ARCH CAPITAL GROUP LTD.
Form 10-Q
August 09, 2013
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

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

For the period ended June 30, 2013

Or

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

Commission file number: 001-26456

ARCH CAPITAL GROUP LTD.
(Exact name of registrant as specified in its charter)

Bermuda
(State or other jurisdiction of incorporation or organization)

Not Applicable
(I.R.S. Employer Identification No.)

Wessex House, 5th Floor, 45 Reid Street
Hamilton HM 12, Bermuda
(Address of principal executive offices)

(441) 278-9250
(Registrant’s telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No ¨

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

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

Large accelerated filer x	Accelerated filer o
Non-accelerated filer o	Smaller reporting company o

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

The number of the registrant’s common shares (par value, $0.0033 per share) outstanding as of August 2, 2013 was 133,420,370.

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Report of Independent Registered Public Accounting Firm

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

We have reviewed the accompanying consolidated balance sheet of Arch Capital Group Ltd. and its subsidiaries (the "Company") as of June 30, 2013, and the related consolidated statements of income and comprehensive income for the three-month and six-month periods ended June 30, 2013 and June 30, 2012, and the consolidated statements of changes in shareholders' equity and cash flows for the six-month periods ended June 30, 2013 and June 30, 2012. These interim financial statements are the responsibility of the Company's management.

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

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

We previously audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheet as of December 31, 2012, and the related consolidated statements of income, comprehensive income, changes in shareholders' equity, and cash flows for the year then ended (not presented herein), and in our report dated March 1, 2013, we expressed an unqualified opinion on those consolidated financial statements. In our opinion, the information set forth in the accompanying consolidated balance sheet as of December 31, 2012, is fairly stated in all material respects in relation to the consolidated balance sheet from which it has been derived.

/s/ PricewaterhouseCoopers LLP

New York, NY
August 9, 2013

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

	(Unaudited) June 30, 2013	December 31, 2012
Assets		
Investments:		
Fixed maturities available for sale, at fair value (amortized cost: $9,619,842 and $9,567,290)	$9,570,583	$9,839,988
Short-term investments available for sale, at fair value (amortized cost: $1,095,497 and $719,848)	1,091,032	722,121
Investment of funds received under securities lending, at fair value (amortized cost: $39,079 and $42,302)	41,062	42,531
Equity securities available for sale, at fair value (cost: $410,219 and $298,414)	438,038	312,749
Other investments available for sale, at fair value (cost: $555,422 and $519,955)	569,407	549,280
Investments accounted for using the fair value option	1,065,684	917,466
Investments accounted for using the equity method	208,796	307,105
Total investments	12,984,602	12,691,240
Cash	375,119	371,041
Accrued investment income	68,413	71,748
Investment in joint venture (cost: $100,000)	108,710	107,284
Fixed maturities and short-term investments pledged under securities lending, at fair value	47,763	50,848
Premiums receivable	876,989	688,873
Reinsurance recoverable on unpaid and paid losses and loss adjustment expenses	1,849,891	1,870,037
Contractholder receivables	947,887	865,728
Prepaid reinsurance premiums	330,854	298,484
Deferred acquisition costs, net	313,010	262,822
Receivable for securities sold	447,545	19,248
Other assets	566,900	519,409
Total Assets	$18,917,683	$17,816,762
Liabilities		
Reserve for losses and loss adjustment expenses	$8,808,594	$8,933,292
Unearned premiums	1,921,849	1,647,978
Reinsurance balances payable	210,113	188,546
Contractholder payables	947,887	865,728
Senior notes	300,000	300,000
Revolving credit agreement borrowings	100,000	100,000
Securities lending payable	49,135	52,356
Payable for securities purchased	853,156	37,788
Other liabilities	492,631	522,196
Total Liabilities	13,683,365	12,647,884
Commitments and Contingencies		
Shareholders’ Equity		

Non-cumulative preferred shares	325,000	325,000
Common shares ($0.0033 par, shares issued: 169,245,371 and 168,255,572)	564	561
Additional paid-in capital	272,955	227,778
Retained earnings	5,776,808	5,354,361
Accumulated other comprehensive income (loss), net of deferred income tax	(49,322)	287,017
Common shares held in treasury, at cost (shares: 35,828,952 and 34,412,959)	(1,091,687)	(1,025,839)
Total Shareholders' Equity	5,234,318	5,168,878
Total Liabilities and Shareholders' Equity	$18,917,683	$17,816,762

See Notes to Consolidated Financial Statements

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

	(Unaudited) Three Months Ended June 30,		(Unaudited) Six Months Ended June 30,	
	2013	2012	2013	2012
Revenues				
Net premiums written	$810,535	$820,233	$1,763,311	$1,683,844
Change in unearned premiums	(51,719)	(93,577)	(251,725)	(276,876)
Net premiums earned	758,816	726,656	1,511,586	1,406,968
Net investment income	68,369	73,608	134,041	147,905
Net realized gains	12,652	34,867	70,992	78,988
Other-than-temporary impairment losses	(724)	(2,454)	(2,972)	(3,485)
Less investment impairments recognized in other comprehensive income, before taxes	—	503	2	511
Net impairment losses recognized in earnings	(724)	(1,951)	(2,970)	(2,974)
Fee income	902	806	1,440	1,349
Equity in net income of investment funds accounted for using the equity method	10,941	7,787	24,764	32,613
Other income (loss)	834	695	2,078	(7,373)
Total revenues	851,790	842,468	1,741,931	1,657,476
Expenses				
Losses and loss adjustment expenses	418,653	399,693	818,056	794,900
Acquisition expenses	131,677	128,289	259,269	247,251
Other operating expenses	127,408	117,701	247,591	224,173
Interest expense	5,852	7,439	11,750	14,960
Net foreign exchange gains	(13,811)	(31,689)	(38,075)	(11,001)
Total expenses	669,779	621,433	1,298,591	1,270,283
Income before income taxes	182,011	221,035	443,340	387,193
Income tax expense	5,071	767	9,924	2,669
Net income	176,940	220,268	433,416	384,524
Preferred dividends	5,485	7,649	10,969	14,110
Loss on repurchase of preferred shares	—	10,612	—	10,612
Net income available to common shareholders	$171,455	$202,007	$422,447	$359,802
Net income per common share				
Basic	$1.31	$1.50	$3.22	$2.68
Diluted	$1.26	$1.46	$3.11	$2.61

Weighted average common shares and common share equivalents outstanding				
Basic	131,377,274	134,529,129	131,143,885	134,241,876
Diluted	135,849,050	138,211,736	135,624,226	138,017,490

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

	(Unaudited) Three Months Ended June 30,		(Unaudited) Six Months Ended June 30,	
	2013	2012	2013	2012
Comprehensive Income (Loss)				
Net income	$176,940	$220,268	$433,416	$384,524
Other comprehensive income, net of deferred income tax				
Unrealized appreciation (decline) in value of investments:				
Unrealized holding gains (losses) arising during period	(259,562)	18,060	(250,091)	112,923
Portion of other-than-temporary impairment losses recognized in other comprehensive income, net of deferred income tax	—	(503)	(2)	(511)
Reclassification of net realized gains, net of income taxes, included in net income	(13,916)	(43,792)	(52,617)	(71,303)
Foreign currency translation adjustments, net of deferred income tax	(5,407)	(15,136)	(33,629)	(1,935)
Other comprehensive income (loss)	(278,885)	(41,371)	(336,339)	39,174
Comprehensive Income (Loss)	$(101,945)	$178,897	$97,077	$423,698

See Notes to Consolidated Financial Statements

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

	(Unaudited) Six Months Ended June 30, 2013	2012
Non-Cumulative Preferred Shares		
Balance at beginning of year	$325,000	$325,000
Shares issued - Series C	—	325,000
Shares repurchased - Series A and B	—	(325,000)
Balance at end of period	325,000	325,000
Common Shares		
Balance at beginning of year	561	549
Common shares issued, net	3	7
Balance at end of period	564	556
Additional Paid-in Capital		
Balance at beginning of year	227,778	161,419
Common shares issued, net	5,362	4,553
Issue costs on Series C preferred shares	—	(9,398)
Reversal of issue costs on repurchase of preferred shares	—	10,612
Exercise of stock options	6,022	4,822
Amortization of share-based compensation	31,466	23,930
Other	2,327	1,687
Balance at end of period	272,955	197,625
Retained Earnings		
Balance at beginning of year	5,354,361	4,796,655
Net income	433,416	384,524
Dividends declared on preferred shares	(10,969)	(14,110)
Loss on repurchase of preferred shares	—	(10,612)
Balance at end of period	5,776,808	5,156,457
Accumulated Other Comprehensive Income (Loss)		
Balance at beginning of year	287,017	153,923
Change in unrealized appreciation (decline) in value of investments, net of deferred income tax	(302,708)	41,620
Portion of other-than-temporary impairment losses recognized in other comprehensive income, net of deferred income tax	(2)	(511)
Foreign currency translation adjustments, net of deferred income tax	(33,629)	(1,935)
Balance at end of period	(49,322)	193,097
Common Shares Held in Treasury, at Cost		
Balance at beginning of year	(1,025,839)	(845,472)
Shares repurchased for treasury	(65,848)	(6,947)
Balance at end of period	(1,091,687)	(852,419)

Total Shareholders' Equity	$5,234,318	$5,020,316

See Notes to Consolidated Financial Statements

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

	(Unaudited) Six Months Ended June 30, 2013	2012
Operating Activities		
Net income	$433,416	$384,524
Adjustments to reconcile net income to net cash provided by operating activities:		
Net realized gains	(73,611)	(80,753)
Net impairment losses recognized in earnings	2,970	2,974
Equity in net income or loss of investment funds accounted for using the equity method and other income or loss	37,493	(18,141)
Share-based compensation	31,466	23,930
Changes in:		
Reserve for losses and loss adjustment expenses, net of unpaid losses and loss adjustment expenses recoverable	(33,163)	107,670
Unearned premiums, net of prepaid reinsurance premiums	251,724	276,877
Premiums receivable	(205,044)	(273,735)
Deferred acquisition costs, net	(51,971)	(45,390)
Reinsurance balances payable	24,267	37,129
Other liabilities	(26,981)	(2,526)
Other items, net	(2,212)	(15,291)
Net Cash Provided By Operating Activities	388,354	397,268
Investing Activities		
Purchases of:		
Fixed maturity investments	(8,599,697)	(7,546,498)
Equity securities	(272,323)	(110,303)
Other investments	(648,915)	(386,243)
Proceeds from the sales of:		
Fixed maturity investments	8,468,641	6,887,186
Equity securities	194,212	198,485
Other investments	506,434	216,964
Proceeds from redemptions and maturities of fixed maturity investments	424,953	598,792
Net purchases of short-term investments	(375,146)	(174,607)
Change in investment of securities lending collateral	3,221	(17,837)
Purchase of business, net of cash acquired	—	28,948
Purchases of furniture, equipment and other assets	(7,092)	(10,208)
Net Cash Used For Investing Activities	(305,712)	(315,321)
Financing Activities		
Proceeds from issuance of Series C preferred shares, net	—	315,789
Repurchase of Series A and B preferred shares	—	(325,000)
Purchases of common shares under share repurchase program	(56,463)	—
Proceeds from common shares issued, net	(517)	348
Repayments of borrowings	—	(73,773)
Change in securities lending collateral	(3,221)	17,837

Other	5,042	3,464
Preferred dividends paid	(10,969)	(17,412)
Net Cash Used For Financing Activities	(66,128)	(78,747)
Effects of exchange rate changes on foreign currency cash	(12,436)	493
Increase in cash	4,078	3,693
Cash beginning of year	371,041	351,699
Cash end of period	$375,119	$355,392

See Notes to Consolidated Financial Statements

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1. General

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

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

Certain information and footnote disclosures normally included in financial statements prepared in accordance with GAAP have been condensed or omitted; however, management believes that the disclosures are adequate to make the information presented not misleading. This report should be read in conjunction with the Company’s Annual Report on Form 10-K for the year ended December 31, 2012, including the Company’s audited consolidated financial statements and related notes.

