to regulate insurance companies and insurance holding company systems. State insurance regulators are members of the National Association of Insurance Commissioners, which seeks to promote uniformity of and to enhance the state regulation of insurance. In addition, the National Association of Insurance Commissioners and state insurance regulators, as part of the National Association of Insurance Commissioners state insurance department accreditation program and in response to new federal laws, have re-examined existing state laws and regulations, specifically focusing on insurance company investments, issues relating to the solvency of insurance companies, licensing and market conduct issues, streamlining agent licensing and policy form approvals, adoption of privacy rules for handling policyholder information, interpretations of existing laws, the development of new laws and the definition of extraordinary dividends.

In recent years, a variety of measures have been proposed at the federal level to reform the current process of Federal and state regulation of the financial services industries in the United States, which include the banking, insurance and securities industries. These measures, which are often referred to as financial services modernization, have as a principal objective the elimination or modification of regulatory barriers to cross-industry combinations involving banks, securities firms and insurance companies. Also, the Federal government has from time to time considered whether to impose overall federal regulation of insurers. If so, we believe state regulation of the insurance business would likely continue. This could result in an additional layer of federal regulation. In addition, some insurance industry trade groups are actively lobbying for legislation that would allow an option for a separate Federal charter for insurance companies. The full extent to which the Federal government could decide to directly regulate the business of insurance has not been determined by lawmakers.

State regulators in many states have initiated or are participating in industry-wide investigations of sales and marketing practices in the insurance industry. Such investigations have resulted in restitution and settlement payments by some companies and criminal charges against some individuals. The investigations have led to changes in the structure of compensation arrangements, the offering of certain products and increased transparency in the marketing of many insurance products. We have cooperated fully with any such investigations and, based on presently available information, do not expect any adverse results from such investigations.

We do not know at this time the full extent to which these Federal or state legislative or regulatory initiatives will or may affect our operations and no assurance can be given that they would not, if adopted, have a material adverse effect on our business or our results of operations.

Employees

At December 31, 2008, we had 1,864 employees. Of this number, 946 are employed by our insurance companies, 625 are employed by our underwriting agencies, 78 are employed by our reinsurance and insurance brokers and 215 are employed at the corporate headquarters and elsewhere. We are not a party to any collective bargaining agreement and have not experienced work stoppages or strikes as a result of labor disputes. We consider our employee relations to be good.

Item 1A. *Risk Factors*

Risks Relating to our Industry

Because we are a property and casualty insurer, our business may suffer as a result of unforeseen catastrophic losses.

Property and casualty insurers are subject to claims arising from catastrophes. Catastrophic losses have had a significant impact on our historical results. Catastrophes can be caused by various events, including hurricanes, tsunamis, windstorms, earthquakes, hailstorms, explosions, severe winter weather and fires and may include man-made events, such as terrorist attacks. The incidence, frequency and severity of catastrophes are inherently unpredictable. The extent of losses from a catastrophe is a function of both the total amount of insured exposure in the area affected by the event and the severity of the event. Insurance companies are not permitted to reserve for a catastrophe until it has occurred. Catastrophes can cause losses in a variety of our property and casualty lines, and most of our past catastrophe-related claims have resulted from hurricanes and earthquakes; however, we experienced a significant loss as a result of the September 11, 2001 terrorist attack. Most of our exposure to catastrophes comes from our London market account. Although we typically purchase reinsurance protection for risks we believe bear a significant level of catastrophe exposure, the nature or magnitude of losses attributed to a catastrophic event or events may result in losses that exceed our reinsurance protection. It is therefore possible that a catastrophic event or multiple catastrophic events could have a material adverse effect on our financial position, results of operations and liquidity.

The insurance and reinsurance business is historically cyclical, and we expect to experience periods with excess underwriting capacity and unfavorable premium rates, which could cause our results to fluctuate.

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 an increase in pricing and, thus, more favorable premium levels. An increase in premium levels is often, over time, offset by an increasing supply of insurance and reinsurance capacity, either by capital provided by new entrants or by the commitment of additional capital by existing insurers or reinsurers, which may cause prices to decrease. Any of these factors could lead to a significant reduction in premium rates, less favorable policy terms and fewer opportunities to underwrite insurance risks, which could have a material adverse effect on our results of operations and cash flows. In addition to these considerations, changes in the frequency and severity of losses suffered by insureds and insurers may affect the cycles of the insurance and reinsurance business significantly. These factors may also cause the price of our common stock to be volatile.

Our loss reserves are based on an estimate of our future liability, which may prove to be inadequate.

We maintain loss reserves to cover our estimated liability for unpaid losses and loss adjustment expenses, including legal and other fees as well as a portion of our general expenses, for reported and unreported claims incurred at the end of each accounting period. Reserves do not represent an exact calculation of liability. Rather, reserves represent an estimate of what we expect the ultimate settlement and administration of claims will cost. These estimates, which generally involve actuarial projections, are based on our assessment of facts and circumstances then known, as well as estimates of future trends in severity or claims, frequency of claims, judicial theories of liability and other factors. These variables are affected by both internal and external events that could increase our exposure to losses including changes in claims handling procedures, inflation, judicial trends, and legislative changes. Current events such as the recent subprime issues, the state of the financial markets, the economic downturn and the severe decline in equity markets may result in an increase in the number of claims and the severity of the claims reported, particularly in lines of business such as directors and officers liability, professional indemnity and trade credit insurance. Many of these items are not directly quantifiable in advance. Additionally, there may be a significant reporting delay between the occurrence of the insured event and the time it is reported to us. The inherent uncertainties of estimating reserves are greater for certain types of liabilities, particularly those in which the various considerations affecting the type of claim are subject to change and in which long periods of time may elapse before a definitive determination of liability is made. Reserve estimates are continually refined in a regular and ongoing process as experience develops and further claims are reported and settled. Adjustments to reserves are reflected in our results of operations in the periods in which such estimates are changed. Because setting reserves is inherently uncertain, there can be no assurance that current reserves will prove adequate in light of subsequent events, particularly in volatile economic times now being experienced. If actual claims prove to be greater than our reserves, our financial position, results of operations and liquidity may be materially adversely affected.

