HCC INSURANCE HOLDINGS INC/DE/
Form 10-Q
August 05, 2015
Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

þ **Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**

for the Quarterly Period Ended June 30, 2015.
¨ **Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**

from________________to__________________

Commission file number 001-13790

HCC Insurance Holdings, Inc.

(Exact name of registrant as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	76-0336636 (IRS Employer Identification No.)
13403 Northwest Freeway, Houston, Texas (Address of principal executive offices)	77040-6094 (Zip Code)

(713) 690-7300

(Registrant s telephone number, including area code)

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 ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes þ No ¨

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

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes ¨ No þ

Indicate the number of shares outstanding of each of the registrant s classes of common stock, as of the latest practicable date.

On July 31, 2015, there were approximately 95.6 million shares of common stock outstanding.

Table of Contents

HCC Insurance Holdings, Inc. and Subsidiaries

Table of Contents

	Page
Part I. FINANCIAL INFORMATION	
Item 1. Financial Statements (Unaudited)	
Consolidated Balance Sheets June 30, 2015 and December 31, 2014	5
Consolidated Statements of Earnings Six and three months ended June 30, 2015 and 2014	6
Consolidated Statements of Comprehensive Income Six and three months ended June 30, 2015 and 2014	7
Consolidated Statement of Changes in Shareholders Equity Six months ended June 30, 2015	8
Consolidated Statements of Cash Flows Six months ended June 30, 2015 and 2014	9
Notes to Consolidated Financial Statements	10
Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations	30
Item 3. Quantitative and Qualitative Disclosures About Market Risk	44
Item 4. Controls and Procedures	44
Part II. OTHER INFORMATION	
Item 1. Legal Proceedings	45
Item 1A. Risk Factors	45
Item 2. Unregistered Sales of Equity Securities and Use of Proceeds	47
Item 3. Defaults Upon Senior Securities	47
Item 4. Mine Safety Disclosures	47
Item 5. Other Information	47

Item 6. Exhibits	48
Signatures	50

Table of Contents

FORWARD-LOOKING STATEMENTS

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

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

the effects of catastrophe losses,

volatility in crop prices and crop yields,

the cyclical nature of the insurance business,

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

the impact of past and future potential economic or credit market downturns, including any potential ratings downgrade or impairment of the debt securities of sovereign issuers,

the effects of emerging claim and coverage issues,

the effects of extensive governmental regulation of the insurance industry,

changes to the country s health care delivery system,

the effects of climate change on the risks we insure,

potential risk with agents and brokers, *the effects of industry consolidations,*

our assessment of underwriting risk,

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

the adequacy of reinsurance protection,

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

the occurrence of terrorist activities,

our ability to maintain our competitive position,

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

changes in our assigned financial strength ratings,

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

Table of Contents

- *attraction and retention of qualified employees,*
- *our ability to successfully expand our business through the acquisition of insurance-related companies,*
- *impairment of goodwill,*
- *the ability of our insurance company subsidiaries to pay dividends in needed amounts,*
- *fluctuations in foreign exchange rates,*
- *failure of, or loss of security related to, our information technology systems,*
- *difficulties with outsourcing relationships,*
- *the effects of mergers, acquisitions or divestitures;*
- *change of control; and*
- *any changes concerning the conditions, terms, termination or closing of our announced merger with Tokio Marine Holdings, Inc.*

We described these risks and uncertainties in greater detail in Item 1A. Risk Factors in our Annual Report on Form 10-K for the year ended December 31, 2014 and in Item 1A. Risk Factors included in this Report.

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

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

Table of Contents

HCC Insurance Holdings, Inc. and Subsidiaries

Consolidated Balance Sheets

(unaudited, in thousands except per share data)

	June 30, 2015	December 31, 2014
ASSETS		
Investments		
Fixed maturity securities available for sale, at fair value (amortized cost: 2015 $6,132,246 and 2014 $6,352,737)	$ 6,296,256	$ 6,610,368
Equity securities available for sale, at fair value (cost: 2015 $382,550 and 2014 $291,070)	390,077	296,352
Short-term investments, at cost (approximates fair value)	283,420	258,186
Other investments (at fair value)	24,957	-
Total investments	6,994,710	7,164,906
Cash	81,864	102,093
Restricted cash and securities	114,229	119,010
Premium, claims and other receivables	925,827	553,027
Reinsurance recoverables	1,165,211	1,168,900
Ceded unearned premium	371,138	316,715
Ceded life and annuity benefits	48,114	48,499
Deferred policy acquisition costs	260,273	220,321
Goodwill	952,130	905,636
Other assets	227,434	115,239
Total assets	$ 11,140,930	$ 10,714,346
LIABILITIES		
Loss and loss adjustment expense payable	$ 3,660,488	$ 3,728,085
Life and annuity policy benefits	48,114	48,499
Reinsurance, premium and claims payable	456,747	301,476
Unearned premium	1,471,835	1,198,930
Deferred ceding commissions	117,530	94,202
Notes payable	909,328	824,251
Accounts payable and accrued liabilities	560,766	615,552

Total liabilities		7,224,808		6,810,995
SHAREHOLDERS EQUITY				
Common stock, $1.00 par value; 250,000 shares authorized (shares issued: 2015 126,837 and 2014 126,472; outstanding: 2015 95,645 and 2014 96,521)		126,837		126,472
Additional paid-in capital		1,122,937		1,113,551
Retained earnings		3,578,315		3,441,424
Accumulated other comprehensive income		110,712		175,014
Treasury stock, at cost (shares: 2015 31,192 and 2014 29,951)		(1,022,679)		(953,110)
Total shareholders equity		3,916,122		3,903,351
Total liabilities and shareholders equity	$	11,140,930	$	10,714,346

See Notes to Consolidated Financial Statements.