The Company has reclassified the presentation of certain prior year information to conform to the current presentation. Such reclassifications had no effect on the Company’s net income, comprehensive income, shareholders’ equity or cash flows. Tabular amounts are in U.S. Dollars in thousands, except share amounts, unless otherwise noted.

2. Share Transactions

Share Repurchases

The board of directors of ACGL has authorized the investment in ACGL’s common shares through a share repurchase program. Repurchases under the program may be effected from time to time in open market or privately negotiated transactions through December 2014. Since the inception of the share repurchase program, ACGL has repurchased approximately 109.9 million common shares for an aggregate purchase price of $2.79 billion. During the 2013 second quarter and six months ended June 30, 2013, ACGL repurchased 0.3 million and 1.2 million common shares, respectively, for an aggregate purchase price of $15.5 million and $56.5 million, respectively. No share repurchases were made in the comparable 2012 periods. At June 30, 2013, $713.4 million of share repurchases were available under the program. The timing and amount of the repurchase transactions under this program will depend on a variety of factors, including market conditions and corporate and regulatory considerations.

Share-Based Compensation

During the 2013 second quarter, the Company made a stock grant of 516,859 stock appreciation rights and stock options and 544,075 restricted shares and units to certain employees and directors with weighted average grant-date fair values of $13.35 and $53.50 per share, respectively. During the 2012 second quarter, the Company made a stock grant of 782,248 stock appreciation rights and stock options and 728,864 restricted shares and units with weighted average grant-date fair values of $9.91 and $38.59 per share, respectively. The stock appreciation rights and stock options were valued at the grant date using the Black-Scholes option pricing model. Such values are being amortized over the respective substantive vesting period. For awards granted to retirement-eligible employees where no service is required for the employee to retain the award, the grant date fair value is immediately recognized as compensation expense at the grant date because the employee is able to retain the award without continuing to provide service. For employees near retirement eligibility, attribution of compensation cost is over the period from the grant date to the retirement eligibility date.

Loss on Repurchase of Preferred Shares

The Company issued $325.0 million of 6.75% Series C preferred shares in April 2012 and subsequently redeemed all of its $200.0 million of 8.0% Series A preferred shares and $125.0 million of 7.875% Series B preferred shares at a redemption price equal to $25.00 per share in May 2012. In accordance with GAAP, upon issuance of the Series A and B preferred shares in 2006, costs of $10.6 million were recognized as a reduction of additional paid-in capital in shareholders' equity. Following the redemption of such shares, such issue costs were recorded as a “loss on repurchase of preferred shares” to remove the costs from additional paid-in capital in the second quarter of 2012, as revised and as disclosed in the Company’s Annual Report on Form 10-K for the year ended December 31, 2012 (see Note 16 and Note 21).
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3. Recent Accounting Pronouncements

Effective January 1, 2013, the Company adopted Financial Accounting Standards Board ("FASB") guidance requiring additional disclosures about reclassification adjustments from accumulated other comprehensive income. As this guidance is disclosure-related only, the adoption of this guidance did not impact the Company’s results of operations, financial condition or liquidity. The additional disclosures are provided in Note 11, "Other Comprehensive Income."

Effective January 1, 2013, the Company adopted FASB guidance requiring additional disclosures about financial instruments and derivative instruments that are either: (1) offset for balance sheet presentation purposes or (2) subject to an enforceable master netting arrangement or similar arrangement, regardless of whether they are offset for balance sheet presentation purposes. The disclosure requirements of this guidance are limited to derivatives, repurchase agreements and reverse repurchase agreements, and securities borrowing/lending transactions. As this guidance is disclosure-related only and did not amend existing balance sheet offsetting guidance, adoption did not impact the Company’s results of operations, financial condition or liquidity. The additional disclosures are provided in Note 7, "Investment Information," and Note 9, "Derivative Instruments."

4. Commitments and Contingencies

Letter of Credit and Revolving Credit Facilities

As of June 30, 2013, the Company had a $300 million unsecured revolving loan and letter of credit facility and a $500 million secured letter of credit facility (the “Credit Agreement”). The Credit Agreement expires on August 18, 2014. In addition, the Company had access to secured letter of credit facilities of approximately $113.9 million as of June 30, 2013, which are available on a limited basis and for limited purposes (together with the secured portion of the Credit Agreement and these letter of credit facilities, the “LOC Facilities”). At June 30, 2013, the Company had $412.7 million in outstanding letters of credit under the LOC Facilities, which were secured by investments with a fair value of $481.3 million, and had $100.0 million of borrowings outstanding under the Credit Agreement. The Company was in compliance with all covenants contained in the LOC Facilities at June 30, 2013.

Investment Commitments

The Company’s investment commitments, which are primarily related to agreements entered into by the Company to invest in funds and separately managed accounts when called upon, were approximately $751.0 million at June 30, 2013.

Acquisition of CMG Mortgage Insurance Company and Mortgage Insurance Operating Platform of PMI

In February 2013, certain of the Company's U.S.-based subsidiaries (collectively “Arch U.S. MI”) entered into a definitive agreement to acquire (1) CMG Mortgage Insurance Company (“CMG MI”) from its current owners, PMI Mortgage Insurance Co. in rehabilitation (“PMI”), which has been under the receivership of the Arizona Department of Insurance since 2011, and CMFG Life Insurance Company, and (2) PMI's mortgage insurance operating platform and certain related assets from PMI. In connection with the closing of the transactions, PMI and an affiliate of the Company's U.S.-based subsidiaries will enter into a quota share reinsurance agreement pursuant to which such affiliate, as the reinsurer, will agree to provide 100% quota share indemnity reinsurance to PMI for all certificates of insurance that were issued by PMI between and including January 1, 2009 and December 31, 2011 that are not in default as of an agreed upon effective date. At closing, it is currently estimated that the Company's U.S.-based subsidiaries will pay aggregate consideration of approximately $300 million under all transaction documents. Additional amounts may be paid based on the actual results of CMG MI's pre-closing portfolio over an agreed upon period. In addition, the Company will enter into a services agreement with PMI to provide for necessary services to administer the run-off of PMI's legacy business at the direction of PMI.

On June 20, 2013, the Arizona receivership court provided the required approval of the acquisition. The transaction is also subject to approvals of the applicable regulators and approvals by the Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation of Arch U.S. MI as an eligible insurance carrier in the U.S. mortgage insurance marketplace, as well as the satisfaction of customary closing conditions. In connection with obtaining such consents of regulatory authorities and government-sponsored entities, it is anticipated that Arch U.S. MI or its affiliates will be required to make certain financial commitments to CMG MI, the form and amount of which will be determined based upon discussions with such authorities and entities. Arch U.S. MI's obligation to the sellers to accept financial requirements imposed by regulatory authorities and government-sponsored entities will be determined on the basis of, among other things, the appropriateness of such requirements in light of Arch U.S. MI's business plan and the consistency of such requirements with those imposed on other active participants in the U.S. mortgage insurance industry, as described in the purchase agreements. If these approvals are obtained, it is expected the transaction will close during the latter part of 2013.

5. Earnings Per Common Share

The following table sets forth the computation of basic and diluted earnings per common share:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
Numerator:				
Net income	$176,940	$220,268	$433,416	$384,524
Preferred dividends	(5,485)	(7,649)	(10,969)	(14,110)
Loss on repurchase of preferred shares	—	(10,612)	—	(10,612)
Net income available to common shareholders	$171,455	$202,007	$422,447	$359,802
Denominator:				
Weighted average common shares outstanding — basic	131,377,274	134,529,129	131,143,885	134,241,876
Effect of dilutive common share equivalents:				
Nonvested restricted shares	1,088,030	800,455	1,181,947	909,524
Stock options (1)	3,383,746	2,882,152	3,298,394	2,866,090
Weighted average common shares and common share equivalents outstanding — diluted	135,849,050	138,211,736	135,624,226	138,017,490
Earnings per common share:				
Basic	$1.31	$1.50	$3.22	$2.68
Diluted	$1.26	$1.46	$3.11	$2.61

(1) Certain stock options were not included in the computation of diluted earnings per share where the exercise price of the stock options exceeded the average market price and would have been anti-dilutive or where, when applying the treasury stock method to in-the-money options, the sum of the proceeds, including unrecognized compensation, exceeded the average market price and would have been anti-dilutive. For the 2013 second quarter and 2012 second quarter, the number of stock options excluded were 1,428,616 and 912,056, respectively. For the six months ended June 30, 2013 and 2012, the number of stock options excluded were 1,730,313 and 688,634,

respectively.

6. Segment Information

The following tables summarize the Company's underwriting income or loss by segment, together with a reconciliation of underwriting income or loss to net income available to common shareholders:

	Three Months Ended June 30, 2013			Three Months Ended June 30, 2012		
	Insurance	Reinsurance	Total	Insurance	Reinsurance	Total
Gross premiums written (1)	$703,904	$337,642	$1,040,738	$676,090	$376,981	$1,051,813
Net premiums written	501,568	308,967	810,535	464,584	355,649	820,233
Net premiums earned	$458,656	$300,160	$758,816	$446,594	$280,062	$726,656
Fee income	529	373	902	628	178	806
Losses and loss adjustment expenses	(291,192)	(127,461)	(418,653)	(290,416)	(109,277)	(399,693)
Acquisition expenses, net	(74,249)	(57,428)	(131,677)	(76,058)	(52,231)	(128,289)
Other operating expenses	(80,167)	(33,192)	(113,359)	(76,617)	(29,140)	(105,757)
Underwriting income	$13,577	$82,452	96,029	$4,131	$89,592	93,723
Net investment income			68,369			73,608
Net realized gains			12,652			34,867
Net impairment losses recognized in earnings			(724)			(1,951)
Equity in net income of investment funds accounted for using the equity method			10,941			7,787
Other income (loss)			834			695
Other expenses			(14,049)			(11,944)
Interest expense			(5,852)			(7,439)
Net foreign exchange gains			13,811			31,689
Income before income taxes			182,011			221,035
Income tax expense			(5,071)			(767)
Net income			176,940			220,268
Preferred dividends			(5,485)			(7,649)
Loss on repurchase of preferred shares			—			(10,612)
Net income available to common shareholders			$171,455			$202,007

Underwriting Ratios												
Loss ratio	63.5	%	42.5	%	55.2	%	65.0	%	39.0	%	55.0	%
Acquisition expense ratio (2)	16.1	%	19.1	%	17.3	%	16.9	%	18.6	%	17.6	%
Other operating expense ratio	17.5	%	11.1	%	14.9	%	17.2	%	10.4	%	14.6	%
Combined ratio	97.1	%	72.7	%	87.4	%	99.1	%	68.0	%	87.2	%

(1) Certain amounts included in the gross premiums written of each segment are related to intersegment transactions. Accordingly, the sum of gross premiums written for each segment does not agree to the total gross premiums written as shown in the table above due to the elimination of intersegment transactions in the total.
(2) The acquisition expense ratio is adjusted to include policy-related fee income.

