CERTIFICATION

April 3, 2013

I, Bruce R. Ramge, Director of Insurance of the State of Nebraska, do hereby certify that the attached is a full and correct copy of

Financial Examination Report of

Arch Reinsurance Company
as of

December 31, 2011

and is now on file and forming a part of the records of this Department.

I hereto subscribe my name under the seal of my office at Lincoln, Nebraska.

STATE OF NEBRASKA
DEPARTMENT OF INSURANCE
APR 3 2013
FILED

DEPARTMENT OF INSURANCE STATE OF NEBRASKA
EQUALITY BEFORE THE LAW
SEAL

Bruce R. Ramge
DIRECTOR OF INSURANCE

STATE OF NEBRASKA

Department of Insurance

EXAMINATION REPORT

OF

ARCH REINSURANCE COMPANY

as of

December 31, 2011

TABLE OF CONTENTS

Morristown, New Jersey
February 13, 2013

Honorable Joseph Torti, III
Chairman, Financial Condition (E) Committee, NAIC
Deputy Director and Superintendent of Insurance
Rhode Island Division of Insurance
1511 Pontiac Avenue, Bldg #69-2
Cranston, Rhode Island 02920

Honorable John M. Huff
Chair, Midwestern Zone, NAIC
Director of Insurance
Missouri Department of Insurance
301 West High Street, Room 530
Jefferson City, Missouri 65101

Honorable Bruce R. Ramge
Director of Insurance
Nebraska Department of Insurance
941 "O" Street, Suite 400
Lincoln, Nebraska 68508

Dear Sirs:

Pursuant to your instruction and authorizations, and in accordance with statutory requirements, an examination has been conducted of the financial condition and business affairs of:

ARCH REINSURANCE COMPANY

which has its Statutory Home Office located at

10306 Regency Parkway Drive
Omaha, Nebraska 68113

with its Principal Executive Office located at

445 South Street, Suite 220
Morristown, New Jersey 07962

(hereinafter also referred to as the "Company") and the report of such examination is respectfully presented herein.

INTRODUCTION

The Company was last examined as of December 31, 2007 by the State of Nebraska. The current financial condition examination covers the intervening period to, and including, the close of business on December 31, 2011, and includes such subsequent events and transactions as were considered pertinent to this report. The State of Nebraska participated in this examination and assisted in the preparation of this report.

SCOPE OF EXAMINATION

This examination was conducted pursuant to and in accordance with both the NAIC Financial Condition Examiners Handbook (Handbook) and Section §44-5904(1) of the Nebraska Insurance Statues. The Handbook requires that examiners plan and perform the examination to evaluate the financial condition and identify prospective risks of the Company by obtaining information about the Company including, but not limited to: corporate governance, identifying and assessing inherent risks within the Company, and evaluating system controls and procedures used to mitigate those risks. The examination also includes assessing the principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation and management's compliance with Statutory Accounting Principles and Annual Statement Instructions, when applicable to domestic state regulations.

A general review was made of the Company's operations and the manner in which its business has been conducted in order to determine compliance with statutory and charter provisions. The Company's history was traced and has been set out in this report under the caption "Description of Company". All items pertaining to management and control were reviewed, including provisions for disclosure of conflicts of interest to the Board of Directors and the departmental organization of the Company. The Articles of Incorporation and By-Laws were reviewed, including appropriate filings of any changes or amendments thereto. The minutes of the meetings of the shareholder, Board of Directors and committees, held during the examination period, were read and noted. Attendance at meetings, proxy information, election of Directors and Officers, approval of investment transactions and authorizations of salaries were also noted.

The fidelity bond and other insurance coverages protecting the Company’s property and interests were reviewed, as were plans for employee welfare and pension. Certificates of Authority to conduct the business of insurance in the various states were inspected and a survey was made of the Company’s general plan of operation.

Data reflecting the Company's growth during the period under review, as developed from the Company's filed annual statements, is reflected in the financial section of this report under the caption "Body of Report".

The Company's reinsurance facilities were ascertained and noted, and have been commented upon in this report under the caption "Reinsurance". Accounting records and procedures were tested to the extent deemed necessary through the risk-focused examination process. The Company’s method of claims handling and procedures pertaining to the adjustment and payment of incurred losses were also noted.

