HCC INSURANCE HOLDINGS INC/DE/
Form 10-Q
November 14, 2003

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-Q

[X] Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the Quarter Ended September 30, 2003.

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

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12B-2 of the Act).

Yes [X] No [ ]

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

On October 31, 2003, there were 63.8 million shares of common stock, $1.00 par value issued and outstanding.

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HCC INSURANCE HOLDINGS, INC.
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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. We have based these forward-looking statements on our current expectations and projections about future events. These forward-looking statements include information about possible or assumed future results of our operations. All statements, other than statements of historical facts, included or incorporated by reference in this report that address activities, events or developments that we expect or anticipate may occur in the future, including such things as future capital expenditures, business strategy, competitive strengths, goals, growth of our business and operations, plans and references to future successes may be considered forward-looking statements. Also, when we use words such as "anticipate," "believe," "estimate," "expect," "intend," "plan," "probably" or similar expressions, we are making forward-looking statements. Many risks and uncertainties may impact the matters addressed in these forward-looking statements.

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

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

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HCC Insurance Holdings, Inc. and Subsidiaries

Condensed Consolidated Balance Sheets

(unaudited, in thousands, except per share data)

	September 30, 2
ASSETS	
Investments:	
Fixed income securities, at market (cost: 2003 - $1,034,445; 2002 - $807,772)	$ 1,069,66
Marketable equity securities, at market (cost: 2003 - $15,118; 2002 - $15,815)	15,02
Short-term investments, at cost, which approximates market	430,37
Other investments, at estimated fair value (cost: 2003 - $2,181; 2002 - $3,264)	2,18
Total investments	1,517,24
Cash	25,00
Restricted cash	211,53
Premium, claims and other receivables	954,59
Reinsurance recoverables	906,64
Ceded unearned premium	255,40
Ceded life and annuity benefits	77,90
Deferred policy acquisition costs	115,72
Goodwill	344,49
Other assets	211,33
TOTAL ASSETS	$ 4,619,88
LIABILITIES	
Loss and loss adjustment expense payable	$ 1,406,84
Life and annuity policy benefits	77,90
Reinsurance balances payable	251,97
Unearned premium	558,70
Deferred ceding commissions	74,42

Premium and claims payable		867,47
Notes payable		310,50
Accounts payable and accrued liabilities		65,58
Total liabilities		3,613,40
SHAREHOLDERS' EQUITY		
Common stock, $1.00 par value; 250.0 million shares authorized; (shares issued and outstanding: 2003 - 63,805; 2002 - 62,358)		63,80
Additional paid-in capital		444,01
Retained earnings		473,67
Accumulated other comprehensive income		24,98
Total shareholders' equity		1,006,48
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	$	4,619,88

See Notes to Condensed Consolidated Financial Statements.

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HCC Insurance Holdings, Inc. and Subsidiaries

Condensed Consolidated Statements of Earnings

(unaudited, in thousands, except per share data)

	For the nine months ended September 30, 2003	2002	
REVENUE			
Net earned premium	$ 535,354	$ 362,399	$
Management fees	78,975	57,052	
Commission income	42,797	31,631	
Net investment income	34,867	27,781	
Net realized investment gain (loss)	352	1,159	
Other operating income	8,275	3,271	
Total revenue	700,620	483,293	
EXPENSE			
Loss and loss adjustment expense	339,065	221,246	
Operating expense:			
Policy acquisition costs, net	64,521	44,467	
Compensation expense	84,181	58,744	
Other operating expense	45,159	36,583	
Total operating expense	193,861	139,794	

Interest expense	5,497	6,892	
Total expense	538,423	367,932	
Earnings before income tax provision	162,197	115,361	
Income tax provision	58,909	41,028	
Net earnings	$ 103,288	$ 74,333	$
BASIC EARNINGS PER SHARE DATA:			
Earnings per share	$ 1.64	$ 1.20	$
Weighted average shares outstanding	63,078	62,170	
DILUTED EARNINGS PER SHARE DATA:			
Earnings per share	$ 1.61	$ 1.18	$
Weighted average shares outstanding	64,106	62,841	
Cash dividends declared, per share	$ 0.205	$ 0.19	$

See Notes to Condensed Consolidated Financial Statements.

