

HCC INSURANCE HOLDINGS INC/DE/

Form 10-K

March 01, 2010

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

Form 10-K

- b ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934.**
- o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934.**
- For the fiscal year ended December 31, 2009**

Commission file number 001-13790

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

Delaware
*(State or other jurisdiction of incorporation or
organization)*

76-0336636
(IRS Employer Identification No.)

**13403 Northwest Freeway,
Houston, Texas**
(Address of principal executive offices)

77040-6094
(Zip Code)

(713) 690-7300

(Registrant's telephone number, including area code)

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

Title of Each Class:	Name of Each Exchange on Which Registered:
Common Stock, \$1.00 par Value	New York Stock Exchange

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

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Indicate by check mark if the registrant is a well-known seasoned issuer as defined in Rule 405 of the Securities Act. Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act. Yes No

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 No

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§ 229.405 of this chapter) is not contained herein and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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 definition of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

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

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

The aggregate market value on June 30, 2009 (the last business day of the registrant's most recently completed second fiscal quarter) of the voting stock held by non-affiliates of the registrant was approximately \$2.7 billion. For purposes of the determination of the above-stated amount, only Directors and executive officers are presumed to be affiliates, but neither the registrant nor any such person concede that they are affiliates of the registrant.

The number of shares outstanding of the registrant's Common Stock, \$1.00 par value, at February 19, 2010 was 114.6 million.

DOCUMENTS INCORPORATED BY REFERENCE:

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

HCC INSURANCE HOLDINGS, INC.

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FORWARD-LOOKING STATEMENTS

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

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

the effects of catastrophic losses,

the cyclical nature of the insurance business,

inherent uncertainties in the loss estimation process, which can adversely impact the adequacy of loss reserves,

the impact of the credit market downturn and subprime market exposures,

the effects of emerging claim and coverage issues,

the effects of extensive governmental regulation of the insurance industry,

potential credit risk with brokers,

the effects of industry consolidation,

our assessment of underwriting risk,

our retention of risk, which could expose us to potential losses,

the adequacy of reinsurance protection,

the ability and willingness of reinsurers to pay balances due us,

the occurrence of terrorist activities,

our ability to maintain our competitive position,

changes in our assigned financial strength ratings,

our ability to raise capital and funds for liquidity in the future,

attraction and retention of qualified employees,

fluctuations in securities markets, which may reduce the value of our investment assets, reduce investment income or generate realized investment losses,

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

impairment of goodwill,

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

fluctuations in foreign exchange rates,

failures or constraints of our information technology systems,

potential changes to the country's health care delivery system,

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the effect, if any, of climate change, on the risks we insure,

change of control, and

difficulties with outsourcing relationships.

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

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

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

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PART I

Item 1. *Business*

Business Overview

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

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

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

Since our founding, we have been consistently profitable, generally reporting annual increases in total revenue and shareholders' equity. During the period 2005 through 2009, we had an average statutory combined ratio of 86.5% versus the less favorable 98.7% (source: A.M. Best Company, Inc.) recorded by the U.S. property and casualty insurance industry overall. During the period 2005 through 2009, our gross written premium increased from \$2.0 billion to \$2.6 billion, an increase of 26%, while net written premium increased 36% from \$1.5 billion to \$2.0 billion. During this period, our revenue increased from \$1.6 billion to \$2.4 billion, an increase of 45%. During the period December 31, 2005 through December 31, 2009, our shareholders' equity increased 78% from \$1.7 billion to \$3.0 billion and our assets increased 26% from \$7.0 billion to \$8.8 billion.

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

Diversified financial products

Group life, accident and health

Aviation

London market account

Other specialty lines

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Our insurance companies have strong financial strength ratings. Standard & Poor's Corporation, Fitch Ratings, Moody's Investors Service, Inc. and A.M. Best Company, Inc. are internationally recognized independent rating agencies. These financial strength ratings are intended to provide an independent opinion of an insurer's ability to meet its obligations to policyholders and are not evaluations directed at investors. Our financial strength ratings as of December 31, 2009 were as follows:

Companies	Standard & Poor's	Fitch Ratings	Moody's	A.M. Best
Domestic insurance companies				
American Contractors Indemnity Company	AA	AA		A
Avemco Insurance Company	AA	AA		A+
HCC Life Insurance Company	AA	AA	A1	A+
HCC Specialty Insurance Company	AA	AA		A+
Houston Casualty Company	AA	AA	A1	A+
Perico Life Insurance Company		AA		A
U.S. Specialty Insurance Company	AA	AA	A1	A+
United States Surety Company	AA	AA		A
International insurance companies				
HCC International Insurance Company	AA			
HCC Europe	AA			
HCC Reinsurance Company	AA			

Standard & Poor's AA (Very Strong) rating is the 3rd highest of their 23 ratings. Fitch Ratings AA (Very Strong) is the 3rd highest of their 21 ratings. Moody's A1 (Good Security) is the 5th highest of their 21 ratings. A.M. Best's A+ (Superior) is the 2nd highest and A (Excellent) is the 3rd highest of their 16 ratings.

