REPORT OF THE

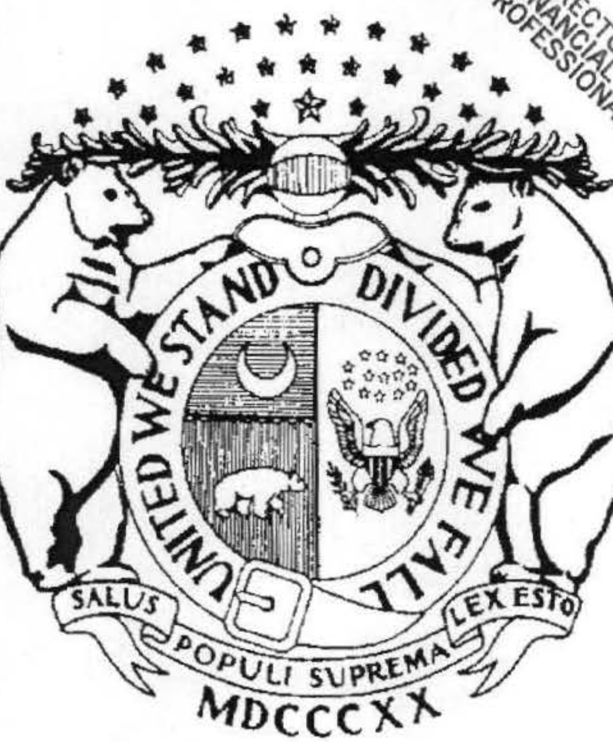
FINANCIAL EXAMINATION OF

ARCH INSURANCE COMPANY

AS OF

DECEMBER 31, 2008

FILED
JUN 20 2010
DIRECTOR OF INSURANCE
FINANCIAL INSTITUTIONS &
PROFESSIONAL REGISTRATION



STATE OF MISSOURI

DEPARTMENT OF INSURANCE, FINANCIAL INSTITUTIONS AND PROFESSIONAL REGISTRATION

JEFFERSON CITY, MISSOURI

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Jersey City, NJ
April 16, 2010

Honorable Alfred W. Gross, Commissioner
Virginia Bureau of Insurance
Chair, NAIC Financial Condition (E) Committee

Honorable Mary Jo Hudson, Director
Ohio Department of Insurance
Midwestern Zone Secretary

Honorable Christina Urias, Director
Arizona Department of Insurance
Western Zone Secretary

Honorable John M. Huff, Director
Missouri Department of Insurance, Financial
Institutions and Professional Registration
301 West High Street, Room 530
Jefferson City, Missouri 65102

Ladies and Gentlemen:

In accordance with your financial examination warrant, a full scope financial association examination has been made of the records, affairs and financial condition of

Arch Insurance Company

hereinafter referred to as such, as AIC, or as the Company. Its administrative office is located at 300 Plaza Three, Jersey City, NJ 07311, telephone number 201-743-4000. The fieldwork for this examination began on August 11, 2009, and concluded on the above date.

SCOPE OF EXAMINATION

Period Covered

We have performed a full scope association financial examination of Arch Insurance Company. The last examination was completed as of December 31, 2005 and was conducted by examiners from the State of Missouri representing the Midwestern Zone of the National Association of Insurance Commissioners (NAIC) with no other zone participating. This examination covers the period of January 1, 2006 through December 31, 2008 and also includes the material transactions and/or events occurring subsequent to the examination date which are noted in this report. The current examination was conducted by examiners from the States of Missouri and California representing the Midwestern and Western Zones of the NAIC.

Procedures

We conducted our examination in accordance with the NAIC Financial Condition Examiners Handbook (Handbook), except where practices, procedures and applicable regulations of the Missouri Department of Insurance, Financial Institutions and Professional Registration (the MO DIFP) and statutes of the State of Missouri prevailed. The Handbook requires that we plan and perform the examination to evaluate the financial condition and identify prospective risks of the Company by obtaining information about the Company including corporate governance, inherent risks within the Company, and system controls and procedures used to mitigate those risks. This examination also included assessing the principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation and management's compliance with Statutory Accounting Principles and annual statement instructions.

All accounts and activities of the Company were considered in accordance with the risk-focused examination approach. Key activities for Arch Insurance Company included: Claims and Reserving, Investments, Premiums and Underwriting, Related Party Transactions, Reinsurance, and Federal Income Taxes.

Reliance Upon Others

The examination relied heavily upon information provided by the Company and its management. Where the examiners have deemed appropriate, this information has been tested or verified with external sources. The examiners also relied upon information supplied by the Company's independent auditor, PricewaterhouseCoopers, LLC, of New York, New York, for its audit covering the period from January 1, 2008, through December 31, 2008. Information relied upon included fraud risk analysis, attorney letters, tests of controls, and narrative descriptions of processes and controls.

SUMMARY OF SIGNIFICANT FINDINGS

Arch Insurance Company does not have approved and executed written allocation agreements for its multi-cedent reinsurance contracts as required by SSAP #62, Property and Casualty Reinsurance, paragraph 9. See the Intercompany Transactions section of this report for a discussion of this exception.

Although the December 31, 2008 Loss and LAE Reserves shown by the Company appear to be reasonable, documentation of actuarial analysis, assumptions, methods, and selections needs to be improved. See the Accounts and Records section of this report for a discussion of this exception.

SUBSEQUENT EVENTS

During 2009, the board member nomination rights of the Warburg Pincus funds lapsed because such funds no longer own the percentage of equity securities required to retain such rights under their shareholders agreement with Arch Capital Group Ltd (ACGL). As of December 31, 2009, the Warburg Pincus funds owned 1.1% of the shares of ACGL common stock. In 2010, Artisan Partners Holding LP (Artisan) beneficial ownership increased as a result of the repurchase of shares by ACGL and, as of March 12, 2010, Artisan beneficially owned 10.1% of ACGL stock.

COMPANY HISTORY

General

Arch Insurance Company, formerly known as First American Insurance Company, was incorporated on December 15, 1971, as a stock casualty insurance company, and was granted authority pursuant to the provisions of Chapter 379 RSMo (Insurance other than Life) to commence the business of insurance effective June 30, 1980. AIC was incorporated as a wholly owned subsidiary of First American Financial Corporation (FAFC).

On June 4, 2001, the MO DIFP approved the acquisition of FAFC and the Company by Arch Capital Group Ltd. In 2002, the name of First American Financial Corporation was changed to Arch Insurance Group Inc. On June 26, 2002, the MO DIFP approved the name change of First American Insurance Company to Arch Insurance Company.

Capital Contributions

Arch Insurance Company received the following capital contributions during the period under examination.

Year of Contribution	Amount of Contribution
2006	\$5,032,039
2007	\$6,491,799
2008	\$13,312,620

Dividends

No dividends were declared or paid during the period under examination.

Mergers and Acquisitions

There were no acquisitions, mergers, or other major corporate events that occurred during the period under examination.

CORPORATE RECORDS

A review was made of the Articles of Incorporation and Bylaws for the period under examination. The Articles of Incorporation were amended and restated, effective November 19, 2009. The changes were considered minor and did not change the organizational structure or business purpose of the Company. No changes were made to the Company's Bylaws during the period under examination.

Selected minutes of the Company's Stockholder, Board of Directors, and committee meetings were reviewed. Generally, the minutes appeared to properly reflect and approve the Company's major transactions and events during the period under examination.

MANAGEMENT AND CONTROL

Board of Directors

The Company's Articles of Incorporation specifies that the Board of Directors shall consist of between nine and twenty-five members. This complies with 379.035 RSMo (Articles of incorporation for stock companies). The Directors of the Company elected and serving as of December 31, 2008[1], were as follows:

[1]On July 15, 2009, the Sole Shareholder of the Corporation, Arch Insurance Group Inc., re-elected the same slate of Directors by written consent, except for Paul H. Stewman who was replaced by David H. McElroy.

