Best's Key Rating Guide® Presentation Report

December 14, 2010

An A.M. Best Publication:

This A.M. Best report is provided compliments of:

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Arch Insurance Company AMB# 003186

Financial Strength A.M. BEST A Excellent

Best's Rating

A g

12/15/2009

Arch Insurance Company, an insurance company domiciled in **Missouri,** is rated **A g (Excellent)** by the A.M. Best Company. The rating outlook is **Stable**.

Five Year Rating History

12/15/09	A
10/08/08	A
08/02/07	A
12/12/06	A
05/01/06	A-

Rating Explanation: **A g (Excellent)**: Assigned to companies that have, in our opinion, an excellent ability to meet their ongoing insurance obligations.

Financial Size Category: XV ($2 billion or more): The Financial Size Category is an indicator of the size of an insurer, and is based on reported Policyholders' Surplus plus conditional or technical reserve funds, such as the asset valuation reserve, other investment and operating contingency funds and/or miscellaneous voluntary reserves reported as liabilities.

History: Arch Insurance Company began business in **1971.**

Organization Type: Stock

Identification Numbers: Arch Insurance Company's A.M. Best number is **003186**, its NAIC number is **11150,** and its FEIN number is **43-0990710**.

Corporate Structure: "003186 - Arch Insurance Company" is 100% owned by "058459 - Arch Capital Group Ltd.", which is the AMB Ultimate Parent and identifies the topmost entity of the corporate structure based on A.M. Best's analysis.

Company Leadership and Location:

- Senior Executive: Mark D. Lyons , Chairman, President & CEO
- Address: 300 Plaza Three, 3rd Floor, Jersey City, NJ 07311
- Phone: 212-651-6500

States & Territories Licensed: The company is licensed in the District of Columbia, Guam, Puerto Rico, U.S. Virgin Islands and all states.

Marketing Type: Broker

Specialty Lines of Business: Specialty Lines

Principal states or territories		**Principal lines of business**	
CA	16.3%	Oth Liab CM	19.3%
NY	11.2%	Workers' Comp	17.1%
TX	9.7%	Oth Liab Occur	14.4%

FL	4.6%	Comm'l Auto Liab	8.5%
IL	4.3%	All Other	7.9%

Key Financial Data *(Annual Reporting)*

Balance Sheet

	2009	2008	2007	2006	2005
Cash & Short Term Invest: (%)	8.5	5.4	4.5	6.3	4.3

This field represents cash and all unaffiliated investments whose maturities (or repurchase dates under repurchase agreements) at the time of acquisition were one year or less, as a percentage of total admitted assets.

	2009	2008	2007	2006	2005
Stocks and Bonds: (%)	68.6	70.5	71.1	68.4	68.1

This field represents investments in common stocks, preferred stocks and bonds as a percentage of Total Admitted Assets.

	2009	2008	2007	2006	2005
All other Assets: (%)	22.9	24.1	24.3	25.4	27.6

This field represents total assets excluding cash, short-term investments, and stocks and bonds as a percentage of total admitted assets.

	2009	2008	2007	2006	2005
Total Admitted Assets: ($000)	1,824,136	1,563,183	1,464,994	1,187,699	1,076,665

This field represents the sum of all admitted assets. These assets are valued in accordance with state laws and regulations, as reported by the company in its financial statements filed with state insurance regulatory authorities. This item is reported net as to encumbrances on real estate (the amount of any encumbrances on real estate is deducted from the value of the real estate), and net as to amounts recoverable from reinsurers (which are deducted from the corresponding liabilities for unpaid losses and unearned premiums).

	2009	2008	2007	2006	2005
Loss Reserves: (%)	51.2	52.4	45.8	37.5	37.2

This field represents the total unpaid losses and loss adjustment expenses (including reserves for incurred but not reported losses, if any), and supplemental reserves established by the company that are reported in the annual statement for the year indicated to total liabilities expressed as a percent. It is the total for all lines of business and all accident years, and is the amount of reserves as originally reported in each year shown.

	2009	2008	2007	2006	2005
Unearned Premiums: (%)	11.3	13.4	15.4	11.9	9.6

This ratio measures the calculated aggregate net amount, after deducting reinsurance credits, which an insurance company would be obliged to tender to its policyholders as return premiums for unexpired terms, should it cancel every policy in force as a percentage of total liabilities.

	2009	2008	2007	2006	2005
All Other Liabilities: (%)	37.5	34.2	38.9	50.6	53.2

This field represents total liabilities excluding loss reserves and unearned premiums as a percentage of total liabilities.

	2009	2008	2007	2006	2005
Total Liabilities: ($000)	1,186,256	986,172	924,446	668,775	600,543

This field represents the sum of all liabilities of the company valued in accordance with state laws and regulations, as reported by the company in its financial statements filed with state insurance regulatory authorities.

	2009	2008	2007	2006	2005
Policyholders' Surplus: ($000)	637,879	577,011	540,548	518,924	476,122

This field represents the sum of paid in capital, paid in and contributed surplus, and net earned surplus, including voluntary contingency reserves. It can also be described as the difference between Total Admitted Assets and Total Liabilities.

