ARCH CAPITAL GROUP LTD.
Form 10-Q
August 05, 2011
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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 quarterly period ended June 30, 2011

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, 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 o

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

Indicate by check mark 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 1, 2011 was 133,244,445.

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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, 2011, and the related consolidated statements of income for the three-month and six-month periods ended June 30, 2011 and June 30, 2010, and the consolidated statements of comprehensive income, changes in shareholders equity and cash flows for the six-month periods ended June 30, 2011 and June 30, 2010. 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, 2010, 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 February 28, 2011, we expressed an unqualified opinion on those consolidated financial statements. In our opinion, the information set forth in the accompanying consolidated balance sheet information as of December 31, 2010, 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 5, 2011

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ARCH CAPITAL GROUP LTD. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(U.S. dollars in thousands, except share data)

	(Unaudited) June 30, 2011	December 31, 2010
Assets		
Investments:		
Fixed maturities available for sale, at fair value (amortized cost: $9,002,395 and $8,771,988)	$ 9,247,002	$ 8,957,859
Short-term investments available for sale, at fair value (amortized cost: $702,595 and $913,488)	704,495	915,841
Investment of funds received under securities lending, at fair value (amortized cost: $145,496 and $69,682)	145,224	69,660
Equity securities available for sale, at fair value (cost: $303,743 and $292,958)	320,434	310,194
Other investments available for sale, at fair value (cost: $270,342 and $252,590)	299,845	275,538
Investments accounted for using the fair value option	321,790	219,173
TALF investments, at fair value (amortized cost: $381,644 and $389,200)	399,341	402,449
Investments accounted for using the equity method	399,968	508,334
Total investments	11,838,099	11,659,048
Cash	411,001	362,740
Accrued investment income	71,083	74,837
Investment in joint venture (cost: $100,000)	105,982	105,698
Fixed maturities and short-term investments pledged under securities lending, at fair value	150,501	75,575
Premiums receivable	712,397	503,434
Reinsurance recoverable on unpaid and paid losses and loss adjustment expenses	1,855,342	1,763,985
Prepaid reinsurance premiums	278,587	263,448
Deferred acquisition costs, net	310,616	277,861
Receivable for securities sold	733,931	56,145
Other assets	746,267	669,164
Total Assets	$ 17,213,806	$ 15,811,935
Liabilities		
Reserve for losses and loss adjustment expenses	$ 8,564,908	$ 8,098,454
Unearned premiums	1,589,497	1,370,075
Reinsurance balances payable	154,860	132,452
Senior notes	300,000	300,000
Revolving credit agreement borrowings	100,000	100,000
TALF borrowings, at fair value (par: $318,596 and $326,219)	318,441	325,770
Securities lending payable	155,072	78,021
Payable for securities purchased	838,787	200,192
Other liabilities	750,972	693,968
Total Liabilities	12,772,537	11,298,932
Commitments and Contingencies		
Shareholders Equity		
Non-cumulative preferred shares - Series A and B	325,000	325,000
Common shares ($0.0033 par, shares issued: 162,363,488 and 160,073,616)	541	534
Additional paid-in capital	142,001	110,325
Retained earnings	4,533,729	4,422,553

Accumulated other comprehensive income, net of deferred income tax		263,584	204,503
Common shares held in treasury, at cost (shares: 29,591,964 and 20,441,391)		(823,586)	(549,912)
Total Shareholders Equity		4,441,269	4,513,003
Total Liabilities and Shareholders Equity	$	17,213,806	15,811,935