All accounts and activities of the Company were considered in accordance with the risk-focused examination process. This included a review of workpapers prepared by PriceWaterhouse Coopers, LLP, the Company’s external auditors, during their audit of the Company’s accounts for the years ended December 31, 2010 and 2011. Portions of the auditor’s workpapers have been incorporated into the workpapers of the examiners and have been utilized in determining the scope and areas of emphasis in conducting the examination. This utilization was performed pursuant to Title 210 (Rules of the Nebraska Department of Insurance), Chapter 56, Section 013.

DESCRIPTION OF COMPANY

HISTORY

The Company, under the name of Risk Capital Reinsurance Company, was incorporated as a stock insurance corporation under the laws of the State of Nebraska on July 20, 1995. The Articles of Incorporation state that it was established for the purpose of writing all types of insurance and reinsurance with the exception of life insurance, variable life insurance, variable annuities and title insurance; and to transact any and all lawful business for which a Nebraska stock insurer may be incorporated as currently provided or as may be provided by subsequent legislative acts.

On April 24, 2000, the Company's Board of Directors adopted a resolution to amend the Articles of Incorporation to change the name of the Company to Arch Reinsurance Company. This amendment was approved by the Company's sole shareholder on May 4, 2000, filed with the Nebraska Secretary of State on May 12, 2000 and approved by the Nebraska Department of Insurance on May 12, 2000.

On August 31, 2006, the Company amended its Articles and By-Laws to reflect the move of its home office in 2002 from Connecticut to Morristown, New Jersey.

On January 22, 2009, the Company was approved by the Nebraska Department of Insurance to add Mortgage and Financial Guaranty insurance to their Certificate of Authority. Under provisions of its amended charter and in conformity with Nebraska Statutes, the Company is currently authorized to write Sickness and Accident, Property, Credit Property, Glass, Burglary and Theft, Boiler and Machinery, Liability, Workers' Compensation and Employers Liability, Vehicle, Fidelity, Surety, Credit, Mortgage Guaranty, Marine, Financial Guaranty, and Miscellaneous insurances as set out in Neb. Rev. Stat §44-201 of the Nebraska Insurance Code.

MANAGEMENT AND CONTROL

Holding Company

The Company is a member of an insurance holding company system as defined by Nebraska Statute. An organizational listing flowing from the 'Ultimate Controlling Person", as reported in the 2011 Annual Statement, is represented by the following (subsidiaries are denoted through the use of indentations, and unless otherwise indicated, all subsidiaries are 100% owned):

- Arch Capital Group Ltd.
    - Arch Reinsurance Ltd.
        - Arch Capital Group (U.S.), Inc.
            - Arch Reinsurance Company
                - Arch Re Facultative Underwriters Inc.
                - Arch Insurance Group, Inc.
                    - Arch Underwriting Agency, LLC
                        - Construction Risk Underwriters, LLC (50%)
                    - Arch Capital UK Ltd.
                    - Arch Specialty Insurance Agency Inc.
                    - First American Service Corporation
                    - Arch Insurance Company
                        - Arch Excess & Surplus Insurance Company
                            - Arch Indemnity Insurance Company
                        - Arch Specialty Insurance Company
                - Capital Protection Insurance Services, LLC (49%)

Shareholder

The Amended Articles of Incorporation, approved by the Nebraska Department of Insurance and filed with the Secretary of the State of Nebraska on February 26, 2002, provide that, "the aggregate numbers of shares which the Company shall have the authority to issue is 1,000,000 shares, consisting only of common stock, with a par value of $5.00 per share."

The Amended and Restated By-Laws provide that, "annual meetings of the shareholders shall be held at the Principal Office of the Company in Morristown, New Jersey, or at such other place as determined by the Board of Directors and stated in the notice to the shareholders. Such annual meetings shall be held on the first Tuesday of June of each year. The purpose of this annual meeting is to receive the report of the Officers and Directors, to elect Directors whose terms expire, and to transact such other business as may be lawful to do."

The Company received non-cash contributions of $16.1 million in 2008, $14.9 million in 2009, $20.2 million in 2010, and $21.0 million in 2011, from its parent, Arch Capital Group (U.S.), Inc.

The following non-cash contributions, in the form of tax benefits on restricted stock/options and option expenses incurred, were made to the Company's wholly owned subsidiaries since the last financial examination:

	2008	**2009**	**2010**	**2011**
Arch Insurance Group, Inc.	$13,312,620	$11,386,594	$16,788,594	$16,502,473
Arch Re Facultative Underwriters, Inc.	293,607	612,245	750,114	1,043,486
	$13,606,227	$11,998,839	$17,538,708	$17,545,959

No cash dividends have been paid during the period under examination or since the inception of the Company.

