Darwin Professional Underwriters Inc
Form 10-K
February 29, 2008

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UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
Form 10-K

þ **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the fiscal year ended December 31, 2007

OR

o **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the transition period from to

Commission file number: 001-32883
DARWIN PROFESSIONAL UNDERWRITERS, INC.
(Exact name of registrant as specified in its charter)

Delaware	**03-0510450**
(*State or other jurisdiction of incorporation or organization*)	(I.*R.S. Employer Identification Number*)
9 Farm Springs Road	**06032**
(*Address of principal executive offices*)	(*Zip Code*)

Registrant s telephone number, including area code:
860-284-1300

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

Title of Each Class	Name of Each Exchange on Which Registered
Common Stock, $0.01 par value	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act:
Not applicable

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

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

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K 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. þ

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Ruler 12b-2 of the Exchange Act. (Check one):

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

Indicate by check mark whether the registrant is a shell company. Yes o No þ

As of February 25, 2008, ***17,025,051*** shares, par value $0.01 per share, of Common Stock of the registrant were outstanding. The aggregate market value (based upon the closing price of these shares on the NYSE as of June 29, 2007) of the shares of Common Stock of registrant held by non-affiliates was approximately $156,282,000.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Proxy Statement relating to the Annual Meeting of Stockholders of Darwin Professional Underwriters, Inc. to be held on May 2, 2008 are incorporated by reference into Part III of this Form 10-K Report.

Darwin Professional Underwriters, Inc.

Annual Report on Form 10-K

For Fiscal Year Ended December 31, 2007

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PART I

Unless the context requires otherwise, references in this Annual Report on Form 10-K to Darwin, the Company, we, our and us are to Darwin Professional Underwriters, Inc. and its subsidiaries, taken as a whole, unless the context otherwise requires. We also refer to Darwin Professional Underwriters, Inc., excluding its subsidiaries, as DPUI. References to Alleghany are to Alleghany Corporation, our ultimate parent company, which is a holding company primarily engaged, through its subsidiaries, in the property and casualty insurance business. Our intermediate holding company subsidiaries are Darwin Group, Inc. (referred to herein as Darwin Group) and Evolution Underwriting Inc. as of November 30, 2007 (referred to herein as Evolution). References to (a) DNA are to our subsidiary Darwin National Assurance Company, (b) Darwin Select are to DNA s subsidiary Darwin Select Insurance Company and (c) Vantapro are to DNA s subsidiary Vantapro Specialty Insurance Company (formerly named Midway Insurance Company of Illinois), and (d) AMS are to Evolution s subsidiaries acquired on January 4, 2008, Agency Marketing Services, Inc., Allsouth Professional Liability, Inc. and Raincross Insurance, Inc., collective. Whenever in this Annual Report we refer to business generated, written or produced by Darwin, we include business produced by DPUI and written on policies of certain insurance company subsidiaries of Alleghany (which we refer to as the Capitol Companies), , all of which policies are now fully reinsured by DNA. This Annual Report gives effect to certain reorganization and reinsurance transactions that were implemented prior to our May 2006 initial public offering as though the structure of our business resulting there from had been in effect since our inception in March 2003. See Business for a description of these transactions.

ITEM 1. *Business.*

Overview

Darwin is a holding company, the subsidiaries of which are engaged in insurance underwriting and distribution across a spectrum of the specialty commercial property-casualty insurance market within four major lines of business. The bulk of our business is the underwriting and administration of liability insurance policies within one of three broad professional liability lines: Directors and Officers Liability (D&O); Errors and Omissions Liability (E&O); and Medical Malpractice Liability. Additionally, we introduced a program of general liability (GL) business during 2007, and we expect to consider additional GL business as attractive opportunities arise in the future. During November 2007, we announced that we had formed Evolution as a new subsidiary to serve as a holding company for our non-risk bearing insurance operations. Concurrently, we announced that Evolution had agreed to acquire all of the stock of the three affiliated insurance distribution entities in Florida, referred to herein as AMS. With Evolution s acquisition of AMS in January 2008, we became the parent of a regional program administrator and wholesale brokerage operation based in Florida. AMS represents diversification from our risk-bearing insurance operation, but we expect that the business generated by AMS will account for only a small portion of our overall revenues and profits.

Our principal objective is to create and sustain superior returns for stockholders by generating consistent underwriting profits across our product lines and through all market cycles. We believe that this can be best accomplished by directing our efforts toward continual growth of our small and middle market business, while taking advantage of opportunities when they are presented by larger accounts in the professional liability insurance market.

Since our formation almost five years ago, we have grown our business to produce $280.3 million of gross premiums written in calendar year 2007, which was up 13.8% from the $246.3 million of gross premiums written in calendar year 2006. Although price levels have been deteriorating within the lines we write, we believe there continue to be growth opportunities for our Company, via penetration of other sectors within the overall market for our target lines of business, which we estimate exceeds $20 billion in annual premium volume. Although, at any given time, our focus will be on those sectors of the market that then represent the most attractive new opportunities, we believe our existing market share (currently less than 2%) allows substantial potential for growth within our existing lines.

Stephen Sills, our President and Chief Executive Officer, and Alleghany formed DPUI in March 2003. At that time, our target classes of business were attractively priced as a result of prior industry losses and the corresponding price increases that resulted. We also took advantage of the opportunity to develop proprietary insurance systems using current technology, and we believe these systems now provide us with a competitive advantage compared to insurance companies that are encumbered by older systems and processes. Since 2003, we have gradually increased the number and variety of coverages offered by our subsidiaries, most recently adding a professional liability product for long-term care facilities, a media liability product and a general liability program for short-line railroads. In November 2007 we formed Evolution and announced its planned acquisition of AMS, our Florida-based program administration and wholesale brokerage firm. The AMS acquisition will add insurance product distribution to Darwin s business mix and modestly diversifies our revenue stream.

These actions demonstrate the high value we place on diversification within our portfolio of insurance products. We will continue to introduce new products from time to time. While our underwriting activities are likely to remain predominantly oriented toward professional liability coverages in the D&O, E&O and Medical Malpractice Liability lines, other specialty property-casualty businesses will also be explored. Our insurance company subsidiaries are currently rated A− (Excellent) by A.M. Best Company (Best).

The executives who founded and continue to lead our Company have significant experience in the insurance industry in general, and particularly in the specialty lines of business that we write. Five of the seven executives who constitute our management team, including Mr. Sills, worked together at Executive Risk Inc., a specialty insurance company that was acquired by The Chubb Corporation in 1999. Company directors, management and other employees own a significant portion of the Company s issued and outstanding shares, an aggregate amount which approximates 10% of such shares (includes ownership in the form of shares awarded under the Company s restricted stock plan). Our majority shareholder, Alleghany, indirectly owns approximately 55% of the Company s issued and outstanding common stock. In August 2007, we filed a Registration Statement on Form S-3 with the Securities and Exchange Commission (SEC) under which we registered for sale all of the Darwin shares held by Alleghany s subsidiary. The registration statement was made effective under SEC Rule 415 (the shelf registration rule) on August 20, 2007. As of the date hereof, Alleghany has not sold any shares of Common Stock under the August 2007 Registration Statement, but it may decide to sell some or all of the registered shares at any time in its sole discretion.

Our insurance group includes both an admitted company (DNA) and a surplus lines company (Darwin Select) (see Management s Discussion and Analysis of Financial Condition and Results of Operations Our History). In addition, we purchased a dormant property-casualty company named Midway Insurance Company of Illinois from Fireman s Fund Insurance Company (Fireman s Fund) that held no operating assets or liabilities in November 2007, and we have filed for regulatory approval of our plan to redomesticate that company from Illinois to Arkansas. We have re-named the new acquisition Vantapro Specialty Insurance Company and we intend to obtain surplus lines approvals for Vantapro in a number of states so as to enhance distribution flexibility for our products. Together, these companies provide us with the ability to write business both on an admitted basis and on a surplus lines basis throughout much of the United States. Surplus lines insurance covers risks that do not fit the underwriting criteria of standard, admitted carriers, usually because of the perceived risk associated with aspects of the insured s business. In contrast to an admitted insurance company, which is required to be licensed in each state where it writes insurance, a surplus lines insurance company does not have to apply for and maintain a license in each state where it writes insurance. It is, however, either required to meet suitability standards or else be subject to approval under each particular state s surplus lines laws in order to be an eligible surplus lines insurance company. Because insureds in the surplus lines market are generally considered higher risk, surplus lines carriers may offer more restrictive coverage at higher prices than would be offered by the standard admitted market. We have written the majority of our business on surplus lines policies (based on the number and dollar amounts of policies written), but we expect our percentage of policies written on an admitted basis to grow over the next few years.

As of December 31, 2007, we had GAAP-based stockholders equity of $254.2 million and statutory surplus of DNA of $218.8 million which includes its investments in DSI and Vantapro. We believe that this level of capital provides us with a conservative balance sheet relative to our net premiums written of $199.7 million in 2007, particularly when taking into consideration the fact that we did not write any insurance business prior to 2003. Based on our capital position at year-end 2007, Best reaffirmed in February 2008 its A− (Excellent) rating for DNA and its A− (Excellent) rating for Darwin Select on a reinsured basis (based on DNA s relationship with Darwin Select).

Our Competitive Strengths

Although smaller than many of the specialty insurers in our markets, we believe the Company possesses a number of strengths which position it to compete effectively. These competitive strengths include:

Experienced Management. Our executive officers have significant experience in the insurance industry in general, and particularly in the specialty lines of business that we write. Our President and Chief Executive Officer, Stephen Sills, has more than 30 years of insurance industry experience and is the former Chief Executive Officer of Executive Risk Inc., which he helped grow from a small, private D&O facility into a leading, publicly-traded specialty lines insurance carrier. Four of our senior executives worked together with Mr. Sills at Executive Risk Inc. prior to its acquisition by The Chubb Corporation in 1999. The seven members of our senior management team average over 25 years of experience in the insurance industry.

Specialized Product Offerings and Underwriting Expertise. We focus on specialty professional liability products, a targeted approach which allows us to better understand the unique needs of our customers and to tailor products and services to meet their needs. We believe it also allows us both to identify opportunities (such as underserved markets, where, in our judgment, the perception of risk is greater than the actual risk) and to recognize problems quickly so that we are able to address them promptly. We believe the Company s specialty focus, disciplined underwriting, collaborative processes and entrepreneurial culture also facilitate our ability to bring new product offerings to market quickly.

Our Knowledge of the Healthcare Industry. We have built a team of professionals dedicated to the specialty insurance needs of the healthcare industry. Their expertise extends across all of our major lines of business and includes underwriting, claims, risk management and actuarial backgrounds. We believe that these experienced professionals and our track record in developing insurance solutions provide us with a competitive advantage within the healthcare industry.

Focused Distribution. We are selective when choosing our distribution partners. As of year-end 2007, we have developed a network of approximately 180 distribution partners that focuses on the lines and classes of business in the professional liability insurance market that we find attractive. Four of our current distribution partners are classified as program administrators, third-party entities authorized to bind business for us subject to underwriting guidelines that we prescribe. In choosing our distribution partners, we look for technical expertise; a shared commitment to excellent service (including value-added elements like risk management and loss control); an ability to significantly penetrate the portion of the distributor s business that is of greatest interest to us; and a willingness to innovate with us in new technologies, processes and products.

Innovative Use of Technology. Our systems platform uses technology that we believe significantly enhances the effectiveness and flexibility of our key functions, including underwriting, claims, finance and accounting. This technology platform facilitates significant real-time management reporting capability and allows us to interact efficiently with our distribution partners. We have developed and rolled out *i-bind,* our web-based underwriting system, to selected distribution partners. The *i-bind* underwriting system allows on-line submission of applications, rating, quoting, proposal, binder and policy issuance.

Strong Rating. Best reaffirmed in February 2008 ratings of A− (Excellent), which is the fourth highest rating of Best s 16 rating categories, for DNA and Darwin Select. Best assigns ratings that are intended to provide an independent opinion of an insurance company s ability to meet its obligations to policyholders; therefore, our subsidiaries ratings are not evaluations directed to the protection of investors. Best s opinions are derived from its evaluation of an insurer s balance sheet strength, operating performance and business profile. While our current ratings are strong, there are business risks associated with the possibility that our rating could decline at some point in the future (see *Risks*

Related to Our Business).