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, 2011	2010	(Unaudited) Six Months Ended June 30, 2011	2010
Revenues				
Net premiums written	$ 706,543	$ 624,258	$ 1,470,821	$ 1,392,012
Change in unearned premiums	(63,664)	(1,247)	(194,247)	(99,084)
Net premiums earned	642,879	623,011	1,276,574	1,292,928
Net investment income	86,671	90,537	174,978	183,509
Net realized gains	45,210	62,114	65,905	109,896
Other-than-temporary impairment losses	(1,969)	(4,718)	(5,227)	(7,054)
Less investment impairments recognized in other comprehensive income, before taxes	285	308	863	1,038
Net impairment losses recognized in earnings	(1,684)	(4,410)	(4,364)	(6,016)
Fee income	784	883	1,599	1,677
Equity in net income (loss) of investment funds accounted for using the equity method	5,973	(348)	35,646	28,702
Other income (loss)	(4,265)	4,528	302	10,506
Total revenues	775,568	776,315	1,550,640	1,621,202
Expenses				
Losses and loss adjustment expenses	431,622	363,145	925,502	791,196
Acquisition expenses	110,639	107,475	219,393	225,099
Other operating expenses	110,563	101,533	212,983	208,339
Interest expense	7,758	7,916	15,479	15,176
Net foreign exchange losses (gains)	18,375	(48,625)	55,287	(87,226)
Total expenses	678,957	531,444	1,428,644	1,152,584
Income before income taxes	96,611	244,871	121,996	468,618
Income tax (benefit) expense	(1,731)	1,420	(2,102)	8,173
Net income	98,342	243,451	124,098	460,445
Preferred dividends	6,461	6,461	12,922	12,922
Net income available to common shareholders	$ 91,881	$ 236,990	$ 111,176	$ 447,523
Net income per common share				
Basic	$ 0.70	$ 1.55	$ 0.84	$ 2.87
Diluted	$ 0.67	$ 1.48	$ 0.80	$ 2.74
Weighted average common shares and common share equivalents outstanding				
Basic	131,232,269	152,962,620	132,359,493	156,022,848
Diluted	137,975,599	159,795,909	139,234,931	163,160,070

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ARCH CAPITAL GROUP LTD. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(U.S. dollars in thousands)

	(Unaudited) Six Months Ended June 30, 2011	(Unaudited) Six Months Ended June 30, 2010
Comprehensive Income		
Net income	$ 124,098	$ 460,445
Other comprehensive income, net of deferred income tax		
Unrealized appreciation in value of investments:		
Unrealized holding gains arising during period	125,232	113,934
Portion of other-than-temporary impairment losses recognized in other comprehensive income, net of deferred income tax	(863)	(1,038)
Reclassification of net realized gains, net of income taxes, included in net income	(67,858)	(70,218)
Foreign currency translation adjustments	2,570	(7,973)
Other comprehensive income	59,081	34,705
Comprehensive Income	**$** 183,179	**$** 495,150

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ARCH CAPITAL GROUP LTD. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS EQUITY

(U.S. dollars in thousands)

	(Unaudited) Six Months Ended June 30, 2011	2010
Non-Cumulative Preferred Shares		
Balance at beginning and end of period	$ 325,000	$ 325,000
Common Shares		
Balance at beginning of year	534	548
Common shares issued, net	7	11
Purchases of common shares under share repurchase program		(30)
Balance at end of period	541	529
Additional Paid-in Capital		
Balance at beginning of year	110,325	253,466
Common shares issued	3,912	3,289
Exercise of stock options	6,372	24,664
Common shares retired		(217,562)
Amortization of share-based compensation	19,505	19,376
Other	1,887	595
Balance at end of period	142,001	83,828
Retained Earnings		
Balance at beginning of year	4,422,553	3,605,809
Dividends declared on preferred shares	(12,922)	(12,922)
Net income	124,098	460,445
Balance at end of period	4,533,729	4,053,332
Accumulated Other Comprehensive Income		
Balance at beginning of year	204,503	138,526
Change in unrealized appreciation in value of investments, net of deferred income tax	57,374	43,716
Portion of other-than-temporary impairment losses recognized in other comprehensive income, net of deferred income tax	(863)	(1,038)
Foreign currency translation adjustments, net of deferred income tax	2,570	(7,973)
Balance at end of period	263,584	173,231
Common Shares Held in Treasury, at Cost		
Balance at beginning of year	(549,912)	
Shares repurchased for treasury	(273,674)	(237,917)
Balance at end of period	(823,586)	(237,917)
Total Shareholders Equity	$ 4,441,269	$ 4,398,003