HCC Insurance Holdings, Inc. and Subsidiaries

Condensed Consolidated Statements of Changes in Shareholders' Equity

For the nine months ended September 30, 2003

(unaudited, in thousands, except per share data, continued)

	Common stock	Additional paid-in capital	Retained earnings	Acc comp i
BALANCE AS OF DECEMBER 31, 2002	$ 62,358	$ 416,406	$ 383,378	$
Net earnings	--	--	103,288	
Other comprehensive income	--	--	--	
Comprehensive income				
1,081 shares of common stock issued for exercise of options, including tax benefit of $3,305	1,081	19,700	--	

Issuance of 52 shares of contractually issuable common stock	52	(52)	--	
Issuance of 314 shares for acquisition of subsidiaries	314	7,958	--	
Cash dividends declared, $0.205 per share	--	--	(12,988)	
BALANCE AS OF SEPTEMBER 30, 2003	$ 63,805	$ 444,012	$ 473,678	$

See Notes to Condensed Consolidated Financial Statements.

HCC Insurance Holdings, Inc. and Subsidiaries

Condensed Consolidated Statements of Cash Flows

(unaudited, in thousands, except per share data)

	For the nine months ended September 30,		For
	2003	2002	2
Cash flows from operating activities:			
Net earnings	$ 103,288	$ 74,333	$
Adjustments to reconcile net earnings to net cash provided by operating activities:			
Change in premium, claims and other receivables	(177,880)	(52,440)	
Change in reinsurance recoverables	(107,708)	52,969	
Change in ceded unearned premium	(91,177)	(63,893)	
Change in loss and loss adjustment expense payable	251,553	(46,305)	
Change in reinsurance balances payable	85,316	58,412	
Change in unearned premium	227,651	100,800	
Change in premium and claims payable, net of restricted cash	67,849	(16,865)	
Depreciation and amortization expense	8,485	7,933	
Other, net	(41,487)	7,884	
Cash provided by operating activities	325,890	122,828	
Cash flows from investing activities:			
Sales of fixed income securities	131,884	197,466	
Maturity or call of fixed income securities	112,248	32,951	
Sales of equity securities	1,165	3,417	
Other proceeds	16,846	--	
Change in short-term investments	(114,801)	55,867	
Cost of securities acquired	(520,491)	(412,521)	(
Payments for purchase of subsidiaries, net of cash received	(16,680)	--	
Purchases of property and equipment	(20,260)	(3,948)	

Cash used by investing activities	(410,089)	(126,768)	(
Cash flows from financing activities:			
Issuance of notes payable, net of costs	134,845	40,000	
Sale of common stock	17,476	10,038	
Payments on notes payable	(68,723)	(15,409)	
Dividends paid and other, net	(14,701)	(12,831)	
Cash provided (used) by financing activities	68,897	21,798	
Net change in cash	(15,302)	17,858	
Cash at beginning of period	40,306	16,891	
CASH AT END OF PERIOD	$ 25,004	$ 34,749	$

See Notes to Condensed Consolidated Financial Statements

HCC Insurance Holdings, Inc. and Subsidiaries

Notes to Condensed Consolidated Financial Statements

(unaudited, in thousands, except per share data)

(1) GENERAL INFORMATION

HCC Insurance Holdings, Inc. and its subsidiaries ("we," "us" and "our") provide specialized property and casualty and accident and health insurance coverages, underwriting agency and intermediary services to commercial customers and individuals. Our lines of business include group life, accident and health; aviation; our London market account (which includes energy, marine, property and some accident and health); diversified financial products (which includes directors and officers liability, errors and omissions, employment practices liability and surety); and other specialty lines of insurance. We operate primarily in the United States, the United Kingdom, Bermuda and Spain, although some of our operations have a broader international scope. We market our products both directly to customers and through a network of independent and affiliated agents and brokers.