5

Table of Contents

HCC Insurance Holdings, Inc. and Subsidiaries

Consolidated Statements of Earnings

(unaudited, in thousands except per share data)

	Six months ended June 30, 2015	Six months ended June 30, 2014	Three months ended June 30, 2015	Three months ended June 30, 2014
REVENUE				
Net earned premium	$ 1,242,403	$ 1,134,860	$ 641,840	$ 572,248
Net investment income	108,220	113,244	54,738	56,438
Other operating income	18,919	19,249	9,700	9,983
Net realized investment gain	13,759	25,151	573	4,905
Total revenue	1,383,301	1,292,504	706,851	643,574
EXPENSE				
Loss and loss adjustment expense, net	760,467	666,643	395,305	335,897
Policy acquisition costs, net	153,670	142,011	78,459	72,970
Other operating expense	188,749	177,250	111,266	90,198
Interest expense	15,030	13,984	7,264	6,865
Total expense	1,117,916	999,888	592,294	505,930
Earnings before income tax expense	265,385	292,616	114,557	137,644
Income tax expense	72,051	87,569	34,140	40,508
Net earnings	$ 193,334	$ 205,047	$ 80,417	$ 97,136
Earnings per common share				
Basic	$ 2.02	$ 2.05	$ 0.84	$ 0.97
Diluted	$ 2.01	$ 2.04	$ 0.84	$ 0.97

See Notes to Consolidated Financial Statements.

Table of Contents

HCC Insurance Holdings, Inc. and Subsidiaries

Consolidated Statements of Comprehensive Income

(unaudited, in thousands)

	Six months ended June 30, 2015	Six months ended June 30, 2014	Three months ended June 30, 2015	Three months ended June 30, 2014
Net earnings	$ 193,334	$ 205,047	$ 80,417	$ 97,136
Other comprehensive income (loss)				
Investment gains (losses):				
Investment gains (losses) during the period	(77,616)	179,825	(97,625)	93,745
Income tax charge (benefit)	(27,320)	63,818	(34,525)	33,248
Investment gains (losses), net of tax	(50,296)	116,007	(63,100)	60,497
Less reclassification adjustments to:				
Net realized investment gain	13,759	25,151	573	4,905
Income tax expense	4,816	8,803	201	1,717
Total reclassifications included in net earnings, net of tax	8,943	16,348	372	3,188
Net unrealized investment gains (losses)	(59,239)	99,659	(63,472)	57,309
Foreign currency translation adjustment	(5,060)	1,691	1,992	903
Income tax charge (benefit)	3	(421)	70	11
Foreign currency translation adjustment, net of tax	(5,063)	2,112	1,922	892
Other comprehensive income (loss)	(64,302)	101,771	(61,550)	58,201
Comprehensive income	$ 129,032	$ 306,818	$ 18,867	$ 155,337

See Notes to Consolidated Financial Statements.

Table of Contents

HCC Insurance Holdings, Inc. and Subsidiaries

Consolidated Statement of Changes in Shareholders Equity

Six months ended June 30, 2015

(unaudited, in thousands except per share data)

	Common stock	Additional paid-in capital	Retained earnings	Accumulated other comprehensive income	Treasury stock	Total shareholders equity
Balance at December 31, 2014	$ 126,472	$ 1,113,551	$ 3,441,424	$ 175,014	$ (953,110)	$ 3,903,351
Net earnings	-	-	193,334	-	-	193,334
Other comprehensive loss	-	-	-	(64,302)	-	(64,302)
Stock-based compensation	402	10,545	-	-	-	10,947
Issuance of 60 shares for exercise of options, including tax effect	60	4,684	-	-	-	4,744
Issuance of 49 shares for employee stock purchase plan	49	1,975	-	-	-	2,024
Surrender of 146 shares of restricted stock for employees tax liability	(146)	(7,818)	-	-	-	(7,964)
Purchase of 1,241 common shares	-	-	-	-	(69,569)	(69,569)
Cash dividends declared, $0.59 per share	-	-	(56,443)	-	-	(56,443)

Balance at June 30, 2015	$	126,837	$	1,122,937	$	3,578,315	$	110,712	$	(1,022,679)	$	3,916,122

See Notes to Consolidated Financial Statements.

Table of Contents

HCC Insurance Holdings, Inc. and Subsidiaries

Consolidated Statements of Cash Flows

(unaudited, in thousands)

	Six months ended June 30, 2015	2014
Operating activities		
Net earnings	$ 193,334	$ 205,047
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Change in premium, claims and other receivables	(194,834)	(109,043)
Change in reinsurance recoverables	180,540	96,770
Change in ceded unearned premium	(21,520)	(35,485)
Change in loss and loss adjustment expense payable	(241,159)	(57,118)
Change in unearned premium	216,788	138,248
Change in reinsurance, premium and claims payable	32,494	55,764
Change in accounts payable and accrued liabilities	(73,290)	(69,414)
Stock-based compensation expense	10,947	10,303
Depreciation and amortization expense	12,322	8,289
Gain on investments	(13,759)	(25,151)
Other, net	(69,110)	(22,924)
Cash provided by operating activities	32,753	195,286
Investing activities		
Sales of available for sale fixed maturity securities	398,848	286,843
Sales of equity securities	71,970	170,182
Maturity or call of available for sale fixed maturity securities	363,541	269,468
Cost of available for sale fixed maturity securities acquired	(518,929)	(675,945)
Cost of equity securities acquired	(147,232)	(78,817)
Cost of other investments acquired	(25,000)	-
Change in short-term investments	(31,300)	(168,241)
Payments for purchase of businesses, net of cash received	(99,060)	(2,579)
Proceeds from sales of subsidiaries	-	12,942
Other, net	(4,584)	(3,902)
Cash provided (used) by investing activities	8,254	(190,049)
Financing activities		
Advances on line of credit	210,000	140,000
Payments on line of credit	(140,004)	(60,000)

Sale of common stock	6,768	11,709
Purchase of common stock	(69,569)	(41,542)
Dividends paid	(56,722)	(45,076)
Other, net	(11,709)	2,278
Cash provided (used) by financing activities	(61,236)	7,369
Net increase (decrease) in cash	(20,229)	12,606
Cash at beginning of year	102,093	58,301
Cash at end of period	$ 81,864	$ 70,907

See Notes to Consolidated Financial Statements.

Table of Contents

HCC Insurance Holdings, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

(unaudited, tables in thousands except per share data)

(1) General Information and Significant Accounting and Reporting Policies

HCC Insurance Holdings, Inc. (HCC) and its subsidiaries (collectively we, us or our) include domestic and foreign property and casualty and life insurance companies and underwriting agencies with offices in the United States, the United Kingdom, Spain and Ireland. We underwrite a variety of largely non-correlated specialty insurance products, including property and casualty, accident and health, agriculture, surety and credit product lines, in approximately 180 countries. We market our products through a network of independent agents and brokers, through managing general agents owned by the company, and directly to consumers. In addition, we assume insurance written by other insurance companies.