Conservative Balance Sheet. As of December 31, 2007, we had stockholders equity of $254.2 million, with $199.7 million of net premiums written in 2007. We believe that our capital base is sufficient to support a greater volume of net premiums than we currently write. Additionally, we believe that our investment portfolio is conservative. As of December 31, 2007, our investment portfolio was entirely invested in cash, fixed-income and equity securities that had an average adjusted duration of 3.90 years, and 95.8% of the fixed-income securities had a quality rating of A or higher from Standard & Poor s or Moody s. We are currently moving forward with plans for diversifying our portfolio to include some classes of common equity for a small percentage of the Company s total portfolio holdings.

Our Strategy

We have developed strategies that we believe assist us in pursuing our objective of creating and sustaining superior returns for our stockholders by generating consistent underwriting profits across our product lines and through all market cycles. These strategies include:

A Balanced Book of Business with a Bias to Smaller Accounts. We strive to balance our four broad lines of business (D&O, E&O, Medical Malpractice Liability and GL), subject to market conditions in any particular segment. Due to softening conditions in recent quarters, the percentage of D&O business has fallen somewhat relative to the other two professional liability lines. Also, during 2007 we began a process of diversifying outside our principal professional liability lines when we commenced writing general liability policies for short-line railroads. While that program is expected to remain small, relative to our specialty liability businesses, we believe that other general liability initiatives are possible over the next several years. We also continue our efforts to grow that portion of our book comprised of small and mid-sized account business, which we believe will maintain more consistent profitability through market cycles and over sustained periods. Smaller businesses represent a significant market opportunity for Darwin, and we believe that *i-bind* will assist us and our distribution partners in producing and managing small account business in a cost-effective manner. However, when market conditions warrant, we plan also to selectively write profitable larger accounts.

A Culture Focused on Underwriting Profitability. Sustained profitability requires careful class of business and individual risk selection, as well as the consistent monitoring of underwriting results, identification of trends and implementation of corrective action when necessary. We believe our management reporting capability enhances our ability to monitor results and make timely, accurate decisions to manage our business profitably. As part of the monitoring process, we hold regular roundtable reviews of underwriting risks; we engage in price and trend monitoring discussions among underwriting, claims and actuarial personnel, as well as senior management; we conduct claim reviews, including quarterly meetings of claims, actuarial and underwriting personnel and senior management to review serious and potentially serious claims; and we perform periodic internal audits of the claims and underwriting functions. We believe these processes are enhanced by our collaborative culture and by the substantial centralization of core functions at our headquarters in Farmington, CT. In addition, our commitment to underwriting profitability is augmented by management s equity ownership interest in the Company and by the incentive compensation structure for our key employees, which ties bonus compensation to long-term underwriting results.

Limited Commodity Business. We seek to avoid business where our products and services are seen as being interchangeable with those of our competitors. Such commodity relationships are difficult to sustain and, generally, are profitable only during the most favorable market conditions. We limit commodity business by:

> *Emphasizing primary and first excess layer business.* We believe that, at these attachment points, we have more influence over terms, conditions, rates, and handling of claims, and that our greater degree of involvement in these matters enables us both to form stronger relationships with customers and to better demonstrate our service capabilities directly to the customers.
>
> *Providing added value to insureds.* We believe both our profitability and the stickiness (loyalty) of our producer and customer relationships are improved when we provide value-enhancing activities, such as risk management and loss control assistance, to insureds.

Constantly looking for new niche opportunities. We believe that we are better positioned than our competitors to capitalize on new opportunities that arise from market dislocations, such as an underserved market, an unmet need for innovation and speed, or a disparity between the perception and reality of a particular type of risk.

Technology that Optimizes Efficiency. As we have built our business, we have used current technology to automate operational functions and processes, and to automatically feed transactional data between systems.

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Presently, our underwriting, claims, financial reporting and accounts receivable and payable systems and processes benefit from these integrated transactional data transfers. We believe that our technology design and the absence of any legacy systems enable us to transact business more efficiently, and to maintain high quality service levels with fewer employees than would be needed if these processes and systems were not in place.

Expanded Use of i-bind. Our proprietary *i-bind* methodology has the potential to significantly assist us in the cost-effective production and underwriting of small account and small premium professional liability business. Because we believe that insurance purchasers want to have an agent or broker to advise them in the purchase of professional liability products, we designed *i-bind* so that, rather than displacing the intermediary, it enables the agent or broker to operate more efficiently. *i-bind* is a dynamic on-line tool that asks for only the relevant information (which is iterative, based on prior answers) and provides intelligent underwriting through the several thousand rules embedded in the system. Users of *i-bind* can get an instantaneous quote upon completion of their application, can bind that quote and print or have emailed to them a completed policy form immediately upon binding. As of December 31, 2007, *i-bind* had been introduced to approximately 60 producers, up from 19 producers at year-end 2006. During 2008, we plan to continue expanding the number of distribution partners who can access the system, as well as the products available on it.

Grow Responsibly into Our Capital Base. We believe our capital base is sufficient to support a greater volume of net premiums than we currently write. In 2007, we had net premiums written of $199.7 million, an increase of 27.2% over 2006. The ratio of net premiums written to statutory surplus is a common industry measure for capital utilization. Our ratio for 2007 was 0.91 : 1, which compares favorably to the 0.96 to 1 ratio reported in a Best study of 214 insurers focused on commercial casualty lines, for net premiums written for 2006 to statutory surplus as of December 31, 2006 (the most recent year for which data is available). Based upon current market conditions, we believe there are opportunities to produce significant premium growth over the next three to five years. Over time, we will continue to deploy our capital while maintaining our focus on underwriting profitability. We also intend to maintain reinsurance buying and investment practices that will protect our balance sheet strength as we increase our volume of net premiums written relative to our capital base.

Selective Acquisitions. We have acquired three insurance company subsidiaries since 2004, the most recent being Vantapro which was acquired as a shell company from Fireman s Fund in November 2007. In addition, we formed Evolution in late 2007 and completed the AMS acquisition in early 2008 (see Evolution and subsidiaries). We believe other attractive acquisition possibilities may arise from time to time, presenting further opportunity to diversify our business profitably. Acquisition opportunities, which may include risk-bearing entities or distribution firms (e.g. program administrators), will be considered if they meet our criteria, which include: enhancing our portfolio of product offerings for our current distribution base, expanding our distribution capabilities for specialty liability insurance and/or increasing our geographic spread of business.

Industry Dynamics

The property and casualty insurance business has historically been subject to cyclical fluctuation in pricing and availability. Soft markets are characterized by an excess of capital and underwriting capacity, and by pricing and policy terms that are relatively less favorable to insurers. Soft markets generally result in intense premium rate competition, an erosion of underwriting discipline and poor operating performance. Quite often, a soft market will be followed by a period of diminishing capacity and increased underwriting discipline; companies may exit unprofitable areas of business and/or increase premiums in order to improve operating performance. This phase of the cycle is generally referred to as a hard market.

Although the specialty liability businesses on which we focus are subject to soft and hard market cycles, the individual lines of business generally have discrete dynamics and rarely move in perfect correlation with one another. For example, over the past several years, the public D&O market has been impacted by options backdating and, more recently, sub-prime mortgage lending issues. On the other hand, the market for insurance agents E&O has been impacted by natural disasters, and the managed care E&O market is still somewhat impacted by certain class-actions brought earlier in the decade. In addition, compared to the smaller and mid-sized accounts that we focus on, large commercial insureds tend to be more impacted by market cycles, are more volatile, and generally more difficult to write profitably over long periods of time. Conversely, we believe that small and mid-sized accounts experience rate increases in hard markets, while their rate decreases are more modest during softer periods.

A survey sponsored by The Council of Insurance Agents & Brokers reported that in 2007 (through the fourth quarter) commercial property and casualty rates for the average small account (defined as accounts with less than $25,000 in commission and fees) decreased by 8.4%,while rates for the average mid-sized account (commissions and fees ranging from $25,000 to $100,000) decreased by 13.5% and rates for the average large account (more than $100,000 in commissions and fees) decreased by 14.4%. Our belief that losses are generally more stable in small and mid-sized risks is also supported by the 2006 Directors and Officers Liability Survey Report by Towers Perrin. According to that study both claims frequency (the average number of claims per participant) and claims susceptibility (the likelihood of incurring a claim) correlate to the insurer s asset size. Entities with smaller asset sizes had significantly less loss frequency and susceptibility than the larger asset size companies. The report noted a particularly strong correlation between entities with asset sizes below $100 million and a reduced susceptibility to and frequency of claims.

Admitted Business and Surplus Lines Business

Our admitted company, DNA, is required to be licensed in each state where it operates. In general, an admitted carrier must file premium and rate schedules and policy or coverage forms for review and approval by the insurance regulators. In many states, an admitted carrier s rates and policy forms must be approved prior to use, and insurance regulators have broad discretion in judging whether an insurer s rates are adequate, not excessive and not unfairly discriminatory. In some states, commercial lines have been deregulated so that admitted insurers are able to write certain commercial risks without obtaining prior review or approval of rates and/or forms, although the content of the policy is still regulated.

Our surplus lines carrier, Darwin Select, is not subject to rate and form requirements and does not participate in the various states guaranty fund programs. Darwin Select can implement changes in policy terms and underwriting guidelines or rates more quickly than DNA. Because of the greater ability to respond to market changes, we use Darwin Select s surplus lines policies where acceptable to the market. However, as described in the discussion of specific classes below, in states where forms and rates have been deregulated for larger commercial insureds, we will write some classes on an admitted basis. If surplus lines are not authorized by regulators for certain business, or if market conditions make surplus lines unacceptable, then we issue policies on an admitted basis.

In November 2007 we acquired Vantapro from Fireman s Fund. Vantapro has one state license (Illinois), but it had been not been writing insurance business for several years. Vantapro has filed for regulatory approval to be re-domesticated to Arkansas, and upon obtaining surplus lines approvals in other states, it will become an additional distribution vehicle for our surplus lines products and services. During 2007, Vantapro did not write any insurance business.

Our Products and Markets

We group our products into the following principal lines of business: Directors and Officers liability (D&O), Errors and Omissions liability (E&O), Medical Malpractice (also known as Medical Professional Liability) and General Liability (GL). Within each of these lines of business we target specific classes that we believe exhibit adequate pricing and favorable terms and conditions. We have gradually diversified the number of classes in which we do business, expanding into areas where we were able to add expertise by hiring key employees or contracting with experienced program administrators. During 2007, for example, we added clinical research facilities and media companies to our product roster. We also commenced new professional liability insurance programs for senior living facilities, as well as a new general liability program for short-line railroads. Like all our program administration relationships, these arrangements call for underwriting by third parties within parameters established and monitored by Darwin. All reinsurance and claims handling for our program business is handled internally by our own employees, except in the case of the short-line railroad program, where we have selected a third-party administrator for claims handling.

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The following table sets forth gross premiums written by line of business during each of the past three years:

	Year Ended December 31,					
	2007		2006		2005	
	Amount	Percent	Amount	Percent	Amount	Percent
	(Dollars in thousands)					
Directors and Officers	$ 38,737	13.8%	$ 40,626	16.5%	$ 32,926	19.9%
Errors and Omissions	140,013	49.9%	111,039	45.1%	58,867	35.5%
Medical Malpractice Liability	100,783	36.0%	94,587	38.4%	74,031	44.6%
General Liability	750	0.3%		0.0%		0.0%
Total	$ 280,283	100.0%	$ 246,252	100.0%	$ 165,824	100.0%

Each of these businesses has underwriting and service needs that are unique to its operations and, therefore, we believe that each provides a distinct underwriting opportunity for us.

Although we generally seek to build a balanced book of business in our four lines, we will write more business in one line or in one industry concentration than another when we see favorable market opportunities. For example, in 2007 our E&O Liability line, where we observed favorable market conditions, totaled 49.9% of gross premiums written.