Basis of Presentation

The unaudited condensed consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America and include all adjustments which are, in our opinion, necessary for a fair presentation of the results of the interim periods. All adjustments made to the interim periods are of a normal recurring nature. The condensed consolidated financial statements include the accounts of HCC Insurance Holdings, Inc. and those of our wholly-owned subsidiaries. All significant intercompany balances and transactions have been eliminated. The condensed consolidated financial statements for periods reported should be read in conjunction with the annual audited consolidated financial statements and related notes. The condensed consolidated balance sheet as of December 31, 2002, was derived from audited financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States of America.

During the fourth quarter of 2002, we completed three acquisitions. The results of operations of these entities are included in our condensed consolidated financial statements beginning on the effective date of each transaction. Thus, our condensed consolidated statements of earnings and cash flows for the nine and three months ended September 30, 2002 do not contain any activity generated by these three entities. We are still in the process of completing the purchase price allocation for one of these acquisitions as we are still gathering some of the information needed to make the required calculations. Any subsequent net adjustment will result in a change to recorded goodwill.

During the first quarter of 2003, we adopted prospectively Financial Accounting Standards Board Interpretation ("FIN") No. 46 entitled "Consolidation of Variable Interest Entities". We now consolidate an investment in a partnership that owns an office building leased to unaffiliated third parties, whereas previously we used the equity method of accounting to account for this investment. The partnership is not material to our financial position, results of operations or cash flows.

Income Tax

For the nine months and three months ended September 30, 2003 and 2002, the income tax provision has been calculated based on an estimated effective tax rate for each of the fiscal years. The difference between our effective tax rate and the Federal statutory rate is primarily the result of state income taxes and tax exempt municipal bond interest.

(1) GENERAL INFORMATION, CONTINUED

Stock Options

We account for stock options granted to employees using the intrinsic value method of APB Opinion No. 25 entitled "Accounting for Stock Issued to Employees". All options have been granted at fixed exercise prices at the market price of our common stock at the grant date. Because of that, no stock-based employee compensation cost is reflected in our reported net earnings. Options vest over a period of up to seven years and expire four to ten years after grant date. The following table illustrates the effects on net earnings and earnings per share if we had used the fair value method of SFAS No. 123 entitled "Accounting for Stock-Based Compensation".

	For the nine months ended September 30, 2003	2002	Fo
Reported net earnings	$ 103,288	$ 74,333	$
Stock-based compensation using fair value method, net of income tax	(5,525)	(3,882)	
Pro forma net earnings	$ 97,763	$ 70,451	$
Reported basic earnings per share	$ 1.64	$ 1.20	$
Fair value stock-based compensation	(0.09)	(0.07)	
Pro forma basic earnings per share	$ 1.55	$ 1.13	$
Reported diluted earnings per share	$ 1.61	$ 1.18	$
Fair value stock-based compensation	(0.08)	(0.06)	
Pro forma diluted earnings per share	$ 1.53	$ 1.12	$

Reclassifications

Certain amounts in our 2002 condensed consolidated financial statements have been reclassified to conform to the 2003 presentation. Such reclassifications had no effect on our net earnings, shareholders' equity or cash flows.

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HCC Insurance Holdings, Inc. and Subsidiaries

Notes to Condensed Consolidated Financial Statements

(unaudited, in thousands, except per share data, continued)

(2) ACQUISITION

On July 1, 2003, we completed the acquisition of the CUL Group of companies, which included Covenant Underwriters Ltd., an underwriting agency, and Continental Underwriters Ltd., an intermediary. The companies were acquired to diversify into a new specialty line of business. This business combination has been recorded using the purchase method of accounting. The results of operations of these companies have been included in our consolidated financial statements beginning on the effective date of the transaction. We are still in the process of completing the purchase price allocation for this acquisition, as we are still gathering some of the information needed to make the required calculations. The consideration paid and the inclusion of the acquired company's financial information in our consolidated financial statements is not material to our financial position or results of operations.