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	Six Months Ended June 30, 2013			Six Months Ended June 30, 2012		
	Insurance	Reinsurance	Total	Insurance	Reinsurance	Total
Gross premiums written (1)	$1,392,721	$813,847	$2,204,437	$1,364,203	$756,957	$2,118,469
Net premiums written	1,006,118	757,193	1,763,311	955,264	728,580	1,683,844
Net premiums earned	$903,621	$607,965	$1,511,586	$888,334	$518,634	$1,406,968
Fee income	1,054	386	1,440	1,158	191	1,349
Losses and loss adjustment expenses	(574,659)	(243,397)	(818,056)	(593,580)	(201,320)	(794,900)
Acquisition expenses, net	(145,007)	(114,262)	(259,269)	(149,928)	(97,323)	(247,251)
Other operating expenses	(156,482)	(66,792)	(223,274)	(149,987)	(55,263)	(205,250)
Underwriting income (loss)	$28,527	$183,900	212,427	$(4,003)	$164,919	160,916
Net investment income			134,041			147,905
Net realized gains			70,992			78,988
Net impairment losses recognized in earnings			(2,970)			(2,974)
Equity in net income of investment funds accounted for using the equity method			24,764			32,613
Other income (loss)			2,078			(7,373)
Other expenses			(24,317)			(18,923)
Interest expense			(11,750)			(14,960)
Net foreign exchange gains			38,075			11,001
Income before income taxes			443,340			387,193
Income tax expense			(9,924)			(2,669)
Net income			433,416			384,524
Preferred dividends			(10,969)			(14,110)
Loss on repurchase of preferred shares			—			(10,612)
Net income available to common shareholders			$422,447			$359,802
Underwriting Ratios						
Loss ratio	63.6 %	40.0 %	54.1 %	66.8 %	38.8 %	56.5 %

Acquisition expense ratio (2)	15.9	%	18.8	%	17.1	%	16.7	%	18.8	%	17.5	%
Other operating expense ratio	17.3	%	11.0	%	14.8	%	16.9	%	10.7	%	14.6	%
Combined ratio	96.8	%	69.8	%	86.0	%	100.4	%	68.3	%	88.6	%

(1) Certain amounts included in the gross premiums written of each segment are related to intersegment transactions. Accordingly, the sum of gross premiums written for each segment does not agree to the total gross premiums written as shown in the table above due to the elimination of intersegment transactions in the total.
(2) The acquisition expense ratio is adjusted to include policy-related fee income.

7. Investment Information

Available For Sale Investments

The following table summarizes the fair value and cost or amortized cost of the Company's investments classified as available for sale:

	Fair Value	Gross Unrealized Gains	Gross Unrealized Losses	Cost or Amortized Cost	OTTI Unrealized Losses (2)
June 30, 2013					
Fixed maturities and fixed maturities pledged under securities lending agreements (1):					
Corporate bonds	$2,473,130	$33,423	$(60,264)	$2,499,971	$—
Mortgage backed securities	1,592,207	16,874	(46,562)	1,621,895	(9,330)
Municipal bonds	1,507,924	35,880	(14,222)	1,486,266	(17)
Commercial mortgage backed securities	838,471	15,687	(13,340)	836,124	(231)
U.S. government and government agencies	975,345	8,744	(7,251)	973,852	(19)
Non-U.S. government securities	1,002,989	9,671	(27,927)	1,021,245	—
Asset backed securities	1,225,183	17,677	(17,948)	1,225,454	(3,348)
Total	9,615,249	137,956	(187,514)	9,664,807	(12,945)
Equity securities	438,038	44,653	(16,834)	410,219	—
Other investments	569,407	32,313	(18,328)	555,422	—
Short-term investments	1,094,129	174	(4,650)	1,098,605	—
Total	$11,716,823	$215,096	$(227,326)	$11,729,053	$(12,945)
December 31, 2012					
Fixed maturities and fixed maturities pledged under securities lending agreements (1):					
Corporate bonds	$2,857,513	$105,798	$(6,710)	$2,758,425	$(62)
Mortgage backed securities	1,532,736	24,809	(7,484)	1,515,411	(9,329)
Municipal bonds	1,463,586	62,322	(1,421)	1,402,685	(17)
Commercial mortgage backed securities	824,165	37,514	(4,468)	791,119	(270)
U.S. government and government agencies	1,131,688	20,178	(1,095)	1,112,605	(19)
Non-U.S. government securities	998,901	33,701	(8,860)	974,060	—
Asset backed securities	1,073,999	25,528	(5,838)	1,054,309	(3,346)
Total	9,882,588	309,850	(35,876)	9,608,614	(13,043)
Equity securities	312,749	26,625	(12,290)	298,414	—
Other investments	549,280	32,582	(3,257)	519,955	—

Short-term investments	730,369	3,521	(1,248)	728,096	—
Total	$11,474,986	$372,578	$(52,671)	$11,155,079	$(13,043)

(1) In securities lending transactions, the Company receives collateral in excess of the fair value of the fixed maturities and short-term investments pledged. For purposes of this table, the Company has excluded the collateral received and reinvested and included the fixed maturities and short-term investments pledged. See "—Securities Lending Agreements."

(2) Represents the total other-than-temporary impairments ("OTTI") recognized in accumulated other comprehensive income ("AOCI"). It does not include the change in fair value subsequent to the impairment measurement date. At June 30, 2013, the net unrealized gain related to securities for which a non-credit OTTI was recognized in AOCI was $4.2 million, compared to a net unrealized gain of $2.0 million at December 31, 2012.

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The following table summarizes, for all available for sale securities in an unrealized loss position, the fair value and gross unrealized loss by length of time the security has been in a continual unrealized loss position:

	Less than 12 Months		12 Months or More		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
June 30, 2013						
Fixed maturities and fixed maturities pledged under securities lending agreements (1):						
Corporate bonds	$1,737,631	$(58,235)	$17,492	$(2,029)	$1,755,123	$(60,264)
Mortgage backed securities	1,015,422	(45,242)	22,558	(1,320)	1,037,980	(46,562)
Municipal bonds	578,711	(13,690)	10,380	(532)	589,091	(14,222)
Commercial mortgage backed securities	450,164	(13,132)	2,111	(208)	452,275	(13,340)
U.S. government and government agencies	621,953	(7,251)	—	—	621,953	(7,251)
Non-U.S. government securities	726,472	(25,265)	23,796	(2,662)	750,268	(27,927)
Asset backed securities	815,150	(14,822)	31,177	(3,126)	846,327	(17,948)
Total	5,945,503	(177,637)	107,514	(9,877)	6,053,017	(187,514)
Equity securities	181,248	(16,499)	2,996	(335)	184,244	(16,834)
Other investments	197,537	(15,113)	23,195	(3,215)	220,732	(18,328)
Short-term investments	161,476	(4,650)	—	—	161,476	(4,650)
Total	$6,485,764	$(213,899)	$133,705	$(13,427)	$6,619,469	$(227,326)
December 31, 2012						
Fixed maturities and fixed maturities pledged under securities lending agreements (1):						
Corporate bonds	$490,784	$(3,692)	$52,334	$(3,018)	$543,118	$(6,710)
Mortgage backed securities	537,883	(4,290)	60,574	(3,194)	598,457	(7,484)
Municipal bonds	147,766	(1,120)	7,052	(301)	154,818	(1,421)
Commercial mortgage backed securities	36,649	(2,261)	8,878	(2,207)	45,527	(4,468)
U.S. government and government agencies	146,526	(1,095)	—	—	146,526	(1,095)
Non-U.S. government securities	244,827	(1,070)	135,564	(7,790)	380,391	(8,860)
Asset backed securities	234,584	(1,508)	57,371	(4,330)	291,955	(5,838)
Total	1,839,019	(15,036)	321,773	(20,840)	2,160,792	(35,876)
Equity securities	130,385	(10,200)	16,469	(2,090)	146,854	(12,290)

Other investments	23,849	(2,474)	35,083	(783)	58,932	(3,257)
Short-term investments	57,415	(1,248)	—	—	57,415	(1,248)
Total	$2,050,668	$(28,958)	$373,325	$(23,713)	$2,423,993	$(52,671)

(1) In securities lending transactions, the Company receives collateral in excess of the fair value of the fixed maturities and short-term investments pledged. For purposes of this table, the Company has excluded the collateral received and reinvested and included the fixed maturities and short-term investments pledged. See "—Securities Lending Agreements."

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At June 30, 2013, on a lot level basis, approximately 2,410 security lots out of a total of approximately 4,590 security lots were in an unrealized loss position and the largest single unrealized loss from a single lot in the Company's fixed maturity portfolio was $4.0 million. At December 31, 2012, on a lot level basis, approximately 910 security lots out of a total of approximately 4,580 security lots were in an unrealized loss position and the largest single unrealized loss from a single lot in the Company's fixed maturity portfolio was $2.5 million.

The contractual maturities of the Company's fixed maturities and fixed maturities pledged under securities lending agreements are shown in the following table. Expected maturities, which are management's best estimates, will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	June 30, 2013		December 31, 2012	
Maturity	Fair Value	Amortized Cost	Fair Value	Amortized Cost
Due in one year or less	$281,901	$276,338	$446,402	$436,376
Due after one year through five years	3,358,388	3,356,354	3,876,062	3,769,426
Due after five years through 10 years	2,082,358	2,108,760	1,949,297	1,869,698
Due after 10 years	236,741	239,882	179,927	172,275
	5,959,388	5,981,334	6,451,688	6,247,775
Mortgage backed securities	1,592,207	1,621,895	1,532,736	1,515,411
Commercial mortgage backed securities	838,471	836,124	824,165	791,119
Asset backed securities	1,225,183	1,225,454	1,073,999	1,054,309
Total	$9,615,249	$9,664,807	$9,882,588	$9,608,614

Securities Lending Agreements

The Company operates a securities lending program under which certain of its fixed income portfolio securities are loaned to third parties, primarily major brokerage firms, for short periods of time through a lending agent. The fair value and amortized cost of fixed maturities and short-term investments pledged under securities lending agreements were $47.8 million and $48.1 million, respectively, at June 30, 2013, compared to $50.8 million and $49.6 million, respectively, at December 31, 2012. The fair value of the portfolio of collateral backing the Company's securities lending program was $41.1 million at June 30, 2013, compared to $42.5 million at December 31, 2012. Such amounts included approximately $6.3 million of sub-prime securities at June 30, 2013, compared to $5.4 million at December 31, 2012. The Company maintains legal control over the securities it lends, retains the earnings and cash flows associated with the loaned securities and receives a fee from the borrower for the temporary use of the securities. An indemnification agreement with the lending agent protects the Company in the event a borrower becomes insolvent or fails to return any of the securities on loan to the Company.

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Other Investments

The following table summarizes the Company's other investments, including available for sale and fair value option components:

	June 30, 2013	December 31, 2012
Available for sale:		
Asian and emerging markets	$343,535	$ 316,860
Investment grade fixed income	219,068	220,410
Other	6,804	12,010
Total available for sale	569,407	549,280
Fair value option:		
Term loan investments (par value: $475,397 and $307,016)	481,773	308,596
Asian and emerging markets	28,932	24,035
Investment grade fixed income	74,320	67,624
Non-investment grade fixed income	9,331	11,093
Other (1)	118,018	116,623
Total fair value option	$712,374	$ 527,971
Total	$1,281,781	$ 1,077,251

(1) Includes fund investments with strategies in mortgage servicing rights, transportation and infrastructure assets and other.