Proposed Merger with Tokio Marine

On June 10, 2015, we announced that HCC had entered into an Agreement and Plan of Merger (Merger Agreement) with Tokio Marine Holdings, Inc., a Japanese corporation (Tokio Marine) and TMGC Investment (Delaware) Inc. (Merger Sub), an indirect wholly-owned subsidiary of Tokio Marine, providing for HCC to be acquired by Tokio Marine through a merger effected under Delaware law (referred to herein as merger). The Merger Agreement provides that, subject to the satisfaction or waiver of the conditions set forth in the Merger Agreement, Merger Sub will merge with and into HCC with HCC continuing as the surviving corporation and an indirect wholly-owned subsidiary of Tokio Marine. Tokio Marine is the ultimate holding company of the Tokio Marine Group, which operates in the non-life insurance business, life insurance business, and financial and general businesses globally.

On completion of the merger, shares of our common stock (Shares) will no longer be listed on any stock exchange or quotation system. If the Merger Agreement is adopted and the merger is completed, each outstanding Share (other than Shares held by HCC, Tokio Marine or Merger Sub or any of their respective subsidiaries, or by any holder who has properly exercised appraisal rights of such Shares in accordance with Section 262 of the General Corporation Law of the State of Delaware) will be converted into the right to receive $78.00 in cash (Merger Consideration), without interest and less any applicable tax withholdings.

The Merger Agreement provides that equity-based awards held by our directors, executive officers and employees as of the effective time of the merger will be treated at the effective time as follows: 1) each outstanding option to purchase Shares (Option) granted under HCC s 2008 Flexible Incentive Plan, as amended (Incentive Plan), whether vested or unvested, will be canceled and will only entitle the holder of the Option the right to receive an amount in cash equal to the product obtained by multiplying (A) the total number of Shares subject to the Option by (B) the excess, if any, of the Merger Consideration over the exercise price per Share of that Option, less any applicable tax withholdings; 2) HCC will waive any vesting or holding conditions or restrictions applicable to each outstanding restricted Share granted under the Incentive Plan or HCC s 2014 Stock Promotion Plan, and at the effective time each Share will be treated in the same manner as a Share of our common stock and will entitle the holder to an amount in cash equal to the Merger Consideration, less any applicable tax withholdings; 3) with respect to any restricted Shares subject to performance based vesting (Performance Shares), the performance criteria will be deemed to have been achieved based on 100% performance and such Performance Shares will be treated the same as all other Shares in the merger and will entitle the holder to an amount in cash equal to the Merger Consideration, less any applicable tax withholdings; and 4) each outstanding restricted stock unit granted under the Incentive Plan (RSU), whether vested or unvested, will be canceled and will entitle the holder of the RSU an amount in cash equal to the product of (A) the total number of Shares subject to the RSU and (B) the Merger Consideration, less any applicable tax withholdings.

Each of the parties has made customary representations and warranties and agreed to covenants in the Merger Agreement. We have agreed, among other things, to use our commercially reasonable efforts to cause our business to be conducted in the ordinary and usual course during the period between the execution of the Merger Agreement and the closing of the merger, and not to take certain actions specified in the Merger Agreement during such time. We have also agreed not to discuss alternative acquisition proposals with, or solicit alternative acquisition proposals from, third parties, subject to exceptions that allow us under certain circumstances to provide information to and participate in discussions with third parties with respect to unsolicited alternative acquisition proposals, and to terminate the Merger Agreement in order to accept such a proposal that constitutes a Superior Proposal (as defined in the Merger Agreement), in each case if HCC s board of directors has determined that the failure to take such action would be inconsistent with HCC s fiduciary duties under applicable law.

Table of Contents

HCC Insurance Holdings, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

(unaudited, tables in thousands except per share data)

The Merger Agreement provides certain termination rights for both HCC and Tokio Marine, and further provides that, upon termination of the Merger Agreement under certain circumstances, we will be obligated to pay Tokio Marine a termination fee of $187.5 million.

The Merger Agreement was unanimously approved by our board of directors and is conditioned, among other things, on: 1) adoption of the Merger Agreement and approval of the merger by our shareholders, 2) receipt of required governmental approvals, including antitrust and insurance regulatory approvals and 3) other customary closing conditions. In addition, Tokio Marine s obligation to consummate the merger is subject to the condition that the required governmental approvals have been obtained without the imposition of any Negative Regulatory Action (as defined in the Merger Agreement).

The merger is expected to close during the fourth quarter of 2015, subject to the closing conditions described above and contained in the Merger Agreement.

Basis of Presentation

Our unaudited consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America (GAAP) and include the accounts of HCC and its subsidiaries. We have made all adjustments that, in our opinion, are necessary for a fair statement of results of the interim periods, and all such adjustments are of a normal recurring nature. All significant intercompany balances and transactions have been eliminated in consolidation. The consolidated financial statements include the results of operations and cash flows of Producers Ag Insurance Group, Inc. (ProAg) from January 1, 2015, the effective acquisition date (see Note 2, Acquisition).

The consolidated financial statements should be read in conjunction with our Annual Report on Form 10-K for the year ended December 31, 2014. The consolidated balance sheet at December 31, 2014 was derived from the audited financial statements but does not include all disclosures required by GAAP.

Management must make estimates and assumptions that affect amounts reported in our consolidated financial statements and in disclosures of contingent assets and liabilities. Ultimate results could differ from those estimates.

In conjunction with the acquisition of ProAg in the first quarter of 2015, HCC s executive management changed the structure under which it manages and evaluates the results of our numerous product lines. See Note 3, Segments for discussion of our new reporting structure.

New Accounting and Reporting Policies

The following policies changed in 2015:

Agriculture

The majority of premium written in our new agriculture business relates to multi-peril crop insurance (MPCI), written through the federal crop insurance program administered by the U.S. Department of Agriculture s Risk Management Agency and the Federal Crop Insurance Corporation (FCIC). We record written premium for our agriculture business as we process acreage reports received from the policyholders. Written premium is earned ratably over the period of risk commencing on the final planting date set by the FCIC, which approximates the start of planting season, and ending on the estimated crop harvest date.