We may be impacted by claims relating to the recent credit market downturn and subprime insurance exposures.

We write corporate directors and officers , errors and omissions and other insurance coverages for financial institutions and financial services companies. The recent financial downturn has had an impact on this industry segment. As a result, this industry segment has been the subject of heightened scrutiny and, in some cases, investigations by regulators with respect to the industry s actions. These events may give rise to increased claims litigation, including class action suits, which may involve our insureds. To the extent that the frequency or severity of claims relating to these events exceeds our current estimates used for establishing reserves, it could increase our exposure to losses from such claims and could have a material adverse effect on our financial condition and results of operations.

The effects of emerging claim and coverage issues on our business are uncertain.

As industry practices and legal, judicial, social and other environmental conditions change, unexpected and unintended liability for claims and coverage may emerge. These changing conditions may adversely affect our business by either extending coverage beyond our underwriting intent or by increasing the number or size of claims. In some instances, these changes may not become apparent until some time 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 and our financial position and results of operations may be materially adversely affected.

We are subject to extensive governmental regulation.

We are subject to extensive governmental regulation and supervision. Our business depends on compliance with applicable laws and regulations and our ability to maintain valid licenses and approvals for our operations. Most insurance regulations are designed to protect the interests of policyholders rather than shareholders and other investors. In the United States, this regulation is generally administered by departments of insurance in each state in which we do business and includes a comprehensive framework of oversight of our operations and review of our financial position. U.S. Federal legislation may lead to additional federal regulation of the insurance industry in the coming years. Also, foreign governments regulate our international operations. Each foreign jurisdiction has its own unique regulatory framework that applies to our operations in that jurisdiction. Regulatory authorities have broad discretion to grant, renew or revoke licenses and approvals. Regulatory authorities may deny or revoke licenses for various reasons, including the violation of regulations. In some instances, we follow practices based on our interpretations of regulations, or those we believe to be generally followed by the industry, which ultimately may be different from the requirements or interpretations of regulatory authorities. If we do not have the requisite licenses and approvals and do not comply with applicable regulatory requirements, the insurance regulatory authorities could preclude or temporarily suspend us from carrying on some or all of our activities or otherwise penalize us. That type of action could have a material adverse effect on our results of operations. Also, changes in the level of regulation of the insurance industry (whether federal, state or foreign), or changes in laws or regulations themselves or interpretations by regulatory authorities, could have a material adverse effect on our business. Virtually all states require insurers licensed to do business in that state to bear a portion of the loss suffered by some insureds as the result of impaired or insolvent insurance companies. The effect of these arrangements could materially adversely affect our 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. Although the law is unsettled and depends upon the facts and circumstances of the particular case, in some jurisdictions, if a broker fails to make such a payment, we might remain liable to the insured or ceding insurer for the deficiency. Conversely, in certain jurisdictions, when the insured or ceding insurer pays premiums for these policies to brokers for payment over to us, these premiums might be considered to have been paid and the insured or ceding insurer 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 brokers with whom we transact business. However, due to the unsettled and fact-specific nature of the law, we are unable to quantify our exposure to this risk.

Risks Relating to our Business

Our inability to accurately assess underwriting risk could reduce our net earnings.

Our underwriting success is dependent on our ability to accurately assess the risks associated with the business on which the risk is retained. We rely on the experience of our underwriting staff in assessing these risks. If we fail to assess accurately the risks we retain, we may fail to establish appropriate premium rates and our reserves may be inadequate to cover our losses, which could reduce our net earnings. The underwriting process is further complicated by our exposure to unpredictable developments, including earthquakes, weather-related events and other natural catastrophes, as well as war and acts of terrorism and those that may result from the current volatility in the financial markets and the economic downturn.

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Retentions in various lines of business expose us to potential losses.

We retain risk for our own account on business underwritten by our insurance companies. The determination to reduce the amount of reinsurance we purchase or not to purchase reinsurance for a particular risk or line of business is based on a variety of factors including market conditions, pricing, availability of reinsurance, the level of our capital and our loss history. Such determinations have the effect of increasing our financial exposure to losses associated with such risks or in such line of business and in the event of significant losses associated with such risks or lines of business could have a material adverse effect on our financial position, results of operations and cash flows.

If we are unable to purchase adequate reinsurance protection for some of the risks we have underwritten, we will be exposed to any resulting unreinsured losses.

We purchase reinsurance for a portion of the risks underwritten by our insurance companies, especially volatile and catastrophe-exposed risks. Market conditions beyond our control determine the availability and cost of the reinsurance protection we purchase. In addition, the historical results of reinsurance programs and the availability of capital also affect the availability of reinsurance. Our reinsurance facilities are generally subject to annual renewal. We cannot assure that we can maintain our current reinsurance facilities or that we can obtain other reinsurance facilities in adequate amounts and at favorable rates. Further, we cannot determine what effect catastrophic losses will have on the reinsurance market in general and on our ability to obtain reinsurance in adequate amounts and, in particular, at favorable rates. If we are unable to renew or to obtain new reinsurance facilities on acceptable terms, either our net exposures would increase or, if we are unwilling to bear such an increase in exposure, we would have to reduce the level of our underwriting commitments, especially in catastrophe-exposed risks. Either of these potential developments could have a material adverse effect on our financial position, results of operations and cash flows. The lack of available reinsurance may also materially adversely affect our ability to generate fee and commission income in our underwriting agency and reinsurance broker operations.