The overwhelming numbers of our policies are claims-made, although we do write a small amount of occurrence coverage. Claims-made policies cover only those lawsuits or other claims that are asserted during the policy period. Occurrence policies cover claims no matter when they are asserted, so long as they are based on incidents that took place during the policy period. Claims-made policies are generally considered to have a shorter tail, meaning that the insurer can recognize its ultimate liabilities, if any, more quickly than under longer-tailed occurrence policies, where the claim may not be asserted until years after the policy period.

D&O. Under various state laws, a corporation is authorized to indemnify its directors and officers against legal claims arising in connection with their work on behalf of the corporation. In order to attract and retain qualified directors and officers, corporations purchase D&O insurance. D&O insurance for public corporations covers directors and officers when the corporation is not legally permitted, or is financially unable, to indemnify them, and policies that address only this exposure are known as A-side D&O coverage. Many D&O policies also cover the corporation to the extent that the corporation has indemnified directors and officers, and they also frequently cover the corporation directly for claims relating to violations of the securities laws. D&O insurance for private or non-profit accounts generally provides broader coverage for the entity, but has little or no exposure to securities claims.

Public Accounts. We write policies providing up to $20 million of coverage in this class of our business, a significant portion of which has resulted from strong service relationships we ve established with a small number of wholesale brokers. Pricing in the public D&O market was hard when we began our business in 2003, but it has since softened. As a result, we have limited our writings in this line of business, and public D&O has declined as a percentage of our total gross premiums written.

Private Accounts and Non-Profit Accounts. This business focuses on small private businesses and non-profit organizations. The U.S. Small Business Administration has estimated that there are over twenty million for-profit, non-farm small businesses in the U.S. We believe that this class has had favorable loss experience in recent years, and we expect this class to represent an increasing part of our D&O business in the near term. We generally write business in this class on an admitted basis and generally issue primary policies. We currently offer limits of up to $15 million in this class, but most of our issued policies have limits of $2 million or less. Average policy premium in this class is relatively low (for calendar year 2007, approximately $4 thousand), and we believe that our *i-bind* system presents an opportunity for us to expand our writings in this class.

We did not market to non-profit accounts until late 2005, when we added a D&O product for non-profit organizations to *i-bind*. One national information source on U.S. non-profits lists over 1.5 million IRS-recognized organizations in its database, which represents a significant market. Private and non-profit D&O coverage is frequently sold with both management liability and employment practices liability (EPL) coverage. Through *i-bind*, we also offer a stand-alone EPL product for those purchasers who are only interested in the EPL coverage.

Healthcare Management Liability. Our target buyers in this class are non-profit health systems and hospitals and managed care organizations. As we are one of the few insurers that write both managed care E&O and D&O, the two products are frequently marketed together to managed care organizations. Most of our D&O for managed care organizations is written on a surplus lines basis, while the majority of our business for hospitals is written on an admitted basis. We currently offer policies with limits of up to $15 million in this class.

Financial Institutions D&O/E&O: In 2006, Darwin began to selectively underwrite risks in the Financial Institutions (FI) sector. This segment includes a variety of financial institutions including banks, insurance companies, investment advisors, mutual funds, hedge funds and private equity funds. These products provide D&O and E&O on a stand-alone and blended basis, and currently offer policy limits of up to $20 million for A-side D&O and $10 million for all other classes. The majority of business in this class is written on a surplus lines basis, with admitted policies available in select states.

E&O. This coverage protects insureds, generally business owners and professional service providers, against claims by clients, customers and other parties that services rendered by the insured were executed negligently or outside of professional standards. We provide insurance against underlying liability claims as well as the legal fees in connection with defending such claims. Some types of organizations or professionals receive a specialized form of policy that is highly customized for their needs and risks (e.g., insurance agents, law firms). Miscellaneous E&O refers to those coverages that can be written on a more generic, less customized form of policy. Our principal E&O product lines are Managed Care E&O, Lawyers Professional E&O and Insurance Agents E&O. Although relatively new additions to our E&O product capabilities, we believe that Technology E&O, Miscellaneous Professional E&O, Standard Lawyers Professional Liability, Municipal Entity and Public Officials E&O and Insurance Company E&O have the potential to be significant contributors to our future growth. E&O tends to be a more fragmented and regionalized marketplace than D&O, since the risks vary significantly depending on the nature of the profession and the geographic area in which it is practiced. Despite this fragmentation and diversity, the E&O business is generally competitive. Despite the increasingly competitive market conditions, we believe that certain classes remain adequately priced and that, with knowledgeable underwriting and well-conceived distribution and claims handling systems, we can be successful in these lines.

Managed Care E&O. Managed Care E&O provides protection for some business activities of managed care organizations such as evaluating the appropriateness of medical services provided for purposes of coverage under a health care plan (utilization review), and selecting, evaluating or contracting with providers of medical services (provider selection). Our E&O policies specifically exclude coverage for any medical professional service (except for vicarious liability claims). We believe that the Managed Care E&O market has comparatively few competitors for the primary and first excess layer business that we target. Therefore, we believe we have become a significant supplier in this class of business. We issue Managed Care E&O policies with limits of up to $20 million. We are most interested in primary and first excess layer placements in this class. The business we have written to date is either on a surplus lines basis or, in states where there has been deregulation which allows us to write business without regulatory review or approval of rates and forms, on an admitted basis.

Lawyers Professional E&O. In this class, we have historically targeted small to mid-sized firms (generally with fewer than 50 attorneys) which the market considers non-standard. Non-standard generally refers to legal specialties that are considered to be more complicated and to carry the potential for greater exposure. We typically write this business on a surplus lines basis, offering liability limits up to $10 million, although actual policy limits are typically between $1 million and $2 million. We believe that with careful underwriting and appropriate pricing, non-standard risks in the lawyers E&O class can produce attractive profits. During 2006, we entered the standard small and mid-size markets. A significant portion of the business that we write in this class are written on an admitted basis and are produced via one or more program administration arrangements with leading agencies in selected geographic areas.

We selectively offer limits of up to $5 million to large law firm risks under appropriate circumstances, although the market in this segment is quite competitive, and opportunities that offer attractive pricing are increasingly rare. In general, we believe that, compared to small and mid-sized law firm business, large law firm business is more volatile and more difficult to write profitably over long periods. Our current overall market share in Lawyers

Professional E&O is very small. However, we believe that the pricing for the law firm risks in our targeted segments remains attractive and that there are significant opportunities to expand this book of business.

Insurance Agents E&O. Claims against insurance agents and agencies tend to increase in frequency and severity following large systemic losses. As a result of the significant catastrophe and liability losses that occurred in the U.S. in recent years, the insurance agents E&O marketplace had been in a hard market cycle. While this segment has been profitable during the past several years, new entrants have caused the market to become more competitive. We focus primarily on the mid-sized managing general agents, managing general underwriters, and wholesale agents and brokers. We will also write more complex business in this class (such as larger specialist retailers and third party administrators) where we see favorable opportunities. We currently offer policies with limits of up to $15 million, and nearly all of our business in this class is being written on a surplus lines basis.

Insurance Company D&O and E&O. In 2006 we began writing coverages for alternative risk transfer (A.R.T .) facilities, including captives, risk retention groups, reciprocals, and exchanges, as well as for privately held non-rated insurance companies (i.e., insurance companies without an A.M. Best Company financial strength rating). The product is a combined management and professional liability policy, and it is geared towards A.R.T. facilities that offer property and casualty, workers compensation, and life, accident, and health insurance, so long as they write $250 million or less in annual gross written premium. The coverages include D&O, E&O and employment practices liability (EPL) components. Coverage is also available for subsidiary operations, including claims administrators, captive managers, and managing general agents/underwriters. The business is produced by both retail and wholesale producers, and is written on a surplus lines basis.

Technology E&O. Technology E&O is one of our newer classes of business. While businesses that provide technology services comprise a significant part of this market, the widespread use of technology in virtually every American industry creates opportunities to provide coverage to companies that use technology. In addition to providing coverage for negligent technology services, a Technology E&O policy may cover risks relating to network security, on-line media, privacy and intellectual property. In addition to liability coverage, some competitors also offer first-party business interruption coverage for certain technology events. We are considering offering this type of first-party coverage as well. Our strategy has been to identify niches where we can develop a depth of knowledge that will allow us to quantify the technology exposures. In addition to technology providers, our Technology E&O business focuses increasingly on technology users providing network security and privacy coverage. We currently offer policies with limits of up to $10 million in this class. A significant portion of the business that we write is produced through wholesale brokers and written on a surplus lines basis.

Municipal Entity and Public Officials E&O. We have entered into an agreement with Professional Government Underwriters, Inc. (PGU), a program administrator that specializes in Municipal Entity and Public Officials E&O. PGU s Municipal Entity and Public Officials E&O business consists of three distinct subclasses: Educators Professional Liability; Police Professionals Liability; and Public Officials Liability. PGU s business focuses on smaller jurisdictions rather than on major metropolitan areas. We believe that this niche of smaller-sized public entity business represents about $600 million to $750 million of gross premiums annually. PGU customers typically are municipalities that seek to purchase professional liability coverages separately from standard property and casualty coverages. Our policies cover the municipality and/or municipal employee for claims such as employment discrimination, mismanagement or improper use of funds, and failure to or improper discharge of official duties. In July 2007, we announced an optional enhancement to our Educators Professional Liability product, which provides coverage for limits up to $250 thousand for crisis management expenses incurred by the named insured following an act of school violence. We currently offer policy limits up to $5 million in this class. Most of the business is written on a surplus lines basis, but in a few states it is offered on an admitted basis. Under this program, PGU markets the program, receives applications and binds the coverage, subject to our underwriting guidelines. We retain responsibility for administration of claims and for any reinsurance.

Psychologists E&O. In 2006 we entered into a program administration agreement with American Professional Agency (APA) to provide Psychologist s E&O Insurance to its nationwide group of mental health professionals. The APA program coverage offers individual limits of up to $2.0 million, and is available in all states on an admitted and surplus lines basis. A wide range of mental health professionals, including psychologists, marriage and family counselors, school counselors, employed counselors, bachelor s-level employed counselors, clergy and pastoral counselors, certified hypnotists, sex counselors, psychoanalysts, and employed marriage and family therapists, are eligible for coverage. Policies are marketed by APA, which also accepts applications, underwrites and binds coverage, in accordance with underwriting guidelines prepared and maintained by our in-house experts. We are solely responsible for all claims administration and reinsurance matters. APA, which also administers our Psychiatrist s Program (see below under Medical Malpractice Liability), is a New York-based risk program administrator with long experience in insuring mental health professionals.

Media Liability. During 2007, Darwin entered the media liability market with a policy form which provides either a claims-made or occurrence coverage, at the purchaser s option. Media liability insurance is intended to provide defense and indemnity for claims arising out of the perils (e.g. defamation, infringement, privacy claims) faced by companies that create, fund, produce or disseminate content into the public domain. Our target segments include publishers, broadcasters, advertising agencies, advertisers, TV and film producers, authors and music industry risks. We have estimated that size of the overall U.S. media liability market is approximately $300 million, and we believe the market is expanding with non-media companies offering more content to the public via the Internet. Darwin offers media liability limits up to $10 million through its existing wholesale and retail producer network, generally on a surplus lines basis.

Miscellaneous Professional E&O. Miscellaneous Professional E&O refers to coverages that are written on a more generic, less customized form of policy. Claims are usually made by clients alleging errors and omissions in the performance of professional services. The insurance industry typically recognizes more than fifty sub-classes within this class, such as travel agents, notary publics, title agents and abstractors. We have written a small amount of Miscellaneous Professional E&O to date, but believe that there is potential to grow this business over the long term as we expand the use of *i-bind*, generally on a surplus lines basis.

Medical Malpractice Liability. We are currently engaged in four distinct classes within our Medical Malpractice Liability line of business: Hospital Professional Liability; Miscellaneous Medical Facilities; Physicians and Physician Groups; and Psychiatrists. In this line of business, we provide coverage to physicians and other healthcare providers as individual practitioners or as members of practice groups. Our insurance protects policyholders against losses arising from professional liability claims and the related defense costs for injuries in which the patient alleges that medical error or malpractice has occurred. Optional coverage is available for the professional corporations in which some physicians practice. We believe that our development and underwriting of these products demonstrates our commitment to, and expertise in, the healthcare market. If current market conditions continue, we believe our Medical Malpractice Liability line should continue to present an opportunity for growth. Most of our Medical Malpractice Liability line is produced by large retailers, regional specialty retailers and wholesalers. In the Medical Malpractice Liability line, we generally write primary and first excess layer placements.