We have a net receivable (payable) due from (to) the FCIC for settlement of MPCI reinsurance. If a net receivable, it is reflected in our consolidated balance sheet with premium, claims and other receivables. If a net payable, it is reflected in our consolidated balance sheet with reinsurance, premium and claims payable.

Table of Contents

HCC Insurance Holdings, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

(unaudited, tables in thousands except per share data)

Goodwill

An indicator of impairment of goodwill exists when the fair value of a reporting unit is less than its carrying value. In conjunction with the change in our reporting structure discussed in Note 3, Segments, we now have three reporting units that are the same as our insurance underwriting segments: 1) North America Property & Casualty, 2) Accident & Health and 3) International.

We conducted our annual goodwill impairment test as of June 30, 2015, which is consistent with the timeframe for our annual assessment in prior years. This test consisted of a qualitative assessment in which we determined that it is more likely than not that the fair value of each of our three reporting units exceeded its carrying amount with no indicators of impairment.

Recent Accounting Guidance

An accounting standard issued in 2014 will change the manner in which most companies recognize revenue. The standard requires that revenue reflect the transfer of goods or services to customers based on the consideration/payment the company expects to be entitled to in exchange for those goods or services; however, the standard does not change the accounting for insurance contracts or investment income. The new standard also requires enhanced disclosures about revenue. This standard is effective in the first quarter of 2018. The standard may be applied on a full retrospective or modified retrospective approach. We are currently assessing the impact the implementation of this standard will have on our consolidated financial statements.

An accounting standard issued in 2015 focuses on improving existing disclosure requirements to provide users with additional information about insurance liabilities for short-duration contracts. The standard does not change the existing recognition and measurement guidance for short-duration contracts. This standard is effective at December 31, 2016 and must be applied retrospectively by providing comparative disclosures for each period presented, except for those requirements that apply only to the current period. Application of this standard will have no impact on our consolidated financial position, results of operations or cash flows.

An accounting standard issued in 2015 changes the presentation of debt issuance costs related to a recognized debt liability. The standard requires debt issuance costs be presented as a reduction of the debt liability, rather than as a deferred charge asset. This standard is effective at March 31, 2016 and must be applied retrospectively. We have immaterial debt issuance costs included in other assets in our consolidated balance sheets that will be reclassified as a reduction to notes payable. Application of this standard will have no impact on our consolidated financial position, results of operations or cash flows.

Table of Contents

HCC Insurance Holdings, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

(unaudited, tables in thousands except per share data)

(2) Acquisition

Effective January 1, 2015, we completed the acquisition of all of the capital stock of ProAg from CUNA Mutual Group for $102.4 million cash. ProAg writes multi-peril crop, crop hail and other named peril insurance. Crop insurance is a non-correlated line of business we strategically targeted to add to our diversified portfolio of specialty insurance businesses.

We completed our accounting for this acquisition in the second quarter of 2015. The following table summarizes the fair values of assets acquired and liabilities assumed at the acquisition date:

Assets		
Investments Fixed maturity securities	$	8,008
Cash		18,979
Premium, claims and other receivables		179,451
Reinsurance recoverables		197,292
Ceded unearned premium		33,127
Other assets		72,347
Total identifiable assets acquired		509,204
Liabilities		
Loss and loss adjustment expense payable		202,265
Reinsurance, premium and claims payable		131,677
Unearned premium		56,946
Notes payable		15,004
Accounts payable and accrued liabilities		48,049
Total liabilities assumed		453,941
Net identifiable assets acquired		55,263
Goodwill		47,145
Net assets acquired	$	102,408

The majority of these assets and liabilities related to ProAg s reinsurance year 2014, which is 100% ceded to the FCIC and third party reinsurers (including CUNA Mutual Group) under existing reinsurance agreements. We expect settlement of reinsurance year 2014 amounts to occur with all parties during the fourth quarter of 2015.

We recognized $54.0 million of intangible assets and $47.1 million of goodwill, neither of which is tax deductible. Finite-lived intangible assets relate to agent relationships and ProAg s trade name with fair values of $23.0 million and $8.0 million, respectively, which will be amortized over a useful life of 15 years and 10 years, respectively. Indefinite-lived intangible assets of $23.0 million relate to state and federal insurance licenses, which will be reviewed annually for impairment. Intangible assets are included in other assets in our consolidated balance sheet. The goodwill primarily represents the value of ProAg s assembled workforce and opportunities for future expansion utilizing ProAg s infrastructure.

HCC Insurance Holdings, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

(unaudited, tables in thousands except per share data)

(3) Segments

In the first quarter of 2015, following the acquisition of ProAg, HCC s executive management changed the structure under which it manages and evaluates the results of our numerous product lines. We now report our results in four operating segments, consisting of three insurance underwriting segments (North America Property & Casualty, Accident & Health, and International) and the Investing segment.

Each of our three insurance underwriting segments bears risk for insurance coverage written within its portfolio of insurance products. Each segment generates income from premium written by our underwriting agencies, through third party agents and brokers, or on a direct basis. Fee and commission income earned by our agencies from third party insurance companies is included in segment revenue. Each segment incurs insurance losses, acquisition costs, claims management costs and other administrative expenses related to our insurance companies and underwriting agencies. Internal claims department costs are managed and reported as a component of loss and loss adjustment expense. We monitor and assess each segment s pretax results based on underwriting profit, gross and net written premium, and its combined ratio, consisting of the segment s net loss ratio and expense ratio.

Included in the portfolio of products for each insurance underwriting segment are the following key products:

North America Property & Casualty directors and officers liability (D&O), primary and excess casualty, small account errors and omissions liability, employment practices liability, agriculture, aviation, sports and entertainment, public risk, surety, and various smaller products.

Accident & Health medical stop-loss, short-term domestic and international medical, and travel.

International marine and energy, property treaty, property (direct and facultative), accident and health, D&O, professional indemnity, liability, surety, and credit.

The North America Property & Casualty segment includes the former U.S. Property & Casualty segment, the U.S. portion of the former Professional Liability segment, the Surety portion of the former U.S. Surety & Credit segment and ProAg s agriculture business. The International segment includes the former International segment, the International portion of the former Professional Liability segment, and the Credit portion of the former U.S. Surety & Credit segment. The Accident & Health and Investing segments are unchanged from the prior presentation. All prior period information has been recast to present our segment disclosures and information on a comparable basis with our new segment reporting structure.