(unaudited, in thousands, except per share data, continued)

(3) REINSURANCE

In the normal course of business our insurance companies cede a portion of their premium to non-affiliated domestic and foreign reinsurers through treaty and facultative reinsurance agreements. Although the ceding of reinsurance does not discharge the primary insurer from liability to its policyholder, our insurance companies participate in such agreements for the purpose of limiting their loss exposure, protecting them against catastrophic loss and diversifying their business. The following table represents the effect of such reinsurance transactions on premium and loss and loss adjustment expense:

	Written Premium	Earned Premium
For the nine months ended September 30, 2003:		
Direct business	$ 1,010,186	$ 846,
Reinsurance assumed	289,581	230,
Reinsurance ceded	(633,640)	(542,
NET AMOUNTS	$ 666,127	$ 535,
For the nine months ended September 30, 2002:		
Direct business	$ 674,258	$ 586,
Reinsurance assumed	177,826	162,
Reinsurance ceded	(449,856)	(386,
NET AMOUNTS	$ 402,228	$ 362,

(3) REINSURANCE, CONTINUED

	Written Premium	Earned Premium
For the three months ended September 30, 2003:		

Direct business	$ 355,576	$ 308,
Reinsurance assumed	87,464	77,
Reinsurance ceded	(220,505)	(195,
NET AMOUNTS	$ 222,535	$ 189,
For the three months ended September 30, 2002:		
Direct business	$ 237,478	$ 208,
Reinsurance assumed	60,986	57,
Reinsurance ceded	(153,898)	(129,
NET AMOUNTS	$ 144,566	$ 136,

The table below represents the composition of reinsurance recoverables in our condensed consolidated balance sheets:

	September 30, 20
Reinsurance recoverable on paid losses	$ 94,800
Reinsurance recoverable on outstanding losses	466,033
Reinsurance recoverable on incurred but not reported losses	357,719
Reserve for uncollectible reinsurance	(11,910
TOTAL REINSURANCE RECOVERABLES	$ 906,642

HCC Insurance Holdings, Inc. and Subsidiaries

Notes to Condensed Consolidated Financial Statements

(unaudited, in thousands, except per share data, continued)

(3) REINSURANCE, CONTINUED

Our insurance companies require their reinsurers not authorized by the respective states of domicile of our insurance companies to collateralize the reinsurance obligations due to us. The table below shows amounts held by us as collateral plus other credits available for potential offset.

September 30, 2003

Payables to reinsurers	$	355,579
Letters of credit		170,371
Cash deposits		11,233
TOTAL CREDITS	$	537,183

The tables below present the calculation of net reserves, net unearned premium and net deferred policy acquisition costs:

		September 30, 2003
Loss and loss adjustment expense payable	$	1,406,843
Reinsurance recoverable on outstanding losses		(466,033)
Reinsurance recoverable on incurred but not reported losses		(357,719)
NET RESERVES	$	583,091
Unearned premium	$	558,701
Ceded unearned premium		(255,401)
NET UNEARNED PREMIUM	$	303,300
Deferred policy acquisition costs	$	115,729
Deferred ceding commissions		(74,424)
NET DEFERRED POLICY ACQUISITION COSTS	$	41,305

We have a reserve of $11.9 million as of September 30, 2003 for potential collectibility issues and associated expenses related to reinsurance recoverables. The adverse economic environment in the worldwide insurance industry, the decline in the market value of investments in equity securities and the terrorist attacks on September 11, 2001 have placed great pressure on certain reinsurers and the results of their operations. Ultimately, these conditions could affect reinsurers' solvency. Historically, there have been insolvencies following a period of competitive pricing in the industry. We limit our exposure by holding funds, letters of credit or other security such that net balances due are significantly less than the gross balances shown in our condensed consolidated balance sheets. While we believe that the reserve is adequate based on currently available information, conditions may change or additional information might be obtained which may result in a future change in the reserve. We periodically review our financial exposure to the reinsurance market and the level of our reserve and continue to take actions in an attempt to mitigate our exposure to possible loss.