If the companies that provide our reinsurance do not pay all of our claims, we could incur severe losses.

We purchase reinsurance by transferring, or ceding, all or part of the risk we have assumed as a direct insurer to a reinsurance company in exchange for all or part of the premium we receive in connection with the risk. Through reinsurance, we have the contractual right to collect the amount reinsured from our reinsurers. Although reinsurance makes the reinsurer liable to us to the extent the risk is transferred or ceded to the reinsurer, it does not relieve us, the reinsured, of our full liability to our policyholders. Accordingly, we bear credit risk with respect to our reinsurers. We cannot assure you that our reinsurers will pay all of our reinsurance claims, or that they will pay our claims on a timely basis. Additionally, catastrophic losses from multiple direct insurers may accumulate within the more concentrated reinsurance market and result in claims that adversely impact the financial condition of such reinsurers and thus their ability to pay such claims. Further, additional adverse developments in the capital markets could affect our reinsurers ability to meet their obligations to us. If we become liable for risks we have ceded to reinsurers or if our reinsurers cease to meet their obligations to us, whether because they are in a weakened financial position as a result of incurred losses or otherwise, our financial position, results of operations and cash flows could be materially adversely affected.

As a direct insurer, we may have significant exposure for terrorist acts.

To the extent that reinsurers have excluded coverage for terrorist acts or have priced such coverage at rates that we believe are not practical, we, in our capacity as a direct insurer, do not have reinsurance protection and are exposed for potential losses as a result of any terrorist acts. To the extent an act of terrorism is certified by the Secretary of Treasury, we may be covered under the Terrorism Risk Insurance Program Reauthorization Act of 2007, for up to 85% of our losses in 2009 up to the maximum amount set out in the Reauthorization Act. However, any such coverage would be subject to a mandatory deductible. Our deductible under the Reauthorization Act during 2009 is approximately $100.7 million.

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In some jurisdictions outside of the United States, where we also have exposure to a loss from an act of terrorism, we have limited access to other government programs that may mitigate our exposure. If we become liable for risks that are not covered under the Reauthorization Act, our financial position, results of operations and cash flows could be materially adversely affected.

We may be unsuccessful in competing against larger or more well-established business rivals.

In our specialty insurance operations, we compete in narrowly-defined niche classes of business such as the insurance of private aircraft (aviation), directors and officers liability (diversified financial products), employer sponsored, self-insured medical plans (medical stop-loss), professional indemnity (diversified financial products) and surety (diversified financial products), as distinguished from such general lines of business as automobile or homeowners insurance. We compete with a large number of other companies in our selected lines of business, including: Lloyd s of London, ACE and XL in our London market business; American International Group and U.S. Aviation Insurance Group (a subsidiary of Berkshire Hathaway, Inc.) in our aviation line of business; United Health and Symetra Financial Corp. in our group life, accident and health business; and American International Group, The Chubb Corporation, ACE, St. Paul Travelers and XL in our diversified financial products business. We face competition from specialty insurance companies, underwriting agencies and reinsurance brokers, as well as from diversified financial services companies that are larger than we are and that have greater financial, marketing and other resources than we do. Some of these competitors also have longer experience and more market recognition than we do in certain lines of business. Furthermore, due to continuing volatility in the financial markets and related negative economic impact, the U.S. government has intervened in the operations of some of our competitors, which could lead to increased competition on uneconomic terms in certain of our lines of business. In addition to competition in the operation of our business, we face competition from a variety of sources in attracting and retaining qualified employees. We cannot assure you that we will maintain our current competitive position in the markets in which we operate, or that we will be able to expand our operations into new markets. If we fail to do so, our results of operations and cash flows could be materially adversely affected.

If rating agencies downgrade our financial strength ratings, our business and competitive position in the industry may suffer.

Ratings have become an increasingly important factor in establishing the competitive position of insurance companies. Our insurance companies are rated by Standard & Poor s Corporation, Fitch Ratings and A.M. Best Company, Inc. The financial strength ratings reflect their opinions of an insurance company s and insurance holding company s financial strength, operating performance, strategic position and ability to meet its obligations to policyholders and are not evaluations directed to investors. Our ratings are subject to periodic review by those entities, and the continuation of those ratings at current levels cannot be assured. If our ratings are reduced from their current levels, our financial position and results of operations could be adversely affected.

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

Our future capital and liquidity requirements depend on many factors, including our ability to write new business successfully, to establish premium rates and reserves at levels sufficient to cover losses, and to maintain our current line of credit. We may need to raise additional funds through financings or curtail our growth and reduce our assets. Any equity or debt financing, if available at all in this period of extreme stress in the financial markets, may be on terms that are not favorable 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 common stock. If we cannot obtain adequate capital or funds for liquidity on favorable terms or at all, our business, results of operations and liquidity could be adversely affected. We may also be pre-empted from making acquisitions.

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Standard & Poor s Corporation, Fitch Ratings and A.M. Best Company rate our credit strength. If our credit ratings are reduced, it might significantly impede our ability to raise capital and borrow money, which could materially affect our business, results of operations and liquidity.

We may be unable to attract and retain qualified employees.