Lloyd's of London, the insurance market through which our two Lloyd's syndicates operate, is composed of numerous managing agents that run independent underwriting syndicates. Participants in each syndicate provide a specified amount of capital to support the syndicate's business. If needed, any shortfall in a syndicate's capital is supported by Lloyd's Central Fund. Lloyd's of London is rated A+ by Fitch Ratings and Standard & Poor's and A by A.M. Best.

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

Our Strategy

Our business philosophy is to maximize underwriting profits while limiting risk in order to preserve shareholders equity and maximize earnings. We concentrate our insurance writings in selected specialty lines of business in which we believe we can achieve an underwriting profit. We also rely on our experienced underwriting personnel and our access to and expertise in the reinsurance marketplace to achieve our strategic

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objectives. We market our insurance products both directly to customers and through affiliated and independent brokers, agents, producers and third party administrators.

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

In our insurance operations, we believe our operational flexibility, which permits us to shift the focus of our insurance underwriting activity among our various lines of business, allows us to implement a strategy of emphasizing more profitable lines of business during periods of increased premium rates and de-emphasizing less profitable lines of business during periods of increased competition.

Following a period in which premium rates rose substantially, premium rates in several of our lines of business became more competitive during the past six years. The rate decreases were more gradual than the prior rate increases; thus, our underwriting activities remain profitable. During the past several years, we expanded our underwriting activities and increased our retentions in lines of business with favorable expected profitability. We were able to accomplish this due to the increased diversification provided by our overall book of business and due to our increased capital strength. These higher retention levels increased our net written and earned premium and have resulted in additional underwriting profits, investment income and net earnings.

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

When we decide to retain more underwriting risk in a particular line of business, we do so with the intention of retaining a greater portion of any underwriting profits. In this regard, we may purchase less proportional or quota share reinsurance, thus accepting more of the risk but possibly replacing it with specific excess of loss reinsurance, in which we transfer to reinsurers both premium and losses on a non-proportional basis for individual and catastrophic occurrence risks above a retention point. Additionally, we may obtain facultative reinsurance protection on individual risks. In some cases, we may choose not to purchase reinsurance in a line of business in which we believe there has been a favorable loss history, our policy limits are relatively low and we determine there is a low likelihood of catastrophe exposure.

We also acquire businesses and hire new underwriting teams that we believe present opportunities for future profits and enhancement of our business. We expect to continue to acquire complementary businesses and add underwriting teams. We believe that we can enhance acquired businesses and platforms for new underwriting teams with our infrastructure, ratings and financial strength.

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

In our ongoing operations, we will continue to:

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

maintain a highly non-correlated portfolio of business,

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

consider the potential acquisition of specialty insurance operations and the hiring of underwriting teams.

Industry Segment and Geographic Information

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

Acquisitions

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

On January 2, 2008, we acquired HCC Medical Insurance Services, LLC (formerly MultiNational Underwriters, LLC), an underwriting agency located in Indianapolis, Indiana, for cash consideration of \$42.7 million and possible additional cash consideration depending upon future underwriting profit levels. This agency writes domestic and international short-term medical insurance through Syndicate 4141 at Lloyd's of London.

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

On February 27, 2009, we acquired Surety Company of the Pacific, a leading California writer of license and permit bonds in the western United States, headquartered in Encino, California.

We continue to evaluate acquisition opportunities, and we may complete additional acquisitions during 2010. Any future acquisitions will be designed to expand and strengthen our existing lines of business or to provide access to additional specialty sectors, which we expect to contribute to our overall growth.

Insurance Company Operations

Lines of Business

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

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companies' total premium written, otherwise known as gross written premium, by line of business and the percentage of each line to total gross written premium (dollars in thousands).