Hospital Professional Liability. Our hospital professional liability book is the largest class within our Medical Malpractice Liability line of business and consists of a portfolio of community hospitals, typically with 300 or fewer licensed beds, located throughout the United States. In this class, we currently offer limits of up to $16 million, generally written on a surplus lines basis (except in a small number of states where we write this business on an admitted basis).

Miscellaneous Medical Facilities. This class consists of surgical centers, out-patient clinics and other specialty medical facilities. Most of the business is written on a surplus lines basis with policy limits in the range of $1 million to $5 million, with maximum limits of $11 million. In 2007 we introduced a product customized for a special niche within this segment, clinical trial professionals, clinical researchers and research facilities, and in 2007 we commenced a program designed specifically for organ-procurement organizations.

Physicians and Physician Groups. Our business in this class falls into two categories: small to mid-sized physician group (generally, groups with fewer than 50 physicians) policies, such groups where a fraction of the physicians who are in the group have raised an underwriting complexity, and individual physicians who are in the non-standard marketplace, such as physicians with prior claims experience or physicians performing particularly high-risk procedures (for example, bariatric surgery). Most of this business is written on a surplus lines basis with policy limits in the range of $1 million to $2 million, with maximum policy limits of $11 million on larger physician groups.

Psychiatrists. This class of business is written through APA, which as noted above (see Psychologists E&O) is a program administrator that specializes in this class. These policies are written on an admitted basis with policy limits of up to $1 million, except that, in certain jurisdictions where we are required to do so, we offer policy limits of $2 million. Under this program, APA has authority to bind policies, subject to our underwriting guidelines. We retain responsibility for administration of claims and any reinsurance.

Senior Living Professional Liability. In September 2007, we announced a new underwriting services agreement with K&B Underwriters, LLC (K&B) to provide coverage for the professional and general liability exposures faced by non-hospital based residential healthcare facilities serving seniors. Eligible risks span the entire spectrum of healthcare delivery; including providers of sub-acute/skilled nursing and intermediate care to assisted/independent living facilities and continuing care retirement communities. We estimate that the current market for those accounts meeting our eligibility requirements represents approximately $700 million in gross premiums annually. The insurance program underwritten by K&B provides primary coverage for $1 million per claim, with up to additional $10 million umbrella coverage available, subject to in-house approval by a Darwin underwriter. Coverage is available in most states exclusively on a surplus lines basis and is offered predominately as claims-made. Under this agreement, K&B markets the program, receives applications and binds the coverage, subject to our underwriting guidelines. We retain responsibility for administration of claims and for any reinsurance.

General Liability: Until 2007, our exposure base had been limited to professional liability lines (such as management and professional liability, malpractice and E&O), the sole exception being GL coverage attendant to our medical malpractice products. As discussed below, we initiated a new GL program in 2007, and we would expect to consider additional GL business as attractive opportunities arise in the future.

Liability for Short-line Railroads. In July 2007, we entered into a new program administration agreement with Empire Insurance Services, LLC (Empire) to provide railroad liability coverage for short-line railroads; terminal and switching railroads; tourist, excursion and scenic railroads; railroad museums and other railroad-related accounts associated with, or serving the short line industry. Empire s business is directed towards small to medium sized accounts, generally limited to Class III railroads (U.S. Surface Transportation Board classification) and similar risks, with annual revenues less than $25 million. Based on publicly available data from various U.S. government agency and trade association sources, we estimate that the current market for this niche segment of the larger railroad industry represents approximately $100 million in gross premiums annually. The Empire program provides coverage for up to $10 million per claim, on a claims-made basis, for railroad liability exposures. This business is currently written on a surplus lines basis and is available in all states. Under this program, Empire markets the program, receives applications and binds the coverage, subject to our underwriting guidelines. We retain responsibility for any reinsurance placements and have entered into a contract with Railroad Claims Services, Inc. (RCSI), a third party claims administrator with extensive experience in this line, for administration of claims and for loss control and risk management services.

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Geographic Concentration

The following table sets forth the geographic distribution of our gross premiums written for the years ended December 31, 2007, 2006, and 2005:

	Year Ended December 31,					
	2007		2006		2005	
	Amount	Percent of Total	Amount	Percent of Total	Amount	Percent of Total
	(Dollars in thousands)					
California(1)	$ 28,998	10.4%	$ 22,567	9.2%	$ 14,156	8.5%
Pennsylvania	23,803	8.5%	20,206	8.2%	10,696	6.4%
Texas	21,738	7.8%	18,205	7.4%	14,786	8.9%
New York(2)	21,149	7.5%	18,240	7.4%	12,441	7.5%
Florida	19,599	7.0%	16,168	6.6%	14,557	8.8%
Illinois	18,909	6.7%	14,714	6.0%	9,405	5.7%
New Jersey	12,874	4.6%	10,636	4.3%	6,289	3.8%
Connecticut	9,893	3.5%	7,033	2.8%	5,437	3.3%
Arizona	8,515	3.0%	6,210	2.5%	2,654	1.6%
Ohio	7,851	2.8%	5,395	2.2%	4,591	2.8%
All others	106,954	38.2%	106,878	43.4%	70,812	42.7%
Total	$ 280,283	100.0%	$ 246,252	100.0%	$ 165,824	100.0%

(1) Darwin Select is currently eligible as a surplus lines carrier in California. DNA received its California license during the fourth quarter of 2007.

(2) DNA is currently licensed in New York. Darwin Select became an eligible surplus lines carrier in New York during the first quarter of 2008.

Concentration by Statutory Line

The following table sets forth our gross premiums written by statutory line for the years ended December 31, 2007, 2006, and 2005:

	Year Ended December 31,					
	2007		2006		2005	
	Amount	Percent of Total	Amount	Percent of Total	Amount	Percent of Total
	(Dollars in thousands)					
Other liability(1), claims-made	$ 175,266	62.5%	$ 147,687	60.0%	$ 91,494	55.2%

Other liability(1), occurrence	4,234	1.5%	3,978	1.6%	299	0.2%
Medical malpractice liability, claims made	100,783	36.0%	94,587	38.4%	74,031	44.6%
Total	$ 280,283	100.0%	$ 246,252	100.0%	$ 165,824	100.0%

(1) Under statutory reporting standards, Other liability includes, but is not limited to, D&O, E&O, and GL.

Underwriting

Our underwriting approach focuses on disciplined analysis, pricing appropriate to risk assumed and prudent coverage terms, accompanied by multi-level underwriting and actuarial reviews. Formal rating strategies and plans have been adopted for each line of business. Underwriting acceptability depends on business class, claims history, experience of the insured s management team, financial stability and other relevant factors. The information is obtained from, among other sources, application forms, underlying insurance coverage (if any), the applicant s policies and procedures, financial condition, public disclosures and interviews with the management team. If an account does not meet acceptability parameters, coverage is declined. In connection with renewal, claims activity is reviewed to test the accuracy of our original profitability assessments and the information obtained during the prior underwriting of the insured is updated.

Darwin s operations are organized so as to maintain underwriting discipline. We have a technical group of product specialists and actuaries which sets underwriting policies and guidelines, which are then implemented by underwriters who maintain relationships with distribution partners. The technical group consists of approximately ten members, headed up by our chief underwriting officer and our chief actuary. In consultation with all relevant disciplines, this group is responsible for product design, rating, underwriting guidelines, testing and overall quality control. Daily underwriting business, including reviews of individual submissions, is conducted by centralized underwriting teams, grouped according to business line and industry. The underwriting authority for each underwriter, who typically specializes in a specific line or class of business, is determined on an individual basis. Except for business bound by program administrators (third-party entities authorized to bind business for us, subject to underwriting guidelines that we prescribe), our in-house underwriters make all underwriting decisions.

We actively monitor the growth and profitability of our business, with the goal of ensuring continued profitability. Included within this monitoring process are: roundtable reviews of underwriting risks; price and trend monitoring discussions among our underwriting, claims and actuarial groups, as well as senior management; quarterly meetings of claims, actuarial, and underwriting personnel (including senior management) to review serious and potentially serious claims; and periodic internal audits of the claims and underwriting functions. We believe that disciplined monitoring of the business we re writing is a key to continued underwriting success, as it provides us with the ability to react quickly to changing market conditions.

Our commitment to sustaining underwriting profitability is reflected in and augmented by our incentive structure for senior management, which ties bonus compensation to long-term underwriting results. Darwin has a Long-Term Incentive Plan (LTIP) under which a profit pool is established for each year. Management personnel selected by the Compensation Committee of Darwin s Board of Directors are assigned percentage participations in the profit pool established for each year. In order to encourage management retention, participants vest in each calendar year s profit pool over a four-year period, with payouts generally made over the fourth, fifth and sixth years following the end of the subject profit pool year. The payout schedule is intended to hold management accountable for loss development over a six-year period. In addition, the LTIP provides for loss carryforwards and loss carrybacks, so that amounts under profit pools for different years are offset against one another and any loss arising in one profit pool needs to be made whole by offset from available credit under another profit pool. We believe that the structure of the LTIP aligns management s interests with the primary objective of creating and sustaining superior returns by generating consistent underwriting profits across product lines and through all market cycles.

Marketing and Distribution

We distribute our products through a select group of approximately 180 distribution partners, including brokers, agents and program administrators. Our business development staff is responsible for selecting the brokers and agents we do business with, as well as training them to market and sell our products and monitoring to ensure compliance with our production and profitability standards. For calendar years 2007, 2006 and 2005, we generated quote ratios (business quoted to applications submitted) of 52.0%, 46.7% and 30.4%, respectively. Among the total policies quoted, we bound 29.8% in 2007, compared with 27.3% and 31.7% in 2006 and 2005. Distribution of our products is somewhat concentrated, with approximately 27.2% of our gross premiums written for calendar year 2007 being distributed through two of our distribution partners: APA and Marsh Inc.

In choosing distribution partners, we look for technical expertise; a shared commitment to excellent service (including value-added elements like risk management and loss control); ability to significantly penetrate the portion of the distributor s business that is of greatest interest to us; and willingness to innovate with us in new technologies, processes and products. We have developed a rating scale to assess new potential partners, which is based on the factors listed above. Approvals for new brokers are limited, and are often granted by line and class of business, rather than on a blanket basis. Since we have used the application process and rating scale, we have reached what we believe to be an optimally sized distribution force based upon the business segments at this time.

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As discussed above, we currently use program administrators in a number of lines. Program administrators are independent product line specialist firms which are authorized to solicit and accept applications for insurance and to issue policies on our behalf within underwriting guidelines that we prescribe. We retain responsibility for administration of claims, although we may opt to outsource claims in selected situations, as we have with the third-party administrator (TPA) we hired to handle the Empire program s short-line railroad claims. In all cases, we retain sole responsibility for reinsurance on the program business. Before we enter into a program administration relationship, we analyze historical loss data associated with the program business and perform a diligence review of the administrator s underwriting, financial condition and information technology. In selecting program administrators, we consider the integrity, experience and reputation of the program administrator, the availability of reinsurance, and the potential profitability of the business. In order to assure the continuing integrity of the underwriting and related business operations in our program business, we conduct additional reviews and audits on an ongoing basis. To help align our interests with those of our program administrators, profit incentives based on long-term underwriting results are a significant component of their fees.

Our distribution partners produce business through traditional channels as well as through *i-bind*, our proprietary web-based underwriting system. As of year-end 2007, *i-bind* has been introduced to approximately sixty producers for our private and non-profit D&O and certain E&O products. We believe that the continuing expansion of our *i-bind* network has the potential to significantly contribute to the growth of the small account business that we target, and we intend to continue our efforts to increase both the number of distributors using *i-bind* and the products available through the system.