Certain of the Company's other investments are in investment funds for which the Company has the option to redeem at agreed upon values as described in each investment fund's subscription agreement. Depending on the terms of the various subscription agreements, investments in investment funds may be redeemed daily, monthly, quarterly or on other terms. Two common redemption restrictions which may impact the Company's ability to redeem these investment funds are gates and lockups. A gate is a suspension of redemptions which may be implemented by the general partner or investment manager of the fund in order to defer, in whole or in part, the redemption request in the event the aggregate amount of redemption requests exceeds a predetermined percentage of the investment fund's net assets which may otherwise hinder the general partner or investment manager's ability to liquidate holdings in an orderly fashion in order to generate the cash necessary to fund extraordinarily large redemption payouts. A lockup period is the initial amount of time an investor is contractually required to hold the security before having the ability to redeem. If the investment funds are eligible to be redeemed, the time to redeem such fund can take weeks or months following the notification.

Fair Value Option

The Company elected to carry certain fixed maturity securities, equity securities and other investments (primarily term loans) at fair value under the fair value option afforded by accounting guidance regarding the fair value option for financial assets and liabilities. Changes in fair value of investments accounted for using the fair value option are included in net realized gains or losses while interest income, dividends received and distributions from fund investments which are not a return of capital are reflected in net investment income. The primary reasons for electing the fair value option were to reflect economic events in earnings on a timely basis and to address practicality and cost-benefit considerations.

The following table summarizes the Company's assets and liabilities which are accounted for using the fair value option:

	June 30, 2013	December 31, 2012
Fixed maturities	$353,310	$ 363,541
Other investments	712,374	527,971
Equity securities	—	25,954
Investments accounted for using the fair value option	1,065,684	917,466
Securities sold but not yet purchased (1)	—	(6,924)
Net assets accounted for using the fair value option	$1,065,684	$ 910,542

(1) Represents the Company's obligation to deliver equity securities that it did not own at the time of sale. Such amounts are included in "other liabilities" on the Company's consolidated balance sheets.

Net Investment Income

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
Fixed maturities	$62,004	$70,290	$124,010	$143,740
Term loan investments (1)	6,026	3,557	10,243	5,856
Equity securities	3,164	2,425	4,587	4,089
Short-term investments	364	760	756	1,132
Other (2)	4,734	2,980	11,033	6,173
Gross investment income	76,292	80,012	150,629	160,990
Investment expenses	(7,923)	(6,404)	(16,588)	(13,085)
Net investment income	$68,369	$73,608	$134,041	$147,905

(1) Included in "investments accounted for using the fair value option" on the Company's consolidated balance sheets.
(2) Amounts include dividends on investment funds and other items.

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Net Realized Gains (Losses)

Net realized gains (losses) were as follows, excluding other-than-temporary impairment provisions:

	Three Months Ended June 30, 2013	Three Months Ended June 30, 2012	Six Months Ended June 30, 2013	Six Months Ended June 30, 2012
Available for sale securities:				
Gross gains on investment sales	$68,853	$67,936	$135,873	$115,948
Gross losses on investment sales	(54,783)	(20,757)	(79,839)	(38,693)
Change in fair value of assets and liabilities accounted for using the fair value option:				
Fixed maturities	(6,702)	(4,810)	(1,644)	3,407
Equity securities	5	(3,589)	704	(202)
Other investments	(9,502)	(1,744)	449	2,009
TALF investments	—	(1,274)	—	(50)
TALF borrowings	—	(176)	—	895
Derivative instruments (1)	15,646	277	15,268	(4,392)
Other	(865)	(996)	181	66
Net realized gains	$12,652	$34,867	$70,992	$78,988

(1) See Note 9 for information on the Company’s derivative instruments.

Other-Than-Temporary Impairments

The Company performs quarterly reviews of its available for sale investments in order to determine whether declines in fair value below the amortized cost basis were considered other-than-temporary in accordance with applicable guidance. The following table details the net impairment losses recognized in earnings by asset class:

	Three Months Ended June 30, 2013	Three Months Ended June 30, 2012	Six Months Ended June 30, 2013	Six Months Ended June 30, 2012
Fixed maturities:				
Mortgage backed securities	$—	$(146)	$(15)	$(892)
Corporate bonds	—	(1,166)	—	(1,362)
Non-U.S. government securities	—	(261)	—	(261)
Asset backed securities	—	(106)	(20)	(106)
U.S. government and government agencies	—	(10)	—	(10)
Total	—	(1,689)	(35)	(2,631)
Investment of funds received under securities lending agreements	—	(6)	—	(87)
Equity securities	(724)	(256)	(2,935)	(256)
Net impairment losses recognized in earnings	$(724)	$(1,951)	$(2,970)	$(2,974)

A description of the methodology and significant inputs used to measure the amount of net impairment losses recognized in earnings in the 2013 periods is as follows:

- Equity securities — the Company utilized information received from asset managers on common stocks, including the business prospects, recent events, industry and market data and other factors. For certain equities which were in an unrealized loss position and where the Company determined that it did not have the intent or ability to hold such securities for a reasonable period of time by which the fair value of the securities would increase and the Company would recover its cost, the cost basis of such securities was adjusted down accordingly;

- Mortgage backed and asset backed securities — the Company utilized underlying data provided by asset managers, cash flow projections and additional information from credit agencies in order to determine an expected recovery value for each security. The analysis includes expected cash flow projections under base case and stress case scenarios which modify the expected default expectations and loss severities and slow down prepayment assumptions. The significant inputs in the models include the expected default rates, delinquency rates and foreclosure costs. The expected recovery values were reduced on a small number of securities, primarily as a result of increases in expected default expectations and foreclosure costs. The amortized cost basis of the securities were adjusted down, if required, to the expected recovery value calculated in the OTTI review process.

The Company believes that the $13.0 million of OTTI included in accumulated other comprehensive income at June 30, 2013 on the securities which were considered by the Company to be impaired was due to market and sector-related factors (i.e., not credit losses). At June 30, 2013, the Company did not intend to sell these securities, or any other securities which were in an unrealized loss position, and determined that it is more likely than not that the Company will not be required to sell such securities before recovery of their cost basis.

The following table provides a roll forward of the amount related to credit losses recognized in earnings for which a portion of an OTTI was recognized in accumulated other comprehensive income:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
Balance at start of period	$61,956	$67,086	$62,001	$66,545
Credit loss impairments recognized on securities not previously impaired	—	1,693	33	1,905
Credit loss impairments recognized on securities previously impaired	—	258	2	1,069
Reductions for increases in cash flows expected to be collected that are recognized over the remaining life of the security	—	—	—	—
Reductions for securities sold during the period	(507)	(6,511)	(587)	(6,993)
Balance at end of period	$61,449	$62,526	$61,449	$62,526

Restricted Assets

The Company is required to maintain assets on deposit, which primarily consist of fixed maturities, with various regulatory authorities to support its insurance and reinsurance operations. The Company's insurance and reinsurance subsidiaries maintain assets in trust accounts as collateral for insurance and reinsurance transactions with affiliated companies and also have investments in segregated portfolios primarily to provide collateral or guarantees for letters of credit to third parties. See Note 4, "Commitments and Contingencies—Letter of Credit and Revolving Credit Facilities," for further details. The following table details the value of the Company's restricted assets:

	June 30, 2013	December 31, 2012
Assets used for collateral or guarantees:		
Affiliated transactions	$4,226,334	$ 4,062,097
Third party agreements	793,162	771,631
Deposits with U.S. regulatory authorities	302,572	290,441
Deposits with non-U.S. regulatory authorities	6,591	247,321
Trust funds	103,021	96,342
Total restricted assets	$5,431,680	$ 5,467,832

8. Fair Value

Accounting guidance regarding fair value measurements addresses how companies should measure fair value when they are required to use a fair value measure for recognition or disclosure purposes under GAAP and provides a common definition of fair value to be used throughout GAAP. It defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly fashion between market participants at the measurement date. In addition, it establishes a three-level valuation hierarchy for the disclosure of fair value measurements. The valuation hierarchy is based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date. The level in the hierarchy within which a given fair value measurement falls is determined based on the lowest level input that is significant to the measurement (Level 1 being the highest priority and Level 3 being the lowest priority).

The levels in the hierarchy are defined as follows:

Level 1: Inputs to the valuation methodology are observable inputs that reflect quoted prices (unadjusted) for identical assets or liabilities in active markets

Level 2: Inputs to the valuation methodology include quoted prices for similar assets and liabilities in active markets, and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument

Level 3: Inputs to the valuation methodology are unobservable and significant to the fair value measurement

Following is a description of the valuation methodologies used for securities measured at fair value, as well as the general classification of such securities pursuant to the valuation hierarchy.

The Company determines the existence of an active market based on its judgment as to whether transactions for the financial instrument occur in such market with sufficient frequency and volume to provide reliable pricing information. The independent pricing sources obtain market quotations and actual transaction prices for securities that have quoted prices in active markets. The Company uses quoted values and other data provided by nationally recognized independent pricing sources as inputs into its process for determining fair values of its fixed maturity investments. To validate the techniques or models used by pricing sources, the Company's review process includes, but is not limited to: (i) quantitative analysis (e.g., comparing the quarterly return for each managed portfolio to its target benchmark, with significant differences identified and investigated); (ii) a review of the average number of prices obtained in the pricing process and the range of resulting fair values; (iii) initial and ongoing evaluation of methodologies used by outside parties to calculate fair value including a review of deep dive reports on selected securities which indicate the use of observable inputs in the pricing process; (iv) comparing the fair value estimates to its knowledge of the current market; (v) a comparison of the pricing services' fair values to other pricing services' fair values for the same investments; and (vi) back-testing, which includes randomly selecting purchased or sold securities and comparing the executed prices to the fair value estimates from the pricing service. For a majority of investments, the Company obtained multiple quotes. A price source hierarchy was maintained in order to determine which price source would be used (i.e., a price obtained from a pricing service with more seniority in the hierarchy will be used over a less senior one in all cases). The hierarchy prioritizes pricing services based on availability and reliability and assigns the highest priority to index providers. Based on the above review, the Company will challenge any prices for a security or portfolio which are considered not to be representative of fair value. At June 30, 2013, the Company adjusted certain prices (primarily on structured securities) obtained from the pricing services and substituted alternate prices (primarily broker-dealer quotes) for such securities. Such adjustments did not have a material impact on the overall fair value of the Company's investment portfolio at June 30, 2013.

The independent pricing sources obtain market quotations and actual transaction prices for securities that have quoted prices in active markets. Each source has its own proprietary method for determining the fair value of securities that are not actively traded. In general, these methods involve the use of “matrix pricing” in which the independent pricing source uses observable market inputs including, but not limited to, investment yields, credit risks and spreads, benchmarking of like securities, broker-dealer quotes, reported trades and sector groupings to determine a reasonable fair value. In addition, pricing vendors use model processes, such as an Option Adjusted Spread model, to develop prepayment and interest rate scenarios. The Option Adjusted Spread model is commonly used to estimate fair value for securities such as mortgage backed and asset backed securities. In certain circumstances, when fair values are unavailable from these independent pricing sources, quotes are obtained directly from broker-dealers who are active in the corresponding markets. Such quotes are subject to the validation procedures noted above. Of the $12.78 billion of financial assets and liabilities measured at fair value at June 30, 2013, approximately $1.45 billion, or 11.4%, were priced using non-binding broker-dealer quotes. Of the $12.40 billion of financial assets and liabilities measured at fair value at December 31, 2012, approximately $927.9 million, or 7.5%, were priced using non-binding broker-dealer quotes.