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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, 2011	2010
Operating Activities		
Net income	$ 124,098	$ 460,445
Adjustments to reconcile net income to net cash provided by operating activities:		
Net realized gains	(71,367)	(111,889)
Net impairment losses recognized in earnings	4,364	6,016
Equity in net income of investment funds accounted for using the equity method and other income	18,590	(18,380)
Share-based compensation	19,505	19,376
Changes in:		
Reserve for losses and loss adjustment expenses, net of unpaid losses and loss adjustment expenses recoverable	286,223	162,604
Unearned premiums, net of prepaid reinsurance premiums	194,123	96,881
Premiums receivable	(196,244)	(136,851)
Deferred acquisition costs, net	(30,261)	(17,617)
Reinsurance balances payable	15,987	(17,402)
Other liabilities	6,753	(15,771)
Other items, net	74,776	(37,275)
Net Cash Provided By Operating Activities	446,547	390,137
Investing Activities		
Purchases of:		
Fixed maturity investments	(7,669,992)	(9,483,319)
Equity securities	(248,947)	(74,010)
Other investments	(207,365)	(283,450)
Proceeds from the sales of:		
Fixed maturity investments	7,622,120	9,111,774
Equity securities	199,650	36,768
Other investments	201,680	177,046
Proceeds from redemptions and maturities of fixed maturity investments	537,410	456,937
Net purchases of short-term investments	(544,295)	(6,682)
Change in investment of securities lending collateral	(77,051)	(680)
Purchases of furniture, equipment and other assets	(12,348)	(7,860)
Net Cash Used By Investing Activities	(199,138)	(73,476)
Financing Activities		
Purchases of common shares under share repurchase program	(266,725)	(450,326)
Proceeds from common shares issued, net	1,478	14,370
Proceeds from borrowings		264,526
Repayments of borrowings	(7,614)	(120,339)
Change in securities lending collateral	77,051	680
Other	3,181	7,357
Preferred dividends paid	(12,922)	(12,922)
Net Cash Used For Financing Activities	(205,551)	(296,654)

Effects of exchange rate changes on foreign currency cash		6,403		(13,109)
Increase in cash		48,261		6,898
Cash beginning of year		362,740		334,571
Cash end of period	$	411,001	$	341,469

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ARCH CAPITAL GROUP LTD. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

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, 2010, 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, shareholders equity or cash flows. Tabular amounts are in U.S. Dollars in thousands, except share amounts, unless otherwise noted.

2. Recent Accounting Pronouncements

In October 2010, the Financial Accounting Standards Board (FASB) issued an Accounting Standards Update (ASU) that modifies the definition of the types of costs incurred by insurance entities that can be capitalized in the acquisition of new or renewal insurance contracts. The amended guidance specifies that certain costs incurred in the successful acquisition of new and renewal insurance contracts should be capitalized. Those costs include incremental direct costs of contract acquisition that result directly from and are essential to the contract transaction and would not have been incurred had the contract transaction not occurred. All other acquisition-related costs, such as costs incurred for soliciting business, administration, and unsuccessful acquisition or renewal efforts should be charged to expense as incurred. Administrative costs, including rent, depreciation, occupancy, equipment, and all other general overhead costs are considered indirect costs and should also be charged to expense as incurred. This ASU is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2011. Earlier adoption is permitted. Retrospective application to all prior periods presented upon the date of adoption is also permitted but is not required. The Company is evaluating the impact this new guidance will have on its consolidated statement of financial position and results of operations.

In May 2011, the FASB issued an ASU that provides clarification or changes to existing fair value measurement and disclosure requirements, including, for example, additional disclosure for fair value measurements categorized within Level 3 of the fair value hierarchy. This ASU is effective for interim and annual periods beginning after December 15, 2011 and is to be applied prospectively. Early application is not permitted. The Company is evaluating the impact the new guidance will have on its consolidated financial statements.

ARCH CAPITAL GROUP LTD. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

In June 2011, the FASB issued an ASU that is intended to increase the prominence of other comprehensive income in the financial statements by allowing only two options for reporting comprehensive income: (1) A single statement that presents the components of net income and total net income, the components of other comprehensive income and total other comprehensive income, and a total for comprehensive income or (2) in a two-statement approach that presents the components of net income and total net income in the first statement. That statement must be immediately followed by a financial statement that presents the components of other comprehensive income, a total for other comprehensive income, and a total for comprehensive income. This ASU is effective for interim and annual periods beginning after December 15, 2011 and should be applied retrospectively. Early adoption is permitted. The Company is evaluating the impact the new guidance will have on its consolidated financial statements.

3. Share Transactions

Three-for-One Share Split

In May 2011, shareholders approved a proposal to amend the memorandum of association by sub-dividing the authorized common shares of ACGL to effect a three-for-one split of ACGL s common shares. The share split changed the Company s authorized common shares to 600 million common shares (200 million previously) with a par value of $0.0033 per share ($0.01 previously). Information pertaining to the composition of the Company s shareholders equity accounts, shares and earnings per share has been retroactively adjusted in the accompanying financial statements and notes to the consolidated financial statements to reflect the share split.