Name and Address	Business Affiliation
Mark D. Lyons Deer Park, IL	Chairman, Chief Executive Officer & President Arch Insurance Company and its subsidiaries
Fred S. Eichler New York, NY	Senior Vice President and Chief Financial Officer Arch Insurance Company and its subsidiaries
Martin J. Nilsen Rockville Centre, NY	Senior Vice President, Secretary & General Counsel Arch Insurance Company and its subsidiaries
Dennis R. Brand Harvard, IL	Executive Vice President Arch Insurance Company and its subsidiaries
John S. Edack Oakland, CA	Executive Vice President Arch Insurance Company and its subsidiaries (except Arch Specialty Insurance Company)
Paul H. Stewman Charlotte, NC	Executive Vice President Arch Insurance Company and its subsidiaries
Mark G. Wade New York, NY	Executive Vice President Arch Insurance Company
Michael R. Murphy Short Hills, NJ	Executive Vice President Arch Insurance Company and its subsidiaries
Lawrence F. Harr Omaha, NE	Practicing Attorney Lamson, Dugan and Murray, LLP

Senior Officers

The following officers were elected and serving as of December 31, 2008:

Name	Office
Mark D. Lyons	Chairman, President, and Chief Executive Officer
Fred S. Eichler	Senior VP and Chief Financial Officer
Martin J. Nilsen	Senior VP, Secretary and General Counsel
Dennis R. Brand	Executive Vice President
William J. Casey	Executive Vice President
Ellen H. Darrigand	Executive Vice President
John S. Edack	Executive Vice President
Daniel Gamble	Executive Vice President
Lyle S. Hitt	Executive Vice President

Roy G. Mahlstedt	Executive Vice President
Thomas McMahon	Executive Vice President
John P. Mentz	Executive Vice President
Michael R. Murphy	Executive Vice President
Steven D. Nelson	Executive Vice President
William A. Palmer	Executive Vice President
Paul H. Stewman	Executive Vice President
Elaine A. Trischetta	Executive Vice President
Mark C. Vonnahme	Executive Vice President
Mark G. Wade	Executive Vice President

Principal Committees

Pursuant to its amended and restated Bylaws, the Board of Directors may appoint one or more committees, including but not limited to, an Executive Committee, a Finance Committee, and an Audit Committee. As of December 31, 2008, the Company had an Executive Committee and an Investment and Finance Committee. These committees operate in accordance with the Company Bylaws.

The members of the Board-appointed Committees as of December 31, 2008 were as follows:

Investment and Finance Committee[2]	Executive Committee
Martin J. Nilsen, Chairman	Martin J. Nilsen, Chairman
Dennis R. Brand	Dennis R. Brand
Fred S. Eichler	Fred S. Eichler
Mark D. Lyons	Mark D. Lyons

No Audit Committee has been established by Arch Insurance Company. Per Company Bylaws, the Audit Committee's main function is to review: the results of the Company's yearly financial audits with the Company's independent auditors; the activities of the internal auditors; as well as the internal accounting, financial and disclosure controls and procedures of the Company. To fulfill this oversight responsibility, the Company has placed reliance on the ACGL Audit Committee, which is composed of outside ACGL directors.

Beside the committees provided for by the Company Bylaws, AIC has established various management committees to provide oversight and guidance. These committees include the Reserve Review Committee, the Reinsurance Steering Committee, the Credit Committee, the Antifraud Controls Committee, and the Information Technology Steering Committee.

[2] The Company appointed David H. McElroy as a fifth (5th) member of the Investment & Finance Committee at its Board of Directors meeting held on August 6, 2009.

Holding Company, Subsidiaries and Affiliates

Arch Insurance Company is a member of an insurance holding company system as defined by RSMo Section 382.010 (Definitions). As of December 31, 2008, AIC was the sole owner of Arch Specialty Insurance Company, Arch Excess & Surplus Insurance Company, and Arch Indemnity Insurance Company. Arch Specialty Insurance Company (ASIC) is a Nebraska-domiciled excess and surplus lines insurer approved to write in 49 states, the District of Columbia, Puerto Rico, and the U.S. Virgin Islands. Arch Excess & Surplus Insurance Company (AESIC) is a Nebraska-domiciled excess and surplus lines insurer approved to write in 47 states and the District of Columbia. Arch Indemnity Insurance Company (AIIC), formerly Western Diversified Casualty Insurance Company, is a Nebraska-domiciled insurer licensed to write Fire, Marine, and Casualty coverage. AIIC is currently inactive but licensed to write in 49 states and the District of Columbia.

Arch Insurance Company is a wholly owned subsidiary of Arch Insurance Group Inc. (AIGI). AIGI is ultimately owned by Arch Capital Group Ltd. (ACGL), a Bermuda-based publicly held limited liability company. ACGL is a holding company whose assets primarily consist of its investments in subsidiaries. ACGL provides insurance and reinsurance on a worldwide basis through its wholly owned subsidiaries in Europe, Bermuda, the United States, and Canada.

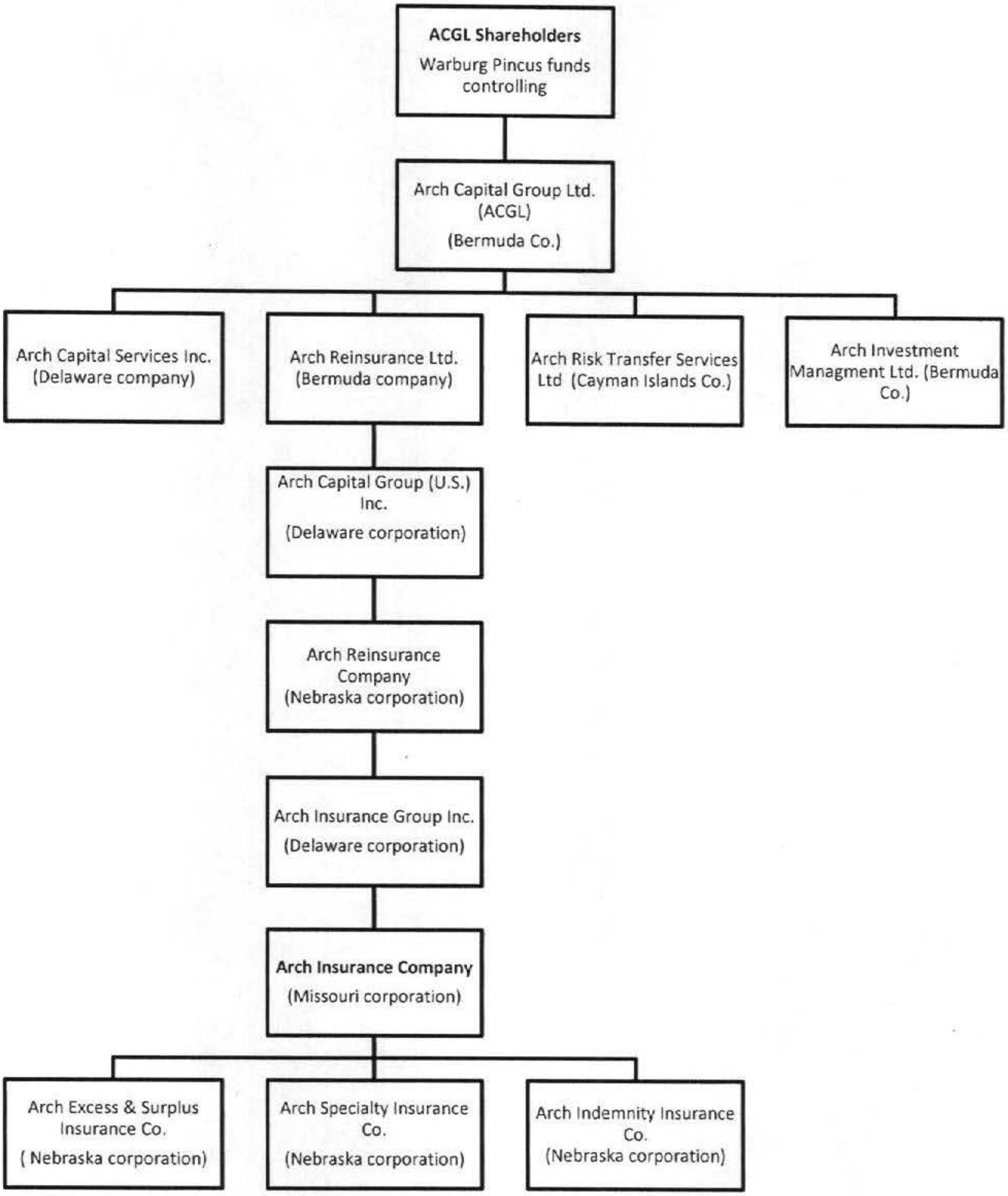
ACGL is a publicly-held company which is traded on the NASDAQ National Market under the symbol ACGL. As of December 31, 2008, there were 60,511,974 shares of ACGL common stock outstanding. Funds associated with Warburg Pincus owned 6.6% and 16.3% of the shares of ACGL in 2008 and 2007 respectively. Pursuant to their shareholder's agreement with ACGL, the Warburg Pincus funds are entitled until 2011 to nominate a prescribed number of directors based on the respective retained percentages of ACGL equity securities purchased in November 2001.[3] As of December 31, 2008, ACGL's board consisted of nine members, which included three directors nominated by the Warburg Pincus funds.