Board of Directors

The Company's Amended and Restated By-Laws provide that, "the property and business of this Company shall be managed by its Board of Directors, the number which shall be between seven (7) and twenty-one (21), as determined, from time to time, by the Board of Directors. At the first annual meeting of the shareholders and at each annual meeting thereafter, the shareholders shall elect Directors to hold office until the next succeeding meeting." The By-

Laws require that at least one third of the Directors shall be persons who are not Officers or employees of the Company or of any entity controlling, controlled or under common control of the Company and who are not beneficial owners of a controlling interest in the voting stock of the Company or any such entity; provided, however, that the board composition requirement shall not apply to the Company if the Company is a member of a holding company system and the person controlling the Company has a Board of Directors that meet the board composition requirement. The Company is member of Arch Capital Group Ltd. and its Board of Directors meets this requirement.

The following persons were serving as Directors at December 31, 2011:

Name and Residence	**Principal Occupation**
John F. Rathgeber Mendham, New Jersey	Chairman of the Board of Directors of Arch Reinsurance Company & Vice Chairman of Arch Worldwide Reinsurance Group
Gary Blumsohn West Orange, New Jersey	Executive Vice President and Chief Actuary of Arch Reinsurance Company
James C. Franson Chester, New Jersey	Executive Vice President – Specialty Casualty of Arch Reinsurance Company
David E. Gansberg Glen Rock, New Jersey	Executive Vice President of Arch Reinsurance Company
Barry E. Golub Manalapan, New Jersey	Chief Financial Officer of Arch Reinsurance Company
Marc Grandisson Smiths, Bermuda	Chairman of the Board of Directors and Chief Executive Officer of Arch Worldwide Reinsurance Group
Lawrence F. Harr Omaha, Nebraska	Partner of Lamson, Dugan and Murray, LLP
Timothy J. Olson Edina, Minnesota	President and Chief Executive Officer of Arch Reinsurance Company

Name and Residence	Principal Occupation
Dale G. Vincent, Jr. Morristown, New Jersey	Executive Vice President and Chief Underwriting Officer of Arch Reinsurance Company

Officers

The By-Laws provide that, "the Officers of the Company shall be a Chairman of the Board, a President, Managing Directors (the number thereof, if any, to be determined by the Board of Directors), Vice Presidents (the number thereof, if any, to be determined by the Board of Directors), a Treasurer and a Secretary, and such other Officers as may be elected or appointed by the Board of Directors. The Vice Presidents may include Executive Vice Presidents and Senior Vice Presidents. Any two (2) or more offices may be held by the same person, except that the President and the Secretary shall not be the same person."

The following is a partial listing of Senior Officers elected and serving the Company at December 31, 2011

Name	Office
John F. Rathgeber	Chairman
Timothy J. Olson	President and Chief Executive Officer
Barry E. Golub	Chief Financial Officer
Timothy W. Forshay	Treasurer
Gary Blumsohn	Executive Vice President and Chief Actuary
James C. Franson	Executive Vice President – Specialty Casualty
David E. Gansberg	Executive Vice President
Dale G. Vincent, Jr.	Executive Vice President and Chief Underwriting Officer
Janet L. Kummert	Vice President and Corporate Secretary

TRANSACTIONS WITH AFFILIATES

Tax Sharing Agreement

The Company entered into a Tax Sharing Agreement on January 1, 2002 with Arch Capital Group (U.S.), Inc. (Arch-US) and its subsidiaries. The purpose of the Tax Sharing

Agreement is for the Company and its affiliates to be included in the filing of consolidated U.S. federal income tax returns in accordance with Sections 1501 of the U.S. Internal Revenue Code of 1986, as amended (the Code), to participate to the extent permitted by applicable state or local law, in combined state and local income tax returns, if so requested by Arch-US, and to allocate and settle among themselves any consolidated U.S. tax liability. Arch-US shall file U.S. federal income tax returns, including any amended returns, on behalf of the Company and its affiliates for each taxable year in accordance with the Code and related federal regulations.