We depend on our ability to attract and retain experienced underwriting talent and other skilled employees who are knowledgeable about our business. Certain of our senior underwriters and other skilled employees have employment agreements that are for definite terms, and there is no assurance we will retain these employees beyond the current terms of their agreements. If the quality of our underwriting team and other personnel decreases, we may be unable to maintain our current competitive position in the specialized markets in which we operate and be unable to expand our operations into new markets, which could materially adversely affect our business.

We invest a significant amount of our assets in securities that have experienced market fluctuations, which may greatly reduce the value of our investment portfolio, reduce investment income or generate realized investment losses.

At December 31, 2008, $4.3 billion of our $4.8 billion investment portfolio was invested in fixed income securities. The fair value of these fixed income securities and the related investment income fluctuate depending on general economic and market conditions, including the recent downturn in the market due to subprime credit and other economic issues. For our fixed income securities, the fair value generally increases or decreases in an inverse relationship with fluctuations in interest rates, while net investment income realized by us from future investments in fixed income securities will generally increase or decrease with interest rates. Mortgage-backed and other asset-backed securities may have different net investment income and/or cash flows from those anticipated at the time of investment. These securities have prepayment risk when there is a risk that the timing of cash flows that result from the repayment of principal might occur earlier than anticipated because of declining interest rates or later than anticipated because of rising interest rates. For mortgage-backed securities, credit risk exists if mortgagees default on the underlying mortgages. Although we maintain an investment grade portfolio (99% are rated A or better), all of our fixed income securities are subject to credit risk. If any of the issuers of our fixed income securities suffer financial setbacks, the ratings on the fixed income securities could fall (with a concurrent fall in fair value) and, in a worst case scenario, the issuer could default on its financial obligations. If the issurer defaults, we could have realized losses associated with the impairment of the securities.

The impact of market fluctuations affects our financial statements. Because the majority of our fixed income securities are classified as available for sale, changes in the fair value of our securities are reflected in our other comprehensive income. Similar treatment is not available for liabilities. Therefore, interest rate fluctuations could adversely affect our financial position. Unrealized pretax net investment gains (losses) on investments in fixed income securities were $(10.4) million in 2008, $26.7 million in 2007 and $6.9 million in 2006.

In 2007 and 2008, the financial markets and the economy have been severely affected by various events. This has impacted interest rates and has caused large writedowns in other companies financial instruments either due to the market fluctuations or the impact of the events on the debtors financial condition. The continuing turmoil in the financial markets and the economy could adversely affect the valuation of our investments and cause us to have to record realized impairment losses on our investments, which could have a material adverse effect on our financial position and result of operations.

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Our strategy of acquiring other companies for growth may not succeed.

Our strategy for growth includes growing through acquisitions of insurance industry related companies. This strategy presents risks that could have a material adverse effect on our business and financial performance, including:

- the diversion of our management s attention,
- our ability to assimilate the operations and personnel of the acquired companies,
- the contingent and latent risks associated with the past operations of, and other unanticipated problems arising in, the acquired companies,
- the need to expand management, administration and operational systems, and
- increased competition for suitable acquisition opportunities and qualified employees.

We cannot predict whether we will be able to acquire additional companies on terms favorable to us or if we will be able to successfully integrate the acquired operations into our business. We do not know if we will realize any anticipated benefits of completed acquisitions or if there will be substantial unanticipated costs associated with new acquisitions. In addition, future acquisitions by us may result in potentially dilutive issuances of our equity securities, the incurrence of additional debt and/or the recognition of potential impairment of goodwill and other intangible assets. Each of these factors could materially adversely affect our financial position and results of operations.

We are exposed to goodwill impairment risk as part of our business acquisition strategy.

We have recorded goodwill in connection with the majority of our business acquisitions. We are required to perform goodwill impairment tests at least annually and whenever events or circumstances indicate that the carrying value may not be recoverable from estimated future cash flows. As a result of our annual and other periodic evaluations, we may determine that a portion of the goodwill carrying value needs to be written down to fair value, which could materially adversely affect our financial position and results of operations.

We are an insurance holding company and, therefore, may not be able to receive dividends in needed amounts from our subsidiaries.

Historically, we have had sufficient cash flow from our non-insurance company subsidiaries to meet our corporate cash flow requirements for paying principal and interest on outstanding debt obligations, dividends to shareholders and corporate expenses. However, in the future we may rely on dividends from our insurance companies to meet these requirements. The payment of dividends by our insurance companies is subject to regulatory restrictions and will depend on the surplus and future earnings of these subsidiaries, as well as the regulatory restrictions. As a result, should our other sources of funds prove to be inadequate, we may not be able to receive dividends from our insurance companies at times and in amounts necessary to meet our obligations, which could materially adversely affect our financial position and liquidity.

Because we operate internationally, fluctuations in currency exchange rates may affect our receivable and payable balances and our reserves.

We underwrite insurance coverages that are denominated in a number of foreign currencies, and we establish and maintain our loss reserves with respect to these policies in their respective currencies. We hold assets denominated in comparable foreign currencies to hedge the foreign currency risk related to these reserves and other liabilities denominated in foreign currencies. Our net earnings could be adversely affected by exchange rate fluctuations if we do not hold offsetting positions. Our principal area of exposure relates to fluctuations in exchange rates between the major European currencies (particularly the British pound sterling and the Euro) and the U.S. dollar. Consequently, a change in the exchange rate between the U.S. dollar and the British pound sterling or the Euro could have a materially adverse effect on our results of operations.

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Our information technology systems may fail or suffer a loss of security, which could adversely affect our business.