The Investing segment includes our consolidated investment portfolio, as well as all investment income, investment related expenses, realized investment gains and losses, and other-than-temporary impairment credit losses on investments. All investment activity is reported as revenue, consistent with our consolidated presentation.

In addition to our segments, we include a Corporate & Other category to reconcile segment results to consolidated totals. The Corporate & Other category includes: 1) corporate operating expenses not allocated to the segments, 2) interest expense on notes payable, 3) foreign currency expense (benefit) and 4) underwriting results of our Exited Lines. Our Exited Lines include product lines that we no longer write and do not expect to write in the future.

Table of Contents

HCC Insurance Holdings, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

(unaudited, tables in thousands except per share data)

The following tables present information by business segment.

	North America Property & Casualty	Accident & Health	International	Investing	Corporate & Other	Consolidated
Six months ended June 30, 2015						
Net earned premium	$ 460,669	$ 510,613	$ 271,121	$ -	$ -	$ 1,242,403
Other revenue	12,664	3,919	1,922	121,979	414	140,898
Segment revenue	473,333	514,532	273,043	121,979	414	1,383,301
Loss and LAE	266,270	373,940	119,718	-	539	760,467
Other expense	138,467	79,639	99,192	-	40,151	357,449
Segment expense	404,737	453,579	218,910	-	40,690	1,117,916
Segment pretax earnings (loss)	$ 68,596	$ 60,953	$ 54,133	$ 121,979	$ (40,276)	$ 265,385
Six months ended June 30, 2014						
Net earned premium	$ 397,855	$ 472,481	$ 263,904	$ -	$ 620	$ 1,134,860
Other revenue	10,352	5,502	1,831	138,395	1,564	157,644
Segment revenue	408,207	477,983	265,735	138,395	2,184	1,292,504
Loss and LAE	208,290	344,944	112,832	-	577	666,643
Other expense	115,688	70,605	95,820	-	51,132	333,245
Segment expense	323,978	415,549	208,652	-	51,709	999,888

Segment pretax earnings (loss)	$	84,229	$	62,434	$	57,083	$	138,395	$	(49,525)	$	292,616
Three months ended June 30, 2015												
Net earned premium	$	251,430	$	255,663	$	134,744	$	-	$	3	$	641,840
Other revenue		6,562		1,906		914		55,311		318		65,011
Segment revenue		257,992		257,569		135,658		55,311		321		706,851
Loss and LAE		149,834		186,929		58,275		-		267		395,305
Other expense		70,119		40,974		51,881		-		34,015		196,989
Segment expense		219,953		227,903		110,156		-		34,282		592,294
Segment pretax earnings (loss)	$	38,039	$	29,666	$	25,502	$	55,311	$	(33,961)	$	114,557
Three months ended June 30, 2014												
Net earned premium	$	196,521	$	240,338	$	135,060	$	-	$	329	$	572,248
Other revenue		4,921		3,862		855		61,343		345		71,326
Segment revenue		201,442		244,200		135,915		61,343		674		643,574
Loss and LAE		104,737		174,139		56,518		-		503		335,897
Other expense		58,150		36,032		49,345		-		26,506		170,033
Segment expense		162,887		210,171		105,863		-		27,009		505,930
Segment pretax earnings (loss)	$	38,555	$	34,029	$	30,052	$	61,343	$	(26,335)	$	137,644

Table of Contents

HCC Insurance Holdings, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

(unaudited, tables in thousands except per share data)

In conjunction with the resegmentation, we reassigned the goodwill associated with the lines of business in our former Professional Liability and U.S. Surety & Credit reporting units at December 31, 2014 to the applicable North America Property & Casualty and International reporting units. We allocated goodwill to the lines of business within the former reporting units based on the relative fair value of each line of business to the sum of the former reporting unit s total fair value at December 31, 2014. We noted no indicators of impairment as of December 31, 2014, after this allocation of goodwill.

The goodwill balances by reportable segment, after allocation of the goodwill in our former reporting units, are presented below.

	North America Property & Casualty	Accident & Health	International	Total
Balance at beginning of year	$ 552,006	$ 144,113	$ 209,517	$ 905,636
Acquisition of ProAg	47,145	-	-	47,145
Other, principally foreign exchange	99	-	(750)	(651)
Balance at June 30, 2015	$ 599,250	$ 144,113	$ 208,767	$ 952,130

The table below presents total assets by segment following our resegmentation.

	June 30, 2015	December 31, 2014
North America Property & Casualty	$ 2,465,227	$ 1,894,756
Accident & Health	243,105	242,278
International	1,131,605	1,073,889
Investing	7,052,910	7,228,608
Corporate & Other	248,083	274,815
Total	$ 11,140,930	$ 10,714,346

Table of Contents

HCC Insurance Holdings, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

(unaudited, tables in thousands except per share data)

(4) Investments

The cost or amortized cost, gross unrealized gain or loss, and fair value of our fixed maturity and equity securities, all of which are classified as available for sale, were as follows:

June 30, 2015		Cost or amortized cost		Gross unrealized gain		Gross unrealized loss		Fair value
U.S. government and government agency securities	$	73,501	$	697	$	(60)	$	74,138
Fixed maturity securities of states, municipalities and political subdivisions		775,017		42,911		(2,173)		815,755
Special purpose revenue bonds of states, municipalities and political subdivisions		2,240,251		106,213		(7,518)		2,338,946
Corporate securities		771,109		17,648		(6,441)		782,316
Residential mortgage-backed securities		784,457		14,943		(7,363)		792,037
Commercial mortgage-backed securities		521,110		13,853		(2,274)		532,689
Asset-backed securities		373,117		530		(856)		372,791
Foreign government securities		145,905		830		(1,484)		145,251
Foreign corporate securities		447,779		7,140		(12,586)		442,333
Total fixed maturity securities	$	6,132,246	$	204,765	$	(40,755)	$	6,296,256
Equity securities	$	382,550	$	29,918	$	(22,391)	$	390,077
December 31, 2014								
U.S. government and government agency securities	$	70,279	$	827	$	(137)	$	70,969
Fixed maturity securities of states, municipalities and political subdivisions		896,130		58,738		(160)		954,708