Each Arch subsidiary that is a member of the tax sharing group shall reimburse Arch-US for their pro rata share of all legal and accounting expenses incurred by Arch-US in the course of conduct of any audit or contest regarding any consolidated tax liability, and for all expenses incurred by Arch-US in the course of any litigation relating thereto. The pro-rata share of expenses for each Arch subsidiary shall be determined by Arch-US in its sole discretion based upon such Arch subsidiary's share of the tax liability giving rise to such expense. The Company's 2011 Federal Income Tax payable was $136 thousand relative to the intercompany tax sharing agreement with Arch-US.

Service Agreement

The Company entered into a Service Agreement on April 1, 2003 with the intent to have Arch Insurance Group provide the Company with operational assistance and support including, but not limited to, data processing, systems work, records, information technology, legal and overhead services (i.e. office space, advertising, allocation of expenses and collection and handling of premium monies).

Under the terms of the Service Agreement, the Company shall pay as compensation to Arch Insurance Group all costs incurred by Arch Insurance Group in providing the services set forth above, except for general overhead services. In addition, the Company shall reimburse Arch Insurance Group for all reasonable and documented out-of-the-pocket expenses. The fees for 2011 amounted to $1.2 million.

Investment Services Agreement

Effective April 1, 2006 the Company entered into a service agreement with Arch Investment Management Limited (AIM), to provide investment advisory services. This agreement was amended January 1, 2010 to change the compensation for asset management and investment consulting. The charges paid by the Company under this arrangement in 2011 were $410 thousand.

Administrative Services Agreement

On March 29, 2007, the Company formed a subsidiary, Arch Re Facultative Underwriters, Inc. (ARFU), a Delaware Corporation. On June 1, 2007, ARFU and the Company entered into a Facultative Administrative Services Agreement, whereby ARFU provides administrative services to the facultative underwriting division, which consist of underwriting supervision, marketing, records maintenance, supervision of employees, and assisting in reserve setting. The changes paid by the Company under this arrangement in 2011 were $8.2 million.

Cost Allocation Agreement

Effective January 1, 2008, the Company entered into the Third Amended and Restated Property Catastrophe Excess of Loss Reinsurance Cost Allocation Agreement with Arch Capital Group Ltd. (ACGL) and its subsidiaries, which provided a method of allocating estimated reinsurance premium cost advanced on a calendar year basis by ACGL. The Company ceased to be a party to this agreement commencing January 1, 2010.

Credit Agreement

On August 18, 2011, ACGL and various designated subsidiary borrowers including the Company (the Group) entered into a three year Restated Credit Agreement for a $300 million unsecured revolving loan and letter of credit facility and a $500 million secured letter of credit facility. The Credit Agreement replaced the Group's former credit agreement, dated as of August 30, 2006. Under the terms of the agreement, the Company is limited to issuing an aggregate of $100 million of unsecured letters of credit as part of the $300 million unsecured revolving loan. Borrowings of revolving loans may be made by ACGL and the Company at a variable rate based on LIBOR or an alternative base rate at the option of the ACGL. Secured letters of credit are available for issuance on behalf of ACGL's insurance and reinsurance subsidiaries. The agreement expires August 18, 2014.

When issued, certain letters of credit are secured by a portion of the Group's investment portfolio. In addition, letter of credit facilities also require the maintenance of certain covenants and conditions, which the Group was in compliance with at December 31, 2011. The Company has no guarantees or obligation in relation to this debt for any of its affiliates. As of December 31, 2011, the Company has used $69.6 million in outstanding letters of credit, which was secured by investments totaling $85.7 million.

TERRITORY AND PLAN OF OPERATION

As evidenced by current or continuous Certificates of Authority, the Company is licensed to transact business in all states, with the exception of Maine, North Carolina, Wisconsin, and Wyoming. The Company is an Accredited Reinsurer in Maine, North Carolina, Wisconsin, and Wyoming.

The Company's lines of business reinsured include, Aviation and Aerospace, Casualty Clash/Catastrophic Coverage, Catastrophe Excess of Loss, Commercial Transportation, Directors' and Officers' Liability, Employment Practices Liability, Errors and Omissions, Fiduciary Liability Crime, Medical Professional Liability, Non-Standard Automobile Liability, Non-traditional Reinsurance, Property, Pro Rata Program with Per Occurrence Caps, Regional U.S. Property Catastrophe, Surety, and Worker's Compensation. The Company utilizes the services of reinsurance intermediaries, including Aon, Benfield, Guy Carpenter, and many other well-known brokers, as the primary means of producing business.