Arch Insurance Company filed Insurance Holding Company System Registration Statements with the State of Missouri annually during the examination period on its own behalf.

Organizational Chart

The following organizational chart depicts the applicable portion of the holding company group, including Arch Insurance Company, as of December 31, 2008:

[3] During 2009, the board member nomination rights of the Warburg Pincus funds lapsed because such funds no longer own the percentage of equity securities required to retain such rights under their shareholders agreement with ACGL. As of December 31, 2009, the Warburg Pincus funds owned 1.1% of the shares of ACGL common stock.


ACGL Shareholders
Warburg Pincus funds controlling
Arch Capital Group Ltd. (ACGL)
(Bermuda Co.)
Arch Capital Services Inc. (Delaware company)
Arch Reinsurance Ltd. (Bermuda company)
Arch Risk Transfer Services Ltd (Cayman Islands Co.)
Arch Investment Managment Ltd. (Bermuda Co.)
Arch Capital Group (U.S.) Inc.
(Delaware corporation)
Arch Reinsurance Company (Nebraska corporation)
Arch Insurance Group Inc.
(Delaware corporation)
Arch Insurance Company
(Missouri corporation)
Arch Excess & Surplus Insurance Co.
(Nebraska corporation)
Arch Specialty Insurance Co.
(Nebraska corporation)
Arch Indemnity Insurance Co.
(Nebraska corporation)

Intercompany Transactions

The Company's intercompany agreements in effect, as of December 31, 2008, are outlined below:

1.	Type:	Service Agreement
	Parties:	Arch Insurance Company and Arch Insurance Group Inc.
	Effective:	July 1, 2004 (This agreement superseded similar agreements in effect dating back to 1985.)
	Terms:	AIGI provides AIC with supervision of all phases of its operations, including, but not limited to, the following: underwriting, actuarial studies, claims service, accounting, data processing, and other responsibilities. For the services provided, AIGI is to be compensated the direct costs incurred in providing services and shall not include any additional mark-ups or fees. AIGI is to submit a bill to AIC for all services provided to the date of the bill. Bills may be submitted up to two months following the month in which services are provided. Amendment No. 1, dated January 14, 2005, added AIC's Canadian branch of operations (Arch Canada) to the arrangement. Services are to be provided to Arch Canada on a cost-recovery basis, with reasonable and documented out-of-pocket expenses and on terms and conditions no less favorable than the terms and conditions under which AIGI would provide services to an arms-length third party. Amendment No. 2, dated September 9, 2008, allowed the right of offset by the parties under the agreement.
2.	Type:	Commission Agreement
	Parties:	AIC and Arch Specialty Insurance Agency, Inc. (ASIA)
	Effective:	November 1, 1997
	Terms:	AIC will provide services and facilities to allow ASIA to produce business for AIC. ASIA will be paid commission on business produced for AIC, subject to a limit based on the net operating results of ASIA. AIC has not written any premium through ASIA since 1999 when its nonstandard auto business went into runoff. However, this agreement remains in effect because ASIA acts as an administrator for the GAP program in Indiana on behalf of AIC. ASIA does not receive any fees for this pass through service.
3.	Type:	Consolidated Federal Income Tax Agreement
	Parties:	Arch Capital Group (U.S.), Inc. (ACG - US) and Subsidiaries (including AIC)
	Effective:	January 1, 2002 (Previously AIC filed a consolidated return with its immediate parent, AIGI.)
	Terms:	The parent is to collect from, or refund to, each subsidiary the amount of taxes or benefits determined as if the subsidiary filed a separate return. Balances arising out of the agreement are to be settled no less often than quarterly.

4. Type: Service Agreement
   Parties: AIC and First American Service Corporation (FASC)
   Effective: November 10, 2000
   Terms: FASC agrees to administer an approved GAP Waiver Program, collecting fees from participating Lenders/Lessors, distributing fees to agents representing said Lenders/Lessors, and purchasing insurance protection through AIC. The GAP coverage insures the Lenders/Lessors for the difference between the fair market value of a totaled vehicle and the loan balance on the vehicle. Per the Agreement, FASC is allowed to retain up to $25 out of the fees collected from Lenders/Lessors; however, FASC did not retain any fees during the exam period. No compensation is due to FASC from AIC.

5. Type: Cost Allocation Agreement
   Parties: AIGI, AIC, ASIC, AESIC, and AIIC
   Effective: June 1, 2004
   Terms: This Agreement provides for the allocation of depreciation expense incurred by AIC in connection with computer equipment purchased by AIC for the use of the group. The parent of AIC, AIGI, has the primary responsibility for purchases of computer equipment; however, this agreement is in place in the event AIGI is not forthcoming with said purchases. Depreciation shall be allocated among AIC, ASIC, AESIC, and AIIC in direct proportion to the ratio of direct premiums written by each of the Companies to total direct premiums written. AIC will bill ASIC, AESIC, and AIIC for their share of the depreciation expense on no less than a quarterly basis. Payment must be made within thirty days of receipt of the bill. AIC had not purchased any equipment subject to this agreement through the date of the examination.

6. Type: Property Catastrophe Excess of Loss Reinsurance Cost Allocation Agreement
   Parties: ACGL, Arch Reinsurance, Ltd., Arch Reinsurance Company (ARC), AIC, AESIC, ASIC, AIIC, and Arch Insurance Company (Europe) Limited (Arch Europe)
   Effective: December 31, 2003
   Terms: ACGL is to purchase property catastrophe (CAT) excess of loss reinsurance protection on behalf of its subsidiaries. Costs of the reinsurance protection are to be allocated to each business line written by the subsidiaries based upon each business line's loss exposure and then allocated to each subsidiary based upon gross net earned premiums. Payments are to be made to ACGL within ten business days after each deposit premium quarterly installment. Depending upon whether additional amounts are due or refunded, annual adjustments are to be paid to ACGL or by ACGL within 10 business days after notification of the final amount. Any recoveries under the coverage are to be paid to the

subsidiary or subsidiaries that paid the losses. Amendment 2, effective January 1, 2007, changed the allocation methodology from a pure CAT pricing approach to a weighted modeled loss approach. Amendment 3, effective January 1, 2008, added ARC to the agreement, clarified the cost allocation methodology based on gross net earned premium rather than direct written premium and updated Schedule A of the agreement regarding treaty coverage layers and deposit premium amounts related to the unaffiliated catastrophe reinsurance agreements.