Special purpose revenue bonds of states, municipalities and political subdivisions	2,246,707	143,291	(986)	2,389,012
Corporate securities	777,242	25,983	(4,656)	798,569
Residential mortgage-backed securities	805,458	20,215	(3,979)	821,694
Commercial mortgage-backed securities	593,956	19,707	(2,032)	611,631
Asset-backed securities	369,103	316	(2,592)	366,827
Foreign government securities	119,479	767	(1,554)	118,692
Foreign corporate securities	474,383	10,776	(6,893)	478,266
Total fixed maturity securities	$ 6,352,737	$ 280,620	$ (22,989)	$ 6,610,368
Equity securities	$ 291,070	$ 24,069	$ (18,787)	$ 296,352

Table of Contents

HCC Insurance Holdings, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

(unaudited, tables in thousands except per share data)

Substantially all of our fixed maturity securities are investment grade. The following tables display the gross unrealized losses and fair value of all available for sale securities that were in a continuous unrealized loss position for the periods indicated.

	Less than 12 months		12 months or more		Total	
	Fair value	Unrealized losses	Fair value	Unrealized losses	Fair value	Unrealized losses
June 30, 2015						
Fixed maturity securities						
U.S. government and government agency securities	$ 9,018	$ (53)	$ 3,985	$ (7)	$ 13,003	$ (60)
Fixed maturity securities of states, municipalities and political subdivisions	119,543	(2,173)	-	-	119,543	(2,173)
Special purpose revenue bonds of states, municipalities and political subdivisions	437,071	(6,738)	18,348	(780)	455,419	(7,518)
Corporate securities	258,668	(4,594)	40,654	(1,847)	299,322	(6,441)
Residential mortgage-backed securities	271,212	(4,160)	98,727	(3,203)	369,939	(7,363)
Commercial mortgage-backed securities	107,636	(1,338)	24,216	(936)	131,852	(2,274)
Asset-backed securities	150,415	(269)	72,839	(587)	223,254	(856)
Foreign government securities	30,582	(1,052)	12,893	(432)	43,475	(1,484)
Foreign corporate securities	171,921	(7,203)	42,054	(5,383)	213,975	(12,586)
Equity securities	169,836	(16,423)	23,288	(5,968)	193,124	(22,391)
Total	$ 1,725,902	$ (44,003)	$ 337,004	$ (19,143)	$ 2,062,906	$ (63,146)
December 31, 2014						
Fixed maturity securities						
U.S. government and government agency securities	$ 14,813	$ (8)	$ 11,236	$ (129)	$ 26,049	$ (137)

Fixed maturity securities of states, municipalities and political subdivisions	3,857	(21)	19,337	(139)	23,194	(160)
Special purpose revenue bonds of states, municipalities and political subdivisions	4,041	(19)	100,947	(967)	104,988	(986)
Corporate securities	211,111	(2,498)	48,091	(2,158)	259,202	(4,656)
Residential mortgage-backed securities	37,434	(100)	226,256	(3,879)	263,690	(3,979)
Commercial mortgage-backed securities	5,228	(26)	99,868	(2,006)	105,096	(2,032)
Asset-backed securities	181,579	(1,245)	78,797	(1,347)	260,376	(2,592)
Foreign government securities	55,280	(1,498)	7,187	(56)	62,467	(1,554)
Foreign corporate securities	182,163	(4,587)	21,571	(2,306)	203,734	(6,893)
Equity securities	111,251	(17,839)	3,934	(948)	115,185	(18,787)
Total	$ 806,757	$ (27,841)	$ 617,224	$ (13,935)	$ 1,423,981	$ (41,776)

18

Table of Contents

HCC Insurance Holdings, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

(unaudited, tables in thousands except per share data)

At June 30, 2015, we held approximately 2,960 fixed maturity and equity securities, of which 36% included at least one lot in an unrealized loss position. A security has an impairment loss when its fair value is less than its cost or amortized cost at the balance sheet date. We evaluate our securities for possible other-than-temporary impairment losses at each quarter end. Our reviews cover all impaired securities where the loss exceeds $1.0 million and the loss either exceeds 10% of cost or the security had been in a loss position for longer than twelve consecutive months. We do not consider the $63.1 million of gross unrealized losses in our portfolio at June 30, 2015 to be other-than-temporary impairments as these losses relate to non-credit factors, such as interest rate changes, fluctuations in exchange rates and market conditions. We recognized no other-than-temporary impairment losses in the first six months of 2015 and 2014.

The amortized cost and fair value of our fixed maturity securities at June 30, 2015, by contractual maturity, are shown below. Expected maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties. The weighted-average life of our mortgage-backed and asset-backed securities was 5.3 years at June 30, 2015.

	Cost or amortized cost	Fair value
Due in 1 year or less	$ 164,158	$ 160,738
Due after 1 year through 5 years	1,133,253	1,158,235
Due after 5 years through 10 years	1,223,353	1,277,278
Due after 10 years through 15 years	874,072	914,971
Due after 15 years	1,058,726	1,087,517
Securities with contractual maturities	4,453,562	4,598,739
Mortgage-backed and asset-backed securities	1,678,684	1,697,517
Total fixed maturity securities	$ 6,132,246	$ 6,296,256

Other investments primarily includes an investment in a fund that is carried at the net asset value of the fund. Changes in the net asset value are included in net investment income in our consolidated statements of earnings.

Realized pretax gains (losses) on the sale of investments included the following:

	Six months ended June 30,		Three months ended June 30,	
	2015	**2014**	**2015**	**2014**
Gains				
Fixed maturity securities	$ 18,505	$ 6,150	$ 4,629	$ 5,018
Equity securities	10,748	25,863	437	1,425
Total gains	29,253	32,013	5,066	6,443
Losses				
Fixed maturity securities	(1,934)	(3,688)	(462)	(1,533)
Equity securities	(13,560)	(3,174)	(4,031)	(5)
Total losses	(15,494)	(6,862)	(4,493)	(1,538)
Net				
Fixed maturity securities	16,571	2,462	4,167	3,485
Equity securities	(2,812)	22,689	(3,594)	1,420
Net realized investment gain	$ 13,759	$ 25,151	$ 573	$ 4,905

Table of Contents

HCC Insurance Holdings, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

(unaudited, tables in thousands except per share data)

(5) Fair Value Measurements

Our financial instruments include assets and liabilities carried at fair value, as well as assets and liabilities carried at cost or amortized cost but disclosed at fair value in our financial statements. In determining fair value, we generally apply the market approach, which uses prices and other relevant data based on market transactions involving identical or comparable assets and liabilities. We classify our financial instruments into the following three-level hierarchy:

Level 1 Inputs are based on quoted prices in active markets for identical instruments.