REINSURANCE

Assumed

The Company writes reinsurance business on both a proportional and non-proportional basis. In a proportional reinsurance arrangement (i.e. pro rata reinsurance, quota share reinsurance or participating reinsurance) the Company pays the cedent a commission which is generally based on the cedent's cost of acquiring the business being reinsured (including commissions, premium taxes, assessments and miscellaneous administrative expenses) and may also include a profit factor. Non-proportional (or excess of loss) reinsurance indemnifies the reinsured against all or a specified portion of losses on underlying insurance policies in excess of a specified amount. Non-proportional business is written in layers and a reinsurer or group of reinsurers accepts a band of coverage up to a specified amount.

The Company generally seeks to write significant lines on less commoditized classes of coverage, such as specialty property and casualty reinsurance treaties. However, with respect to other classes of coverage, such as property catastrophe and casualty clash, the Company participates in a relatively large number of treaties and assumes smaller lines where it believes that it can underwrite and process the business efficiently.

Arch Reinsurance Company focuses on the following areas:

- *Casualty:* The Company reinsures third party liability and workers' compensation exposures from ceding company clients primarily on a treaty basis. The exposures that it reinsures include, among others, directors' and officers' liability, professional liability, automobile liability, worker's compensation and excess and umbrella liability. The Company writes this business on a proportional and non-proportional basis. On proportional and non-proportional "working casualty business", which is treated separately from casualty clash business, the Company prefers to write treaties where there is a meaningful amount of actuarial data and where loss activity is more predictable.

- *Property Excluding Property Catastrophe:* The Company reinsures individual property risks of a ceding company. Property per risk treaty and pro rata reinsurance contracts written by the Company cover claims from individual insurance policies issued by reinsureds and include both personal lines and commercial property exposures (principally covering buildings, structures, equipment and contents). The primary perils in this business include fire, explosion, collapse, riot, vandalism, wind, tornado, flood and earthquake. Additionally, through the property facultative reinsurance group, reinsurance is written on a facultative basis whereby the reinsurer assumes all or part of the risk under a single insurance contract. Facultative reinsurance is typically purchased by ceding companies for individual risks not covered by their reinsurance treaties, for unusual risks or for amounts in excess of the limits on their reinsurance treaties. The property facultative reinsurance group focuses on commercial property risks on an excess of loss basis.

- *Other Specialty:* The Company writes other specialty lines, including non-standard automobile surety, accident and health, workers' compensation catastrophe, trade credit and political risk.

- *Property Catastrophe:* The Company reinsures catastrophic perils for reinsureds on a treaty basis. Treaties in this type of business provide protection for most catastrophic losses that are covered in the underlying policies written by reinsureds. The primary perils include hurricane, earthquake, flood, tornado, hail and fire. The Company may also provide coverage for other perils on a case-by-case basis. Property catastrophe reinsurance provides coverage on an excess of loss basis when aggregate losses and loss adjustment expense from a single occurrence of covered peril exceed the retention specified in the contract. The multiple claimant nature of property catastrophe reinsurance requires careful monitoring and control of cumulative aggregate exposure.

- *Aviation:* The Company writes aviation business, which includes coverages for airline and general aviation risks.

- *Other:* The Company also writes non-traditional business, which is intended to provide insurers with risk management solutions that complement traditional reinsurance, and casualty clash business.

Ceded

The Company entered into a quota share agreement with Arch Reinsurance Ltd. (ARL), a Bermuda affiliate. Under the terms of this agreement, the Company cedes 90% of all net retained liability, after the application of all inuring reinsurance, arising from all insurance business undertaken. Effective January 1, 2006 the agreement was amended changing the percentage ceded from 90% to 80%. Effective January 1, 2011 the agreement was amended changing the percentage ceded from 80% to 50%. This contract ceded $178.5 million of the $332.4 million (53.7%) in direct and assumed premium in 2011.

In order for the Company to obtain full financial credit for this reinsurance, due to the fact that ARL is an unauthorized reinsurer, the Company signed a Trust Agreement to permit ARL to collateralize its obligations. ARL has agreed to fund reserves in respect of unearned premium, known outstanding losses reported to it and allocated loss adjustment expense relating thereto, losses and allocated loss adjustment expense paid by the Company but not recovered from ARL, plus reserves for losses incurred but not reported. Within thirty days of ARL's receipt of the quarterly premium and loss reports, ARL is required to adjust the assets held in the trust account so that the market value of such assets meets or exceeds 100% of ARL's obligations.