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 2012. Since the inception of the share repurchase program, ACGL has repurchased approximately 104.1 million common shares for an aggregate purchase price of $2.54 billion. During the 2011 second quarter, ACGL repurchased 0.9 million common shares for an aggregate purchase price of $29.6 million, compared to 10.9 million common shares for an aggregate purchase price of $269.1 million during the 2010 second quarter. For the six months ended June 30, 2011, ACGL repurchased 8.9 million common shares for an aggregate purchase price of $266.7 million, compared to 18.5 million common shares for an aggregate purchase price of $450.3 million for the 2010 period.

At June 30, 2011, $962.8 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 2011 second quarter, the Company made a stock grant of 697,632 stock appreciation rights and stock options and 727,641 restricted shares and units to certain employees and directors. The weighted average grant-date fair value of the stock appreciation rights and options and restricted shares and units granted during the 2011 second quarter were approximately $9.75 and $33.91 per share, respectively. During the 2010 second quarter, the Company made a stock grant of 865,257 stock appreciation rights and stock options and 895,965 restricted shares and units to certain employees. The weighted average grant-date fair value of the stock appreciation rights and options and restricted shares and units granted during the 2010 second quarter were approximately $7.66 and $25.01 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

ARCH CAPITAL GROUP LTD. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

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.

4. Commitments and Contingencies

Letter of Credit and Revolving Credit Facilities

As of June 30, 2011, the Company had a $300 million unsecured revolving loan and letter of credit facility and a $1.0 billion secured letter of credit facility (the Credit Agreement). The Company was in compliance with all covenants contained in the Credit Agreement at June 30, 2011. The Credit Agreement expires on August 30, 2011. In addition, the Company had access to secured letter of credit facilities of approximately $180 million as of June 30, 2011, which were primarily used to support the Company s syndicate at Lloyd s of London, and to other secured letter of credit facilities, some of 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). The Company was in compliance with all covenants contained in the LOC Facilities at June 30, 2011. At June 30, 2011, the Company had $629.0 million in outstanding letters of credit under the LOC Facilities, which were secured by investments with a fair value of $714.6 million, and had $100.0 million of borrowings outstanding under the Credit Agreement.

Dividends for Preferred Shares

On May 6, 2011, the Company s board of directors declared dividends with respect to the $200.0 million principal amount of 8.0% series A non-cumulative preferred shares outstanding and $125.0 million principal amount of 7.875% series B non-cumulative preferred shares outstanding (together, Preferred Shares). All such dividends will be payable out of lawfully available funds for the payment of dividends under Bermuda law on August 15, 2011 to holders of record of the Preferred Shares as of August 1, 2011, unless determined otherwise by the board of directors or the executive committee of the board of directors on or prior to the applicable effective date. At June 30, 2011, the Company had declared an aggregate of $3.3 million of dividends to be paid to the holders of the Preferred Shares.

Investment Commitments

The Company s investment commitments, which are primarily related to investment funds accounted for using the equity method, were approximately $158.2 million at June 30, 2011.

5. Segment Information

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

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ARCH CAPITAL GROUP LTD. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

The following table summarizes 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, for the 2011 second quarter and 2010 second quarter:

	Three Months Ended June 30, 2011			Three Months Ended June 30, 2010		
	Insurance	Reinsurance	Total	Insurance	Reinsurance	Total
Gross premiums written (1)	$ 635,005	$ 277,766	$ 911,939	$ 616,353	$ 203,695	$ 817,100
Net premiums written	438,263	268,280	706,543	422,837	201,421	624,258
Net premiums earned	$ 410,819	$ 232,060	$ 642,879	$ 405,473	$ 217,538	$ 623,011
Fee income	702	82	784	874	9	883
Losses and loss adjustment expenses	(301,642)	(129,980)	(431,622)	(275,294)	(87,851)	(363,145)
Acquisition expenses, net	(66,543)	(44,096)	(110,639)	(65,359)	(42,116)	(107,475)
Other operating expenses	(76,765)	(22,401)	(99,166)	(71,727)	(19,303)	(91,030)
Underwriting income (loss)	$ (33,429)	$ 35,665	2,236	$ (6,033)	$ 68,277	62,244
Net investment income			86,671			90,537
Net realized gains			45,210			62,114
Net impairment losses recognized in earnings			(1,684)			(4,410)
Equity in net income (loss) of investment funds accounted for using the equity method			5,973			(348)
Other income (loss)			(4,265)			4,528
Other expenses			(11,397)			(10,503)
Interest expense			(7,758)			(7,916)
Net foreign exchange gains (losses)			(18,375)			48,625
Income before income taxes			96,611			244,871
Income tax benefit (expense)			1,731			(1,420)
Net income			98,342			243,451
Preferred dividends			(6,461)			(6,461)
Net income available to common shareholders			$ 91,881			$ 236,990
Underwriting Ratios						
Loss ratio	73.4%	56.0%	67.1%	67.9%	40.4%	58.3%
Acquisition expense ratio (2)	16.0%	19.0%	17.1%	15.9%	19.4%	17.1%
Other operating expense ratio	18.7%	9.7%	15.4%	17.7%	8.9%	14.6%
Combined ratio	108.1%	84.7%	99.6%	101.5%	68.7%	90.0%