	2009		2008		2007	
Diversified financial products	\$ 1,147,913	45%	\$ 1,051,722	42%	\$ 963,355	39%
Group life, accident and health	846,041	33	829,903	33	798,684	33
Aviation	176,073	7	185,786	8	195,809	8
London market account	186,603	7	175,561	7	213,716	9
Other specialty lines	203,009	8	251,021	10	280,040	11
Discontinued lines of business	152		4,770		(425)	
Total gross written premium	\$ 2,559,791	100%	\$ 2,498,763	100%	\$ 2,451,179	100%

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

	2009		2008		2007	
Diversified financial products	\$ 915,595	45%	\$ 872,007	42%	\$ 771,648	39%
Group life, accident and health	796,778	39	789,479	38	759,207	38
Aviation	124,336	6	136,019	7	145,761	7
London market account	102,407	5	107,234	5	118,241	6
Other specialty lines	107,047	5	151,120	8	191,151	10
Discontinued lines of business	126		4,759		(399)	
Total net written premium	\$ 2,046,289	100%	\$ 2,060,618	100%	\$ 1,985,609	100%

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

	2009	2008	2007
Diversified financial products	80%	83%	80%
Group life, accident and health	94	95	95
Aviation	71	73	74
London market account	55	61	55
Other specialty lines	53	60	68
Consolidated percentage retained	80%	82%	81%

Diversified Financial Products

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

directors and officers liability

employment practices liability

errors and omissions liability

surety and credit

fidelity

various financial products

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

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In 2002 and 2003, following several years of insurance industry losses, significant rate increases were experienced throughout our diversified financial products line of business, particularly directors and officers liability, which we began underwriting in 2002. We benefited greatly from these improved conditions despite the fact that we had not been involved in the past losses. Rates softened between 2004 and 2009 for some of the products in this line, but some of the products had rate increases in 2008 and 2009. Our underwriting margins remain profitable. There is also considerable investment income derived from diversified financial products due to the extended periods involved in any claims resolution. Although individual losses in the directors and officers public company liability business and portions of our U.S. errors and omissions business may have potential severity, the remainder of the diversified financial products business is less volatile with relatively low limits.

Group Life, Accident and Health

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

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

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

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

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

Aviation

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

antique and vintage military aircraft

cargo operators

commuter airlines

corporate aircraft

fixed base operations

military law enforcement aircraft

private aircraft owners

rotor wing aircraft

We offer coverages that include hulls, engines, avionics and other systems, liabilities, cargo and other ancillary coverages. We generally do not insure major airlines and major manufacturers. Insurance claims

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related to general aviation business tend to be seasonal, with the majority of the claims being incurred during warm weather months.

We are one of the largest writers of personal aircraft insurance in the United States. Our aviation gross premium has remained relatively stable since 1998, but it has decreased slightly in 2007 through 2009 due to competition and decreasing rates, principally in the domestic business. We have generally increased our retentions since 1998 as this business is predominantly written with small limits and has generally predictable results.

London Market Account

Our London market account business consists of marine, energy, property, and accident and health business and has been primarily underwritten by Houston Casualty Company's London branch office. During 2006, we began to utilize HCC International Insurance Company to underwrite the non-U.S. based risks for this line of business. Beginning in 2009, we have utilized our Lloyd's of London Syndicate 4141 to write certain of this business. We expect to increase the use of that platform in the future.

This line includes a significant portion of our catastrophe exposures. We have underwritten these risks for more than 15 years, increasing or decreasing our premium volume depending on market conditions, which can be very volatile in this line. The following table presents the details of net premium written within the London market account line of business (in thousands).

	2009	2008	2007
Marine	\$ 14,373	\$ 14,413	\$ 30,685
Energy	43,807	44,554	45,962
Property	22,941	28,827	19,856
Accident and health	21,286	19,440	21,738
Total London market account net written premium	\$ 102,407	\$ 107,234	\$ 118,241

Marine

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

Energy

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

drilling rigs

gas production and gathering platforms

natural gas facilities

petrochemical plants

pipelines

refineries

The market was soft for this business and rates were at relatively low levels from the late 1990 s through 2004. During this period, we underwrote the business selectively and also bought large amounts of facultative reinsurance to protect our exposure to risk. Hurricane Ivan produced large energy losses to the industry in 2004 and both Hurricane Katrina and Rita produced large losses to the industry in 2005. A very hard market developed for underwriting year 2006, with large rate increases and restrictive policy terms, including imposition of aggregate named windstorm limits in vulnerable areas, rather than just occurrence limits. We had ample capacity to increase our business in this line, and did so due to the attractive prices and terms in 2006 for taking the additional underwriting risk. After a very profitable 2006, prices weakened in 2007 and 2008, but at levels we still considered reasonable, and we generally maintained our book at similar exposure levels as in 2006. In 2008, Hurricane Ike produced large losses to the industry, which resulted in another upswing in pricing in 2009. Although we had growth in premium due to the rising rates in 2009, the growth