Per an October 1, 2007 amendment, Mellon Bank succeeded The Bank of New York as trustee and entitlement holder with respect to the assets deposited into the trust account. ARL has agreed to pay all fees and also agreed to reimburse Mellon Bank for all out-of-pocket expenses and disbursements (including attorney's fees and expenses) in connection with Mellon Bank's duties under the Trust Agreement.

Deposit Accounting

The Company assumes certain policies and contracts that are deemed, for financial purposes, not to transfer sufficient insurance risk, and are accounted for using the deposit method of accounting. For those contracts that contain an element of insurance underwriting risk, the estimated profit margin is deferred and amortized over the contract period and such amount is included in the Company's underwriting results. When the estimated profit margin is explicit, the margin is reflected as miscellaneous income. When the estimated profit margin is implicit, it is reflected as an offset to paid losses.

During the examination period, the Company reported interest income for 2008 and 2009 of $1,063,176 and $449,313, respectively and interest expenses for 2010 and 2011 of $362,301 and $72,529, respectively.

The NAIC Annual Statement Instructions require that under Note #23G of the Notes to Financial Statements, the Company must describe all reinsurance agreements that have been accounted for as deposits. The instructions contain an illustration, which includes a description of each contract and the deposit asset, deposit liability and income amounts at inception and as of the reporting date.

The Company stated under Note #23G of the 2011 Annual Statement, "the Company has recorded assets which consist of cash deposits or in some instances payments for $26.6 million, offset by a corresponding liability of $30.5 million and unassigned surplus of $3.9 million, which included income statement items, consisting of a current year charge to interest expense of $72 thousand."

The following is a listing of the reinsureds, the type of contract and the corresponding balance sheet amounts for each contract accounted for as deposit accounting:

Ceding Company / Type of Contract	Effective	Asset	Liability
Alea North American Insurance Company			
Workers' Comp. Excess of Loss	1/1/03 – 12/31/03	$ 1,800,000	$ 2,079,461
Alea North American Insurance Company			
Workers' Comp. Excess of Loss	1/1/04 – 12/31/04	3,034,462	3,321,802
Alea North American Insurance Company			
Workers' Comp. Excess of Loss	1/1/05 – 12/31/05	2,191,556	2,243,622
Colonial Lloyds			
Texas Homeowners Quota Share	4/1/04 – 6/1/05	950,438	3,767
Commercial Mutual Insurance Company			
Auto Physical Damage Quota Share	10/1/03 – 12/31/04	94,211	0
Commercial Mutual Insurance Company			
Auto Physical Damage Quota Share	1/1/05 – 12/31/06	128,624	(1)
Companion Property & Casualty Insurance Company			
Casualty Excess of Loss	10/1/02 – 10/1/03	152,500	0
Cypress Property & Casualty Insurance Company			
Casualty Excess of Loss	1/1/02 - 5/31/03	(45,935)	0
Cypress Property & Casualty Insurance Company			
Property Quota Share	1/1/03 – 12/31/03	1,176,773	6
Cypress Property & Casualty Insurance Company			
Property Quota Share	1/1/04 – 12/31/04	(3,686,198)	39,557
Cypress Texas Lloyds			
Texas Homeowners Quota Share	7/1/03 – 12/31/04	499,970	204
Cypress Texas Lloyds			
Texas Homeowners Excess	7/1/03 – 12/31/04	15,741	0
Discover Reinsurance Company			
Workers' Comp. Excess Quota Share	9/1/02 – 9/1/03	6,463,503	6,971,648
Discover Reinsurance Company			
Workers' Comp. Excess Quota Share	9/1/03 – 9/1/04	15,125,814	14,026,906
Discover Reinsurance Company			
Workers' Comp. Excess Quota Share	10/1/04 – 10/1/05	1,835,424	1,848,409
Wisconsin Reinsurance Corporation			
First Auto Physical Damage Quota Share	4/1/03 – 4/1/04	441,756	1,566
Qualsure Insurance Company			
Workers' Comp. Excess Quota Share	1/1/04 – 1/1/05	520,717	0
St. John's Insurance Company			
Florida Homeowners Quota Share	6/1/04 – 6/1/05	$ (4,080,371)	$ 0
Total deposit accounting assets & liabilities:		$26,618,985	$30,536,947

General

All contracts reviewed contained standard insolvency, arbitration, errors and omissions, and termination clauses where applicable. All contracts contained the clauses necessary to assure reinsurance credits could be taken.