Arrangements with the Capitol Companies

The Company was initially formed in March 2003 as a non risk-bearing underwriting manager for the Capitol Companies, pending the establishment or acquisition of a separate insurance carrier for Darwin business. Effective June 1, 2003, DPUI entered into an underwriting management agreement with each of the Capitol Companies pursuant to which DPUI was appointed by each of the Capitol Companies to underwrite and administer specialty liability insurance business. These policies are written by the Capitol Companies pursuant to the underwriting management agreements currently in effect and are fully reinsured by DNA. During the third quarter of 2006, DNA collateralized reinsurance payables to the Capitol Companies with the establishment of reinsurance trusts which are, and are required in the future to be, funded at 100% of the reinsurance payables outstanding from time to time.

Since November 2005, when our insurance company subsidiaries obtained their own A.M. Best ratings of A− (Excellent), DPUI has written coverage on policies issued by DNA or Darwin Select whenever possible. Regulatory constraints prevent our writing on DNA in some states, however. In addition, the Capitol Companies have A.M. Best ratings of A (Excellent), and insureds in certain classes (primarily public company D&O) require policies issued by an A rated insurer. Consequently, although we write the majority of our business on DNA or Darwin Select policies, we continue to depend for a portion of our business on our ability to underwrite policies issued by the Capitol Companies subsidiaries, under the underwriting management agreements with each of them, each of which is fully reinsured by DNA. For the year ended December 31, 2007, we wrote gross premiums of $42.9 million (15.3% of our total gross premium written) through the Capitol Companies arrangement. This is a decrease from the year ended December 31, 2006, when we wrote gross premiums of $65.8 million (26.7% of our total gross premiums written) through the Capitol Companies arrangement. Of the 2007 amount, $29.6 million related to business where our insured required a policy from an A.M. Best A rated carrier. While our reliance on the Capital Companies arrangement related to regulatory constraints has greatly diminished during 2007, we do not expect that our issuance of policies written on the Capitol Companies for the insureds who require an A.M. Best rating of A (Excellent) will decline so long as our rating is A− (Excellent). Most of the insureds in this category are public companies purchasing D&O insurance.

The following table indicates the amount of public company D&O gross premiums written in each of the periods presented as a percentage of total gross premiums written for such period. Management believes that public

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company D&O is the most rating sensitive class of business we write and, accordingly, that it provides the best available indicator of our level of rating sensitive business.

	Year Ended December 31, 2007	2006	2005
	(Dollars in millions)		
Public D&O Gross Premiums Written	$ 21.0	$ 29.0	$ 26.3
Total Gross Premiums Written	$ 280.3	$ 246.3	$ 165.8
Percentage of Total Represented by Public D&O	7.5%	11.8%	15.9%

The fees charged to Darwin for the issuance of Capitol Companies policies in respect of business produced by DPUI during 2007 were 3.0% of gross premiums written. In addition, under the fee arrangements, Darwin is required to reimburse the Capitol Companies for direct expenses that they incur in connection with the issuance of Darwin-produced policies (such as premium taxes and guaranty association assessments). Pursuant to the fee arrangements, Darwin incurred fees payable to the Capitol Companies of $1.3 million in 2007, and reimbursed the Capitol Companies an additional $0.5 million during 2007 for direct expenses incurred, in connection with the business written on policies of the Capitol Companies.

The term of the underwriting management agreements between DPUI and the Capitol Companies run from June 1 through May 31 of each year. However, either party may terminate effective upon an expiration date, provided that the terminating party provides 60 days prior notice of termination. In addition, a Capitol Company may terminate at any time, by written notice, when Alleghany does not own at least 51% of the outstanding equity interests in DPUI or upon a sale of all or substantially all of the assets of DPUI to a person other than Alleghany or an affiliate of Alleghany. DPUI may terminate its underwriting management agreement with a Capitol Company at any time, by written notice, when Alleghany does not own at least 51% of the outstanding equity interests in the subject Capitol Company or upon a sale of all or substantially all of the assets of the subject Capitol Company to any person other than Alleghany or an affiliate of Alleghany. Effective as of the end of 2007, DPUI delegated the performance of obligations under the underwriting management agreements to its subsidiary, DNA, with the Capital Companies consent.

Reinsurance

Ceded Reinsurance

We reinsure a portion of our business with other insurance companies. Ceding reinsurance permits us to diversify risk and limit our exposure to loss arising from large or unusually hazardous risks or catastrophic events in addition to frequency risks. We are subject to credit risk with respect to our reinsurers, as ceding risk to reinsurers does not relieve us of liability to our insureds. To mitigate reinsurer credit risk, we cede business to reinsurers only if they meet our requirement of an A.M. Best rating of A− (Excellent). If a reinsurer s A.M. Best rating falls below A− (Excellent), our contract with the reinsurer generally provides that we may prospectively terminate the reinsurer s participation in our reinsurance program upon 30 days notice.

In general we retain the first $1 million of loss per claim across most classes of business including many of the E&O classes, private and non-profit D&O and most medical malpractice classes. However for commercial D&O, healthcare management and FI D&O, managed care and FI E&O and short-line railroad liability we retain the first $2 million of loss per claim. On other specific classes we retain lower limits that currently range from $0.3 million to $0.5 million of loss per claim. In addition we retain various additional amounts known as co-insurances that vary between 10% and

25% of the limits above these retentions. The table below provides more details of our retentions and the maximum amount we retain for the largest policy amount that we write.

Generally, there are two types of traditional reinsurance, treaty reinsurance and facultative (individual risk) reinsurance. We currently purchase treaty reinsurance and, as described below, in certain cases we purchase facultative reinsurance.

Treaty Reinsurance. Our treaty reinsurance program consists of excess of loss reinsurance.

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The following is a summary of our major treaty reinsurance coverages effective for policies written at December 31, 2007:

Treaty	Product Lines Covered	MaximumPolicy Limits Offered	Reinsurance Coverage	Description of Company Retention	Total Company Retention at Maximum Limit Offered
Professional Lines(1)	Commercial, Healthcare and FI D&O, FI E&O and Shortline Railroad General Liability	$20 million per claim for A-Side D&O; $15 million per claim for Healthcare D&O; and $10 million per claim for all other classes	$18 million excess of $2 million per claim for A-Side D&O; $13 million excess of $2 million for Healthcare D&O; $8 million excess of $2 million per claim for all other classes	First $2 million per claim; 25% of the next $3 million of loss per claim; 15% of the next $10 million of loss per claim; and 10% of the next $5 million of loss per claim	$4.75 million per claim for A-Side D&O; $4.25 million per claim for Healthcare D&O; and $3.5 million per claim for all other classes
Professional Lines(1)	Private and Non-Profit D&O, E&O (Technology E&O, Lawyers Professional E&O for law firms with fewer than 100 lawyers, Insurance Agents E&O, Insurance Company E&O, Miscellaneous Professional E&O, and Media)	$15 million per claim for Private and Non-Profit D&O and Insurance Agents E&O; and $10 million per claim for all other classes	$14 million excess of $1 million per claim for Private and Non- Profit D&O and Insurance Agents E&O; $9 million excess of $1 million per claim for all other classes	First $1 million per claim; 25% of the next $4 million of loss per claim; and 15% of the next $10 million of loss per claim	$3.5 million per claim for Private and Non-Profit D&O and Insurance Agents E&O; $2.75 million per claim for all other classes
Managed Care E&O(1)	Managed Care E&O	$20 million per claim for Managed Care E&O	$18 million excess of $2 million per claim	First $2 million per claim; 25% of the next $3 million of loss per claim; 15% of the next $5 million of loss per claim; and 10% of the next $10 million of loss per claim	$4.5 million per claim
Medical Malpractice(1)	Physicians, Hospitals	$16 million per claim	$10 million excess of $1.0 million	First $1 million per claim; 15% of loss in excess of $1 million	$2.5 million per claim

			per claim	per claim	
Psychiatrists	Psychiatrists Professional Liability	$2 million per claim	$1.5 million excess of $0.5 million per claim	$0.5 million per claim	$0.5 million per claim
Psychologists	Psychologists E&O Liability	$2 million per claim	$1.50 million excess of $0.5 million per claim	$0.5 million per claim	$0.5 million per claim
Public Entity(1)	Municipal Entity and Public Officials, Police and Governmental Employees E&O	$5 million per claim	$4.7 million excess of $0.3 million per claim	First $0.3 million per claim; 15% of $1 million in excess of $1 million per claim; 10% of $3 million in excess of $2 million per claim	$0.75 million per claim

(1) Caps or aggregate limits apply to various layers of coverage as set forth in each reinsurance contract.

We purchase excess of loss reinsurance to mitigate the volatility of our book of business by limiting exposure to frequency and severity losses. We purchase both fixed rate and variable rate excess of loss reinsurance.

Fixed rate excess of loss reinsurance, under which we cede a fixed percentage of premiums to our reinsurers depending upon the policy limits written, provides indemnification to us in excess of a fixed amount of losses incurred up to a maximum recoverable amount. The maximum amount recoverable is expressed as either a dollar amount or a loss ratio cap which is expressed as a percentage of the maximum amount of the ceded premium. In some instances the contracts are expressed as the greater of a dollar amount or a loss ratio cap. The maximum amounts recoverable when expressed as a loss ratio cap vary from a minimum of 250% to a maximum in excess of 700% of ceded premium payable within the terms of the contracts.

Variable rate excess of loss reinsurance is structured on a basis that enables us to retain a greater portion of premium if our ultimate loss ratio is lower than an initial loss pick threshold set by our reinsurers. For these contracts our ultimate ceded premium incurred on these treaties is determined by the loss ratio on the business subject to the reinsurance treaty. As the expected ultimate loss ratio increases or decreases, the ceded premiums and losses recoverable from reinsurers will also increase or decrease relationally within a minimum and maximum range for ceded premium and up to a loss ratio cap for losses recoverable. Until such time as the ceded premium reaches the maximum rate within the terms of the contract, ceded premium paid to the reinsurer will be in excess of the amount of any losses recoverable from reinsurers. After the ceded premium incurred reaches the maximum rate stated in the contract, losses incurred covered within the contract are recoverable from reinsurers up to a maximum amount recoverable, without any required additional ceded premium payment. The maximum amount recoverable is expressed as either a dollar amount or a loss ratio cap which is expressed as a percentage of the maximum amount of the ceded premium. In some instances the contracts are expressed as the greater of a dollar amount or a loss ratio cap. When expressed as a loss ratio cap these variable rated contracts vary from 225% to 300% of the maximum rate of ceded premium payable within the terms of the contracts. As a result, the same uncertainties associated with estimating loss and loss adjustment expense (LAE) reserves affect the estimates of ceded premiums and losses recoverable from reinsurers on these contracts. In some instances we have purchased variable rated excess of loss reinsurance that has no maximum amount recoverable.

We also purchase pro rata reinsurance for certain portions of our book of business. Pro rata reinsurance allows us to grow our book of business cautiously by managing our loss exposure and net premiums written position. Furthermore, pro rata reinsurance allows us to collect a ceding commission equal to a percentage of ceded premiums. We typically use such ceding commission on pro rata reinsurance to offset product development expenses and policy acquisition costs.

The principal reinsurance intermediary used by Darwin, R.K. Carvill & Co., Ltd., employs the brother of our Senior Vice President Underwriting, David Newman, who is a member of Darwin management s reinsurance purchasing committee. Mr. Newman s brother, who resides in the United Kingdom, is compensated with respect to reinsurance transactions in which the Company engages, but Mr. Newman receives no personal benefit from such compensation. The Company s reinsurance purchasing committee also consists of the Company s Chief Executive Officer, Chief Financial Officer and Chief Actuary.

Facultative Reinsurance. If a particular risk that we would like to write falls outside of the underwriting parameters of our treaty reinsurance, we utilize the facultative reinsurance market. Generally, facultative reinsurance enables us to take advantage of opportunities that arise from time to time to write specific, one-off risks on terms that we believe to be favorable.

Risk Transfer Requirements. Reinsurance contracts that do not result in a reasonable possibility that the reinsurer may realize a significant loss from the insurance risk assumed and that do not provide for the transfer of significant insurance risk generally do not meet the requirements for reinsurance accounting and are accounted for as deposits. Darwin has no contracts with third-party reinsurers that do not meet the risk transfer provisions of Financial Accounting Standards Board (FASB) Statement No. 113, *Accounting for Reinsurance* (SFAS No. 113).