(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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ARCH CAPITAL GROUP LTD. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

The following table summarizes 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, for the six months ended June 30, 2011 and 2010:

	Six Months Ended June 30, 2011			Six Months Ended June 30, 2010		
	Insurance	Reinsurance	Total	Insurance	Reinsurance	Total
Gross premiums written (1)	$ 1,269,588	$ 608,779	$ 1,876,505	$ 1,249,929	$ 527,172	$ 1,770,787
Net premiums written	887,554	583,267	1,470,821	875,761	516,251	1,392,012
Net premiums earned	$ 818,410	$ 458,164	$ 1,276,574	$ 834,950	$ 457,978	$ 1,292,928
Fee income	1,480	119	1,599	1,627	50	1,677
Losses and loss adjustment expenses	(599,365)	(326,137)	(925,502)	(587,305)	(203,891)	(791,196)
Acquisition expenses, net	(127,958)	(91,435)	(219,393)	(132,790)	(92,309)	(225,099)
Other operating expenses	(151,502)	(43,058)	(194,560)	(152,447)	(39,701)	(192,148)
Underwriting income (loss)	$ (58,935)	$ (2,347)	(61,282)	$ (35,965)	$ 122,127	86,162
Net investment income			174,978			183,509
Net realized gains			65,905			109,896
Net impairment losses recognized in earnings			(4,364)			(6,016)
Equity in net income of investment funds accounted for using the equity method			35,646			28,702
Other income			302			10,506
Other expenses			(18,423)			(16,191)
Interest expense			(15,479)			(15,176)
Net foreign exchange gains (losses)			(55,287)			87,226
Income before income taxes			121,996			468,618
Income tax benefit (expense)			2,102			(8,173)
Net income			124,098			460,445
Preferred dividends			(12,922)			(12,922)
Net income available to common shareholders			$ 111,176			$ 447,523
Underwriting Ratios						
Loss ratio	73.2%	71.2%	72.5%	70.3%	44.5%	61.2%
Acquisition expense ratio (2)	15.5%	20.0%	17.1%	15.7%	20.2%	17.3%

Other operating expense ratio	18.5%	9.4%	15.2%	18.3%	8.7%	14.9%
Combined ratio	107.2%	100.6%	104.8%	104.3%	73.4%	93.4%

(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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6. Investment Information

Available For Sale Securities

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

	Estimated Fair Value	Gross Unrealized Gains	Gross Unrealized Losses	Cost or Amortized Cost	OTTI Unrealized Losses (2)
At June 30, 2011					
Fixed maturities and fixed maturities pledged under securities lending agreements (1):					
Corporate bonds	$ 2,847,018	$ 107,792	$ (8,879)	$ 2,748,105	$ (17,680)
Mortgage backed securities	1,540,523	19,167	(18,015)	1,539,371	(19,204)
Municipal bonds	1,141,706	51,558	(1,757)	1,091,905	(125)
Commercial mortgage backed securities	1,190,058	27,321	(3,421)	1,166,158	(3,453)
U.S. government and government agencies	1,166,222	16,925	(6,033)	1,155,330	(207)
Non-U.S. government securities	775,380	45,346	(6,742)	736,776	(72)
Asset backed securities	736,596	26,023	(2,457)	713,030	(3,927)
Total	9,397,503	294,132	(47,304)	9,150,675	(44,668)
Equity securities	320,434	25,387	(8,696)	303,743	
Other investments	299,845	30,415	(912)	270,342	
Short-term investments	704,495	2,251	(351)	702,595	
Total	$ 10,722,277	$ 352,185	$ (57,263)	$ 10,427,355	$ (44,668)
At December 31, 2010					
Fixed maturities and fixed maturities pledged under securities lending agreements (1):					
Corporate bonds	$ 2,714,375	$ 97,400	$ (18,343)	$ 2,635,318	$ (18,047)
Mortgage backed securities	1,806,813	18,801	(26,893)	1,814,905	(21,147)
Municipal bonds	1,182,100	40,410	(6,958)	1,148,648	(125)
Commercial mortgage backed securities	1,167,299	31,743	(6,028)	1,141,584	(3,481)
U.S. government and government agencies	872,149	20,150	(5,696)	857,695	(207)
Non-U.S. government securities	732,666	39,539	(11,894)	705,021	(72)
Asset backed securities	558,032	20,672	(3,990)	541,350	(3,954)
Total	9,033,434	268,715	(79,802)	8,844,521	(47,033)
Equity securities	310,194	20,660	(3,424)	292,958	
Other investments	275,538	24,280	(1,332)	252,590	