The Company reviews its securities measured at fair value and discusses the proper classification of such investments with investment advisors and others. A discussion of the general classification of the Company's financial instruments follows:

Fixed maturities. The Company determined that all U.S. Treasuries would be classified as Level 1 securities due to observed levels of trading activity, the high number of strongly correlated pricing quotes received on U.S. Treasuries and other factors. Where the Company believes that quoted market prices are not available or that the market is not active, fair values are estimated by using quoted prices of securities with similar characteristics, pricing models or matrix pricing and are generally classified as Level 2 securities. The Company determined that Level 2 securities included corporate bonds, mortgage backed securities, municipal bonds, asset backed securities and non-U.S. government securities. The Company determined that certain Euro-denominated corporate bonds which invest in underlying portfolios of fixed income securities for which there is a low level of transparency around inputs to the valuation process should be classified within Level 3 of the valuation hierarchy and certain other corporate bonds.

Equity securities. The Company determined that exchange-traded equity securities would be included in Level 1 as their fair values are based on quoted market prices in active markets. Other equity securities are included in Level 2 of the valuation hierarchy.

Other investments. The fair values for certain of the Company's other investments are determined using net asset values (“NAV”) as advised by external fund managers. The NAV is based on the fund manager's valuation of the underlying holdings in accordance with the fund's governing documents. Periodically, the Company performs a number of monitoring procedures in order to assess the quality of the NAVs, including regular review and discussion of each fund's performance, regular evaluation of fund performance against applicable benchmarks and the backtesting of the NAVs against audited and interim financial statements. Other investments with liquidity terms allowing the Company to substantially redeem its holdings in a short time frame at the applicable NAV are reflected in Level 2. Other investments with redemption restrictions that prevent the Company from redeeming in the near term are classified in Level 3 of the valuation hierarchy.

Short-term investments. The Company determined that certain of its short-term investments held in highly liquid money market-type funds would be included in Level 1 as their fair values are based on quoted market prices in active markets. Other short-term investments are classified in Level 2 of the valuation hierarchy.

The Company reviews the classification of its investments each quarter. No transfers were made in the periods presented.

In securities lending transactions, the Company receives collateral in excess of the fair value of the fixed maturities and short-term investments pledged under securities lending agreements. For purposes of the following tables, the Company has excluded the collateral received and reinvested and included the fixed maturities and short-term investments pledged under securities lending agreements, at fair value.

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The following table presents the Company's financial assets and liabilities measured at fair value by level at June 30, 2013:

	Fair Value	Fair Value Measurement Using: Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets measured at fair value:				
Available for sale securities:				
Fixed maturities and fixed maturities pledged under securities lending agreements (1):				
Corporate bonds	$2,473,130	$—	$2,470,770	$2,360
Mortgage backed securities	1,592,207	—	1,592,207	—
Municipal bonds	1,507,924	—	1,507,924	—
Commercial mortgage backed securities	838,471	—	838,471	—
U.S. government and government agencies	975,345	975,345	—	—
Non-U.S. government securities	1,002,989	—	1,002,989	—
Asset backed securities	1,225,183	—	1,225,183	—
Total	9,615,249	975,345	8,637,544	2,360
Equity securities	438,038	437,278	760	—
Other investments	569,407	—	379,514	189,893
Short-term investments	1,094,129	1,062,472	31,657	—
Fair value option:				
Investments accounted for using the fair value option:				
Corporate bonds	293,976	—	293,976	—
Non-U.S. government bonds	59,334	—	59,334	—
Other investments	712,374	—	422,185	290,189
Equity securities	—	—	—	—
Total	1,065,684	—	775,495	290,189
Total assets measured at fair value	$12,782,507	$2,475,095	$9,824,970	$482,442
Liabilities measured at fair value:				
Fair value option:				
Securities sold but not yet purchased (2)	$—	$—	$—	$—
Total liabilities measured at fair value	$—	$—	$—	$—

(1) In securities lending transactions, the Company receives collateral in excess of the fair value of the fixed maturities and short-term investments pledged. For purposes of this table, the Company has excluded the collateral received and reinvested and included the fixed maturities and short-term investments pledged.

(2) Represents the Company's obligation to deliver securities that it did not own at the time of sale. Such amounts are included in "other liabilities" on the Company's consolidated balance sheets.

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The following table presents the Company’s financial assets and liabilities measured at fair value by level at December 31, 2012:

	Fair Value	Fair Value Measurement Using: Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets measured at fair value:				
Available for sale securities:				
Fixed maturities and fixed maturities pledged under securities lending agreements (1):				
Corporate bonds	$2,857,513	$—	$2,759,109	$98,404
Mortgage backed securities	1,532,736	—	1,532,736	—
Municipal bonds	1,463,586	—	1,463,586	—
Commercial mortgage backed securities	824,165	—	824,165	—
U.S. government and government agencies	1,131,688	1,131,688	—	—
Non-U.S. government securities	998,901	—	998,901	—
Asset backed securities	1,073,999	—	1,073,999	—
Total	9,882,588	1,131,688	8,652,496	98,404
Equity securities	312,749	312,666	83	—
Other investments	549,280	—	365,078	184,202
Short-term investments	730,369	678,441	51,928	—
Fair value option:				
Investments accounted for using the fair value option:				
Corporate bonds	275,132	—	275,132	—
Non-U.S. government bonds	88,409	—	88,409	—
Other investments	527,971	—	332,621	195,350
Equity securities	25,954	25,954	—	—
Total	917,466	25,954	696,162	195,350
Total assets measured at fair value	$12,392,452	$2,148,749	$9,765,747	$477,956
Liabilities measured at fair value:				
Fair value option:				
Securities sold but not yet purchased (2)	$6,924	$6,924	$—	$—
Total liabilities measured at fair value	$6,924	$6,924	$—	$—

(1) In securities lending transactions, the Company receives collateral in excess of the fair value of the fixed maturities and short-term investments pledged. For purposes of this table, the Company has excluded the collateral received and reinvested and included the fixed maturities and short-term investments pledged.

(2) Represents the Company’s obligation to deliver securities that it did not own at the time of sale. Such amounts are included in “other liabilities” on the Company’s consolidated balance sheets.

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The following tables present a reconciliation of the beginning and ending balances for all investments measured at fair value on a recurring basis using Level 3 inputs:

	Fair Value Measurements Using: Significant Unobservable Inputs (Level 3)			
s	Available-For-Sale		Fair Value Option	
	Corporate Bonds	Other Investments	Other Investments	Total
Three Months Ended June 30, 2013				
Balance at beginning of period	$97,298	$185,934	$179,370	$462,602
Total gains or (losses) (realized/unrealized)				
Included in earnings (1)	3,187	—	(2,075)	1,112
Included in other comprehensive income	(1,363)	3,959	—	2,596
Purchases, issuances, sales and settlements				
Purchases	—	—	118,916	118,916
Issuances	—	—	—	—
Sales	(96,655)	—	—	(96,655)
Settlements	(107)	—	(6,022)	(6,129)
Transfers in and/or out of Level 3	—	—	—	—
Balance at end of period	$2,360	$189,893	$290,189	$482,442
Three Months Ended June 30, 2012				
Balance at beginning of period	$96,655	$6,215	$—	$102,870
Total gains or (losses) (realized/unrealized)				
Included in earnings (1)	(548)	—	—	(548)
Included in other comprehensive income	(4,032)	171	—	(3,861)
Purchases, issuances, sales and settlements				
Purchases	—	—	—	—
Issuances	—	—	—	—
Sales	—	—	—	—
Settlements	(39)	—	—	(39)
Transfers in and/or out of Level 3	—	—	—	—
Balance at end of period	$92,036	$6,386	$—	$98,422

(1) Gains or losses on corporate bonds were included in net realized gains (losses) while gains or losses on other investments were recorded in net realized gains (losses) or net investment income.

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	Fair Value Measurements Using: Significant Unobservable Inputs (Level 3)			
s	Available-For-Sale		Fair Value Option	
	Corporate Bonds	Other Investments	Other Investments	Total
Six Months Ended June 30, 2013				
Balance at beginning of period	$98,404	$184,202	$195,350	$477,956
Total gains or (losses) (realized/unrealized)				
Included in earnings (1)	4,679	4,762	(1,702)	7,739
Included in other comprehensive income	(3,051)	5,871	—	2,820
Purchases, issuances, sales and settlements				
Purchases	—	5,000	160,570	165,570
Issuances	—	—	—	—
Sales	(96,655)	—	—	(96,655)
Settlements	(1,017)	(9,942)	(64,029)	(74,988)
Transfers in and/or out of Level 3	—	—	—	—
Balance at end of period	$2,360	$189,893	$290,189	$482,442
Six Months Ended June 30, 2012				
Balance at beginning of period	$92,091	$5,124	$—	$97,215
Total gains or (losses) (realized/unrealized)				
Included in earnings (1)	1,783	81	—	1,864
Included in other comprehensive income	(1,759)	1,262	—	(497)
Purchases, issuances, sales and settlements				
Purchases	—	—	—	—
Issuances	—	—	—	—
Sales	—	—	—	—
Settlements	(79)	(81)	—	(160)
Transfers in and/or out of Level 3	—	—	—	—
Balance at end of period	$92,036	$6,386	$—	$98,422

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(1) Gains or losses on corporate bonds were included in net realized gains (losses) while gains or losses on other investments were recorded in net realized gains (losses) or net investment income.

The amount of total losses for the 2013 second quarter included in earnings attributable to the change in unrealized gains or losses relating to assets still held at June 30, 2013 was $2.2 million, while the amount of total gains for the six months ended June 30, 2013 included in earnings attributable to the change in unrealized gains or losses relating to assets still held at June 30, 2013 was $4.4 million. The amount of total losses for the 2012 second quarter included in earnings attributable to the change in unrealized gains or losses relating to assets still held at June 30, 2012 was $0.5 million, while the amount of total gains for the six months ended June 30, 2012 was $1.9 million.

Financial Instruments Disclosed, But Not Carried, At Fair Value

The Company uses various financial instruments in the normal course of its business. The carrying values of cash, accrued investment income, receivable for securities sold, certain other assets, payable for securities purchased and certain other liabilities approximated their fair values at June 30, 2013, due to their respective short maturities. As these financial instruments are not actively traded, their respective fair values are classified within Level 2.

At June 30, 2013, the Company's senior notes were carried at their cost of $300.0 million and had a fair value of $368.8 million. The fair values of these securities were obtained from a third party pricing service and are based on observable market inputs. As such, the fair values of the senior notes are classified within Level 2.

9. Derivative Instruments

The Company's investment strategy allows for the use of derivative securities. The Company's derivative instruments are recorded on its consolidated balance sheets at fair value. The fair values of those derivatives are based on quoted market prices. All realized and unrealized contract gains and losses are reflected in the Company's results of operations. The Company utilizes exchange traded U.S. Treasury note, Eurodollar and other futures contracts and commodity futures to manage portfolio duration or replicate investment positions in its portfolios. Certain of the Company's corporate bonds are managed in a global bond portfolio which incorporates the use of foreign currency forward contracts which are intended to provide an economic hedge against foreign currency movements on the portfolio's non-U.S. Dollar denominated holdings. The Company routinely utilizes other foreign currency forward contracts, currency options, index futures contracts and other derivatives as part of its total return objective.

In addition, the Company purchases to-be-announced mortgage backed securities ("TBAs") as part of its investment strategy. TBAs represent commitments to purchase a future issuance of agency mortgage backed securities. For the period between purchase of a TBA and issuance of the underlying security, the Company's position is accounted for as a derivative. The Company purchases TBAs in both long and short positions to enhance investment performance and as part of its overall investment strategy. The Company did not hold any derivatives which were designated as hedging instruments at June 30, 2013 or December 31, 2012.

The following table summarizes information on the fair values and notional values of the Company's derivative instruments. The fair value of TBAs is included in "fixed maturities available for sale, at fair value" while the fair value of all other derivatives is included in "other investments available for sale, at fair value" in the consolidated balance sheets.