HCC Insurance Holdings, Inc. and Subsidiaries

Notes to Condensed Consolidated Financial Statements

(unaudited, in thousands, except per share data, continued)

(3) REINSURANCE, CONTINUED

A number of reinsurers have delayed or suspended the payment of amounts recoverable under certain reinsurance contracts to which we are a party. Such delays have affected, although not materially to date, the investment income of our insurance companies, but not to any extent their liquidity. In some instances, the reinsurers have withheld payment without reference to a substantive basis for the delay or suspension. In other cases, the reinsurers have claimed they are not liable for payment to us of all or part of the amounts due under the applicable reinsurance agreement. We believe these claims are substantially without merit and expect to collect the full amounts recoverable. We are currently in negotiations with most of these parties, but if such negotiations do not result in a satisfactory resolution of the matters in question, we may seek or be involved in a judicial or arbitral determination of these matters. In some cases, the final resolution of such disputes through arbitration or litigation may extend over several years. In this regard, as of September 30, 2003, our insurance companies had initiated one litigation proceeding against reinsurers. As of such date, our insurance companies had an aggregate amount of $6.1 million which had not been paid to us under the agreements and we estimate that there could be up to an additional $7.7 million of incurred losses and loss expenses and other balances which could become due under the subject agreements.

(4) SEGMENT AND GEOGRAPHIC INFORMATION

The performance of each segment is evaluated based upon net earnings and is calculated after tax and after all corporate expense allocations, purchase price allocations and intercompany eliminations have been charged or credited to the individual segments. The following tables show information by business segment and geographic location. Geographic location is determined by physical location of our offices and does not represent the location of insureds or reinsureds from whom the business was generated.

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HCC Insurance Holdings, Inc. and Subsidiaries

Notes to Condensed Consolidated Financial Statements

(unaudited, in thousands, except per share data, continued)

(4) SEGMENT AND GEOGRAPHIC INFORMATION, CONTINUED

	Insurance	Underwriting	Other

(unaudited, in thousands, except per share data, continued)

	Company	Agency	Intermediary	Operations
For the nine months ended September 30, 2003:				
Revenue:				
Domestic	$ 412,063	$ 71,257	$ 17,141	$ 7,576
Foreign	155,248	9,703	26,734	--
Inter-segment	--	35,854	2,572	--
TOTAL SEGMENT REVENUE	$ 567,311	$ 116,814	$ 46,447	$ 7,576
Inter-segment revenue				
CONSOLIDATED TOTAL REVENUE				
Net earnings:				
Domestic	$ 48,942	$ 29,873	$ 3,754	$ 3,710
Foreign	12,166	3,079	6,263	--
TOTAL SEGMENT NET EARNINGS	$ 61,108	$ 32,952	$ 10,017	$ 3,710
Inter-segment eliminations				
CONSOLIDATED NET EARNINGS				
Other items:				
Net investment income	$ 30,831	$ 2,135	$ 965	$ 33
Depreciation and amortization	2,468	2,983	1,307	380
Interest expense (benefit)	47	4,989	2,449	581
Capital expenditures	2,211	715	1,498	--
Income tax provision	29,750	22,030	5,353	1,554
Inter-segment eliminations				
CONSOLIDATED INCOME TAX PROVISION				

(4) SEGMENT AND GEOGRAPHIC INFORMATION, CONTINUED

Insurance Company	Underwriting Agency	Intermediary	Other Operations

For the nine months ended September 30, 2002:				
Revenue:				
Domestic	$ 324,746	$ 58,918	$ 18,535	$ 1,335
Foreign	64,648	510	13,827	--
Inter-segment	--	20,457	746	--
TOTAL SEGMENT REVENUE	$ 389,394	$ 79,885	$ 33,108	$ 1,335
Inter-segment revenue				
CONSOLIDATED TOTAL REVENUE				
Net earnings:				
Domestic	$ 42,873	$ 17,270	$ 4,658	$ 750
Foreign	5,137	300	2,406	--
TOTAL SEGMENT NET EARNINGS	$ 48,010	$ 17,570	$ 7,064	$ 750
Inter-segment eliminations				
CONSOLIDATED NET EARNINGS				
Other items:				
Net investment income	$ 24,713	$ 2,144	$ 731	$ 34
Depreciation and amortization	2,241	4,585	256	77
Interest expense (benefit)	127	5,748	1,931	--
Capital expenditures	1,510	1,155	1,041	--
Income tax provision	23,375	11,682	5,165	364
Inter-segment eliminations				
CONSOLIDATED INCOME TAX PROVISION				