Short-term investments		915,841		2,845		(492)		913,488		
Total	$	10,535,007	$	316,500	$	(85,050)	$	10,303,557	$	(47,033)

(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, 2011, the net unrealized gain related to securities for which a non-credit OTTI was recognized in AOCI was $0.5 million, compared to a net unrealized loss of $7.1 million at December 31, 2010.

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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	
	Estimated Fair Value	Gross Unrealized Losses	Estimated Fair Value	Gross Unrealized Losses	Estimated Fair Value	Gross Unrealized Losses
At June 30, 2011						
Fixed maturities and fixed maturities pledged under securities lending agreements (1):						
Corporate bonds	$ 502,806	$ (7,537)	$ 27,144	$ (1,342)	$ 529,950	$ (8,879)
Mortgage backed securities	429,033	(10,002)	45,886	(8,013)	474,919	(18,015)
Municipal bonds	176,280	(1,695)	1,065	(62)	177,345	(1,757)
Commercial mortgage backed securities	284,888	(2,818)	9,123	(603)	294,011	(3,421)
U.S. government and government agencies	661,493	(6,033)			661,493	(6,033)
Non-U.S. government securities	251,687	(6,000)	22,373	(742)	274,060	(6,742)
Asset backed securities	117,233	(863)	11,055	(1,594)	128,288	(2,457)
Total	2,423,420	(34,948)	116,646	(12,356)	2,540,066	(47,304)
Equity securities	120,546	(8,696)			120,546	(8,696)
Other investments	45,802	(912)			45,802	(912)
Short-term investments	30,046	(351)			30,046	(351)
Total	$ 2,619,814	$ (44,907)	$ 116,646	$ (12,356)	$ 2,736,460	$ (57,263)
At December 31, 2010						
Fixed maturities and fixed maturities pledged under securities lending agreements (1):						
Corporate bonds	$ 530,956	$ (16,580)	$ 20,351	$ (1,763)	$ 551,307	$ (18,343)
Mortgage backed securities	913,138	(20,331)	57,895	(6,562)	971,033	(26,893)
Municipal bonds	294,978	(6,440)	8,465	(518)	303,443	(6,958)
Commercial mortgage backed securities	311,703	(5,273)	22,030	(755)	333,733	(6,028)
U.S. government and government agencies	190,497	(5,696)			190,497	(5,696)
Non-U.S. government securities	271,446	(7,418)	45,884	(4,476)	317,330	(11,894)
Asset backed securities	75,655	(827)	8,126	(3,163)	83,781	(3,990)
Total	2,588,373	(62,565)	162,751	(17,237)	2,751,124	(79,802)
Equity securities	68,629	(3,424)			68,629	(3,424)
Other investments	46,750	(916)	2,850	(416)	49,600	(1,332)
Short-term investments	42,030	(492)			42,030	(492)

Total	$	2,745,782	$	(67,397)	$	165,601	$	(17,653)	$	2,911,383	$	(85,050)