	Asset Derivatives Fair Value	Liability Derivatives Fair Value	Net Derivatives Fair Value	Notional Value
June 30, 2013				
Futures contracts	$160	$(54)	$106	$303,286
Foreign currency forward contracts	15,779	(7,605)	8,174	887,815
TBAs	436,215	(270,629)	165,586	687,560
Other	670	(40)	630	203,466
Total	$452,824	$(278,328)	$174,496	
December 31, 2012				
Futures contracts	$52	$(52)	$—	$340,400
Foreign currency forward contracts	2,809	(2,678)	131	396,468
TBAs	23,599	(4,346)	19,253	26,000
Other	448	(676)	(228)	50,341
Total	$26,908	$(7,752)	$19,156	

The Company's derivative instruments are generally traded under master netting agreements, which establish terms that apply to all derivative transactions with a counterparty. In the event of a bankruptcy or other stipulated event of default, such agreements provide that the non-defaulting party may elect to terminate all outstanding derivative transactions, in which case all individual derivative positions (loss or gain) with a counterparty are closed out and netted and replaced with a single amount, usually referred to as the termination amount, which is expressed in a single currency. The resulting single net amount, where positive, is payable to the party "in-the-money" regardless of whether or not it is the defaulting party, unless the parties have agreed that only the non-defaulting party is entitled to receive a termination payment where the net amount is positive and is in its favor. Effectively, contractual close-out netting reduces derivatives credit exposure from gross to net exposure. At June 30, 2013, asset derivatives and liability derivatives of $223.5 million and $76.8 million, respectively, were subject to a master netting agreement, compared to $26.9 million and $7.8 million, respectively, at December 31, 2012. The remaining derivatives included in the table above were not subject to a master netting agreement.

The following table summarizes net realized gains (losses) recorded on the Company's derivative instruments in the consolidated statements of income:

Derivatives not designated as hedging instruments	Three Months Ended June 30, 2013	2012	Six Months Ended June 30, 2013	2012
Futures contracts	$10,623	$(2,322)	$9,794	$(4,343)
Foreign currency forward contracts	7,605	938	6,880	(943)
TBAs	(3,751)	1,419	(3,210)	1,742
Other	1,169	242	1,804	(848)
Total	$15,646	$277	$15,268	$(4,392)

10. Income Taxes

ACGL is incorporated under the laws of Bermuda and, under current Bermuda law, is not obligated to pay any taxes in Bermuda based upon income or capital gains. The Company has received a written undertaking from the Minister of Finance in Bermuda under the Exempted Undertakings Tax Protection Act 1966 that, in the event that any legislation is enacted in Bermuda imposing any tax computed on profits, income, gain or appreciation on any capital asset, or any tax in the nature of estate duty or inheritance tax, such tax will not be applicable to ACGL or any of its operations until March 31, 2035. This undertaking does not, however, prevent the imposition of taxes on any person ordinarily resident in Bermuda or any company in respect of its ownership of real property or leasehold interests in Bermuda.

ACGL and its non-U.S. subsidiaries will be subject to U.S. federal income tax only to the extent that they derive U.S. source income that is subject to U.S. withholding tax or income that is effectively connected with the conduct of a trade or business within the U.S. and is not exempt from U.S. tax under an applicable income tax treaty with the U.S. ACGL and its non-U.S. subsidiaries will be subject to a withholding tax on dividends from U.S. investments and interest from certain U.S. payors (subject to reduction by any applicable income tax treaty). ACGL and its non-U.S. subsidiaries intend to conduct their operations in a manner that will not cause them to be treated as engaged in a trade or business in the United States and, therefore, will not be required to pay U.S. federal income taxes (other than U.S. excise taxes on insurance and reinsurance premium and withholding taxes on dividends and certain other U.S. source investment income). However, because there is uncertainty as to the activities which constitute being engaged in a trade or business within the United States, there can be no assurances that the U.S. Internal Revenue Service will not contend successfully that ACGL or its non-U.S. subsidiaries are engaged in a trade or business in the United States. If ACGL or any of its non-U.S. subsidiaries were subject to U.S. income tax, ACGL's shareholders' equity and earnings could be materially adversely affected. ACGL has subsidiaries and branches that operate in various jurisdictions around the world that are subject to tax in the jurisdictions in which they operate. The significant jurisdictions in which ACGL's subsidiaries and branches are subject to tax are the United States, United Kingdom, Ireland, Canada, Switzerland and Denmark.

The Company's income tax provision on income before income taxes resulted in an expense of 2.2% for the six months ended June 30, 2013, compared to an expense of 0.7% for the 2012 period. The Company's effective tax rate, which is based upon the expected annual effective tax rate, may fluctuate from period to period based on the relative mix of income or loss reported by jurisdiction and the varying tax rates in each jurisdiction. The Company had a net deferred tax asset of $140.7 million at June 30, 2013, compared to $98.6 million at December 31, 2012. In addition, the Company paid $4.8 million in income taxes for the six months ended June 30, 2013, while the Company paid $4.3

million for the 2012 period.

The United States also imposes an excise tax on insurance and reinsurance premiums paid to non-U.S. insurers or reinsurers with respect to risks located in the United States. The Company incurs federal excise taxes on certain of its reinsurance transactions, including amounts ceded through intercompany transactions. The Company incurred $4.3 million of federal excise taxes for the six months ended June 30, 2013, compared to $4.0 million for the 2012 period. Such amounts are reflected as acquisition expenses in the Company’s consolidated statements of income.

11. Other Comprehensive Income (Loss)

The following table presents the changes in each component of accumulated other comprehensive income ("AOCI"), net of tax:

	Unrealized Gains on Available-For-Sale Securities	Foreign Currency Translation Adjustments	Total
Three Months Ended June 30, 2013			
Beginning balance	$ 260,725	$(31,162)	$229,563
Other comprehensive income before reclassifications	(259,562)	(5,407)	(264,969)
Amounts reclassified from accumulated other comprehensive income	(13,916)	—	(13,916)
Net current period other comprehensive income (loss)	(273,478)	(5,407)	(278,885)
Ending balance	$ (12,753)	$(36,569)	$(49,322)
Six Months Ended June 30, 2013			
Beginning balance	$ 289,957	$(2,940)	$287,017
Other comprehensive income before reclassifications	(250,093)	(33,629)	(283,722)
Amounts reclassified from accumulated other comprehensive income	(52,617)	—	(52,617)
Net current period other comprehensive income (loss)	(302,710)	(33,629)	$(336,339)
Ending balance	$ (12,753)	$(36,569)	$(49,322)

The following table presents details about amounts reclassified from accumulated other comprehensive income:

Details About AOCI Components	Consolidated Statement of Income Line Item That Includes Reclassification	Amounts Reclassed from AOCI	
		Three Months Ended June 30, 2013	Six Months Ended June 30, 2013
Unrealized Gains on Available-For-Sale Securities			
	Net realized gains	$14,634	$58,999
	Net impairment losses included in earnings	(724)	(2,970)
	Total before tax	13,910	56,029
	Income tax benefit (expense)	6	(3,412)
	Net of tax	$13,916	$52,617

The following table presents the tax effects allocated to each component of other comprehensive income (loss):

	Before Tax Amount	Tax Expense (Benefit)	Net of Tax Amount
Three Months Ended June 30, 2013			
Unrealized appreciation (decline) in value of investments:			
Unrealized holding gains arising during period	$(281,388)	$(21,826)	$(259,562)
Portion of other-than-temporary impairment losses recognized in other comprehensive income (loss)	—	—	—
Less reclassification of net realized gains included in net income	13,910	(6)	13,916
Foreign currency translation adjustments	(5,407)	—	(5,407)
Other comprehensive income (loss)	$(300,705)	$(21,820)	$(278,885)
Three Months Ended June 30, 2012			
Unrealized appreciation (decline) in value of investments:			
Unrealized holding gains arising during period	$23,524	$5,464	$18,060
Portion of other-than-temporary impairment losses recognized in other comprehensive income (loss)	(503)	—	(503)
Less reclassification of net realized gains included in net income	45,384	1,592	43,792
Foreign currency translation adjustments	(16,699)	(1,563)	(15,136)
Other comprehensive income (loss)	$(39,062)	$2,309	$(41,371)
Six Months Ended June 30, 2013			
Unrealized appreciation (decline) in value of investments:			
Unrealized holding gains arising during period	$(271,043)	$(20,952)	$(250,091)
Portion of other-than-temporary impairment losses recognized in other comprehensive income (loss)	(2)	—	(2)
Less reclassification of net realized gains included in net income	56,029	3,412	52,617
Foreign currency translation adjustments	(33,627)	2	(33,629)
Other comprehensive income (loss)	$(360,701)	$(24,362)	$(336,339)
Six Months Ended June 30, 2012			
Unrealized appreciation (decline) in value of investments:			
Unrealized holding gains arising during period	$109,241	$(3,682)	$112,923
Portion of other-than-temporary impairment losses recognized in other comprehensive income (loss)	(511)	—	(511)
Less reclassification of net realized gains included in net income	76,143	4,840	71,303
Foreign currency translation adjustments	(2,830)	(895)	(1,935)
Other comprehensive income (loss)	$29,757	$(9,417)	$39,174

12. Legal Proceedings

The Company, in common with the insurance industry in general, is subject to litigation and arbitration in the normal course of its business. As of June 30, 2013, the Company was not a party to any litigation or arbitration which is expected by management to have a material adverse effect on the Company's results of operations and financial condition and liquidity.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following is a discussion and analysis of our financial condition and results of operations. This should be read in conjunction with our consolidated financial statements included in Item 1 of this report and also our Management's Discussion and Analysis of Financial Condition and Results of Operations contained in our Annual Report on Form 10-K for the year ended December 31, 2012 ("2012 Form 10-K"). In addition, readers should review "Risk Factors" set forth in Item 1A of Part I of our 2012 Form 10-K. Tabular amounts are in U.S. Dollars in thousands, except share amounts, unless otherwise noted.

Arch Capital Group Ltd. ("ACGL" and, together with its subsidiaries, "we" or "us") is a Bermuda public limited liability company with approximately $5.63 billion in capital at June 30, 2013 and, through operations in Bermuda, the United States, Europe and Canada, writes insurance and reinsurance on a worldwide basis. While we are positioned to provide a full range of property and casualty insurance and reinsurance lines, we focus on writing specialty lines of insurance and reinsurance. It is our belief that our underwriting platform, our experienced management team and our strong capital base that is unencumbered by significant pre-2002 risks have enabled us to establish a strong presence in the insurance and reinsurance markets.

Current Outlook

The broad market environment continued to show improvement in the 2013 second quarter as rates rose at roughly the same level as in the first quarter. In our U.S. insurance business, weighted rate increases in the quarter provided 1.5% of expected margin improvement (i.e., rates in excess of loss cost trends) in the 2013 second quarter. These improvements, on a line by line basis, ranged from minus 3% to as high as a positive 11%. In addition, the movement of business from the admitted market to the excess and surplus lines market continues. In March 2013, we expanded our insurance underwriting platform in the excess and surplus lines market by starting a binding authority insurance facility that caters to smaller accounts through the wholesale distribution channel. This group contributed to our 2013 second quarter premiums and is gaining traction across Arch's distribution platform. Notwithstanding the improvement in the rate environment in the 2013 second quarter, on an absolute basis, we believe that longer-tail lines still require significant rate improvement to meet our return objectives. In our reinsurance business, terms and conditions were relatively stable in the 2013 second quarter. Our reinsurance business wrote less property catastrophe business relative to the 2012 second quarter due to rate reductions, a decrease in capacity deployed and an increase use of retrocessions. Our underwriting teams continue to execute a disciplined strategy by emphasizing small and medium-sized accounts over large accounts and focusing more on short-tail business.