Exception: Although this agreement has been approved by MO DIFP, it has not received the required approval from the Nebraska Department of Insurance (NDI) and consequently has not been executed by the Company. The Company should work with NDI and MO DIFP to modify this agreement such that it is acceptable to both states, obtain the required approvals, and execute the agreement.

7. Type: Cost Allocation Agreement(s) for multi-cedent reinsurance contracts other than the Property Catastrophe Excess of Loss Reinsurance

Parties: ACGL, Arch Reinsurance Ltd., AIC, AESIC, ASIC, AIIC, Arch Europe, and ARC

Effective: There are more than 25 separate underlying reinsurance agreements that renew annually. The individual contract effective dates of these underlying contracts are spread throughout the year.

Terms: This agreement provides for the allocation of premiums paid to the reinsurers and loss and LAE payments received from the reinsurers related to multi-cedent reinsurance contracts. Costs for reinsurance protection under the various excess of loss contracts are allocated to each business line based on each business line's loss exposure, using a weighted modeled loss approach, and then allocated to each cedent based on direct premiums written in each line. Costs under the quota share agreements are allocated on a pro-rata basis. Cedents pay that percentage of their premiums written as described in the individual contracts. Recoveries under all coverages are paid to the cedent which incurred and paid the losses.

Exception: Pursuant to SSAP #62, Property and Casualty Reinsurance, paragraph 9, multi-cedent reinsurance contracts require written allocation agreements as either a part of the reinsurance contract or as separate intercompany agreements. The underlying reinsurance contracts do not contain an allocation agreement and no separate written agreement(s) has been provided by the Company other than the agreement for the CAT reinsurance coverage discussed above. Arch Insurance Company should develop one or more written intercompany agreement(s) which detail how reinsurance premiums due and reinsurance payments received are split between the ACGL group companies and which establish a timeframe for making the disbursements. Prior to executing the agreements, the Company must obtain approval from the domiciliary states of the parties to the agreement. MO DIFP approval is required pursuant to RSMo 382.195 (Prohibited transactions, exceptions).

8. Type: Investment Manager Agreement
   Parties: AIC and Arch Investment Management Ltd. (AIML)
   Effective: April 1, 2006
   Terms: AIML is to provide investment management services on behalf of AIC. The services are to include the investment and reinvestment of the AIC's assets, the reporting of the market value of investments, the reconciliation of accounting, transaction, and investment summary data with custodian reports, and the appointment of brokers. AIC shall compensate AIML on a quarterly basis in arrears based upon its pro-rata portion of the average of the total assets of the Arch Companies managed by AIML. AIML shall receive 10 basis points for the first $500 million of assets and 8 basis points for assets over $500 million.

9. Type: Power of Attorney (POA) and Bond Administration Agreement
   Parties: AIC and Arch Reinsurance Company (ARC)
   Effective: August 14, 2003
   Terms: ARC authorizes AIC to issue and administer on behalf of ARC bonds that require a United States Treasury Department authorized surety.

10. Type: Co-Surety Facility Agreement
    Parties: AIC and Arch Reinsurance Company (ARC)
    Effective: August 14, 2003
    Terms: ARC grants AIC the authority to issue and administer co-surety bonds on behalf of ARC where non-federal bond obligees require only one of the bond co-sureties to be authorized by the United States Treasury Department.

11. Type: Intercompany Short Term Advance Agreement
    Parties: AIGI, AIC, ASIC, AESIC, and AIIC
    Effective: December 31, 2007
    Terms: Parties to the agreement are authorized to make advances to one another for a maximum term of thirty (30) days. No advances may exceed more than three percent (3%) of the lending or borrowing party's policyholders' surplus as of December 31 of the preceding year. The rate of interest will be the prime rate plus 100 basis points.

In addition to the above listed agreements, AIC also has reinsurance transactions with various affiliates, the most significant of which are described in the Reinsurance section of this report.

Intercompany Payments

Following is a table of the fees incurred under the above described Arch Insurance Company intercompany agreements (excluding the Consolidated Federal Income Tax Agreement, the Property Catastrophe Excess of Loss Reinsurance Cost Allocation Agreement, and the Cost Allocation Agreement(s) for other multi-cedent reinsurance contracts). This table shows the other party to the agreement, the agreement name, and the dollar amount incurred by AIC under each agreement for 2008, 2007, and 2006:

	2008	2007	2006
Arch Insurance Group Inc. -			
Service Agreement – U.S. Operations	$164,195,000	$143,664,000	$128,598,000
Service Agreement - Canadian Branch	240,000	221,319	219,093
Arch Specialty Insurance Agency, Inc. –			
Commission Agreement	0	0	0
First American Service Corporation –			
Service Agreement	0	0	0
ASIC, AESIC, and AIIC –			
Cost Allocation Agreement	0	0	0
Arch Investment Management Ltd. –			
Investment Manager Agreement	573,066	494,104	NA
Arch Reinsurance Company –			
POA & Bond Admin. Agreement	0	0	0
Co-Surety Facility Agreement	0	0	0
Totals	$165,008,066	$144,379,423	$128,817,093

FIDELITY BOND AND OTHER INSURANCE

The Company is a named insured, along with other subsidiaries of Arch Capital Group Ltd., on a financial institution bond with a single loss limit of liability of $10 million, an aggregate loss liability limit of $20 million and a $100,000 single loss deductible. Coverage is also provided under an excess policy for losses above the single and aggregate limits included in the primary policy. The excess policy provides coverage up to $10 million per loss and $20 million aggregate. This coverage complies with the suggested minimum amount of fidelity insurance according to NAIC guidelines.

The Company is also a named insured on the following other insurance policies: property and general liability, commercial automobile liability, workers compensation, umbrella coverage, directors' and officers' liability and fiduciary liability coverage.

PENSION, STOCK OWNERSHIP AND INSURANCE PLANS

The Company had thirty-three direct employees as of December 31, 2008 dedicated to its Canadian branch of operations. Employee benefits are available to these employees, including a defined contribution pension plan, health care, dental, short-term and long-term disability, and group life insurance. AIC contributes 5 percent of employee compensation to the pension plan and will match the employees contribution up to 3 percent.

Services are also provided to Arch Insurance Company by employees of affiliates of AIC, as described in the Intercompany Transactions section of this report. The typical employee benefits are available to employees of the ACGL holding company system including, but not limited to, pension, 401(k), flexible benefits, health care, dental, short-term and long-term disability, and group life insurance. The expenses for these benefits are charged to AIC through intercompany service fees. Other than any unpaid billings under intercompany agreements at year-end 2008, AIC had no additional liability for the benefits provided.

The Company has stated that employees of the Arch holding company system are encouraged to share in its economic growth and success. To that end, on May 11, 2007, ACGL, the indirect parent of AIC, adopted the 2007 Employee Share Purchase Plan (ESPP). The purpose of the ESPP is to give employees of the holding company system an opportunity to purchase common shares through payroll deductions. During the examination period, ACGL continued to offer certain employees of AIC's affiliates and as well as AIC's Canadian direct employees restricted stock awards and /or stock options.

TERRITORY AND PLAN OF OPERATIONS

Arch Insurance Company is licensed by the Missouri Department of Insurance, Financial Institutions and Professional Registration under RSMo Chapter 379 (Insurance other than life) to write the business of property and casualty. As of December 31, 2008, the Company was licensed in all 50 states, the District of Columbia, the Virgin Islands, Puerto Rico, Guam, and Canada. The largest states in 2008, by volume of written premium, were California 18.9% and New York 11.6%; no other jurisdiction exceeded 10%.