(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, 2011, on a lot level basis, approximately 1,230 security lots out of a total of approximately 4,490 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 $1.4 million. At December 31, 2010, on a lot level basis, approximately 1,130 security lots out of a total of approximately 4,360 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 $2.6 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, 2011		December 31, 2010	
Maturity	**Estimated Fair Value**	**Amortized Cost**	**Estimated Fair Value**	**Amortized Cost**
Due in one year or less	$ 435,294	$ 412,582	$ 414,390	$ 398,795
Due after one year through five years	3,135,468	3,023,360	2,924,879	2,833,955
Due after five years through 10 years	2,058,035	2,002,934	1,719,446	1,671,306
Due after 10 years	301,529	293,240	442,575	442,626
	5,930,326	5,732,116	5,501,290	5,346,682
Mortgage backed securities	1,540,523	1,539,371	1,806,813	1,814,905
Commercial mortgage backed securities	1,190,058	1,166,158	1,167,299	1,141,584
Asset backed securities	736,596	713,030	558,032	541,350
Total	$ 9,397,503	$ 9,150,675	$ 9,033,434	$ 8,844,521

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 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. At June 30, 2011, the fair value and amortized cost of fixed maturities and short-term investments pledged under securities lending agreements were $150.5 million and $148.3 million, respectively, compared to $75.6 million and $72.5 million at December 31, 2010, respectively. At June 30, 2011, the portfolio of collateral backing the Company s securities lending program included approximately $9.5 million fair value of sub-prime securities with an average credit quality of CCC from Standard & Poor s and Caa3 from Moody s, compared to $13.2 million with an average credit quality of B- from Standard & Poor s and Caa2 from Moody s at December 31, 2010.

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Fair Value Option

The Company elected to carry certain fixed maturity securities, equity securities and other investments 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 (losses). The primary reasons for electing the fair value option were to reflect economic events in earnings on a timely basis and address simplification and cost-benefit considerations.

The Company also elected to carry the securities and related borrowings under the Federal Reserve Bank of New York s (FRBNY) Term Asset-Backed Securities Loan Facility (TALF) at fair value under the fair value option. The primary reason for electing the fair value option on the TALF investments and TALF borrowings was to mitigate volatility in equity from using different measurement attributes (*i.e.*, TALF investments carried at fair value whereas the related TALF borrowings would be recorded on an accrual basis absent electing the fair value option). Changes in fair value for both the securities and borrowings are included in Net realized gains (losses) while interest income on the TALF investments is reflected in net investment income and interest expense on the TALF borrowings is reflected in interest expense.

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

	June 30, 2011	December 31, 2010
Fixed maturities	$ 102,897	$ 124,969
Equity securities	152,844	94,204
Other investments (par: $66,480 and $0)	66,049	
Investments accounted for using the fair value option	321,790	219,173
Securities sold but not yet purchased (1)	(51,626)	(41,143)
TALF investments	399,341	402,449
TALF borrowings	(318,441)	(325,770)
Net assets accounted for using the fair value option	$ 351,064	$ 254,709

(1) 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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Net Investment Income

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

	Three Months Ended June 30, 2011	Three Months Ended June 30, 2010	Six Months Ended June 30, 2011	Six Months Ended June 30, 2010
Fixed maturities	$ 84,420	$ 94,181	$ 169,564	$ 191,842
Equity securities	1,844	80	3,391	290
Short-term investments	505	256	1,183	485
Other (1)	6,307	846	13,361	1,122
Gross investment income	93,076	95,363	187,499	193,739
Investment expenses	(6,405)	(4,826)	(12,521)	(10,230)
Net investment income	$ 86,671	$ 90,537	$ 174,978	$ 183,509

(1) Includes interest on term loan investments (included in investments accounted for using the fair value option), dividends on investment funds and other items.

Net Realized Gains (Losses)

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

	Three Months Ended June 30, 2011	Three Months Ended June 30, 2010	Six Months Ended June 30, 2011	Six Months Ended June 30, 2010
Available for sale securities:				
Gross gains on investment sales	$ 71,578	$ 63,619	$ 143,295	$ 120,010
Gross losses on investment sales	(15,917)	(21,169)	(63,667)	(41,463)
Change in fair value of assets and liabilities accounted for using the fair value option:				
Fixed maturities	(8,483)	(7,420)	(8,393)	(8,697)
Equity securities	(6,484)	(4,630)	(3,050)	(5,291)
Other investments	196		323	
TALF investments	2,795	4,320	4,447	7,897

TALF borrowings	(138)	1,512	(285)	540
Derivative instruments (1)	3,176	28,135	(8,144)	35,552
Other	(1,513)	(2,253)	1,379	1,348
Net realized gains	$ 45,210	$ 62,114	$ 65,905	$ 109,896

(1) See Note 8 for information on the Company s derivative instruments.