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

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

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

Natural Catastrophe Risk

We monitor our natural catastrophe risk globally for all perils and regions, in each case, where we believe there is significant exposure. Our models employ both proprietary and vendor-based systems and include cross-line correlations for property, marine, offshore energy, aviation, workers compensation and personal accident. Currently, we seek to limit our 1-in-250 year return period net probable maximum pre-tax loss from a severe catastrophic event in any geographic zone to approximately 25% of total shareholders' equity. We reserve the right to change this threshold at any time. Based on in-force exposure estimated as of July 1, 2013, our modeled peak zone catastrophe exposure was a windstorm affecting the Northeastern

U.S., with a net probable maximum pre-tax loss of $858 million, followed by windstorms affecting the Gulf of Mexico and Florida Tri-County with net probable maximum pre-tax losses of $746 million and $606 million, respectively. Based on in-force exposure estimated as of April 1, 2013, our modeled peak zone exposure was a windstorm affecting the Northeastern U.S., with a net probable maximum pre-tax loss of $886 million, followed by windstorms affecting the Gulf of Mexico and Florida Tri-County with net probable maximum pre-tax losses of $798 million and $582 million, respectively. Our exposures to other perils, such as U.S. earthquake and international events, was less than the exposures arising from U.S. windstorms and hurricanes in both periods. As of July 1, 2013, our modeled peak zone earthquake exposure (New Madrid earthquake) represented less than 50% of our peak zone catastrophe exposure, and our modeled peak zone international exposure (Japan earthquake) was substantially less than both our peak zone windstorm and earthquake exposures. Net probable maximum pre-tax loss estimates are net of expected reinsurance recoveries, before income tax and before excess reinsurance reinstatement premiums. Loss estimates are reflective of the zone indicated and not the entire portfolio. Since hurricanes and windstorms can affect more than one zone and make multiple landfalls, our loss estimates include clash estimates from other zones.

The loss estimates shown above do not represent our maximum exposures and it is highly likely that our actual incurred losses would vary materially from the modeled estimates. There can be no assurances that we will not suffer a net loss greater than 25% of our total shareholders' equity from one or more catastrophic events due to several factors, including the inherent uncertainties in estimating the frequency and severity of such events and the margin of error in making such determinations resulting from potential inaccuracies and inadequacies in the data provided by clients and brokers, the modeling techniques and the application of such techniques or as a result of a decision to change the percentage of shareholders' equity exposed to a single catastrophic event. Actual losses may also increase if our reinsurers fail to meet their obligations to us or the reinsurance protections purchased by us are exhausted or are otherwise unavailable. See "Risk Factors—Risk Relating to Our Industry" and "Management's Discussion and Analysis of Financial Condition and Results of Operations—Natural and Man-Made Catastrophic Events" in our 2012 Form 10-K.

Financial Measures

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

Book Value per Common Share

Book value per common share represents total common shareholders' equity divided by the number of common shares outstanding. Management uses growth in book value per common share as a key measure of the value generated for our common shareholders each period and believes that book value per common share is the key driver of ACGL's share price over time. Book value per common share is impacted by, among other factors, our underwriting results, investment returns and share repurchase activity, which has an accretive or dilutive impact on book value per common share depending on the purchase price. Book value per common share was $36.80 at June 30, 2013, compared to $37.66 at March 31, 2013 and $34.45 at June 30, 2012. The 2.3% reduction in the 2013 second quarter was primarily driven by the impact of rising interest rates and wider credit spreads on our fixed income portfolio which also depressed the growth for the trailing twelve months ended June 30, 2013 to 6.8%.

Operating Return on Average Common Equity

Operating return on average common equity ("Operating ROAE") represents annualized after-tax operating income available to common shareholders divided by the average of beginning and ending common shareholders' equity during the period. After-tax operating income available to common shareholders, a "non-GAAP measure" as defined in the SEC rules, represents net income available to common shareholders, excluding net realized gains or losses, net impairment losses recognized in earnings, equity in net income or loss of investment funds accounted for using the equity method and net foreign exchange gains or losses, net of income taxes. Management uses Operating ROAE as a key measure of the return generated to common shareholders and has set an objective to achieve an average Operating ROAE of 15% or greater over the insurance cycle, which it believes to be an attractive return to common shareholders given the risks we assume. See “Comment on Non-GAAP Financial Measures.” Our Operating ROAE was 10.9% for the 2013 second quarter, compared to 12.3% for the 2012 second quarter. The lower Operating ROAE for the 2013 second quarter primarily resulted from a higher level of catastrophic activity compared to the 2012 second quarter.

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Total Return on Investments

Total return on investments includes investment income, equity in net income or loss of investment funds accounted for using the equity method, net realized gains and losses and the change in unrealized gains and losses generated by our investment portfolio. Total return is calculated on a pre-tax basis and before investment expenses and includes the effect of financial market conditions along with foreign currency fluctuations. Management uses total return on investments as a key measure of the return generated to common shareholders on the capital held in the business, and compares the return generated by our investment portfolio against benchmark returns which we measured our portfolio against during the periods. The benchmark return is a weighted average of the benchmarks assigned to each of our investment managers and vary based on the nature of the portfolios under management.

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

At June 30, 2013, the benchmark return index had an average credit quality of “Aa2” by Moody’s Investors Service (“Moody’s”), an estimated duration of 3.59 years and included weightings to the following indices:

	Weighting	
The Bank of America Merrill Lynch 1-10 Year U.S. Treasury & Agency Index	30.875	%
The Bank of America Merrill Lynch 1-10 Year AA U.S. Corporate & Yankees Index	20.875	%
The Bank of America Merrill Lynch U.S. Mortgage Backed Securities Index	11.875	%
Barclays Capital CMBS, AAA Index	10.000	%
The Bank of America Merrill Lynch 1-10 Year U.S. Municipal Securities Index	7.125	%
MSCI World Free Index	5.000	%
The Bank of America Merrill Lynch 0-3 Month U.S. Treasury Bill Index	4.750	%
The Bank of America Merrill Lynch U.S. High Yield Constrained Index	2.375	%
Barclays Capital U.S. High-Yield Corporate Loan Index	2.375	%
The Bank of America Merrill Lynch 1-10 Year U.K. Gilt Index	2.375	%
The Bank of America Merrill Lynch 1-10 Year Euro Government Index	2.375	%
Total	100.000	%

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

	Arch Portfolio		Benchmark Return	
Pre-tax total return (before investment expenses):				
2013 second quarter	(1.59	)%	(1.43	)%
2012 second quarter	0.63	%	0.86	%
Six Months Ended June 30, 2013	(1.11	)%	(0.97	)%
Six Months Ended June 30, 2012	2.53	%	2.43	%

Total return for the 2013 periods reflected the impact of both higher interest rates and wider credit spreads in the 2013 second quarter, offset somewhat by the positive returns of our equity and alternatives portfolios. Excluding foreign exchange, total return was (1.56)% for the 2013 second quarter, compared to 1.04% for the 2012 second quarter, and (0.57)% for the six months ended June 30, 2013, compared to 2.66% for the 2012 period.

Comment on Non-GAAP Financial Measures

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

We believe that net realized gains or losses, net impairment losses recognized in earnings, equity in net income or loss of investment funds accounted for using the equity method and net foreign exchange gains or losses in any particular period are not indicative of the performance of, or trends in, our business. Although net realized gains or losses, net impairment losses recognized in earnings, equity in net income or loss of investment funds accounted for using the equity method and net foreign exchange gains or losses are an integral part of our operations, the decision to realize investment gains or losses, the recognition of the change in the carrying value of investments accounted for using the fair value option in net realized gains or losses, the recognition of net impairment losses, the recognition of equity in net income or loss of investment funds accounted for using the equity method and the recognition of foreign exchange gains or losses are independent of the insurance underwriting process and result, in large part, from general economic and financial market conditions. Furthermore, certain users of our financial information believe that, for many companies, the timing of the realization of investment gains or losses is largely opportunistic. In addition, net impairment losses recognized in earnings on our investments represent other-than-temporary declines in expected recovery values on securities without actual realization. The use of the equity method on certain of our investments in certain funds that invest in fixed maturity securities is driven by the ownership structure of such funds (either limited partnerships or limited liability companies). In applying the equity method, these investments are initially recorded at cost and are subsequently adjusted based on our proportionate share of the net income or loss of the funds (which include changes in the market value of the underlying securities in the funds). This method of accounting is different from the way we account for our other fixed maturity securities and the timing of the recognition of equity in net income or loss of investment funds accounted for using the equity method may differ from gains or losses in the future upon sale or maturity of such investments. The loss on repurchase of preferred shares related to the redemption of the Series A and B preferred shares in April 2012 and had no impact on total shareholders' equity or cash flows. Due to these reasons, we exclude net realized gains or losses, net impairment losses recognized in earnings, equity in net income or loss of investment funds accounted for using the equity method, net foreign exchange gains or losses and loss on repurchase of preferred shares from the calculation of after-tax operating income available to common shareholders.

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

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RESULTS OF OPERATIONS

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
After-tax operating income available to common shareholders	$135,021	$141,400	$293,769	$255,060
Net realized gains, net of tax	13,779	33,275	68,702	74,148
Net impairment losses recognized in earnings, net of tax	(724)	(1,951)	(2,970)	(2,974)
Equity in net income of investment funds accounted for using the equity method, net of tax	10,941	7,787	24,764	32,613
Net foreign exchange gains, net of tax	12,438	32,108	38,182	11,567
Loss on repurchase of preferred shares, net of tax	—	(10,612)	—	(10,612)
Net income available to common shareholders	$171,455	$202,007	$422,447	$359,802

Segment Information

We classify our businesses into two underwriting segments — insurance and reinsurance — and corporate and other (non-underwriting). Management measures segment performance based on underwriting income or loss. We do not manage our assets by segment and, accordingly, investment income is not allocated to each underwriting segment. In addition, other revenue and expense items are not evaluated by segment.

Insurance Segment

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

	Three Months Ended June 30,			Six Months Ended June 30,		
	2013	2012	% Change	2013	2012	% Change
Gross premiums written	$703,904	$676,090	4.1	$1,392,721	$1,364,203	2.1
Net premiums written	501,568	464,584	8.0	1,006,118	955,264	5.3
Net premiums earned	$458,656	$446,594	2.7	$903,621	$888,334	1.7
Fee income	529	628		1,054	1,158	
Losses and loss adjustment expenses	(291,192)	(290,416)		(574,659)	(593,580)	
Acquisition expenses, net	(74,249)	(76,058)		(145,007)	(149,928)	
Other operating expenses	(80,167)	(76,617)		(156,482)	(149,987)	
Underwriting income (loss)	$13,577	$4,131	228.7	$28,527	$(4,003)	n/m
Underwriting Ratios			% Point Change			% Point Change
Loss ratio	63.5 %	65.0 %	(1.5)	63.6 %	66.8 %	(3.2)
Acquisition expense ratio (1)	16.1 %	16.9 %	(0.8)	15.9 %	16.7 %	(0.8)
Other operating expense ratio	17.5 %	17.2 %	0.3	17.3 %	16.9 %	0.4
Combined ratio	97.1 %	99.1 %	(2.0)	96.8 %	100.4 %	(3.6)

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

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Premiums Written.