Arch Insurance Company's stated overall strategy is to focus on writing specialty lines of business. AIC management believes that the existing underwriting platform, a strong management team, and capital unencumbered by significant exposure to pre-2002 risks have enabled the Company to establish a strong presence in the insurance marketplace. AIC specializes in writing primarily commercial lines property and casualty business through managing general agents, managing general underwriters, general agents, and brokers. Profit-sharing plans exist with many of the underwriting managers. Actuarial analyses are performed on each new line in order to project loss ratios and rate changes. The producers of these lines are then examined periodically to determine if targets are achieved and if underwriting guidelines are followed.

Arch Insurance Company underwriting can be classified into three business lines:

- The Specialty line of business which includes Executive Assurance, Casualty, Professional Liability, Healthcare, Construction, Surety, Property, Alternative Markets, National Accounts, Travel and Accident, High Excess Workers Comp, and Special Risks.
- Traditional Programs and Guaranteed Cost Compensation in the Stamford Managed segment.
- The Lender line which includes GAP insurance for lenders of automobile loans and Collateral Protection Insurance.

The underwriting of these lines leads to business in most of the traditional property and casualty lines. The largest lines, by direct written premiums in 2008, were: Other Liabilities-Claims Made 23.1%, Worker's Compensation 15.1%, and Other Liability-Occurrence 12.6%.

GROWTH OF THE COMPANY AND LOSS EXPERIENCE

The Company continued to grow during the current examination period: assets increased by \$486 million and total capital & surplus increased by \$101 million from December 31, 2005 through December 31, 2008. Although net premiums written decreased by \$13 million from 2007 to 2008, it more than doubled during the current three-year examination period. The loss ratio improved from 2006 to 2007 because the net retained business assumed from AIC's two subsidiaries, Arch Specialty Insurance Company and Arch Excess and Surplus Insurance Company, had lower loss ratios than the direct written business. The loss ratio increased from 2007 to 2008 due to an increase in claim activity as the Company's business ages, hurricanes Ike and Gustave, and various other large non catastrophe losses, most notable in the aviation line of business. The growth and loss experience of the Company is summarized in the schedule below covering the period under examination:

	2008	2007	2006
Direct Written Business	\$1,317,331,567	\$1,311,392,474	\$1,254,158,562
Net Written Premiums	\$298,764,956	\$311,788,953	\$170,304,387
Net Income (Loss)	\$22,274,815	\$5,733,312	\$5,968,427
Net Loss & LAE Reserves	\$517,202,437	\$423,100,783	\$250,877,675
Total Capital & Surplus	\$577,011,288	\$540,547,567	\$518,923,903
Total Admitted Assets	\$1,563,183,065	\$1,464,993,174	\$1,187,699,401
Direct Written Premium to Surplus	228.3%	242.6%	241.7%
Net Written Premium to Surplus	51.8%	57.7%	32.8%
Net Loss & LAE Reserves to Surplus	89.6%	78.3%	48.3%
Net Loss Incurred to Premiums Earned	57.6%	48.8%	52.2%

REINSURANCE

General

The Company's premium activity on a direct, assumed and ceded written basis for the period under examination is detailed below:

Premiums:	2008	2007	2006
Direct Business	\$1,317,331,567	\$1,311,392,474	\$1,254,158,562
Reinsurance Assumed:			
Affiliates	286,820,925	633,147,168	1,144,532
Non-affiliates	85,137,894	64,362,659	34,030,217
Reinsurance Ceded:			
Affiliates	(1,026,876,565)	(1,314,708,938)	(747,699,386)
Non-affiliates	(363,648,865)	(382,404,410)	(371,329,538)
Net Premiums Written	**\$ 298,764,956**	**\$ 311,788,953**	**\$ 170,304,387**

Assumed

Effective January 1, 2007, the Company began assuming the net retained liability on covered business from its three wholly owned insurance subsidiaries, Arch Specialty Insurance Company, Arch Excess and Surplus Insurance Company, and Arch Indemnity Insurance Company. This business is then retroceded to a Bermuda based affiliate, Arch Reinsurance Ltd. (ARL). As of December 31, 2008, all reinsurance recoverables from ARL were fully collateralized by assets held in a trust account.

Effective January 1, 2003, Arch Insurance Company joined the LaReunion Aviation and Space Pool. This pool is a French-organized joint aviation and space branch of the insuring members. Effective December 31, 2007, AIC ceased underwriting new business within the pool; however, loss and LAE payments related to the prior period coverage continue to be incurred. At December 31, 2008, AIC's assumed case losses and loss adjustment expense reserves related to this assumed pool business were \$10.6 million.

AIC also assumes smaller amounts of business from a number of companies and from mandatory pools.

Ceded

Arch Insurance Company has a complex ceded reinsurance program which varies by the type of business written and/or the business division. The general purpose of the reinsurance program is to protect the assets of the Company and thereby its capital and surplus. The retention, limit, and structure of the program will vary based on the gross limits underwritten and the availability of acceptable reinsurance counter-party credit.

The majority of Arch Insurance Company's 2008 ceded premiums, $964.4 million, was ceded to an affiliate, Arch Reinsurance Ltd. (ARL). Effective March 1, 2002, the Company entered into a quota-share agreement with ARL. Under the original terms of this agreement, AIC ceded 90% of all net retained liability arising from all insurance business undertaken, excluding business produced by certain of its business units, namely the Program, Alternative Markets, and Lenders units. Effective January 1, 2003, this agreement was amended to expand the business covered to include AIC's Program business with inception dates or renewal dates on or after January 1, 2003. Effective January 1, 2007, the agreement was amended to reduce the ceding percentage to 80% and expand coverage to include policies assumed from its subsidiaries, Arch Specialty Insurance Company, Arch Excess and Surplus Insurance Company, and Arch Indemnity Insurance Company, but excluding business produced by the (i) Alternative Markets units of such subsidiaries and the Company and (ii) the Company's Canada branch. At December 31, 2008, net amounts recoverable from ARL under this agreement were $2.5 billion and fully secured by a trust account.

The amount ceded under the ARL contract is reduced by amounts ceded to other reinsurers. Prior to invoking the quota share agreement with ARL, AIC cedes a smaller portion of its business, $62 million in ceded premiums for 2008, to two other affiliates, Arch Reinsurance Company and Alternative Re Limited. AIC also cedes business to other unaffiliated authorized and unauthorized reinsurers under a variety of treaty and facultative reinsurance contracts on a quota share and excess of loss basis. For 2008, ceded premiums to unaffiliated reinsurers were $363.6 million with the largest reinsurer accounting for $45.9 million. As of December 31, 2008, net amounts recoverable from unaffiliated reinsurers were $517 million from authorized reinsurers and $146 million from unauthorized reinsurers. Ninety-seven percent (97%) of net recoverables from unaffiliated unauthorized reinsurers were secured by funds held, letters of credit, or trust accounts.

Arch Insurance Company also participates in a multi-cedent property CAT reinsurance program with other members of the ACGL holding company group. This CAT reinsurance program provides $275 million in catastrophic coverage in several layers, excess of the group's $75 million initial retention for 2008. Additional retentions within each CAT coverage layer, totaling $81 million for 2008, along with the initial retention, are shared on a co-participation basis by the group members. Total coverage and retentions for the CAT program are adjusted annually based on the group's risk analysis for the covered period. See the Intercompany Transactions section of this report for discussion of the cost allocation agreement related to this reinsurance contract and similar cost allocation agreements related to other multi-cedent reinsurance contracts.

The Company is contingently liable for all reinsurance losses ceded or retroceded to others. This contingent liability would become an actual liability in the event that an assuming reinsurer fails to perform its obligations under its reinsurance agreement with the Company.

ACCOUNTS AND RECORDS

Jon W. Michelson, FCAS, MAAA, of Expert Actuarial Services, LLC performed an actuarial analysis and review of the Loss and LAE Reserves of Arch Insurance Company as of December 31, 2008 as a consulting actuary for the MO DIFP. The following comments and recommendations are based on Mr. Michelson's review and the MO DIFP's determination of the impact of the findings of his review related to the process and its documentation.