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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 OTTI recognized in earnings by asset class:

	Three Months Ended June 30, 2011	Three Months Ended June 30, 2010	Six Months Ended June 30, 2011	Six Months Ended June 30, 2010
Fixed maturities:				
Mortgage backed securities	$ 1,310	$ 1,816	$ 2,428	$ 2,261
Asset backed securities		813	10	1,974
Corporate bonds		128	359	128
Total	1,310	2,757	2,797	4,363
Investment of funds received under securities lending agreements	374	1,653	1,230	1,653
Equity securities			337	
Total OTTI recognized in earnings	$ 1,684	$ 4,410	$ 4,364	$ 6,016

A description of the methodology and significant inputs used to measure the amount of OTTI in the 2011 periods is as follows:

- Mortgage 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 number of mortgage backed securities, primarily as a result of increases in expected default expectations and foreclosure costs. The amortized cost basis of the mortgage backed securities were adjusted down, if required, to the expected recovery value calculated in the OTTI review process;

- Investment of funds received under securities lending agreements the Company utilized analysis from its securities lending program manager in order to determine an expected recovery value for certain collateral backing the Company s securities lending program which was invested in sub-prime securities. The analysis provided expected cash flow projections for the securities using similar criteria as described in the mortgage backed securities section above. The amortized cost basis of the investment of funds received under securities lending agreements was adjusted down, if required, to the expected recovery value calculated in the OTTI review process;

- Corporate bonds the Company reviewed the business prospects, credit ratings, estimated loss given default factors, foreign currency impacts and information received from asset managers and rating agencies for certain corporate bonds. The amortized cost basis of the corporate bonds were adjusted down, if required, to the expected recovery value calculated in the OTTI review process;

- Equity securities the Company utilized information received from an asset manager on a small number of common stocks and reduced the cost basis of the equity securities where appropriate.

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The Company believes that the $44.7 million of OTTI included in accumulated other comprehensive income at June 30, 2011 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, 2011, 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,	
	2011	2010	2011	2010
Balance at start of period	$ 84,858	$ 85,488	$ 86,040	$ 84,147
Credit loss impairments recognized on securities not previously impaired	1,194	350	2,863	554
Credit loss impairments recognized on securities previously impaired	490	4,060	1,164	5,462
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	(256)	(709)	(3,781)	(974)
Balance at end of period	$ 86,286	$ 89,189	$ 86,286	$ 89,189

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, 2011	December 31, 2010
Assets used for collateral or guarantees:		

Affiliated transactions	$	4,448,991	$	4,491,649
Third party agreements		846,993		948,020
Deposits with U.S. regulatory authorities		269,891		263,077
Deposits with non-U.S. regulatory authorities		152,022		122,341
Trust funds		60,047		48,140
Total restricted assets	$	5,777,944	$	5,873,227

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7. 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 indicated 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. At June 30, 2011, the Company obtained an average of 2.7 quotes per investment, compared to 2.7 quotes at December 31, 2010. Where multiple quotes or prices were obtained, a price source hierarchy was maintained in order to determine which price source provided the fair value (*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. The Company did not adjust the prices or quotes provided by the pricing services at June 30, 2011 or December 31, 2010.

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

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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 $11.81 billion of financial assets and liabilities measured at fair value at June 30, 2011, approximately $1.42 billion, or 12.0%, were priced using non-binding broker-dealer quotes. Of the $11.52 billion of financial assets and liabilities measured at fair value at December 31, 2010, approximately $1.81 billion, or 15.7%, 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. Upon adoption of the accounting guidance regarding fair value measurement, the Company determined that Level 1 securities included highly liquid, recent issue U.S. Treasuries and certain of its short-term investments held in highly liquid money market-type funds where it believes that quoted prices are available in an active market. On January 1, 2010, 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. Such determination resulted in $1.09 billion of U.S. Treasuries previously classified as Level 2 being moved into Level 1. In addition, the Company determined that exchange-traded equity securities would be included in Level 1.

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, non-U.S. government securities, TALF investments and TALF borrowings, certain equities, certain short-term securities and certain other investments.

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. In addition, the Company determined that certain mutual funds, included in other investments, 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. The Company reviews the classification of its investments each quarter.

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 this table, 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, 2011:

		Fair Value Measurement Using:		
	Estimated Fair Value	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	$ 2,847,018	$		