BODY OF REPORT

GROWTH

The following comparative data reflects the growth of the Company during the period covered by this examination:

	2008	2009	2010	2011
Bonds	$ 384,487,816	$ 444,569,920	$ 458,636,791	$ 500,137,430
Admitted assets	1,142,493,497	1,202,342,521	1,207,564,150	1,223,532,816
Loss reserves	154,666,925	159,189,375	162,953,654	197,389,391
Unearned premiums	37,198,919	33,576,060	28,470,699	61,483,702
Ceded reinsurance premiums payable	110,909,640	89,119,607	78,102,760	53,551,086
Total liabilities	376,485,511	351,869,419	336,963,819	400,593,651
Unassigned funds	180,726,136	250,290,077	250,181,527	181,490,035
Capital and surplus	585,281,500	600,183,025	620,418,804	641,449,130
Premiums earned	88,462,280	82,894,399	66,641,461	112,250,586
Losses incurred	60,634,954	46,360,103	33,616,360	77,304,738
Net underwriting gain/(loss)	(11,242,071)	9,536,650	4,607,085	(16,526,493)
Net investment income	18,824,255	20,087,613	16,556,925	13,681,219
Net income	10,031,230	23,640,129	16,888,186	(3,145,611)

FINANCIAL STATEMENTS

The following statement of admitted assets and liabilities, together with the accompanying summary of operations, reflects the financial condition of the Company at December 31, 2011 and its transactions during the year 2011 as determined through this examination. A reconciliation of the capital and surplus account for the period under review is also included.

FINANCIAL STATEMENT
December 31, 2011

Assets	**Assets**	**Assets Not Admitted**	**Net Admitted Assets**
Bonds	$ 500,137,430		$ 500,137,430
Common stocks	536,404,550	$ 2,507,456	533,897,094
Cash and short-term investments	45,328,636		45,328,636
Receivable for securities	12,293		12,293
Securities lending	18,701,814		18,701,814
Subtotal, cash and invested assets	$1,100,584,723	$ 2,507,456	$1,098,077,267
Investment income due and accrued	4,798,126		4,798,126
Uncollected premiums and agents' balances in course of collection	11,128,578	1,031,733	10,096,845
Deferred premiums and agents' balances and installments booked but deferred	66,173,899		66,173,899
Amounts recoverable from reinsurers	34,606,123		34,606,123
Funds held with reinsured companies	1,885,770		1,885,770
Net deferred tax asset	17,902,687	11,179,173	6,723,514
Electronic data processing and equipment	151,555		151,555
Furniture and equipment	392,424	392,424	
Net adjustment due to foreign exchange rates	502,555		502,555
Receivables from parent, subsidiaries and affiliates	309,509		309,509
Advance claim payments	159,440		159,440
Other	48,213		48,213
Prepaid expenses	362,796	362,796	
Totals	$1,239,006,398	$15,473,582	$1,223,532,816

Liabilities, Surplus, and Other Funds

Losses	$ 197,389,391
Reinsurance payable on paid loss and loss adjustment expenses	4,147,727
Loss adjustment expenses	23,411,470
Other expenses	10,187,143
Current federal income taxes	136,464
Unearned premiums	61,483,702
Ceded reinsurance premiums payable	53,551,086
Provision for reinsurance	1,047,912
Payable for securities lending	18,701,814
Deposit accounting liability	30,526,942
Total liabilities	$ 400,593,651
Common capital stock	$ 5,000,000
Gross paid in and contributed surplus	636,449,130
Unassigned funds (surplus)	181,490,035
Total capital and surplus	$ 822,939,165
Totals	$1,223,532,816

STATEMENT OF INCOME – 2011

Underwriting Income

Premiums earned	$112,250,586
Losses incurred	77,304,738
Loss adjustment expenses incurred	5,770,483
Other underwriting expenses incurred	45,701,858
Total underwriting deductions	$128,777,079
Net underwriting gain/(loss)	$ (16,526,493)

Investment Income

Net investment income earned	$ 12,424,469
Net realized capital gain	1,256,750
Net investment gain	$ 13,681,219