Level 2 Inputs are based on observable market data (other than quoted prices), or are derived from or corroborated by observable market data.

Level 3 Inputs are unobservable and not corroborated by market data.

Our Level 1 investments consist of U.S. Treasuries, money market funds and equity securities traded in an active exchange market. We use unadjusted quoted prices for identical instruments to measure fair value.

Our Level 2 investments include most of our fixed maturity securities, which consist of U.S. government agency securities, foreign government securities, municipal bonds (including those held as restricted securities), corporate debt securities, bank loans, middle market senior loans, foreign debt securities, mortgage-backed and asset-backed securities (including collateralized loan obligations), and deposits supporting our Lloyd s syndicate business. Level 2 also includes certificates of deposit and other interest-bearing deposits at banks, which we report as short-term investments. We measure fair value for the majority of our Level 2 investments using matrix pricing and observable market data, including benchmark securities or yields, reported trades, broker/dealer quotes, issuer spreads, two-sided markets, bids, offers, default rates, loss severity and other economic measures. We measure fair value for our structured securities using observable market data in cash flow models.

We are responsible for the prices used in our fair value measurements. We use independent pricing services to assist us in determining fair value of all of our Level 2 investments. The pricing services provide a single price or quote per security. We use data provided by our third party investment managers and Lloyd s of London to value the remaining Level 2 investments. To validate that these quoted prices are reasonable estimates of fair value, we perform various quantitative and qualitative procedures, including: 1) evaluation of the underlying methodologies, 2) analysis of recent sales activity, 3) analytical review of our fair values against current market prices and 4) comparison of the pricing services fair value to other pricing services fair value for the same investment. No markets for our investments were judged to be inactive at period end. Based on these procedures, we did not adjust the prices or quotes provided by our independent pricing services, third party investment managers or Lloyd s of London as of June 30, 2015 or December 31, 2014.

Our Level 2 financial instruments also include our notes payable. We determine the fair value of our 6.30% Senior Notes based on quoted prices in an inactive market. The fair value of borrowings under our Revolving Loan Facility approximates the carrying amount because interest is based on 30-day LIBOR plus a margin.

Our Level 3 securities include certain fixed maturity securities and an insurance contract that we account for as a derivative and classify in other assets. Our Level 3 category also includes liabilities for future earnout payments due to former owners of businesses we acquired, which are classified within accounts payable and accrued liabilities. We determine fair value of the derivative and the earnout payments based on internally developed models that use assumptions or other data that are not readily observable from objective sources.

Table of Contents

HCC Insurance Holdings, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

(unaudited, tables in thousands except per share data)

The following tables present the fair value of our financial instruments that were carried or disclosed at fair value. Unless indicated, these items were carried at fair value on our consolidated balance sheets. There were no material transfers between Level 1, Level 2 or Level 3 in the first six months of 2015 and 2014.

June 30, 2015	**Level 1**	**Level 2**	**Level 3**	**Total**
Fixed maturity securities				
U.S. government and government agency securities	$ 68,889	$ 5,249	$ -	$ 74,138
Fixed maturity securities of states, municipalities and political subdivisions	-	815,755	-	815,755
Special purpose revenue bonds of states, municipalities and political subdivisions	-	2,338,946	-	2,338,946
Corporate securities	-	782,169	147	782,316
Residential mortgage-backed securities	-	792,037	-	792,037
Commercial mortgage-backed securities	-	532,689	-	532,689
Asset-backed securities	-	372,791	-	372,791
Foreign government securities	-	145,251	-	145,251
Foreign corporate securities	-	442,333	-	442,333
Total fixed maturity securities	68,889	6,227,220	147	6,296,256
Equity securities	390,077	-	-	390,077
Short-term investments*	154,674	128,746	-	283,420
Other investments**	17	-	-	17
Restricted cash and securities	-	3,780	-	3,780
Premium, claims and other receivables	-	53,749	-	53,749
Other assets	-	-	1,632	1,632
Total assets measured at fair value	$ 613,657	$ 6,413,495	$ 1,779	$ 7,028,931
Notes payable*	$ -	$ 951,601	$ -	$ 951,601
Accounts payable and accrued liabilities -	-	3,780	7,530	11,310

earnout liabilities				
Total liabilities measured at fair value	$ -	$ 955,381	$ 7,530	$ 962,911

* Carried at cost or amortized cost on consolidated balance sheet.

** Excludes investment with a fair value of $24,940 that is measured at net asset value as a practical expedient.

Table of Contents

HCC Insurance Holdings, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

(unaudited, tables in thousands except per share data)

December 31, 2014	Level 1	Level 2	Level 3	Total
Fixed maturity securities				
U.S. government and government agency securities	$ 63,663	$ 7,306	$ -	$ 70,969
Fixed maturity securities of states, municipalities and political subdivisions	-	954,708	-	954,708
Special purpose revenue bonds of states, municipalities and political subdivisions	-	2,389,012	-	2,389,012
Corporate securities	-	798,421	148	798,569
Residential mortgage-backed securities	-	821,694	-	821,694
Commercial mortgage-backed securities	-	611,631	-	611,631
Asset-backed securities	-	366,827	-	366,827
Foreign government securities	-	118,692	-	118,692
Foreign corporate securities	-	478,266	-	478,266
Total fixed maturity securities	63,663	6,546,557	148	6,610,368
Equity securities	296,352	-	-	296,352
Short-term investments*	159,297	98,889	-	258,186
Restricted cash and securities	-	2,729	-	2,729
Premium, claims and other receivables	-	56,493	-	56,493
Other assets	18	-	1,306	1,324
Total assets measured at fair value	$ 519,330	$ 6,704,668	$ 1,454	$ 7,225,452
Notes payable*	$ -	$ 875,094	$ -	$ 875,094
Accounts payable and accrued liabilities - earnout liabilities	-	2,729	8,744	11,473
Total liabilities measured at fair value	$ -	$ 877,823	$ 8,744	$ 886,567

* Carried at cost or amortized cost on consolidated balance sheet.