Although the December 31, 2008 Loss and LAE Reserves shown by the Company appear to be reasonable, documentation of actuarial analysis, assumptions, methods, and selections needs to be improved in order for the MO DIFP to be able to rely upon the Company's process and its controls with respect to the establishment of future Loss and LAE Reserves.

Specific concerns noted are as follows:

- AIC's development factor selections relied exclusively on benchmark factors and ignored the Company's own development experience with no clear and convincing documentation to support this approach. For a large block of the analysis, the benchmark factors used were materially and consistently below what was implied by AIC's own development experience.

- Actuarial indicated results were based heavily on expected loss ratios or previously booked loss ratios even for the Company's older and relatively more mature periods. While it was acknowledged that the weighting of various methods' results is a matter of actuarial judgment, in such cases, more weight would typically and appropriately be assigned to projection techniques that give consideration to claim costs actually experienced.

- The Company's *selected* results often seemed to be unrelated to the actuarially *indicated* results with no explanation as to the difference.

The Company is directed to enhance the documentation contained in AIC's actuarial report such that it is sufficient to clearly explain 1.) AIC's development factor selections and the reasons for any significant deviations from AIC's own development experience, especially where such seems consistent and credible; 2.) AIC's stated actuarial indicated results and the reasons for any significant deviations from results based on methods that recognize claim costs actually experienced for relatively mature periods; and 3.) AIC's selected results and the reasons for any significant variation from actuarial indicated results.

STATUTORY DEPOSITS

Deposits with the State of Missouri

The funds on deposit with the MO DIFP as of December 31, 2008, as reflected below, were sufficient to meet the capital deposit requirements for the State of Missouri in accordance with RSMo Section 379.098 (Insurance other than life-Security deposits). The funds on deposit as of December 31, 2008, were as follows:

Type of Security	Par Value	Fair Value	Statement Value
U.S. Treasury Note	$1,500,000	$1,676,080	$1,591,605

Deposits with Other States, Territories, and Countries

The Company also has funds on deposit with various other states, Canada, and the territories of Puerto Rico, the United States Virgin Islands, and Guam. Those funds on deposit as of December 31, 2008 were as follows:

State, Territory, Country	Type of Security	Par Value	Fair Value	Stmt Value
Arizona	U.S. Treasury Notes	$2,700,000	$3,168,180	$2,960,775
Arkansas	U.S. Treasury Note	250,000	269,120	259,273
California	State & Local Bonds	199,355,000	213,500,346	206,902,988
Florida	U.S. Treasury Note	300,000	304,272	303,520
Georgia	U.S. Treasury Note	80,000	89,004	80,317
Idaho	U.S. Treasury Note	605,000	670,257	603,598
Louisiana	U.S. Treasury Note	80,000	89,826	79,168
Massachusetts	U.S. Treasury Note	150,000	167,807	150,327
Montana	U.S. Treasury Note	30,000	33,561	30,065
New Mexico	FNMA Note	400,000	447,428	425,953
North Carolina	U.S. Treasury Note	500,000	571,325	560,129
Oregon	U.S. Treasury Notes	1,860,000	2,004,628	1,946,828
Virginia	FNMA Note	250,000	273,923	264,565
Guam	Time Deposit	55,000	55,000	55,000
Puerto Rico	Commonwealth Bond	1,255,000	1,190,936	1,378,751
US Virgin Islands	U.S. Treasury Note	520,000	581,656	553,739
Canada	Canadian Bonds	43,125,153	57,300,000	55,308,006
Totals		$251,515,153	$280,717,269	$271,863,002

Deposits with the Department of Labor

The Company has funds on deposit required by the U.S. Department of Labor with the Federal Reserve Bank of St. Louis. Those funds on deposit as of December 31, 2008, were as follows:

Type of Security	Par Value	Fair Value	Statement Value
U.S. Treasury Note	$400,000	$406,952	$398,684

Deposits for Letters of Credit

The Company has funds on deposit as collateral for various letters of credit. Those funds on deposit as of December 31, 2008, were as follows:

Type of Security	Par Value	Fair Value	Statement Value
U.S. Treasury Notes	\$4,935,000	\$5,602,795	\$5,335,711

Deposits for Assumed Reinsurance

In addition, the Company has the following trust deposit related to assumed reinsurance as of December 31, 2008:

Deposit Holder	Type of Security	Par Value	Fair Value	Stmt Value
UMB Trust Bank	U.S. Treasury Note	\$200,000	\$224,564	\$197,920

FINANCIAL STATEMENTS

The following financial statements, with supporting exhibits, present the financial condition of Arch Insurance Company for the period ending December 31, 2008. Any examination adjustments to the amounts reported in the financial statements and/or comments regarding such are made in the "Comments on Financial Statement Items." The failure of any column of numbers to add to its respective total is due to rounding or truncation.

There may have been additional differences found in the course of this examination, which are not shown in the "Comments on Financial Statement Items." These differences were determined to be immaterial concerning their effect on the financial statements and therefore were only communicated to the Company and noted in the workpapers for each individual activity.

Assets

	Assets	Non-Admitted Assets	Net Admitted Assets
Bonds	$750,992,197	$ 0	$750,992,197
Common Stocks	350,854,207	0	350,854,207
Cash and Short-term Investments	84,647,767	0	84,647,767
Investment Income Due and Accrued	9,241,311	0	9,241,311
Uncollected Premium and Agents' Balances			
In the Course of Collection	44,184,605	7,080,634	37,103,971
Deferred Premiums, Agents' Balances and Installments Booked and Not Yet Due	112,147,100	1,420,069	110,727,031
Amounts Recoverable from Reinsurers	42,167,321	0	42,167,321
Funds Held by or Deposited with Reinsured Companies	2,144,683	0	2,144,683
Other Amounts Receivable Under Reinsurance	720,294	0	720,294
Net Deferred Tax Asset	59,323,309	25,893,038	33,430,271
Electronic Data Processing Equip. and Software	7,621	7,621	0
Furniture and Equipment	690,654	690,654	0
Receivable from Parent and Affiliates	1,088,309	0	1,088,309
Aggr. Write-Ins for Other than Invested Assets:			
Advance Claim Payments	83,786,150	0	83,786,150
Equity and Deposits in Pools and Associations	24,366,929	0	24,366,929
Deductible Recovery	27,331,590	1,054,299	26,277,291
Claim Deposits	5,633,842	0	5,633,842
Other Assets Nonadmitted	16,968,964	16,968,964	0
Miscellaneous Receivables	1,896	405	1,491
TOTAL ASSETS	**$1,616,298,749**	**$53,115,684**	**$1,563,183,065**

Liabilities, Surplus and Other Funds

Losses	$404,643,349
Reinsurance Payable on Paid Losses and Loss Adjustment Expenses	2,287,817
Loss Adjustment Expenses	112,559,088
Commissions Payable, Contingent Commissions and Other Similar Charges	6,503,528
Other Expenses (Excluding Taxes, Licenses and Fees)	1,674,541
Taxes, Licenses and Fees (Excluding Federal and Foreign Income Taxes)	12,765,594
Current Federal and Foreign Income Taxes	2,066,444
Unearned Premiums	132,136,368
Dividends Declared and Unpaid – Policyholders	1,679,171
Ceded Reinsurance Premiums Payable (Net of Ceding Commissions)	79,021,882
Funds Held by Company Under Reinsurance Treaties	25,407,455
Amounts Withheld or Retained by Company for Account of Others	97,144,472
Remittances and Items Not Allocated	31,338,532
Provision for Reinsurance	8,559,336
Payable to Parent, Subsidiaries and Affiliates	8,673,252
Aggregate Write-Ins for Liabilities:	
Deferred Ceding Commission Liability	39,459,836
Claims Payable	9,510,496
Return Premium Payable	6,515,472
Reserve for Deferred TPA Fee	2,187,870
Other Liabilities	2,037,274
TOTAL LIABILITIES	**$986,171,777**
Common Capital Stock	5,000,000
Gross Paid In and Contributed Surplus	433,096,394
Unassigned Funds (Surplus)	138,914,894
Surplus as Regards Policyholders	**$577,011,288**
TOTAL LIABILITIES AND SURPLUS	**$1,563,183,065**