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was limited due to policyholders choosing to self insure portions of their insurance programs that they formerly insured. During the large catastrophe period of 2004 – 2008, we were able to generate profits from the business due to the individual hurricane losses remaining within our expectations and within the excess of loss reinsurance purchased by us to cover such events.

Property

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

factories	office buildings
hotels	retail locations
industrial plants	utilities

We have written property business since 1986, including business interruption, physical damage and catastrophe risks, such as flood and earthquake. Rates increased significantly following September 11, 2001, but trended downward by 2005 despite the hurricane activity in 2004. Massive losses from hurricanes in 2005 resulted in substantial rate increases, but due to over capacity, policy conditions have remained unchanged, unlike energy risks. Accordingly, we substantially reduced our involvement in policies with coastal exposures in the Florida and U.S. Gulf Coast regions. We continue to buy substantial catastrophe reinsurance, unlike many industry participants, which was shown to be adequate during 2004 and 2005 when large amounts of industry capital were lost. While the hurricane activity seriously affected our earnings in the third quarters of 2004 and 2005, we still were able to produce record annual earnings in those years. This business was profitable in 2006, 2007 and 2009 as there were no significant catastrophe losses, and in 2008 despite the losses from two hurricanes.

In the fourth quarter of 2009, we added an underwriting team to write property treaty reinsurance.

Accident and Health

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

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

Other Specialty Lines

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

Insurance Companies and Lloyd's of London Syndicates

Houston Casualty Company

Houston Casualty Company is our largest insurance company subsidiary. It is domiciled in Texas and insures risks worldwide. Houston Casualty Company underwrites business produced by independent agents and brokers, affiliated underwriting agencies, reinsurance brokers, and other insurance and reinsurance companies. Houston Casualty Company writes diversified financial products, aviation, London market account

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and other specialty lines of business. Houston Casualty Company's 2009 gross written premium, including Houston Casualty Company-London, its United Kingdom branch, was \$539.4 million.

Houston Casualty Company-London

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

HCC International Insurance Company

HCC International Insurance Company PLC writes diversified financial products business, primarily surety, credit and professional indemnity products, and non-United States based London market account risks. HCC International Insurance Company has been in operation since 1982 and is domiciled in the United Kingdom. HCC International Insurance Company's 2009 gross written premium was \$231.0 million. We intend to continue to expand the underwriting activities of HCC International Insurance Company and to use it as an integral part of a European platform for our international insurance operations.

Lloyd's of London Syndicates

We currently participate in Lloyd's of London Syndicate 4040, which writes business included in our other specialty lines of business, and Lloyd's of London Syndicate 4141, which writes business in our diversified financial products, London market account and group life, accident and health lines of business. These syndicates are managed by HCC Underwriting Agency, Ltd. (UK). Syndicate 4040 will merge into Syndicate 4141 in 2013, after the 2009 year of account is closed in accordance with Lloyd's rules. We expect to use our Lloyd's platform and the licenses it affords us to write business unique to Lloyd's and business in countries where our other insurance companies are not currently licensed.

HCC Europe

Houston Casualty Company Europe, Seguros y Reaseguros, S.A. is a Spanish insurer. It underwrites diversified financial products business. HCC Europe has been an issuing carrier for diversified financial products business underwritten by affiliated underwriting agencies. Beginning in 2010, this business will be underwritten by HCC International Insurance Company. HCC Europe has been in operation since 1978. HCC Europe's gross written premium in 2009 was \$115.8 million.

HCC Reinsurance Company

HCC Reinsurance Company Limited is a Bermuda-domiciled reinsurance company that writes assumed reinsurance from our insurance companies and a limited amount of direct insurance. HCC Reinsurance Company is an issuing carrier for diversified financial products business underwritten by our underwriting agency, HCC Indemnity Guaranty. HCC Reinsurance Company's gross written premium in 2009 was \$122.8 million.