Our business is highly dependent upon the successful and uninterrupted functioning of our computer and data processing systems. We rely on these systems to perform actuarial and other modeling functions necessary for writing business, to process our premiums and policies, to process and make claims payments and to prepare all of our management and external financial statements and information. The failure of these systems could interrupt our operations. This could result in a material adverse effect on our business results.

In addition, a security breach of our computer systems could damage our reputation or result in liability. We retain confidential information regarding our business dealings in our computer systems. We may be required to spend significant capital and other resources to protect against security breaches or to alleviate problems caused by such breaches. It is critical that these facilities and infrastructure remain secure. Despite the implementation of security measures, this infrastructure may be vulnerable to physical break-ins, computer viruses, programming errors, attacks by third parties or similar disruptive problems. In addition, we could be subject to liability if hackers were able to penetrate our network security or otherwise misappropriate confidential information.

The new administration in Washington, D.C. is a proponent of potential changes in the country s health care delivery system.

The new administration is Washington, D.C. has as one of its key goals to significantly increase the percentage of the population that is covered for health care costs. This may result in significant changes in our health care delivery system in the United States. The type and scope of changes, if any, are not known at this time, but, if changes are made, they could have a material adverse effect on the volume and profitability of our medical stop-loss, medical excess and short-term medical insurance products.

We may not be able to delay or prevent an inadequate or coercive offer for change in control and regulatory rules and required approvals might delay or deter a favorable change of control.

Our certificate of incorporation and bylaws do not have provisions that could make it more difficult for a third party to acquire a majority of our outstanding common stock. As a result, we may be more susceptible to an inadequate or coercive offer that could result in a change in control than a company whose charter documents have provisions that could delay or prevent a change in control.

Many state insurance regulatory laws contain provisions that require advance approval by state agencies of any change of control of an insurance company that is domiciled or, in some cases, has substantial business in that state. Control is generally presumed to exist through the ownership of 10% or more of the voting securities of a domestic insurance company or of any company that controls a domestic insurance company. We own, directly or indirectly, all of the shares of stock of insurance companies domiciled in a number of states. Any purchaser of shares of common stock representing 10% or more of the voting power of our common stock will be presumed to have acquired control of our domestic insurance subsidiaries unless, following application by that purchaser, the relevant state insurance regulators determine otherwise. Any transactions that would constitute a change in control of any of our individual insurance subsidiaries would generally require prior approval by the insurance departments of the states in which the insurance subsidiary is domiciled. Also, one of our insurance subsidiaries is domiciled in the United Kingdom and another in Spain. Insurers in those countries are also subject to change of control restrictions under their individual regulatory frameworks. These requirements may deter or delay possible significant transactions in our common stock or the disposition of our insurance companies to third parties, including transactions that could be beneficial to our shareholders.

Item 1B. *Unresolved Staff Comments*

None.

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Item 2. *Properties*

Our principal and executive offices are located in Houston, Texas, in buildings owned by Houston Casualty Company. We also maintain offices in 55 locations elsewhere in the United States, the United Kingdom, Spain, Bermuda and Ireland. The majority of these additional locations are in leased facilities.

Our principal office facilities are as follows:

Subsidiary	Segment	Location	Sq. Ft.	Termination Date of Lease
HCC and Houston Casualty Company	Insurance Company and Corporate	Houston, Texas	51,000	Owned
Houston Casualty Company	Insurance Company	Houston, Texas	77,000	Owned
Professional Indemnity Agency	Agency	Mount Kisco, New York	38,000	Owned
HCC Life Insurance Company	Insurance Company	Atlanta, Georgia	29,000	December 31, 2011
U.S. Specialty Insurance Company Aviation Division	Insurance Company	Dallas, Texas	28,000	August 31, 2013
HCC Specialty Underwriters	Agency	Wakefield, Massachusetts	28,000	December 31, 2010
G. B. Kenrick & Associates, Inc.	Agency	Auburn Hills, Michigan	27,000	May 31, 2012
HCC Surety Group	Insurance Company	Los Angeles, California	40,000	May 31, 2017
Health Products Division	Insurance Company	Minneapolis, Minnesota	25,000	September 30, 2012
HCC International and Rattner Mackenzie	Insurance Company and Agency	London, England	30,000	December 24, 2015

See also Note 13 to our Consolidated Financial Statements included in this Form 10-K.

Item 3. *Legal Proceedings*

Litigation

We are a party to lawsuits, arbitrations and other proceedings that arise in the normal course of our business. Many of such lawsuits, arbitrations and other proceedings involve claims under policies that we underwrite as an insurer or reinsurer, the liabilities for which, we believe, have been adequately included in our loss reserves. Also, from time to time, we are a party to lawsuits, arbitrations and other proceedings that relate to disputes with third parties, or that involve alleged errors and omissions on the part of our subsidiaries. We have provided accruals for these items to the extent we deem the losses probable and reasonably estimable. Although, the ultimate outcome of these matters cannot be determined at this time, based on present information, the availability of insurance coverage and advice received from our outside legal counsel, we believe the resolution of any such matters will not have a material adverse effect on our consolidated financial position, results of operations or cash flows.

Item 4. *Submission of Matters to a Vote of Security Holders*

There were no matters submitted to a vote of security holders during the fourth quarter of 2008.

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PART II

Item 5. *Market for the Registrant s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities*

Price Range of Common Stock

Our common stock trades on the New York Stock Exchange under the ticker symbol HCC.

The intra-day high and low sales prices for quarterly periods from January 1, 2007 through December 31, 2008, as reported by the New York Stock Exchange, were as follows:

	2008		2007	
	High	Low	High	Low
First quarter	$ 29.03	$ 21.26	$ 32.89	$ 29.39
Second quarter	25.99	20.48	34.45	30.43
Third quarter	30.00	19.12	34.21	25.12
Fourth quarter	26.95	14.17	31.64	27.99

On February 20, 2009, the last reported sales price of our common stock as reported by the New York Stock Exchange was $22.12 per share.