Summary of Operations

Underwriting Income:	
Premiums Earned	$306,648,650
Deductions:	
Losses Incurred	176,750,374
Loss Adjustment Expenses Incurred	53,245,990
Other Underwriting Expenses Incurred	73,180,999
Net Underwriting Gain or (Loss)	**$3,471,287**
Investment Income:	
Net Investment Income Earned	$28,895,549
Net Realized Capital Gains or (Losses)	4,261,922
Net Investment Gain or (Loss)	**$33,157,471**
Other Income:	
Net Gain or (Loss) from Agents' or Premium Balances Charged Off	($881,824)
Finance and Service Charges Not Included in Premiums	198,954
Aggregate Write-ins for Miscellaneous Income:	
Fee Income – Miscellaneous	1,087,049
Realized Foreign Exchange Gain (Loss)	317,364
Intercompany Interest Income	8,828
Miscellaneous Gain (Loss)	($198,954)
Total Other Income	**$531,417**
Net Income Before Dividends to Policyholders and Income Taxes	$37,160,175
Dividends to Policyholders	186,051
Net Income Before Federal and Foreign Income Taxes	**$36,974,124**
Federal and Foreign Income Taxes Incurred	14,699,309
NET INCOME	**$22,274,815**

Capital and Surplus Account

Surplus as Regards Policyholders, December 31, 2007	\$540,547,567
Net Income	22,274,815
Change in Net Unrealized Capital Gains or (Losses)	11,811,596
Change in Net Unrealized Foreign Exchange Capital Gain (Loss)	(6,493,035)
Change in Net Deferred Income Tax	6,488,449
Change in Non-Admitted Assets	(8,160,710)
Change in Provision for Reinsurance	(2,770,014)
Surplus Adjustment: Paid In	13,312,620
Examination Change	(0)
Net Change in Surplus as Regards Policyholders for 2008	**\$36,463,721**
Surplus as Regards Policyholders, December 31, 2008	**\$577,011,288**

FINANCIAL STATEMENT CHANGES RESULTING FROM EXAMINATION

None.

COMMENTS ON FINANCIAL STATEMENT ITEMS

None.

SUMMARY OF RECOMMENDATIONS

Intercompany Transactions (page 10)

Although the Property Catastrophe Excess of Loss Reinsurance Cost Allocation Agreement has been approved by MO DIFP, it has not received the required approval from the Nebraska Department of Insurance (NDI) and consequently has not been executed by the Company. The Company should work with NDI and MO DIFP to modify this agreement such that it is acceptable to both states, obtain the required approvals, and execute the agreement.

Intercompany Transactions (page 11)

AIC is party to more than twenty-five multi-cedent reinsurance agreements which do not contain an allocation agreement nor is there a separate written intercompany agreement to address allocation as required by SSAP #62, Property and Casualty Reinsurance, paragraph 9. Arch Insurance Company should develop one or more written intercompany agreement(s) which detail how reinsurance premiums due and reinsurance payments received are split between the ACGL group companies, and establish a timeframe for making the disbursements. Prior to executing the agreements, the Company must obtain approval from the domiciliary states of the parties to the agreement. MO DIFP approval is required pursuant to RSMo 382.195 (Prohibited transactions, exceptions).

Accounts and Records (page 18)

Although the December 31, 2008 Loss and LAE Reserves shown by the Company appear to be reasonable, documentation of actuarial analysis, assumptions, methods, and selections needs to be improved in order for the MO DIFP to be able to rely upon the Company's process and its controls with respect to the establishment of future Loss and LAE Reserves. The Company is directed to enhance the documentation contained in AIC's actuarial report such that it is sufficient to clearly explain 1.) AIC's development factor selections and the reasons for any significant deviations from AIC's own development experience, especially where such seems consistent and credible; 2.) AIC's stated actuarial indicated results and the reasons for any significant deviations from results based on methods that recognize claim costs actually experienced for relatively mature periods; and 3.) AIC's selected results and the reasons for any significant variation from actuarial indicated results.

ACKNOWLEDGMENT

The assistance and cooperation extended by the officers and the employees of Arch Insurance Company during the course of this examination is hereby acknowledged and appreciated. In addition to the undersigned, Al Garon, CFE, Steven Koonse, CFE, Bernie Troop, CFE, and Timothy Carroll, examiners for the MO DIFP, participated in this examination. Jon W. Michelson, FCAS, MAAA, of Expert Actuarial Services, LLC also participated as a consulting actuary.

RECEIVED
MAY 14 2010
DEPT OF INSURANCE, FINANCIAL INSTITUTIONS & PROFESSIONAL REGISTRATION

VERIFICATION

State of Missouri)
County of)

I, Vicki L. Denton, on my oath swear that to the best of my knowledge and belief the above examination report is true and accurate and is comprised of only facts appearing upon the books, records or other documents of Arch Insurance Company, its agents or other persons examined or as ascertained from the testimony of its officers or agents or other persons examined concerning its affairs and such conclusions and recommendations as the examiners find reasonably warranted from the facts.

Vicki L. Denton

Vicki L. Denton, CFE
Examiner-In-Charge
MO DIFP

Sworn to and subscribed before me this 13th day of May, 2010.
My commission expires: 5-14-2012 Sheila R. Briscoe
Notary Public

SHEILA R. BRISCOE NOTARY PUBLIC STATE OF KANSAS My Appt. Expires 5-14-2012

State of Kansas)
County of Johnson)

I, David Carter, on my oath swear that to the best of my knowledge and belief the above examination report is true and accurate and is comprised of only facts appearing upon the books, records or other documents of Arch Insurance Company, its agents or other persons examined or as ascertained from the testimony of its officers or agents or other persons examined concerning its affairs and such conclusions and recommendations as the examiners find reasonably warranted from the facts.

David Carter

David Carter, CFE
California Department of Insurance
Representing NAIC Western Zone

Sworn to and subscribed before me this 4th day of May, 2010.
My commission expires: September 30, 2012 MaryAnn Mangione
Notary Public
MaryAnn Mangione
Notary Public
CONNECTICUT
Fairfield County
My Commission Expires Sept. 30, 2012

MaryAnn Mangione NOTARY PUBLIC CONNECTICUT

SUPERVISION

The examination process has been monitored and supervised by the undersigned. The examination report and supporting workpapers have been reviewed and approved. Compliance with NAIC procedures and guidelines as contained in the Financial Condition Examiners Handbook has been confirmed.

Mark Nance, CFE, CPA
Audit Manager
MO DIFP

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Martin J. Nilsen
Senior Vice President,
Secretary & General Counsel
Group Compliance Officer
Email: mnilsen@archinsurance.com
Telephone: 201.743.4123 Direct

June 4, 2010

VIA E-MAIL AND PRIORITY MAIL

Mr. Frederick G. Heese, CFE, CPA
Department of Insurance,
Financial Institutions and Professional Registration
Division of Insurance Company Regulation
301 West High Street, Room 530
P.O. Box 690
Jefferson City, MO 65102-0690

Attention: Ms. Tammy Rodieck (via E-Mail and Priority Mail)

Re: *Examination Report of Arch Insurance Company*

Dear Mr. Heese:

This will acknowledge receipt of your letter dated April 29, 2010, addressed to Mr. Mark Lyons, President of Arch Insurance Company ("AIC" or the "Company"), and the Examination Report (the "Report") of Arch Insurance Company for the period ending December 31, 2008, which accompanied your letter.