22

HCC Insurance Holdings, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

(unaudited, tables in thousands except per share data)

(6) Reinsurance

In the normal course of business, our insurance companies cede a portion of their premium to reinsurers through treaty and facultative reinsurance agreements. Although reinsurance does not discharge the direct insurer from liability to its policyholder, our insurance companies participate in such agreements in order to limit their loss exposure, protect them against catastrophic losses and diversify their business. The following tables present the effect of such reinsurance transactions on our premium, loss and loss adjustment expense and policy acquisition costs.

	Six months ended June 30, 2015	Six months ended June 30, 2014	Three months ended June 30, 2015	Three months ended June 30, 2014
Direct written premium	$ 1,617,584	$ 1,369,751	$ 900,536	$ 749,239
Reinsurance assumed	186,305	209,700	77,217	83,490
Reinsurance ceded	(368,840)	(342,255)	(211,620)	(185,715)
Net written premium	$ 1,435,049	$ 1,237,196	$ 766,133	$ 647,014
Direct earned premium	$ 1,445,719	$ 1,288,995	$ 742,135	$ 651,682
Reinsurance assumed	144,001	152,341	72,833	76,318
Reinsurance ceded	(347,317)	(306,476)	(173,128)	(155,752)
Net earned premium	$ 1,242,403	$ 1,134,860	$ 641,840	$ 572,248
Direct loss and loss adjustment expense	$ 937,382	$ 743,616	$ 478,656	$ 383,987
Reinsurance assumed	38,930	63,274	11,714	21,472
Reinsurance ceded	(215,845)	(140,247)	(95,065)	(69,562)
Net loss and loss adjustment expense	$ 760,467	$ 666,643	$ 395,305	$ 335,897
Policy acquisition costs	$ 238,995	$ 215,210	$ 123,925	$ 110,565
Ceding commissions	(85,325)	(73,199)	(45,466)	(37,595)

Net policy acquisition costs	$ 153,670	$ 142,011	$ 78,459	$ 72,970

The table below shows the components of our reinsurance recoverables in our consolidated balance sheets.

	June 30, 2015	**December 31, 2014**
Reinsurance recoverable on paid losses	$ 92,897	$ 99,937
Reinsurance recoverable on outstanding losses	439,252	443,059
Reinsurance recoverable on incurred but not reported losses	634,562	627,404
Reserve for uncollectible reinsurance	(1,500)	(1,500)
Total reinsurance recoverables	$ 1,165,211	$ 1,168,900

Table of Contents

HCC Insurance Holdings, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

(unaudited, tables in thousands except per share data)

At each quarter end, we review our financial exposure to the reinsurance market based on our individual reinsurance recoverable balances as of the prior quarter end. We take actions to collect outstanding balances or to mitigate our exposure to possible uncollectible amounts. We had a $1.5 million reserve for potentially uncollectible amounts at June 30, 2015. Reinsurance recoverables related to our settlement of Spanish surety bond claims totaled $78.1 million at June 30, 2015, including $40.8 million on paid losses. Our reinsurers have paid our reinsurance claims in full on a timely basis, with the exception of a small number of reinsurers that are currently in run-off and disputing balances owed us. Recoverables from these run-off reinsurers totaled $41.6 million, including $38.3 million on paid losses, at June 30, 2015 (at quarter-end foreign currency exchange rate). No payments have been received from these reinsurers despite their participation in contracts on essentially the same terms of our other reinsurers. We are vigorously pursuing collection of these recoverables, including through arbitration where necessary, and believe these amounts are fully recoverable. Accordingly, we have not recorded a reserve for uncollectibility related to these amounts. While we believe our current reserve is adequate based on information currently available, market conditions may change or additional information might be obtained that may require us to change the reserve in the future.

(7) Liability for Unpaid Loss and Loss Adjustment Expense

The table below provides a reconciliation of our liability for loss and loss adjustment expense payable (referred to as reserves). We recognized no prior year loss development in the first six months and second quarter of 2015 and 2014.

	Six months ended June 30,		Three months ended June 30,	
	2015	2014	2015	2014
Reserves at beginning of period	$ 3,728,085	$ 3,902,132	$ 3,692,522	$ 3,847,417
Less reinsurance recoverables on reserves	1,070,463	1,122,731	1,082,484	1,098,576
Net reserves at beginning of period	2,657,622	2,779,401	2,610,038	2,748,841
Net reserve additions from acquired business	8,743	-	-	-
Net loss and loss adjustment expense	760,467	666,643	395,305	335,897
Net loss and loss adjustment expense payments	(820,513)	(691,775)	(431,975)	(327,917)
Foreign currency adjustment	(19,645)	5,979	13,306	3,427
Net reserves at end of period	2,586,674	2,760,248	2,586,674	2,760,248
Plus reinsurance recoverables on reserves	1,073,814	1,081,249	1,073,814	1,081,249

Reserves at end of period	$ 3,660,488	$ 3,841,497	$ 3,660,488	$ 3,841,497

HCC Insurance Holdings, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

(unaudited, tables in thousands except per share data)

(8) Notes Payable

Our notes payable consisted of the following:

		June 30, 2015		December 31, 2014
6.30% Senior Notes	$	299,328	$	299,251
$825.0 million Revolving Loan Facility		610,000		525,000
Total notes payable	$	909,328	$	824,251

There have been no changes to the terms and conditions related to our 6.30% Senior Notes or the $825.0 million Revolving Loan Facility (the Facility) from those described in Note 7, Notes Payable to the Consolidated Financial Statements in our Annual Report on Form 10-K for the year ended December 31, 2014. We were in compliance with debt covenants related to our 6.30% Senior Notes and the Facility at June 30, 2015.

The weighted-average interest rate on borrowings under the Facility at June 30, 2015 was 1.4%. The borrowings and letters of credit issued under the Facility reduced our available borrowing capacity on the Facility to $210.1 million at June 30, 2015.

(9) Income Taxes

The following table summarizes the differences between our effective tax rate for financial statement purposes and the Federal statutory rate.

	Six months ended June 30,		Three months ended June 30,	
	2015	2014	2015	2014
Statutory tax rate	35.0 %	35.0 %	35.0 %	35.0 %