Operations

	2009	2008	2007	2006	2005
Direct Premiums Written: ($000)	1,389,712	1,317,332	1,311,392	1,254,159	1,091,913

This field represents the aggregate amount of recorded originated premiums, other than reinsurance, written during the year whether collected or not at the close of the year (plus retrospective audit premium collections), after deducting all return premiums.

	2009	2008	2007	2006	2005
Net Premiums Written: ($000)	304,329	298,765	311,789	170,304	140,134

This field represents gross premiums written, direct and reinsurance assumed, less reinsurance ceded.

	2009	2008	2007	2006	2005
Business Net Retention: (%)	20.7	21.3	22.7	13.2	12.4

This field represents the percentage of a company's gross writings that are retained for its own account. Gross writings are the sum of direct writings and assumed writings. This measure excludes affiliated writings.

Net Underwriting Income: ($000)	16,854	3,285	-5,395	-3,328	11,185

This field represents premiums earned less incurred losses, loss adjustment expenses, underwriting expenses incurred, and dividends to policyholders.

Net Investment Income: ($000)	29,024	28,896	27,490	20,714	12,948

This field represents investment income earned during the year less investment expenses and depreciation on real estate. Investment expenses are the expenses related to generating investment income and capital gains excluding income taxes.

Pretax Operating Income: ($000)	44,756	32,712	23,495	17,440	25,651

This field represents pretax operating earnings, before any capital gains, generated from underwriting, investment, and other miscellaneous operating sources.

Net Income: ($000)	36,506	22,275	5,733	5,968	12,357

This field represents the total after-tax earnings generated from operations and realized capital gains.

Profitability Tests

	2009	2008	2007	2006	2005
Loss Ratio: (X)	74.2	75.0	69.2	76.1	78.6

The ratio of incurred losses and loss adjustment expenses to net premiums earned, expressed as a percent. This ratio measures the company's underlying profitability, or loss experience on its total book of business.

Expense Ratio: (X)	20.2	24.5	26.4	22.7	12.6

The ratio of underwriting expenses (including commissions) to Net Premiums Written, expressed as a percent. This ratio measures the company's operational efficiency in underwriting its book of business.

Combined Ratio After Policyholder Dividends: (X)	94.5	99.6	95.6	99.0	91.6

measures the company's overall underwriting profitability. It is the sum of the Loss Ratio,Expense Ratio and Policyholder Dividend Ratio (policyholder dividends to net premium earned). This ratio does not reflect investment income or income taxes. A Combined Ratio of less than 100 indicates the company has reported an underwriting profit. Generally, the acceptable range for this test for property insurers is from 95 to 105 and for casualty insurers is from 100 to 110.

Operating Ratio: (X)	85.0	90.1	84.6	85.1	82.2

measures a company's overall operating profitability from underwriting and investment activity. This ratio does not reflect other operating income/expense, capital gains or income taxes. The normal range for this test for all types of insurers is from 85 to 95. An Operating Ratio of more than 100 indicates a company is unable to generate profits from its underwriting and investment activities.

Pretax Return on Revenue: (%)	14.7	10.7	9.4	11.7	18.7

measures a company's operating profitability and is calculated as pretax operating income divided by net premiums earned. This return measure is before capital gains/losses and income taxes. The normal range for this test for all types of insurers is from 3% to 10%.

Yield on Invested Assets: (%)	2.2	2.5	2.8	2.5	2.0

measures the average return on a company's invested assets by dividing annual net investment income, after expenses by the mean of net invested assets. This return measure is before capital gains/losses and income taxes. The normal range for this test for all types of insurers is from 4% to 6%.

Return on PHS: (%)	7.7	6.1	4.1	6.7	8.2

measures a company's overall after-tax profitability from underwriting and investment activity, divided by the mean of prior and current year-end surplus. This measure is calculated after income taxes and includes capital gains/losses. The normal range for this test is from 5% to 15%.

Leverage Tests

	2009	2008	2007	2006	2005
Change in NPW: (%)	1.9	-4.2	83.1	21.5	-8.3

measures the annual percentage change in net premiums written. A company should demonstrate its ability to support controlled business growth with quality surplus growth from strong internal capital generation. The normal range for this test is from 3% to

10%, however, this will vary based on market conditions.

NPW to PHS: (X)	0.5	0.5	0.6	0.3	0.3

measures the company's net retained premium writings, after reinsurance assumed and ceded,in relation to its surplus. This ratio measures the company's net exposure to pricing errors in its current book of business. Generally, the acceptable range for this test for all types of insurers is below 2.0.

Best's Capital Adequacy Ratio: (X)	154.8				

This absolute measure compares an insurer's economic surplus position relative to the required capital necessary to support its business risks. Companies deemed to have "adequate" capital strength normally generate a BCAR score of over 100 and will usually carry a Secure Best's Rating.