Darwin Select Reinsurance Recoverable. In connection with its acquisition from Ulico Casualty Company in May 2005, the entity that became Darwin Select ceded all liabilities on insurance business it had written or assumed prior to the acquisition to Ulico Casualty Company. Darwin Select and Ulico Casualty Company also entered into a trust agreement under which Ulico Casualty Company established a trust account for the benefit of Darwin Select. Under the trust agreement, the obligations of Ulico Casualty Company to Darwin Select are collateralized by a deposit of trust assets, which are limited to cash and investment securities permitted by Arkansas insurance laws. At December 31, 2007, the aggregate amount of gross reserves in respect of the liabilities reinsured under the reinsurance agreement carried on the balance sheet of Darwin Select was $1.5 million. In addition, Ulico

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Casualty Company has agreed to indemnify both DNA (the purchaser) and Darwin Select against liabilities arising out of the operations prior to the closing. ULLICO Inc. has guaranteed the performance by Ulico Casualty Company of its indemnification obligations and of its obligations under the reinsurance agreement and the trust agreement. The trust fund balance was in excess of $1.5 million as of December 31, 2007.

Vantapro Reinsurance Recoverable. In connection with the acquisition of Vantapro in November 2007 from Fireman s Fund, Vantapro ceded all liabilities on insurance business it had written or assumed prior to the acquisition to Fireman s Fund. At December 31, 2007, the aggregate amount of gross reserves in respect of liabilities reinsured under that reinsurance agreement was $449,000. In addition to the reinsurance contract, Fireman s Fund has indemnified Vantapro for all remaining liabilities or obligations arising prior to the sale. Fireman s Fund is rated A (Excellent) by A.M. Best.

Principal Reinsurers

The following table sets forth our ten largest reinsurers in terms of amounts recoverable as of December 31, 2007. Also shown are the amounts of ceded unearned reinsurance premiums for each reinsurer less net ceded premiums payable and amounts in trust accounts or secured by letters of credit to determine the net credit exposure by reinsurer as of December 31, 2007.

Reinsurer	A.M. Best Rating	Reinsurance Recoverable on Paid and Unpaid Losses	Ceded Unearned Reinsurance Premiums	Less Reinsurance Ceded Premiums Payable (Receivable)	Less Amounts in Trust Accounts or Secured by Letters of Credit	Net Exposure to Reinsurer	Reinsurance Recoverable on Losses as a % of Total Reinsurance Recoverable on Paid and Unpaid Losses
				(Dollars in thousands)			
Transatlantic Reinsurance Company	A+	$ 31,642	$ 8,293	$ 1,411	$	$ 38,524	23.2%
Max Re Limited	A−	18,571	7,690	2,078	24,183		13.6%
AXIS Reinsurance Company	A	16,986	8,953	3,506		22,433	12.5%
ACE Property and Casualty Insurance Company	A+	15,224	355	(181)		15,760	11.2%
Allied World Assurance Corporation	A	14,745	3,511	1,257	17,000		10.8%
	A	11,245	5,923	2,504		14,664	8.2%

Liberty Syndicate 4472(1)							
Platinum Underwriters Reinsurance, Inc.	A	11,142	6,277	1,433		15,986	8.2%
Partner Reinsurance Company of the U.S.	A+	3,322	96	(322)		3,740	2.5%
American Reinsurance Company	A	2,516	130	(8)		2,654	1.8%
Ulico Casualty Company	B+	1,515			1,528		1.1%
Subtotal		126,908	41,228	11,678	42,711	113,761	93.1%
All other reinsurers		9,462	2,016	38	1,712	9,728	6.9%
Total reinsurance receivable		$ 136,370	$ 43,244	$ 11,716	$ 44,423	$ 123,489	100.0%

(1) Liberty Syndicate 4472 is a wholly-owned subsidiary of Liberty Mutual Group Inc.

Reinsurance Assumed from the Capitol Companies. As described above (See Arrangements with the Capitol Companies), all of the obligations of the Capitol Companies relating to business produced by DPUI and written on policies of the Capitol Companies are fully reinsured by DNA and fully collateralized by a reinsurance trust. At December 31, 2007, the market value of trust assets was $217.6 million. Darwin retains ownership rights to the investments held in the trust and the investment income continues to accrue to the Company. In addition, Darwin has authority to substitute similar assets without prior notification to the Capitol Companies.

Claims Management and Administration

Our claims department, which is organized by product, manages all claims arising under insurance policies we have underwritten, except for claims in connection with our short-line railroad program which are managed for us by a third-party administrator with special expertise in that business. The policies we write may be either duty to defend or indemnity coverages. With duty to defend policies, we are obliged to appoint counsel to defend our insured. In connection with this, we have developed lists of counsel who have the expertise to defend claims professionally and in a cost-effective manner. With indemnity policies, the insured selects the defense counsel, subject to our approval. In either case, our claims department is actively involved in the evaluation, strategy and resolution of any case. With regard to our most severe claims, or claims which may involve coverage disputes, we retain monitoring counsel. These lawyers represent our interests, but may also add value to the defense team s ability to resolve a claim.

Setting accurate and timely case reserves is an important function of the claims department. We use a severity code system to help assure that claims are being properly monitored and reserved, with more severe claims receiving the most attention but with all claims monitored through a diary system. Each claims handler is assigned the reserving and settlement authority that we believe is appropriate for his or her experience and the nature of the claims they handle.

Our claims professionals are located at our Farmington, CT headquarters and have regular interaction with underwriters, actuaries and the finance and accounting department. We also have quarterly claims meetings of claims and underwriting personnel and senior management to review serious claims and claims with the potential to become serious claims. We believe that this regular interaction provides us with the ability to efficiently monitor results.

Reserves for Unpaid Losses and LAE

We establish reserves on our balance sheet for unpaid losses and LAE related to our insurance contracts. As of any particular balance sheet date, there are claims that have not yet been reported. Although most of our insurance policies are issued on a claims-made basis, we do have some occurrence policies. In the case of occurrence policies, there may be claims that are not reported for years after the date that a loss event occurs. As a result, for both claims-made and occurrence business, the liability for unpaid losses and LAE at any given date includes significant estimates for claims incurred but not reported. Additionally, many of the claims that have been reported will be in various stages of resolution. Each claim is resolved individually based upon its merits, and some may take years to resolve, especially if litigated. As a result, the liability for unpaid losses and LAE at any given date reflects significant judgments, assumptions and estimates made by management relating to the ultimate losses that will arise from the claims. Due to the inherent uncertainties in the process of establishing these liabilities, the actual ultimate loss from a claim is likely to differ, perhaps materially, from the liability initially recorded, and the amount of the difference between the actual ultimate loss and the recorded amount could be material to the results of our operations.

As with any insurance company s balance sheet date, some of the claims that have occurred will have not yet been reported; some that have been reported will not have been resolved. The time period between occurrence of a loss and its resolution by the insurer is referred to as the claims tail. Although Darwin s predominance of claims-made policies has a positive impact in terms of reducing claim tails, most of our coverages are nonetheless regarded as having moderate or longer tails. This is because our lines of business frequently involve litigation by third parties against insureds, and the litigation may take years before resolution by judgment or settlement. Our reference to moderate and longer tail business generally refers to claim tails of between three and seven years.

We use a variety of techniques that employ significant judgments and assumptions to establish the liabilities for unpaid losses and LAE recorded on the balance sheet date. These techniques include statistical analyses and standard actuarial methodologies applied to our claim history supplemented with loss experience for the insurance industry overall (through use of publicly-available data). The techniques may consider open and closed claims counts, settlement activity, claim frequency, internal loss experience, loss reporting and payout patterns, reported and projected ultimate loss ratios, changes in pricing or coverages, and severity data, depending upon the statistical credibility of the available information. Subjective techniques are used to complement actuarial analyses, especially when statistical data is insufficient or unavailable. These liabilities also reflect implicit or explicit assumptions regarding the potential effects of future inflation, changes in price levels, judicial decisions, changes in laws and recent trends in such factors, as well as a number of actuarial assumptions that vary across our lines of business. This data is analyzed by line of business and accident/report year, as appropriate.

Our loss reserve review process uses actuarial methods and underlying assumptions from which we select the carried reserve for each class of business. The estimates underlying the liabilities for loss reserves are derived from generally accepted actuarial techniques, applied to our actual experience, though limited to our approximate five years of operating history, and take into account insurance industry data to the extent judged relevant to our operations.

While not necessarily indicative of future results, in the years since our inception, reported losses have been below expectations. The relatively low volume of losses to date limits the applicability of many standard actuarial analysis methods (which require a significantly higher volume of losses). The actuarial methods used by Darwin include the Bornhuetter-Ferguson method for incurred losses. We continually evaluate the potential for changes, both positive and negative, in our estimates of such liabilities and use the results of these evaluations to adjust both recorded liabilities and underwriting criteria. With respect to liabilities for unpaid losses and LAE established in prior years, such liabilities are periodically analyzed and their expected ultimate cost adjusted, where necessary, to reflect positive or negative development in loss experience and new information. Adjustments to previously recorded liabilities for unpaid losses and LAE, both positive and negative, are reflected in our financial results for the periods in which such adjustments are made and are referred to as prior year reserve development.

Changes in Historical Net Loss and LAE Reserves

The following table shows changes in our historical net loss and LAE reserves for years 2003 through 2007. Reported reserve development is derived primarily from information included in statutory financial statements of the Capitol Companies and of our insurance company subsidiaries DNA and Darwin Select. The Net liability as of the end of the period line of the table shows the net reserves at December 31 of each of years 2003, 2004, 2005, 2006 and 2007, representing the estimated amounts of net outstanding losses and LAE for claims arising during the period and in all prior periods that are unpaid, including losses that have been incurred but not yet reported. The Cumulative amount of net liability paid as of line of the table shows the cumulative net amounts paid with respect to the net reserve liability for each period. The Net liability re-estimated as of line of the table shows the re-estimated amount of the previously recorded net reserves for each period based on experience as of the end of each succeeding period. The estimate changes as more information becomes known about claims for individual periods. The Gross cumulative redundancy (deficiency) represents, as of December 31, 2007, the difference between the latest re-estimated liability and the reserves as originally estimated. A redundancy means the original estimate was higher than the current estimate; and a deficiency means that the current estimate is higher than the original estimate.

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Conditions and trends that have affected the development of the net reserve liability in the past may not necessarily occur in the future. Accordingly, you should not extrapolate future redundancies or deficiencies based on this table.

	Year Ended December 31,				
	2003	**2004**	**2005**	**2006**	**2007**
	(Dollars in thousands)				
Gross liability-end of period	$ 3,485	$ 47,207	$ 138,404	$ 263,549	$ 387,865
Reinsurance recoverable on unpaid losses-end of period	990	15,572	51,229	96,258	136,012
Net liability-end of period	2,495	31,635	87,175	167,291	251,853
Cumulative amount of net liability paid as of:					
One year later	50	1,782	6,231	11,999	
Two years later	555	3,250	12,023		
Three years later	557	4,134			
Four years later	549				
Net liability re-estimates as of:					
One year later	2,495	31,601	84,915	153,505	
Two years later	2,527	29,341	77,158		
Three years later	2,186	22,495			
Four years later	1,066				
Net cumulative redundancy (deficiency)	$ 1,429	$ 9,140	$ 10,017	$ 13,786	
Gross liability-end of period	$ 3,485	$ 47,207	$ 138,404	$ 263,549	$ 387,865
Reinsurance recoverable on unpaid losses-end of period	990	15,572	51,229	96,258	136,012
Net liability-end of period	$ 2,495	$ 31,635	$ 87,175	$ 167,291	$ 251,853
Gross re-estimated liability-latest	$ 1,596	$ 30,745	$ 113,044	$ 238,015	
Re-estimated recoverable-latest	530	8,250	35,886	84,510	
Net re-estimate liability-latest	1,066	22,495	77,158	153,505	
Gross cumulative redundancy (deficiency)	$ 1,889	$ 16,462	$ 25,360	$ 25,534	

Net Loss and LAE Reserves

The reconciliation between our aggregate net loss and LAE reserves reported in the annual statements filed with state insurance departments prepared in accordance with statutory accounting principles (SAP) and those reported in our historical consolidated financial statements prepared in accordance with GAAP is shown below:

Reconciliation of Reserves for Losses and LAE from SAP Basis to GAAP Basis

	Year Ended December 31, 2007	2006	2005
	(Dollars in thousands)		
Statutory reserves	$ 251,853	$ 167,291	$ 87,175
Reinsurance recoverables on unpaid losses	136,012	96,258	51,229
GAAP reserves	$ 387,865	$ 263,549	$ 138,404

The reconciliation of beginning and ending aggregate reserves for unpaid losses and LAE is shown below:

Reconciliation of Reserves for Losses and LAE

	2007	2006	2005
	(Dollars in thousands)		
Gross reserves balance at January 1,	$ 263,549	$ 138,404	$ 47,207
Less reinsurance recoverables on unpaid losses	(96,258)	(51,229)	(15,572)
Net reserves balance at January 1,	167,291	87,175	31,635
Add acquired gross reserves	449		6,693
Less reinsured acquired gross reserves	(449)		(6,693)
Net reserve balance	167,291	87,175	31,635
Incurred losses and LAE, net of reinsurance, related to:			
Current period	115,064	90,879	58,640
Prior periods	(13,786)	(2,260)	(34)
Total incurred	101,278	88,619	58,606
Paid losses and LAE, net of reinsurance, related to:			
Current period	4,717	2,272	1,284
Prior periods	11,999	6,231	1,782
Total paid	16,716	8,503	3,066
Net reserve balance at December 31,	251,853	167,291	87,175
Plus reinsurance recoverables on unpaid losses	136,012	96,258	51,229
Gross reserves balance at December 31,	$ 387,865	$ 263,549	$ 138,404

Ceded Premium Adjustments for Prior Periods Reduction in Estimated Incurred Losses and LAE

Part of the Company s reinsurance ceded excess of loss program is structured on a variable cost basis, which enables us to retain a greater portion of the premium if the ultimate loss ratio is lower than our agreed-upon benchmark. For these contracts our ultimate ceded premium incurred on these treaties is determined by the loss ratio on the business subject to the reinsurance treaty. As the expected ultimate loss ratio increases or decreases, the ceded premiums and losses recoverable from reinsurers will also increase or decrease relationally within a minimum and maximum range for ceded premium and up to a loss ratio cap for losses recoverable. The prior period s reduction in estimated loss and LAE incurred above have resulted in the reporting of downward ceded premium adjustments for the reinsurance ceded variable cost contracts. The following table presents the downward ceded premium adjustment recorded in the years ending December 31, 2007, 2006, and 2005 by accident year:

Ceded

Calendar Year	Premium Adjustment Amount	Accident Year Ending December 31, 2006	2005	2004	2003
	(Dollars in thousands)				
2005	$ 293	$	$	$	$ 293
2006	1,700			1,259	441
2007	7,406	741	5,005	1,659	1
Totals	$ 9,399	$ 741	$ 5,005	$ 2,918	$ 735

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Asbestos, Environmental Impairment and Mold Claims Reserves

We believe that we have not provided insurance coverage that could reasonably be expected to produce material levels of asbestos, environmental or mold claims activity.

Sub-prime Lending Claims and Exposure

Sub-prime mortgages and related credit practices have emerged as a new potential source of liability for many American businesses. Although the full extent of potential sub-prime related loss on insurance policies is still developing, we have attempted to analyze our potential exposure. To date, we have received notice of only three such claims. Each involves excess policies, two of which were issued to the same insured (one claim related to a D&O policy and the other to a fiduciary liability policy). The third claim entails excess coverage on an A-side only basis (i.e., for directors individually where corporate indemnification is unavailable.) All claims are in very early stages; their ultimate outcomes and our exposure on them are uncertain.

With regard to any future exposure beyond these claims, we believe that we are currently well-positioned to avoid substantial loss. Much of the sub-prime litigation to date has involved financial institutions that originated, securitized, or purchased sub-prime instruments. Darwin has written insurance policies for only a modest number of financial institutions. Litigation has also focused on businesses related to real estate such as home builders, mortgage brokers, and real estate appraisers. We have substantially avoided real estate-related classes in our underwriting decisions. In addition to our internal analysis, several independent sources such as Bear Stearns and Advisen have created lists of entities that they believe may have a sub-prime exposure. A review of these outside lists offers additional support to our current belief that our policyholder exposure to sub-prime losses should be relatively modest. However, the scope of sub-prime exposures and underlying theories of liability are still developing.

Competition

The property-casualty insurance industry is highly competitive, and it is trending toward even more competitive conditions in the future as additional insurers enter the marketplace. We compete with domestic and foreign insurers and reinsurers, some of which have greater financial, marketing and management resources than we do. We may also be subject to additional future competition from new market entrants. Competition is based on many factors, including the perceived financial strength of the insurer, pricing and other terms and conditions, services provided, ratings assigned by independent rating organizations (including A.M. Best), the speed of claims payment and the reputation and experience of the insurer. Our competitors vary by line and class of business. Collectively, however, we consider our major competitors to include American International Group, Inc., The Chubb Corporation, XL Capital Ltd., The Travelers Companies, Inc., Lloyd s of London, ACE Limited, Liberty Mutual Group Inc., The Hartford Financial Services Group, Inc., The Navigators Group, Inc., HCC Insurance Holdings, Inc., United States Liability Insurance Group, OneBeacon Insurance Group LLC, RSUI, Great American Insurance Group, Endurance Specialty Insurance Ltd., CNA Financial Corporation, Arch Insurance Group, Inc., AXIS Capital Holdings Limited, W.R. Berkeley, Markel Insurance Company and Zurich Financial Services.

Ratings

Best is the leading provider of ratings, news, data and financial information for the global insurance industry, and Best ratings currently range from A++ (Superior) to F (Liquidation), with a total of 16 separate ratings categories. The objective of Best s rating system is to provide an independent opinion as to an insurer s financial strength and ability to meet obligations to policyholders. Best s opinions are derived from an evaluation of a company s balance sheet strength, operating performance and business profile. Particularly for companies that have limited operating histories like us, Best s rating methodology incorporates a conservative view of business risks and balance sheet position. As a result, in order to optimize our Best s rating we currently hold capital that we believe is significantly in excess of the level required to support our current premium volume. We expect that this additional capital will be available to support our future growth.

In February 2008, Best reaffirmed its prior assignment to DNA of an independent A− (Excellent) rating and its assignment to Darwin Select of an A− (Excellent) rating on a reinsured basis. According to *A Guide to Best s*

Financial Strength Ratings, which is available on Best s website, A / A– (Excellent) ratings are assigned to insurers that have, in Best s opinion, an excellent ability to meet their ongoing obligations to policyholders. Best bases its ratings on factors that concern policyholders and not upon factors concerning investor protection. Accordingly, such ratings are subject to change and are not recommendations to buy, sell or hold securities.

Our insurance ratings are subject to periodic review by Best, and may be revised or revoked at any time at Best s sole discretion. A downgrade of our ratings could cause our current and future distribution partners and insureds to choose higher-rated competitors and could also increase the cost or reduce the availability of reinsurance to us. As a result, a downgrade in our ratings could cause a substantial reduction in the number of policies we write, which would have a material adverse effect on our financial condition and results of operations.

Evolution and Subsidiaries

In November 2007, we announced that we had formed Evolution as a new subsidiary to serve as a holding company for our non-risk bearing insurance operations. Concurrently, we announced that Evolution had agreed to acquire all of the stock of the three affiliated AMS insurance distribution entities in Florida. Effective with the acquisition of AMS on January 4, 2008, this also includes a program administrator and wholesale broker for a lawyers professional liability insurance program for small law firms in Florida. Allsouth Professional Liability, Inc. is a wholesale broker for a variety of professional liability and other products for accounts located throughout the southeastern U.S., and Raincross Insurance Inc. is currently dormant. Together, the new subsidiaries had produced insurance premiums totaling $35.4 million during 2007, approximately $0.3 million of such total being on Darwin policies.

The new Evolution subsidiaries are located in St. Pete Beach, Florida. We have employed two Florida Lawyers Professional Liability (LPL) specialists, Boyd Wolf and David Gough, to serve as senior managers of AMS. Messrs. Wolf and Gough had been principals of Wolf Professional Risk, Inc., a Tampa-based program administrator with which we had in place a program for Florida-based LPL accounts. With their employment by AMS, Wolf Professional Risk is now dormant and its program business is being rolled into AMS. We have entered into a new program administration relationship with Agency Marketing Services, Inc. (AMS Inc.). In all other respects, we expect to treat the AMS entities as independent third-party intermediaries, and we will compete for their business on an arm s length basis, alongside of the other underwriting companies with which AMS Inc. and Allsouth have long-established relationships.

Employees

At January 31, 2008, we employed 163 full-time and 12 part-time employees. Of that total, 136 were DNA employees located at our headquarters in Farmington, 7 were DNA employees located at remote offices and 32 were employees of the Evolution subsidiaries in Florida. Up until December 31, 2007, the 136 DNA employees had been employees of DPUI. None of our employees is subject to collective bargaining agreements and we know of no current efforts to implement such agreements. We believe that we have an excellent relationship with our employees.

Available Information on the Internet

This report and all other filings made by the Company with the Securities and Exchange Commission (SEC) pursuant to Section 13(a) or 15(d) of the Securities Exchange Act are made available to the public by the SEC. All filings can be read and copied at the SEC Public Reference Room, located at 100 F Street, NE, Washington, DC 20549. Information pertaining to the operation of the Public Reference Room can be obtained by calling 1-800-SEC-0330. Further, the Company is an electronic filer, so all reports, proxy and information statements, and other information can be found at the SEC website, www.sec.gov. The Company s website address is http://www.darwinpro.com. Through its website, the Company makes available, free of charge, its Annual Report on Form 10-K, quarterly reports on

Form 10-Q, current reports on Form 8-K and all amendments to those reports as soon as reasonably practicable after such material is electronically filed with or furnished to the SEC. The Annual Report to stockholders, press releases and recordings of our earnings release conference calls are also provided on our website.

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State Regulation

General

We are regulated by insurance regulatory agencies in the states in which we conduct business. State insurance laws and regulations generally are designed to protect the interests of policyholders, consumers or claimants rather than stockholders or other investors. The nature and extent of state regulation varies by jurisdiction, and state insurance regulators generally have broad administrative power relating to, among other matters, setting capital and surplus requirements, licensing of insurers and agents, establishing standards for reserve adequacy, prescribing statutory accounting methods and the form and content of statutory financial reports, regulating certain transactions with affiliates, prescribing the types and amounts of investments, payments of dividends and of distributions and proposed acquisitions or control of domestic or licensed insurers. Additionally, although the federal government does not directly regulate the business of insurance, federal initiatives often affect the insurance industry in a variety of ways.

Certain types of state insurance regulation applicable to us are described more fully below.

Required Licensing

DNA is organized under the laws of Delaware and is authorized (licensed) in Delaware to transact certain lines of property and casualty insurance. As of year-end 2007, DNA was licensed in 50 jurisdictions (including the District of Columbia) and was eligible to write on a surplus lines basis in one other state. Insurance licenses are issued by state insurance regulators and may be of perpetual duration or may require periodic renewal. We must obtain appropriate new licenses before we can expand into a new state on an admitted basis or offer new lines of insurance that require separate or additional licensing.

As an admitted insurer DNA must usually file its premium rates and policy forms for review and approval by each state s insurance regulators. In many states, rates and forms must be approved prior to use, and insurance regulators have broad discretion in judging whether an insurer s rates are adequate, not excessive and not unfairly discriminatory. In some states, there has been deregulation for large commercial risks, which may reduce or eliminate form and rate approval requirements in certain circumstances.

Darwin Select is organized under the laws of Arkansas and authorized (licensed) in Arkansas to transact certain lines of property and casualty insurance. In certain other states, Darwin Select policies may be placed on a surplus lines basis. As of December 31, 2007, Darwin Select was eligible to have its policies placed on a surplus lines basis in 49 jurisdictions (including the District of Columbia). Darwin Select is not required to apply for or maintain a license in those states. However, in order to remain an eligible surplus lines insurer in a particular jurisdiction, Darwin Select must either meet suitability standards or obtain approval under such jurisdiction s surplus lines laws. Except for Arkansas (where it is licensed) Darwin Select maintains surplus lines eligibility in all of the states where it operates. As a surplus lines writer, Darwin Select does not file rates or policy forms, and it can therefore adjust its pricing and coverage terms more quickly than an admitted insurer can.