U.S. Specialty Insurance Company

U.S. Specialty Insurance Company is a Texas-domiciled property and casualty insurance company. It primarily writes diversified financial products, aviation and accident and health business. U.S. Specialty Insurance Company acts as an issuing carrier for certain business underwritten by our underwriting agencies. U.S. Specialty Insurance Company's gross written premium in 2009 was \$656.5 million.

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HCC Life Insurance Company

HCC Life Insurance Company is an Indiana-domiciled life insurance company. It operates as primarily a larger group life, accident and health insurer. Its primary products are medical stop-loss and medical excess business. This business is primarily produced by unaffiliated agents, brokers and third party administrators. HCC Life Insurance Company's gross written premium in 2009 was \$674.8 million.

Perico Life Insurance Company

Perico Life Insurance Company is a Delaware-domiciled life insurance company. Perico Life Insurance Company now operates as primarily a small group life, accident and health insurer. Its principal product is medical stop-loss business. Perico Life Insurance Company's 2009 gross written premium was \$84.1 million.

Avemco Insurance Company

Avemco Insurance Company is a Maryland-domiciled property and casualty insurer and operates as a direct market underwriter of general aviation business. It has also been an issuing carrier for accident and health business and some other lines of business underwritten by our underwriting agencies and a previously affiliated underwriting agency. Avemco Insurance Company's gross written premium in 2009 was \$40.9 million.

American Contractors Indemnity Company

American Contractors Indemnity Company is a California-domiciled surety company. It writes court, specialty contract, license and permit, and bail bonds. American Contractors Indemnity Company has been in operation since 1990 and operates as a part of our HCC Surety Group. American Contractors Indemnity Company's 2009 gross written premium was \$101.4 million.

United States Surety Company

United States Surety Company is a Maryland-domiciled surety company that has been in operation since 1996. It writes contract bonds and operates as a part of our HCC Surety Group. United States Surety Company's 2009 gross written premium was \$22.2 million.

HCC Specialty Insurance Company

HCC Specialty Insurance Company is an Oklahoma-domiciled property and casualty insurance company in operation since 2002. It writes diversified financial products and other specialty lines of business produced by affiliated underwriting agencies. HCC Specialty Insurance Company's gross written premium in 2009 was \$20.5 million and was 100% ceded to Houston Casualty Company.

Underwriting Agency Operations

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

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

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insurance companies may reinsure all or part of the business. Our underwriting agencies generated total revenue in 2009 of \$182.1 million.

Professional Indemnity Agency

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

HCC Specialty Underwriters

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

HCC Global Financial Products

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

HCC Indemnity Guaranty Agency

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

HCC Underwriting Agency

HCC Underwriting Agency, Ltd. (UK) is a managing agent for two Lloyd's of London syndicates, Syndicates 4040 and 4141. HCC Underwriting Agency, Ltd. (UK) has been in operation since 2004.

HCC Medical Insurance Services

HCC Medical Insurance Services, LLC, based in Indianapolis, Indiana, is an underwriting agency specializing in domestic and international short-term medical insurance, which is written principally through an internet platform. The domestic business is written on behalf of one of our domestic insurance companies and the international business is written by Lloyd's of London Syndicate 4141.

Other Operations

In the past, we invested in insurance related entities, had a trading portfolio of securities and issued a mortgage guaranty contract, which was accounted for utilizing deposit accounting. We have sold the trading portfolio and the investments and have commuted the mortgage guaranty contract. The income and gains and losses from these items

are included in other operating income, together with other miscellaneous income and income related to two mortgage impairment insurance contracts which, while written as insurance policies, receive accounting treatment as derivative financial instruments.

Other operating income was \$34.4 million in 2009, \$9.6 million in 2008 and \$43.5 million in 2007, and varied considerably from period to period depending on the amount of trading, investment or disposition activity and, in 2009, from the commutation.

Table of Contents**Operating Ratios****Premium to Surplus Ratio**

Our insurance companies are subject to regulation and supervision by the jurisdictions in which they do business. Statutory accounting is generally based on a liquidation concept with the intent to protect the policyholders. This table shows the ratio of statutory gross written premium and net written premium to statutory policyholders' surplus for our property and casualty insurance companies (dollars in thousands):

	2009	2008	2007	2006	2005
Gross written premium	\$ 2,568,609	\$ 2,510,612	\$ 2,460,498	\$ 2,243,843	\$ 2,049,116
Net written premium	2,052,309	2,064,091	1,985,641	1,812,896	1,495,931
Policyholders' surplus	2,103,892	1,852,684	1,744,889	1,342,054	1,110,268
Gross written premium ratio	122.1%	135.5%	141.0%	167.2%	184.6%
Gross written premium industry average(1)	*	180.5%	160.7%	171.0%	192.7%
Net written premium ratio	97.5%	111.4%	113.8%	135.1%	134.7%
Net written premium industry average(1)	82.2%**	93.5%	84.2%	90.4%	99.8%

(1) Source: A.M. Best Company, Inc.