Shareholders

We have one class of authorized capital stock: 250.0 million shares of common stock, par value $1.00 per share. On February 13, 2009, there were 116.6 million shares of common stock issued and 113.6 million shares of common stock outstanding held by 746 shareholders of record; however, we estimate there are approximately 58,000 beneficial owners.

Dividend Policy

Cash dividends declared on a quarterly basis in 2008 and 2007 were as follows:

	2008	2007
First quarter	$ .110	$ .100
Second quarter	.110	.100
Third quarter	.125	.110
Fourth quarter	.125	.110

Beginning in June 1996, we announced a planned quarterly program of paying cash dividends to shareholders. Our Board of Directors may review our dividend policy from time to time, and any determination with respect to future dividends will be made in light of regulatory and other conditions at that time, including our earnings, financial condition, capital requirements, loan covenants and other related factors. Under the terms of our bank loan facility, we are prohibited from paying dividends in excess of an agreed upon maximum amount in any year. That limitation should not affect our ability to pay dividends in a manner consistent with our past practice and current expectations.

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Issuer Purchases of Equity Securities

During the fourth quarter of 2008, we purchased our common stock, as follows:

Period	Total Number of Shares Purchased	Average Price Paid Per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Approximate Dollar Value of Shares that May Yet Be Purchased Under the Plans or Programs
October 1 October 31, 2008	550,142	$ 22.30	550,142	$ 65,860,594
November 1 November 30, 2008	1,326,614	$ 20.75	1,326,614	$ 38,329,778
December 1 December 31, 2008	76,900	$ 21.65	76,900	$ 36,664,593

On June 20, 2008, our Board of Directors approved the repurchase of up to $100.0 million of common stock. The share repurchase plan authorizes repurchases to be made in the open market or in privately negotiated transactions from time-to-time in compliance with applicable rules and regulations, including Rule 10b-18 under the Securities Exchange Act of 1934, as amended. Repurchases under the plan will be subject to market and business conditions, as well as the Company s level of cash generated from operations, cash required for acquisitions, debt covenant compliance, trading price of the stock being at or below book value and other relevant factors. The repurchase plan does not obligate the Company to purchase any particular number of shares, and may be suspended or discontinued at any time at the Company s discretion. As of December 31, 2008, we had repurchased 3,012,761 shares of our common stock in the open market pursuant to our repurchase program.

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Performance Graph

The following graph shows a comparison of cumulative total returns for an investment of $100.00 made on December 31, 2003 in the common stock of HCC Insurance Holdings, Inc., the Standard & Poor s Composite 1500 Index and the Standard & Poor s Midcap 400 Index. The graph assumes that all dividends were reinvested.

COMPARISON OF CUMULATIVE FIVE YEAR TOTAL RETURN

Total Return to Shareholders
(Includes reinvestment of dividends)

Company/Index	2003	2004	2005	2006	2007	2008
HCC Insurance Holdings, Inc.	$ 100.00	$ 105.19	$ 143.22	$ 156.67	$ 141.98	$ 135.01
S&P Composite 1500 Index	100.00	111.78	118.10	136.21	143.66	90.91
S&P Midcap 400 Index	100.00	116.48	131.11	144.64	156.18	99.59

This performance graph shall not be deemed to be incorporated by reference into our Securities and Exchange Commission filings and should not constitute soliciting material or otherwise be considered filed under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended.

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Item 6. ***Selected Financial Data***

The selected consolidated financial data set forth below has been derived from the Consolidated Financial Statements. All information contained herein should be read in conjunction with the Consolidated Financial Statements, the related Notes thereto and Management s Discussion and Analysis of Financial Condition and Results of Operations included elsewhere in this Report.

	Years Ended December 31,				
	2008	**2007**	**2006**	**2005**	**2004**
	(In thousands, except per share data)				
Statement of earnings data:					
Revenue					
Net earned premium	$ 2,007,774	$ 1,985,086	$ 1,709,189	$ 1,369,988	$ 1,010,692
Fee and commission income	125,201	140,092	137,131	132,628	183,802
Net investment income	164,751	206,462	152,804	98,851	64,885
Net realized investment gain (loss)	(27,941)	13,188	(841)	1,448	5,822
Other operating income	9,638	43,545	77,012	39,773	19,406
Total revenue	2,279,423	2,388,373	2,075,295	1,642,688	1,284,607
Expense					
Loss and loss adjustment expense, net	1,211,873	1,183,947	1,011,856	919,697	645,230
Policy acquisition costs, net	381,441	366,610	319,885	261,708	222,323
Other operating expense	233,509	241,642	222,324	180,990	168,045
Interest expense	16,288	10,304	11,396	7,684	8,374
Total expense	1,843,111	1,802,503	1,565,461	1,370,079	1,043,972
Earnings from continuing operations before income tax expense	436,312	585,870	509,834	272,609	240,635
Income tax expense on continuing operations	131,544	190,441	167,549	84,177	81,940
Earnings from continuing operations	304,768	395,429	342,285	188,432	158,695
Earnings from discontinued operations, net of income taxes(1)				2,760	4,004
Net earnings	$ 304,768	$ 395,429	$ 342,285	$ 191,192	$ 162,699
Basic earnings per share data:					
Earnings from continuing operations	$ 2.65	$ 3.50	$ 3.08	$ 1.78	$ 1.63