Your letter states that the Company has 30 days in which to submit to the Missouri Department of Insurance, Financial Institutions and Professional Registration (the "MO DIFP") in writing any response or rebuttal to the Report, and further states that the Company should indicate in such response whether it is the Company's wish that such response or rebuttal is to be included in the Report as a public document. In addition, your letter requires that the Company set forth its responses to the General Comments and/or Recommendations section of the Report, and indicate any corrective action that has been or will be taken by the Company. This letter will constitute our response to the Report generally and to the Recommendations set forth on pages 24 and 25 of the Report specifically, and will provide the Company's comments intended to clarify the observations and findings as contained in the Report related to the Company's reserves. **Please consider this a request to include our response in the Report as a public document.**

Before we set forth our final responses, we would ask that you review the minor comments and corrections noted on the attached marked pages from the Report.

Responses to Recommendations

With respect to the Recommendations (which, for ease of reference, are reproduced herein), our responses are set forth below.

Intercompany Transactions (page 10)

Recommendation

Although the Property Catastrophe Excess of Loss Reinsurance Cost Allocation Agreement has been approved by MO DIFP, it has not received the required approval from the Nebraska Department of Insurance (the "NDI") and consequently has not been executed by the Company. The Company should work with NDI and MO DIFP to modify this agreement such that it is acceptable to both states, obtain the required approvals, and execute the agreement.

Response

The Company has worked to comply with changes requested by the NDI and expects to resubmit the agreement in acceptable format to both the NDI and the MO DIFP within the next 60 days in order to seek requisite approvals.

Intercompany Transactions (page 11)

Recommendation

AIC is party to more than twenty-five multi-cedent reinsurance agreements which do not contain an allocation agreement nor is there a separate written intercompany agreement to address allocation as required by SSAP #62, Property and Casualty Reinsurance, paragraph 9. Arch Insurance Company should develop one or more written intercompany agreement(s) which detail how reinsurance premiums due and reinsurance payments received are split between the [Arch Capital Group Ltd. ("ACGL")] group companies, and establish a timeframe for making the disbursements. Prior to executing the agreements, the Company must obtain approval from the domiciliary states of the parties to the agreement. MO DIFP approval is required pursuant to RSMo 382.195 (Prohibited transactions, exceptions).

Response

The Company is in the process of preparing a written intercompany agreement specifying the method by which reinsurance premiums due and reinsurance payments received are to be allocated among the ACGL companies and setting forth a timeline for making disbursements. The agreement will be submitted for the approval from domiciliary regulators as required.

Accounts and Records (page 18)

Recommendation

Although the December 31, 2008 Loss and LAE Reserves shown by the Company appear to be reasonable, documentation of actuarial analysis, assumptions, methods, and selections needs to be improved in order for the MO DIFP to be able to rely upon the Company's process and its controls with respect to the establishment of future Loss and LAE Reserves. The Company is directed to enhance the documentation contained in AIC's actuarial report such that it is sufficient to clearly explain 1.) AIC's development factor selections and the reasons for any significant deviations from AIC's own development experience, especially where such seems consistent and credible 2.) AIC's stated actuarial indicated results and the reasons for any significant deviations from results based on methods that recognize claim costs actually experienced for relatively mature periods; and 3.) AIC's selected results and the reasons for any significant variation from the actuarial indicated results.

Response

The Company will comply with the above directives to enhance the documentation for its actuarial reports to explain development factor selections, stated actuarial indicated results and selected results.

Comments on Reserves

The following comments will provide clarification of the Report's observations and findings related to reserves (within the Accounts and Records section on page 18 of the Report).

The key finding articulated in the Accounts and Records section of the Report is the conclusion by Expert Actuarial Services, LLC ("EAS") that Arch's reserves as of 12/31/2008 are reasonable. This is consistent with the views of other third parties who reviewed Arch's 12/31/08 reserves and, concluded that Arch's reserves were adequate to slightly redundant.

Given this fact, the "specific concerns" identified by EAS are inconsistent with these independent conclusions. We have never before received similar comments as referenced in this Report, which in conjunction with the financial conclusion of the Report may indicate that these items relate more to actuarial judgment regarding process but which do not have a material impact on the overall results.

In addressing the "specific concerns" outlined in the Accounts and Records section of the Report, we offer the following:

Our approach to arriving at a reasonable reserve level has focused on the establishment and setting of reasonable expected loss ratios ("ELR's") and Plan loss ratios, utilizing, among other factors, industry loss development factors. We believe that, as of 12/31/2008, Arch's own historical loss development was still not credible, not stable, and not mature enough to be relied upon for loss development factor selections. In addition, the mix of business within each division has changed as each division moved from the initial development stage to initial product offerings to expanded product offerings. This change in mix has a more material impact on the loss development triangles such that a longer time period will be needed for development factor credibility than if the mix had stayed constant from day one. That said, we do intend during 2010 to supplement the use of industry loss development factors with Arch's own development to varying degrees depending on the line of business. The amount of weight given to company development is a professional difference of opinion, which is common in preparing actuarial projections and estimates. What we question is the conclusion drawn that "benchmark factors used were materially and consistently below what was implied by Arch's own development experience." Given our position regarding the lack of credibility in earlier ages of loss development, there is an even greater lack of credibility in using Arch's own data on which to base tail factors. Given the changes in mix of business noted previously and our judgment that the data lacked sufficient credibility to be relied upon in selecting loss development factors, we felt that the utilization of benchmark industry patterns over the entire development period was more appropriate for Arch's book of business at year-end 2008.

Arch's selection of ELR's reflects thoughtful and thorough consideration of pricing expectations, loss and premium trends, and external factors impacting loss ratio experience. The use of well-thought-out ELR's and the Expected Loss Ratio reserving method is a well established, widely used, and sound method to rely on in selecting ultimate loss ratios. Similar to our comments on the loss development above, Arch's reliance on ELR's in addition to the Bornhuetter-Ferguson and loss development methods takes into consideration the stability, maturity and credibility of the company's loss data in determining the amount of weight given to each method. As mentioned in the Report, the weighting of methods is a matter of actuarial judgment and consistent with the findings in this Report as well as the other independent reserve reviews, we feel the methods utilized are appropriate for our book of business and have produced reasonable loss reserve estimates.

Arch's selected results are directly related to the actuarially indicated results. The Report does not consider the fact that the methods Arch relied upon are valid, well established and sound methods and are directly related to what the definition of "actuarially indicated results" means. We believe it to mean the culmination of all the analyses, methods, judgments, and selections made by the Company's reserving function and not necessarily the results of a mechanical, rote set of calculations.

The comments regarding the need to enhance the documentation contained in the actuarial report are duly noted. In the latter half of 2008, there was a transition to a new corporate actuary. As part of that transition, the reserving methodologies and documentation were enhanced during 2009. Further enhancements have continued during 2010 and are expected to continue in 2011 and beyond.

During 2009, some of the enhancements made included:

- a refinement of the reserve groups and reserve methodologies
- an enhanced ELR analysis
- enhanced long duration contract and premium reserve deficiency analyses

- additional documentation

During 2010, some of the enhancements underway include:

- a loss development factor study using industry loss development factors complemented with Arch's own development in varying degrees depending on the line of business
- experience exhibits

All of these enhancements are consistent with the documentation directive in the Accounts and Records summary (page 25).

In conclusion, the "specific concerns" referenced previously are directly related to differences in actuarial judgment. Several actuaries each applying their own set of actuarial judgments independently concluded that Arch's reserves were reasonable as of 12/31/2008.

Please do not hesitate to contact the undersigned in the event you have any questions.

Sincerely,

Martin J. Nilsen

MJN/tf

cc: Ms. Vicki L. Denton – via e-mail and priority mail
Mr. Mark D. Lyons – via e-mail
Mr. Dennis R. Brand – via e-mail
Mr. Fred S. Eichler – via e-mail
Mr. Thomas Ahern – via e-mail
Mr. Brian Hughes – via e-mail
Ms. Janet Lindstrom – via e-mail

Attachments enclosed