Other Income

Deposit accounting interest expense	$ (72,529)
Total other income	$ (72,529)
Net income before federal income taxes	$ (2,917,803)
Federal income taxes incurred	227,808
Net income	$ (3,145,611)

CAPITAL AND SURPLUS ACCOUNT

	2008	2009	2010	2011
Capital and surplus, beginning	$718,979,573	$766,007,986	$850,473,102	$870,600,331
Net income	$ 10,031,230	$ 23,640,129	$ 16,888,186	$ (3,145,611)
Change in net unrealized capital gains	18,796,584	50,115,864	(17,782,459)	(66,134,289)
Change in net unrealized foreign exchange capital gain	249,381	(449,679)	408,079	294,775
Change in net deferred income tax	(1,520,878)	245,996	(775,923)	3,621,098
Change in nonadmitted assets	3,213,021	(3,634,053)	1,114,129	(2,726,432)
Change in provision for reinsurance	177,000	(354,317)	39,438	(601,033)
Surplus paid in	16,082,075	14,901,175	20,235,779	21,030,326
Net change for the year	$ 47,028,413	$ 84,465,115	$ 20,127,229	$ (47,661,166)
Capital and surplus, ending	$766,007,986	$850,473,102	$870,600,331	$822,939,165

EXAMINATION CHANGES IN FINANCIAL STATEMENTS

Unassigned funds (surplus) in the amount of $181,490,035, as reported in the Company's 2011 Annual Statement, has been accepted for examination purposes. Examination findings, in the aggregate, were considered to have no material effect on the Company’s financial condition.

COMPLIANCE WITH PREVIOUS RECOMMENDATIONS

No recommendations were made as a result of the previous examination.

COMMENTARY ON CURRENT EXAMINATION FINDINGS

Investments – Custodial Agreements

During review of the custodial agreements, it was noted that various custodial agreements were not in compliance with all of the provisions of Title 210, Chapter 81 of the Nebraska Department of Insurance Rules and Regulations, in particular 003.02(a), 003.02(b), 003.02(c), 003.02(g)(i), 003.02(g)(ii), 003.02(i), 003.02(j), 003.02(m), 003.02(n), and 003.02(o). It is suggested that the Company revise its custodial agreements to include all provisions related to safeguards and controls of securities pursuant to Title 210 (Nebraska Department of Insurance Rules and Regulations), Chapter 81.

SUMMARY OF COMMENTS AND RECOMMENDATIONS

The following comments and recommendations have been made as a result of this examination:

> **Investments – Custodial Agreements** – It is suggested that the Company revise its custodial agreements with the custodians holding securities on its behalf to include all provisions related to safeguards and controls of securities pursuant to Title 210 (Nebraska Department of Insurance Rules and Regulations), Chapter 81.

ACKNOWLEDGEMENT

The courteous cooperation extended by the Officers and employees of the Company during this examination is hereby acknowledged.

In addition to the undersigned, Kim A. Hurst, CFE, Brian J. Davis, Wade B. Fleischacker, Financial Examiners; Gary E. Evans, CISA, AES, CFE, Information Systems Specialist; and Gordon K. Hay, FCAS, MAAA, CPCU, Actuarial Examiner; all with the Nebraska Department of Insurance, participated in this examination and assisted in the preparation of this report.

Respectfully submitted,

Isaak J. Russell
Supervisory Examiner
Department of Insurance
State of Nebraska

State of Nebraska,

County of Lancaster,

Isaak Russell ______________________, being duly sworn, states as follows:

1. I have authority to represent the Department of Insurance of the State of Nebraska in the examination of Arch Reinsurance Company.

2. The Department of Insurance of the State of Nebraska is accredited under the National Association of Insurance Commissioners Financial Regulation Standards and Accreditation.

3. I have reviewed the examination work papers and examination report, and the examination of Arch Reinsurance Company was performed in a manner consistent with the standards and procedures required by the Department of Insurance of the State of Nebraska.

The affiant says nothing further.

____
Examiner-in-Charge's Signature

Subscribed and sworn before me by ISAAK RUSSELL on this 5 day of MARCH, 20 13.

(SEAL) GENERAL NOTARY - State of Nebraska
SUSAN D. WILLIAMS
My Comm. Exp. Sept. 16, 2013

Susan D. Williams
____
Notary Public

My commission expires 9/16/2013 [date].