Net Leverage: (X)	2.3	2.2	2.3	1.6	1.5

represents the sum of a company's Net Premiums Written and Net Liability Ratios. This ratio measures the combination of a company's exposure to pricing errors and errors of estimation in its liabilities, after reinsurance, in relation to policyholders' surplus. Generally, the acceptable range for this test is below 4.0 for property carriers and below 6.0 for long-tailed casualty carriers.

Gross Leverage: (X)	10.0	10.4	11.1	7.2	6.5

represents the sum of Net Leverage and Ceded Reinsurance Leverage (reinsurance recoverables, ceded balances payable and ceded premiums written, less funds held divided by policyholders' surplus) Ratios. This ratio measures a company's gross exposure to pricing errors in the current book of business, errors of estimating its liabilities, and exposure to its reinsurers. Generally, the acceptable range for this test is below 5.0 for property insurers and below 7.0 for long-tailed liability insurers.

Reinsurance Recoverables to PHS: (%)	546.8	576.3	571.4	342.2	300.7

Measures a company's dependence upon its reinsurers and the potential exposure to reinsurance collectibility problems. This ratio represents total ceded reinsurance recoverables due from non-affiliated reinsurers expressed as a percentage of surplus. Total ceded reinsurance recoverables is calculated as the sum of non-affiliated ceded paid losses, ceded unpaid losses, ceded IBNR losses, ceded unearned premiums and ceded commissions, less funds held from reinsurers. The normal range for this test is 50% to 150% for all types of insurers.

Liquidity Tests

	2009	2008	2007	2006	2005
Quick Liquidity: (%)	24.4	15.9	15.1	26.3	32.6

is an indicator of a company's short term liquidity and measures the proportion of net liabilities covered by cash and investments which can be quickly converted to cash. This ratio may indicate a company's ability to settle its liabilities without prematurely selling long-term investments or to borrow money. It represents quick assets divided by net liabilities, plus ceded reinsurance balances payable, expressed as a percent. The normal range for this test is from 30% to 50% for property insurers and from 20% to 30% for long-tailed liability insurers.

	2009	2008	2007	2006	2005
Current Liquidity: (%)	90.3	86.5	85.8	88.2	92.1

represents current assets divided by net liabilities plus ceded reinsurance balances payable, expressed as a percent. This ratio measures the proportion of liabilities covered by unencumbered cash and unaffiliated investments. If this ratio is less than 100, the company's overall liquidity is dependent on the collectibility or marketability of premium balances and investments in affiliates. The normal range for this test is 120% to 140% for property insurers and 100% to 120% for long-tailed liability insurers.

	2009	2008	2007	2006	2005
Overall Liquidity: (%)	155.7	159.9	159.5	178.6	180.3

represents total admitted assets divided by total liabilities less conditional reserves, expressed as a percent. This ratio indicates a company's ability to cover net liabilities with total assets. The ratio does not address the quality and marketability of premium balances, affiliated investments and other uninvested assets. The normal range is from 140% to 180% for property insurers and 110% to 150% for long-tailed liability insurers.

	2009	2008	2007	2006	2005
Operating Cash Flow: ($000)	138,188	52,380	190,508	31,958	75,550

represents funds generated from insurance operations, which includes the change in cash and invested assets attributable to underwriting activities, net investment income and federal income taxes. Negative amounts may indicate unprofitable underwriting results or lowyielding assets.

	2009	2008	2007	2006	2005
Class 3-6 Bonds(% of PHS): (%)	...	0.2	...	...	...

Measures exposure to non-investment grade bonds as a percentage of surplus. Generally, non-investment grade bonds carry higher default and illiquidity risks. The designation of Class 3 through 6 bonds as non-investment grade utilizes the NAIC bond quality classifications that coincide with different bond ratings assigned by major credit rating agencies.

Loss Reserve Tests

	2009	2008	2007	2006	2005

Development to PHS: (%)	...	-1.7	-3.4	-6.3	-5.0

measures reserve deficiency or redundancy in relation to surplus and reflects the degree to which year-end surplus was either understated (-) or overstated (+) in each of the past several years, if the original reserves had been restated to reflect subsequent development through the current year. The normal range for this test is from 0% to -25%.

Loss and LAE Reserves to PHS: (%)	95.3	89.6	78.3	48.3	46.9

measures the trend and magnitude of a company's total loss reserves to surplus. The higher the multiple of loss reserves to surplus, the more critical is a company's solvency dependent upon having and maintaining reserve adequacy. The normal range for this test is from 50% to 100% for property insurers and from 200% to 300% for long-tailed liability insurers.

A Best's Financial Strength Rating opinion addresses the relative ability of an insurer to meet its ongoing insurance obligations. The ratings are not assigned to specific insurance policies or contracts and do not address any other risk, including, but not limited to, an insurer's claims-payment policies or procedures; the ability of the insurer to dispute or deny claims payment on grounds of misrepresentation or fraud; or any specific liability contractually borne by the policy or contract holder. A Best's Financial Strength Rating is not a recommendation to purchase, hold or terminate any insurance policy, contract or any other financial obligation issued by an insurer, nor do they address the suitability of any particular policy or contract for a specific purpose or purchaser.

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