Earnings from discontinued operations(1)								0.03		0.04
Net earnings	$	2.65	$	3.50	$	3.08	$	1.81	$	1.67
Weighted average shares outstanding		114,848		112,873		111,309		105,463		97,257

	Years Ended December 31,				
	2008	2007	2006	2005	2004
	(In thousands, except per share data)				
Diluted earnings per share data:					
Earnings from continuing operations	$ 2.64	$ 3.38	$ 2.93	$ 1.72	$ 1.61
Earnings from discontinued operations(1)				0.03	0.04
Net earnings	$ 2.64	$ 3.38	$ 2.93	$ 1.75	$ 1.65
Weighted average shares outstanding	115,474	116,997	116,736	109,437	98,826
Cash dividends declared, per share	$ 0.470	$ 0.420	$ 0.375	$ 0.282	$ 0.213

	December 31,				
	2008	2007	2006	2005	2004
	(In thousands, except per share data)				
Balance sheet data:					
Total investments	$ 4,804,283	$ 4,672,277	$ 3,927,995	$ 3,257,428	$ 2,468,491
Premium, claims and other receivables	770,823	763,401	864,705	884,654	891,360
Reinsurance recoverables	1,054,950	956,665	1,169,934	1,361,983	1,104,026
Ceded unearned premium	234,375	244,684	226,125	239,416	311,973
Goodwill	858,849	776,046	742,677	532,947	444,031
Total assets	8,332,383	8,074,645	7,630,132	7,028,800	5,900,568
Loss and loss adjustment expense payable	3,415,230	3,227,080	3,097,051	2,813,720	2,089,199
Unearned premium	977,426	943,946	920,350	807,109	741,706
Premium and claims payable	405,287	497,974	646,224	753,859	766,765
Notes payable	344,714	324,714	308,887	309,543	311,277
Shareholders equity	2,639,341	2,440,365	2,042,803	1,690,435	1,325,498
Book value per share(2)	$ 23.27	$ 21.21	$ 18.28	$ 15.26	$ 12.99

(1) Discontinued operations in 2005 and 2004 represent gains from a contractual earnout related to the 2003 sale of our retail brokerage operation, HCC Employee Benefits, Inc.

(2) Book value per share is calculated by dividing outstanding shares into total shareholders equity.

Item 7. *Management s Discussion and Analysis of Financial Condition and Results of Operations*

The following Management s Discussion and Analysis should be read in conjunction with the Selected Financial Data, the Consolidated Financial Statements and the related Notes thereto.

Overview

We are a specialty insurance group with offices in the United States, the United Kingdom, Spain, Bermuda and Ireland, transacting business in approximately 150 countries. Our group consists of insurance companies, participations in two Lloyd s of London syndicates that we manage, underwriting agencies and a London-based reinsurance broker. Our shares are traded on the New York Stock Exchange and closed at $26.75 on December 31, 2008. We had a market capitalization of $2.5 billion at February 20, 2009.

We have shareholders equity of $2.6 billion at December 31, 2008. Our book value per share increased 10% in 2008 to $23.27 at December 31, 2008, up from $21.21 per share at December 31, 2007. We had net earnings of $304.8 million, or $2.64 per diluted share, and generated $506.0 million of cash flow from operations in 2008. We declared dividends of $0.47 per share in 2008, compared to $0.42 per share in 2007, and paid $52.5 million of dividends in 2008. We repurchased 3.0 million shares of our common stock for $63.3 million, at an average cost of $21.02 per share in 2008. We currently have $4.3 billion of fixed maturity securities with an average rating of AA+ that are available to fund claims and other liabilities. We maintain a $575.0 million Revolving Loan Facility that allows us to borrow up to the maximum on a revolving basis, under which we have $340 million of additional capacity at February 20, 2009. The facility expires in December 2011. We are rated AA (Very Strong) by Standard & Poor s Corporation and AA (Very Strong) by Fitch Ratings. Our major domestic insurance companies are rated A+ (Superior) by A.M. Best Company, Inc.

We earned $304.8 million or $2.64 per diluted share in 2008, compared to $395.4 million or $3.38 per diluted share in 2007. The reductions are due to catastrophic losses from hurricanes occurring in 2008 and lower income from investment-related items, which are discussed in the Results of Operations section. Profitability from our underwriting operations remains at acceptable levels despite rate pressure from competitors on certain lines of business and losses from the 2008 hurricanes. During 2008, we had $82.4 million of positive reserve development, of which 70% was offset by increases in ultimate loss ratios in accident year 2008 above those set at the beginning of the year for certain of our business written in 2007 and 2008, due to higher notices of claims stemming from recent credit market issues. We had $26.4 million of positive reserve development in 2007, of which 50% was offset by increases in ultimate loss ratios in accident year 2007 for certain business written in 2006 and 2007. Our 2008 combined ratio was 85.4%, which included 1.2 percentage points for the 2008 hurricane losses, compared to 83.4% for 2007. Investment income on our fixed income securities grew $24.1 million in 2008, but our alternative investments, consisting mainly of fund-of-fund hedge fund investments, incurred losses of $30.8 million, and we had realized investment losses of $27.9 million from the sale or other-than-temporary impairment of fixed income securities with credit-related issues.

We underwrite a variety of specialty lines of business identified as diversified financial products; group life, accident and health; aviation; London market account; and other specialty lines of business. Products in each line are marketed by our insurance companies and agencies, through a network of independent agents and brokers, directly to customers or through third party administrators. The majority of our business is low limit or small premium business that has less intense price competition, as well as lower catastrophe and volatility risk. We reinsure a significant portion of our catastrophic exposure to hurricanes and earthquakes to minimize the impact on our net earnings and shareholders equity.