* Not available

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

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

Combined Ratio - GAAP

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

2009	2008	2007	2006	2005
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Loss ratio	59.7%	60.4%	59.6%	59.2%	67.1%
Expense ratio	25.2	25.0	23.8	25.0	26.1
Combined ratio GAAP	84.9%	85.4%	83.4%	84.2%	93.2%

Combined Ratio Statutory

The statutory combined ratio is a combination of the loss ratio (the ratio of incurred losses and loss adjustment expenses to net earned premium) and the expense ratio (the ratio of policy acquisition costs and other underwriting expenses, net of ceding commissions, to net written premium). We calculate the statutory combined ratio using financial data derived from the combined financial statements of our insurance company

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subsidiaries reported in accordance with statutory accounting principles. Our insurance companies' statutory loss ratios, expense ratios and combined ratios are shown in the following table:

	2009	2008	2007	2006	2005
Loss ratio	60.7%	60.8%	60.6%	60.0%	67.1%
Expense ratio	25.7	24.3	23.9	24.0	25.5
Combined ratio Statutory	86.4%	85.1%	84.5%	84.0%	92.6%
Industry average	100.6%*	103.9%	95.7%	92.5%	100.7%

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

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

Reserves

Our net loss and loss adjustment expense reserves are composed of reserves for reported losses and reserves for incurred but not reported losses (which include provisions for potential movement in reported losses, as well as for claims that have occurred but have not yet been reported to us). Reinsurance recoverables offset our gross reserves based upon the contractual terms of our reinsurance agreements. Reserves are recorded by product line and are undiscounted, except for reserves related to acquisitions.

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

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

- information used to price the applicable policies,
- historical loss information where available,
- any public industry data for that line or similar lines of business,
- an assessment of current market conditions, and

a claim-by-claim review by management, where actuarially homogenous data is unavailable.

Management also considers the point estimates and ranges calculated by our actuaries, together with input from our experienced underwriting and claims personnel. Our actuaries utilize standard actuarial techniques in making their actuarial point estimates. These techniques require a high degree of judgment, and changing conditions can cause fluctuations in the reserve estimates. Because of the nature and complexities of the specialized types of business we insure, management may give greater weight to the expectations of our underwriting and claims personnel, who often perform a claim by claim review, rather than to the actuarial estimates. However, we utilize the actuarial point and range estimates to monitor the adequacy and reasonableness of our recorded reserves.

Each quarter, management compares recorded reserves to the most recent actuarial point estimate and range for each line of business. If the recorded reserves vary significantly from the actuarial point estimate,

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management determines the reasons for the variances and may adjust the reserves up or down to an amount that, in management's judgment, is adequate based on all of the facts and circumstances considered, including the actuarial point estimates. We believe that our review process is effective, such that any required changes are recognized in the period of change as soon as the need for the change is evident. Our total consolidated net reserves have consistently been above the total actuarial point estimate but within the actuarial range.

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

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

We underwrite risks that are denominated in a number of foreign currencies and, therefore, maintain loss reserves with respect to these policies in the respective currencies. These reserves are subject to exchange rate fluctuations, which may have an effect on our net earnings. Generally, we match the reserves denominated in foreign currencies with assets denominated in the same currency resulting in a natural economic hedge that mitigates the effects of exchange rate fluctuation.

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

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

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

	2008	2007	2006	2005	2004	2003	2002	2001
9,309	\$ 3,415,230	\$ 3,227,080	\$ 3,097,051	\$ 2,813,720	\$ 2,089,199	\$ 1,525,313	\$ 1,158,915	\$ 1,132,258
	24,897	57,028	48,119	26,088	6,113		5,587	
9,309	3,440,127	3,284,108	3,145,170	2,839,808	2,095,312	1,525,313	1,164,502	1,132,258
	887,040	902,352	797,217	689,126	511,766	396,077	418,809	390,232
		1,305,179	1,260,672	1,077,954	780,130	587,349	548,941	612,129
			1,527,443	1,385,011	993,655	772,095	659,568	726,805