All of the business of Darwin Select is written through licensed surplus lines agents and brokers who must comply with specific rules and regulations concerning surplus lines placements. For example, surplus lines agents and brokers are often required to certify that a certain number of licensed admitted insurers had been offered and declined to write a particular risk prior to placing that risk with Darwin Select.

In November 2007 we acquired Midway Insurance Company of Illinois from Fireman s Fund. That entity, which we have renamed Vantapro Specialty Insurance Company, is domiciled in Illinois and licensed by Illinois to transact certain lines of property and casualty insurance business. We have filed an application to redomesticate Vantapro to

Arkansas. During the first quarter of 2008 we expect to commence the process of obtaining for Vantapro eligibility to write on a surplus lines basis in states other than Arkansas. Vantapro will be available to offer coverage in situations where Darwin Select cannot, due to its existing program relationships or other contractual constraints.

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Insurance holding company laws

We operate within the insurance holding company system and are subject to regulation in the states in which our insurance company subsidiaries are domiciled. These laws require that each of our insurance company subsidiaries register with the insurance department of its state of domicile and furnish information about the operations of the companies within the insurance holding company system that may materially affect the operations, management or financial condition of the insurers within the system. These laws also provide that all transactions between the insurer domiciled in that jurisdiction and any member of its holding company system must be fair and reasonable. Transactions between insurance company subsidiaries and their parents and affiliates generally must be disclosed to the state regulators, and notice and prior approval of the state insurance regulator is required for material or extraordinary transactions. Transactions between DNA, Darwin Select or Vantapro, on the one hand, and Alleghany or any other member of the Alleghany holding company system (including the subsidiaries we refer to as the Capitol Companies), on the other hand, are subject to these regulatory requirements of notice and prior approval.

Payment of dividends

General. DPUI has not historically had significant operations other than our underwriting manager business, and we anticipate that subsidiary payments, including dividends paid by our subsidiaries, will be our primary source of funds for the foreseeable future. To protect insurer solvency, state insurance laws restrict insurance subsidiaries ability to pay dividends or to make other payments to holding companies. Regulators require insurance companies to maintain specified levels of statutory capital and surplus. Generally, dividends may only be paid out of earned surplus, and the insurer s surplus following payment of any dividends must be both reasonable in relation to its outstanding liabilities and adequate to meet its financial needs. Also, prior approval of the insurance department of its state of domicile is required before any of our insurance company subsidiaries can declare and pay an extraordinary dividend to us. In February 2007, the Delaware Insurance Department approved the declaration by DNA of a $3.5 million extraordinary dividend to DPUI. The following paragraph outlines the statutory criteria for the payment of extraordinary dividends:

Delaware. Under Delaware law, DNA may not pay an extraordinary dividend, which includes a dividend or distribution paid at a time when the Company does not have a positive earned surplus balance, or a dividend the fair market value of which, together with that of other dividends or distributions made within the preceding 12 months, exceeds the greater of (i) 10% of statutory surplus as of the prior year-end or (ii) statutory net income less realized capital gains for such prior year, until thirty days after the Insurance Commissioner of the State of Delaware (Delaware Commissioner) has received notice of such dividend and has either (i) not disapproved such dividend within such thirty day period or (ii) approved such dividends within such thirty day period. In addition, DNA must provide notice to the Delaware Commissioner of all dividends and other distributions to stockholders within five business days after declaration and at least ten days prior to payment.

Arkansas. Darwin Select is domiciled in Arkansas and Vantapro has filed with the insurance regulator an application to be re-domesticated to Arkansas. Under that State s Arkansas law it may not pay an extraordinary dividend, defined as any dividend or distribution, the fair market value of which, together with that of other dividends or distributions made within the preceding 12 months, exceeds the greater of (i) 10% of statutory surplus as of the prior year-end or (ii) statutory net income less realized capital gains for such prior year, until thirty days after the Insurance Commissioner of the State of Arkansas (Arkansas Commissioner) has received notice of such dividend and has either (i) not disapproved such dividend within such thirty day period or (ii) approved such dividends within such thirty day period. In addition, an Arkansas insurance company must provide notice to the Arkansas Commissioner of all dividends and other distributions to stockholders within five business days after the declaration thereof and at least ten days prior to payment.

The dividend and distribution limitations imposed by the state insurance laws described above are based on the statutory financial results of the respective insurance company subsidiaries as determined by statutory accounting principles, which differ from GAAP in various ways. Key differences relate to, among other things, deferred policy acquisition costs, limitations on deferred income taxes and required investment reserves. See Statutory Accounting Principles below. Insurance regulators can block payments to us from our insurance company subsidiaries that would otherwise be permitted without prior approval if the regulators determine that the payments (such as payments under our underwriting management agreements or tax sharing agreements or payments for employee or other services) would be adverse to the interests of policyholders or creditors.

As noted, DNA paid an extraordinary dividend to us in 2007. Based on the dividend restrictions under applicable laws and regulations described above, we believe that DNA is now in financial position to declare and pay regular dividends to us. Neither Darwin Select nor Vantapro has paid any dividends to DNA.

Change of control

Many state insurance laws contain provisions for advance approval by the insurance commissioner of any change of control of an insurer domiciled (or, in some cases, has such substantial business that it is deemed to be commercially domiciled) in that state. Before approving an application to acquire control of an insurer, a commissioner will typically consider such factors as the acquirer s financial strength, the integrity of its directors and executive officers, its plans for future operations of the insurer and any anti-competitive result that may arise from the change of control. Generally, state statutes provide that control of an insurer is presumed to exist if any person, directly or indirectly, owns, controls, holds with the power to vote, or holds proxies representing, 10% or more of the voting shares of the insurer or of any company that controls the insurer, although this presumption of control may be rebutted. Therefore, if any person were to acquire 10% or more of DPUI s voting shares without prior approval of the Delaware and the Arkansas Commissioners there would be a violation of those states laws, subjecting such acquirer to injunctive action as the relevant regulator may determine appropriate, such as, for example, required disposition of the common stock or prohibition against voting such stock.

In addition, the laws of many states contain provisions requiring pre-notification to a regulatory agency prior to any change of control of a non-domestic insurance company admitted to transact business in that jurisdiction. While these pre-notification statutes do not authorize the regulatory agency to disapprove the change of control, they do authorize issuance of cease and desist orders with respect to the non-domestic insurer if it is determined that some conditions, such as undue market concentration, would result from the change of control.

These requirements may discourage acquisition proposals and may delay or prevent transactions affecting the control of our common stock, including transactions, and in particular unsolicited transactions, that some or all of our stockholders may consider desirable.

Statutory accounting principles

Statutory accounting principles (or SAP) is a basis of accounting developed to assist insurance regulators in monitoring and regulating the solvency of insurance companies. SAP was developed primarily to measure the ability to pay all current and future obligations to policyholders and creditors. Regulators in the domiciliary states of our insurance company subsidiaries, Delaware and Arkansas, have adopted the NAIC s statutory principles, with certain modifications. SAP and related regulations determine, among other things, the amount of statutory surplus and statutory net income of our insurance company subsidiaries and thus determine, in part, the amount of funds these subsidiaries have available to pay to us as dividends.

The values for assets, liabilities and equity reflected in financial statements prepared in accordance with GAAP may be different from those reflected in financial statements prepared under SAP. GAAP is designed to measure a business on a going-concern basis. It gives more consideration to the matching of revenue and expenses than SAP does and, as a result, certain expenses are capitalized when incurred and then amortized over the life of the associated policies. The valuation of assets and liabilities under GAAP is based in part upon best estimates made by the insurer. Stockholder s equity represents both amounts currently available and amounts expected to become available over the life of the business.

Guaranty association assessments

Most of the states require property and casualty insurers writing business on an admitted basis in that state to participate in guaranty associations. These associations are organized to pay benefits owed to policyholders and claimants pursuant to insurance policies issued by insurers which have become impaired or insolvent. Typically, a

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state assesses each licensed insurer an amount related to the licensed insurer s proportionate share of premiums written by all licensed insurers in the state in the line of business in which the impaired or insolvent insurer was engaged. Some states permit licensed insurers to recover a portion of these payments through full or partial premium tax credits or, in limited circumstances, by surcharging policyholders. In some states where full and partial premium tax credits are allowed, there have been legislative efforts to limit or repeal the tax offset provisions.

For the year ended December 31, 2007, assessments aggregating $130,000 were levied against either DNA or Darwin Select. No assessments were levied against Vantapro. Although the amount and timing of future assessments are not predictable, we have established liabilities for guaranty fund assessments that we consider adequate for assessments with respect to insurers that currently are subject to insolvency proceedings in states where our insurance company subsidiaries are licensed to transact business.

Insurance Regulatory Information System

The NAIC Insurance Regulatory Information System, or IRIS, was developed to help state regulators identify companies that may require special attention. IRIS identifies twelve key financial ratios and specifies usual ranges for each ratio. Insurers typically submit financial information about themselves to the NAIC annually, which in turn analyzes the data using the prescribed ratios. These ratios assist state insurance departments in executing their statutory mandates to oversee the financial condition of insurance companies operating in their respective states.

Departures from the usual ranges of ratios may lead to inquiries from the insurance departments. Generally, regulators will begin to investigate or monitor an insurance company if four or more of its ratios fall outside the usual ranges. Due to the significant impact of year-over-year growth in premiums and reserves on the finances of our relatively young insurance company subsidiaries, we expect to generate unusual IRIS values within each of our insurance company subsidiaries for the coming years. However, we are not aware of any insurance company subsidiary being subject to regulatory scrutiny because of these ratios.

Risk-based capital

In order to enhance the regulation of insurer solvency, the NAIC has adopted a formula and a model law to implement risk-based capital, or RBC, requirements to assess the minimum amount of capital that an insurance company needs to support its overall business operations and to assure that it has an acceptably low likelihood of becoming financially impaired. The RBC formula takes into account various risk factors including asset risk, credit risk, underwriting risk and interest rate risk. As the ratio of an insurer s total adjusted capital and surplus decreases relative to its risk-based capital, the RBC laws provide for increasing levels of regulatory intervention such as supervision and rehabilitation, and culminating with mandatory control of the operations of the insurer by the domiciliary insurance department at the so-called mandatory control level. As of December 31, 2007, the RBC ratios of our insurance company subsidiaries are above the range that would trigger any regulatory or corrective action.

Market conduct examinations

The laws and regulations of the states where our insurance company subsidiaries operate include numerous provisions governing the marketplace activities of admitted insurers, including provisions governing the form and content of disclosure to consumers, product illustrations, advertising, sales and underwriting practices, complaint handling and claims handling. These provisions are enforced by the state insurance regulatory agencies through periodic market conduct examinations.

Financial examinations

As part of the regulatory oversight process, state insurance departments conduct periodic detailed examinations of the books, records, accounts, policy filings and business practices of insurers domiciled in their state, generally once every three to five years. These examinations generally are conducted in cooperation with the insurance departments of two or three other states or jurisdictions, representing each of the NAIC zones, under

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guidelines promulgated by the NAIC. The most recent financial exam for DNA was conducted during 2007 for the year ended December 31, 2005 and did not result in any significant findings or adjustments.

Insurance reserves

Under the laws and regulations of their respective states of domicile, our insurance company subsidiaries are required to conduct annual analyses of the sufficiency of their reserves. In addition, other states in which DNA is licensed and in which Darwin Select or Vantapro is an eligible surplus lines carrier may have certain reserve requirements that differ from those of their domiciliary states. In each case, a qualified actuary must submit an opinion that states that the aggregate statutory reserves, when considered in light of the assets held with respect to those reserves, make adequate provisions for the associated contractual obligations and related expenses of the insurer.

Regulation of investments

Our insurance company subsidiaries are subject to laws and regulations that require diversification of their investment portfolios and limit the amount of investments in certain asset categories, such as below investment grade fixed-income securities, equity real estate, other equity investments and derivatives. Failure to comply with these laws and regulations would cause investments exceeding regulatory limi