We generate our revenue from six primary sources:

risk-bearing earned premium produced by our insurance companies operations,

non-risk-bearing fee and commission income received by our underwriting agencies and brokers,

ceding commissions in excess of policy acquisition costs earned by our insurance companies,

investment income earned by all of our operations, realized investment gains and losses related to our fixed income securities portfolio, and

other operating income and losses, mainly from strategic investments.

We produced $2.3 billion of total revenue in 2008, which was 5% lower than in 2007. Total revenue decreased $109.0 million year-over-year due to certain investment-related items discussed in the Results of Operations section.

During the past several years, we substantially increased our shareholders equity by retaining most of our earnings. With this additional equity, we increased the underwriting capacity of our insurance companies and made strategic acquisitions, adding new lines of business or expanding those with favorable underwriting characteristics. During the past three years, we acquired two insurance businesses for total consideration of $152.2 million and eight underwriting agencies for total consideration of $100.2 million. Net earnings and cash flows from each acquired entity are included in our operations beginning on the effective date of each transaction.

The following section discusses our key operating results. The reasons for any significant variations between 2007 and 2006 are the same as those discussed for variations between 2008 and 2007, unless otherwise noted. Amounts in the following tables are in thousands, except for earnings per share, percentages, ratios and number of employees.

Results of Operations

Net earnings were $304.8 million ($2.64 per diluted share) in 2008 compared to $395.4 million ($3.38 per diluted share) in 2007. The decrease in net earnings primarily resulted from hurricane losses and the investment-related items described below. Diluted earnings per share benefited from the repurchase of 3.0 million shares of our common stock in 2008. Both the share repurchases and our lower stock price in 2008 caused the reduction in our diluted weighted-average shares outstanding from 117.0 million in 2007 to 115.5 million in 2008.

The following items affected pretax earnings in 2008 compared to 2007:

	2008	2007	2006
Pretax earnings (loss) from:			
2008 hurricanes (including reinsurance reinstatement premium)	$ (22,304)	$	$
Prior years reserve development, net of increases in current year loss ratios	24,893	13,132	11,915
Alternative investments	(30,766)	23,930	14,161
Net realized investment loss (excluding 2007 foreign currency gain)	(16,808)	(209)	(841)
Other-than-temporary impairments	(11,133)		
Trading securities	(11,698)	3,881	24,100
Strategic investments	9,158	21,618	39,368

We incurred gross losses of $98.2 million resulting from Hurricanes Gustav and Ike (referred to herein as the 2008 hurricanes). Our pretax loss after reinsurance in 2008 was $22.3 million, which included $19.4 million of losses reported in loss and loss adjustment expense and $2.9 million of premiums to reinstate our excess of loss reinsurance protection, which reduced net earned premium.

In 2008, we had favorable development of our prior years net loss reserves of $82.4 million, which was offset by $57.5 million of loss expense for increases in ultimate loss ratios in accident year 2008 above those set at the beginning of the year for business written in 2007 and 2008. In 2007, we had favorable development of prior years loss reserves of $26.4 million, which was offset by $13.3 million of loss expense for increases in ultimate loss ratios in accident year 2007 for business written in 2006 and 2007.

Our alternative investments generated $30.8 million of market-related losses in 2008, compared to $23.9 million of income in 2007. The related income or loss is included in net investment income. We gave notice to redeem all of the alternative investments in the third quarter of 2008. We received $48.6 million of cash through February 2009, which we reinvested in fixed income securities. We had $46.0 million of alternative investments at year-end 2008, for which we will receive the funds in 2009.

In 2008, to manage credit-related risk in our investment portfolio, we sold all of our investments in preferred stock and certain bonds of entities that were experiencing financial difficulty. We recorded a realized investment loss of $23.4 million related to these sales. The total net realized investment loss on the sale of all securities was $16.8 million in 2008, compared to a net realized investment gain of $13.2 million in 2007. The 2007 gain included $13.4 million of embedded currency conversion gains on certain available for sale fixed income securities that we sold in 2007, which was offset by a $13.4 million foreign currency loss recorded in other operating expense.

We recognized other-than-temporary impairments on securities in our available for sale securities portfolio of $11.1 million in 2008, which we recorded in net realized investment loss. There were no such impairments recorded in 2007.

Our trading portfolio had losses of $11.7 million in 2008, compared to gains of $3.9 million in 2007. These gains and losses are reported in other operating income. We discontinued the active trading of securities in late 2006 and sold the remaining two positions in 2008.

We sold strategic investments in 2008 and 2007 and realized gains of $9.2 million and $21.6 million, respectively. These gains are reported within other operating income.

Net earnings increased 16% in 2007, from $342.3 million ($2.93 per diluted share) in 2006 to $395.4 million ($3.38 per diluted share) in 2007, mainly due to growth in underwriting profits, favorable prior year loss development and higher net investment income. Net earnings in 2006 included an after-tax loss of $13.1 million due to a reinsurance commutation. During 2006, we reached agreements with various reinsurers to commute a large reinsurance contract on certain run-off assumed accident and health reinsurance business included in our discontinued lines, for which we had reinsurance recoverables of $120.2 million at the date of commutation. In consideration for discounting the recoverables and reassuming the associated loss reserves, we agreed to accept cash payments that were less than the related recoverables. We recorded pretax losses of $20.2 million in 2006 related to this commutation, which was included in loss and loss adjustment expense in our insurance company segment. We expect to recoup these losses over future years as we earn interest on the cash proceeds from the commutations prior to the related claims being paid.

The following table sets forth the relationships of certain income statement items as a percent of total revenue.