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

	Three Months Ended June 30,				Six Months Ended June 30,			
	2013		2012		2013		2012	
	Amount	%	Amount	%	Amount	%	Amount	%
Programs	$122,981	25	$92,998	20	$223,496	22	$174,614	18
Property, energy, marine and aviation	81,675	16	86,390	19	165,286	16	166,209	17
Professional liability	66,148	13	65,198	14	121,922	12	135,759	14
Executive assurance	43,721	9	60,205	13	104,073	10	128,583	13
Construction	55,418	11	49,784	11	97,630	10	83,437	9
National accounts	13,642	3	4,961	1	58,758	6	40,399	4
Casualty	26,237	5	30,638	7	50,032	5	57,611	6
Lenders products	22,840	5	20,477	4	44,513	4	42,892	4
Travel and accident	16,758	3	20,294	4	33,215	3	43,130	5
Surety	17,501	3	12,723	3	32,757	3	24,857	3
Healthcare	10,374	2	7,959	2	20,020	2	18,594	2
Other (1)	24,273	5	12,957	2	54,416	7	39,179	5
Total	$501,568	100	$464,584	100	$1,006,118	100	$955,264	100

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

2013 second quarter versus 2012. Net premiums written were 8.0% higher than in the 2012 second quarter with increases in programs, national accounts, contract binding (launched in early 2013) and construction lines, partially offset by a reduction in executive assurance premiums. The increase in program business resulted from a mix of underlying exposure growth within existing programs, new business and rate increases. The increase in national accounts primarily resulted from new business and rate increases, while the growth in construction reflected a higher net retention. The decrease in executive assurance, primarily in the insurance segment's U.K. operations, reflected lower participation on certain accounts due to the lack of favorable rate movements.

Six Months Ended June 30, 2013 versus 2012. Net premiums written were 5.3% higher than in the 2012 period with increases in programs, national accounts, construction, accident and health and contract binding lines, partially offset by reduction in executive assurance and professional liability premiums. The increase in program business resulted from a mix of underlying exposure growth within existing programs, new business and rate increases. The increase in national accounts primarily resulted from new business and rate increases, while the growth in construction reflected a higher net retention. The decrease in executive assurance and professional liability, primarily in the insurance segment's U.K. operations, reflected lower participation on certain accounts due to the lack of favorable rate movements.

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Net Premiums Earned.

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

	Three Months Ended June 30,				Six Months Ended June 30,			
	2013		2012		2013		2012	
	Amount	%	Amount	%	Amount	%	Amount	%
Programs	$99,721	22	$80,589	18	$189,644	21	$154,587	17
Property, energy, marine and aviation	71,978	16	77,590	17	149,983	17	156,084	18
Professional liability	59,397	13	68,017	15	118,054	13	131,273	15
Executive assurance	55,540	12	60,856	14	113,694	13	119,622	13
Construction	37,251	8	31,692	7	72,490	8	63,500	7
National accounts	23,942	5	18,415	4	45,585	5	37,551	4
Casualty	24,461	5	28,102	6	50,284	6	57,167	6
Lenders products	20,855	5	21,411	5	41,812	5	53,564	6
Travel and accident	17,893	4	20,661	5	30,798	3	37,374	4
Surety	14,306	3	10,798	2	27,489	3	21,358	2
Healthcare	9,442	2	9,077	2	18,449	2	17,975	2
Other (1)	23,870	5	19,386	5	45,339	4	38,279	6
Total	$458,656	100	$446,594	100	$903,621	100	$888,334	100

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

Net premiums written are primarily earned on a pro rata basis over the terms of the policies for all products, usually 12 months. Net premiums earned reflect changes in net premiums written over the previous five quarters.

Losses and Loss Adjustment Expenses.

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

	Three Months Ended June 30,				Six Months Ended June 30,			
	2013		2012		2013		2012	
Current year	67.0	%	68.9	%	65.9	%	68.8	%
Prior period reserve development	(3.5	)%	(3.9	)%	(2.3	)%	(2.0	)%
Loss ratio	63.5	%	65.0	%	63.6	%	66.8	%

Current Year Loss Ratio.

The insurance segment's current year loss ratio was 1.9 points lower in the 2013 second quarter compared to the 2012 second quarter and 2.9 points lower for the six months ended June 30, 2013 than in the 2012 period. The 2013 second quarter loss ratio reflected 1.5 points of current year catastrophic activity, primarily related to U.S. tornado and hailstorm events, while catastrophic activity for the 2012 second quarter was minimal. The loss ratio for the six months ended June 30, 2013 reflected 0.7 points of catastrophic activity, compared to 0.5 points for the 2012 period. The loss ratios for the 2013 periods reflected a lower level of large attritional loss activity than in the 2012 periods and also reflected changes in the mix of business earned.

Prior Period Reserve Development.

2013 second quarter: The insurance segment’s net favorable development of $16.0 million, or 3.5 points, consisted of $11.7 million of net favorable development in short-tailed lines and $4.3 million of net favorable development in medium-tailed and long-tailed lines. Favorable development in short-tailed lines primarily consisted of reductions in property (including special risk other than marine) reserves from the 2008 to 2011 accident years (i.e., the year in which a loss occurred), primarily due to varying levels of reported claims activity. Development on the 2005 to 2012 named catastrophic events was favorable by $7.2 million in the quarter. Net favorable development in medium-tailed and long-tailed lines reflected a reduction of $8.2 million in marine reserves, $3.1 million of favorable development in healthcare reserves and $2.0 million in national accounts, all spread across various accident years. Such amounts were partially offset by a net increase of $4.1 million in professional liability and executive assurance reserves, primarily from a small number of claims in the 2006 accident year, and $5.8 million in casualty reserves, primarily from the 2012 accident year on certain Canadian captive business which has been non-renewed.

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2012 second quarter: The insurance segment's net favorable development of $17.2 million, or 3.9 points, consisted of net favorable development of $16.2 million in short-tailed lines and $11.4 million in medium-tailed lines, partially offset by net adverse development of $10.4 million in long-tailed lines. Favorable development in short-tailed lines primarily consisted of reductions in property (including special risk other than marine) reserves from the 2010 and 2011 accident years, primarily due to varying levels of reported claims activity, while favorable development in medium-tailed lines reflected reductions in professional liability reserves, primarily from the 2009 accident year, in healthcare reserves, across most accident years, and in surety reserves, primarily from the 2007 and 2008 accident years. Net adverse development in long-tailed lines included a net increase of $6.9 million in construction reserves, primarily from the 2007 and 2008 accident years, and $4.8 million in executive assurance reserves in the 2011 accident year, primarily due to an increase in loss picks in reaction to claims development.

Six Months Ended June 30, 2013: The insurance segment's net favorable development of $21.0 million, or 2.3 points, consisted of $27.8 million of net favorable development in short-tailed lines, partially offset by $6.8 million of net adverse development in medium-tailed and long-tailed lines. Favorable development in short-tailed lines primarily consisted of reductions in property (including special risk other than marine) reserves from the 2009 to 2011 accident years, primarily due to varying levels of reported claims activity. Development on the 2005 to 2012 named catastrophic events was favorable by $8.6 million in the period. Net adverse development in medium-tailed and long-tailed lines included an increase of $10.4 million in casualty reserves, primarily related to claims from the two most recent accident years on certain Canadian accounts which have been non-renewed, a net increase of $7.9 million in professional liability and executive assurance reserves, primarily from a small number of claims in the 2006 accident year. Such amounts were partially offset by favorable development of $7.5 million in healthcare reserves, $4.5 million in marine, and $4.2 million in national accounts, all spread across various accident years.

Six Months Ended June 30, 2012: The insurance segment's net favorable development of $17.7 million, or 2.0 points, consisted of net favorable development of $37.4 million in short-tailed lines and $13.8 million in medium-tailed lines, partially offset by net adverse development of $33.5 million in long-tailed lines. Favorable development in short-tailed lines primarily consisted of reductions in property (including special risk other than marine) reserves from the 2007 to 2011 accident years, primarily due to varying levels of reported claims activity, while favorable development in medium-tailed lines reflected reductions in healthcare reserves across most accident years, and in professional liability reserves, primarily from the 2009 accident year. Net adverse development in long-tailed lines included a net increase of $15.8 million in executive assurance reserves, primarily due to a small number of international D&O claims in more recent accident years, $11.3 million in casualty reserves, primarily from the 2004 to 2008 accident years, and $8.2 million in construction reserves, primarily from the 2007 to 2009 accident years.

Underwriting Expenses.

2013 second quarter versus 2012: The insurance segment's underwriting expense ratio was 33.6% in the 2013 second quarter, compared to 34.1% in the 2012 second quarter. The acquisition expense ratio was 16.1% in the 2013 second quarter, compared to 16.9% in the 2012 second quarter. The comparison of the 2013 second quarter and 2012 second quarter acquisition expense ratios is influenced by, among other things, the mix and type of business written and earned and the level of ceding commissions. In addition, the 2013 second quarter acquisition expense ratio included 0.5 points of commission expense related to development in prior year loss reserves, compared to 0.1 point in the 2012 second quarter. The other operating expense ratio was 17.5% for the 2013 second quarter, compared to 17.2% for the 2012 second quarter. The 2013 second quarter operating expense ratio reflected a higher level of aggregate expenses than in the 2012 second quarter due, in part, to selected expansion of the insurance segment's operating platform and increased share based compensation costs.

Six Months Ended June 30, 2013 versus 2012: The insurance segment's underwriting expense ratio was 33.2% for the 2013 period, compared to 33.6% for the 2012 period. The acquisition expense ratio was 15.9% for the 2013 period, compared to 16.7% for the 2012 period. The acquisition expense ratio for the 2013 period included 0.2 points of commission expense related to development in prior year loss reserves, compared to 0.5 points in the 2012 second quarter. The other operating expense ratio was 17.3% for the 2013 period, compared to 16.9% for the 2012 period. The operating expense ratio for the 2013 period reflected a higher level of aggregate expenses than in the 2012 period due, in part, to selected expansion of the insurance segment's operating platform and increased share based compensation costs.

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Reinsurance Segment

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

	Three Months Ended June 30,			Six Months Ended June 30,		
	2013	2012	% Change	2013	2012	% Change
Gross premiums written	$337,642	$376,981	(10.4)	$813,847	$756,957	7.5
Net premiums written	308,967	355,649	(13.1)	757,193	728,580	3.9
Net premiums earned	$300,160	$280,062	7.2	$607,965	$518,634	17.2
Fee income	373	178		386	191	
Losses and loss adjustment expenses	(127,461)	(109,277)		(243,397)	(201,320)	
Acquisition expenses, net	(57,428)	(52,231)		(114,262)	(97,323)	
Other operating expenses	(33,192)	(29,140)		(66,792)	(55,263)	
Underwriting income	$82,452	$89,592	(8.0)	$183,900	$164,919	11.5
Underwriting Ratios			% Point Change			% Point Change
Loss ratio	42.5%	39.0%	3.5	40.0%	38.8%	1.2
Acquisition expense ratio	19.1%	18.6%	0.5	18.8%	18.8%	—
Other operating expense ratio	11.1%	10.4%	0.7	11.0%	10.7%	0.3
Combined ratio	72.7%	68.0%	4.7	69.8%	68.3%	1.5

Premiums Written.

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

	Three Months Ended June 30,				Six Months Ended June 30,			
	2013		2012		2013		2012	
	Amount	%	Amount	%	Amount	%	Amount	%
Other specialty (1)	$61,480	20	$73,590	21	$192,817	25	$168,873	23
Property catastrophe	99,874	32	129,224	36	177,016	23	215,798	30
Property excluding property catastrophe (2)	62,938	20	65,734	19	151,998	20	141,227	19
Casualty (3)	51,502	17	42,373	12	148,747	20	126,512	17