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HCC Insurance Holdings, Inc. and Subsidiaries

Notes to Condensed Consolidated Financial Statements

(unaudited, in thousands, except per share data, continued)

(4) SEGMENT AND GEOGRAPHIC INFORMATION, CONTINUED

	Insurance Company	Underwriting Agency	Intermediary	Other Operation

For the three months ended September 30, 2003:				
Revenue:				
Domestic	$ 145,287	$ 26,423	$ 5,170	$ 2,92
Foreign	55,213	3,929	9,564	-
Inter-segment	--	12,174	1,100	-
TOTAL SEGMENT REVENUE	$ 200,500	$ 42,526	$ 15,834	$ 2,92
Inter-segment revenue				
CONSOLIDATED TOTAL REVENUE				
Net earnings (loss):				
Domestic	$ 16,982	$ 10,783	$ 737	$ 1,77
Foreign	4,965	1,178	3,224	-
TOTAL SEGMENT NET EARNINGS (LOSS)	$ 21,947	$ 11,961	$ 3,961	$ 1,77
Inter-segment eliminations				
CONSOLIDATED NET EARNINGS				
Other items:				
Net investment income	$ 10,605	$ 893	$ 374	$ 2
Depreciation and amortization	851	1,520	230	5
Interest expense (benefit)	22	1,578	659	19
Capital expenditures	980	47	610	-
Income tax provision	10,549	8,900	1,693	68
Inter-segment eliminations				
CONSOLIDATED INCOME TAX PROVISION				

HCC Insurance Holdings, Inc. and Subsidiaries

Notes to Condensed Consolidated Financial Statements

(unaudited, in thousands, except per share data, continued)

(4) SEGMENT AND GEOGRAPHIC INFORMATION, CONTINUED

	Insurance Company	Underwriting Agency	Intermediary	Other Operations

For the three months ended September 30, 2002:				
Revenue:				
Domestic	$ 114,667	$ 19,001	$ 6,033	$ 730
Foreign	30,700	(81)	4,638	--
Inter-segment	--	7,579	391	--
TOTAL SEGMENT REVENUE	$ 145,367	$ 26,499	$ 11,062	$ 730
Inter-segment revenue				
CONSOLIDATED TOTAL REVENUE				
Net earnings:				
Domestic	$ 12,634	$ 5,871	$ 1,774	$ 455
Foreign	2,397	43	1,138	--
TOTAL SEGMENT NET EARNINGS	$ 15,031	$ 5,914	$ 2,912	$ 455
Inter-segment eliminations				
CONSOLIDATED NET EARNINGS				
Other items:				
Net investment income	$ 8,739	$ 814	$ 267	$ 7
Depreciation and amortization	723	1,474	86	11
Interest expense (benefit)	54	1,868	643	--
Capital expenditures	503	355	346	--
Income tax provision (benefit)	7,361	4,377	1,584	312
Inter-segment eliminations				
CONSOLIDATED INCOME TAX PROVISION				

HCC Insurance Holdings, Inc. and Subsidiaries

Notes to Condensed Consolidated Financial Statements

(unaudited, in thousands, except per share data, continued)

(4) SEGMENT AND GEOGRAPHIC INFORMATION, CONTINUED

The following tables present revenue by line of business within each operating segment for the periods indicated:

	For the nine months ended September 30,	F

(unaudited, in thousands, except per share data, continued)

	2003	2002	
Insurance company:			
Group life, accident and health	$ 220,253	$ 170,155	$
Diversified financial products	80,399	14,030	
London market account	101,733	62,305	
Aviation	72,779	76,599	
Other specialty lines of business	35,833	13,347	
	510,997	336,436	
Discontinued lines of business	24,357	25,963	
TOTAL NET EARNED PREMIUM	$ 535,354	$ 362,399	$
Underwriting agency:			
Group life, accident and health	$ 27,565	$ 36,347	$
Property and casualty	51,410	20,705	
TOTAL MANAGEMENT FEES	$ 78,975	$ 57,052	$
Intermediary:			
Group life, accident and health	$ 23,353	$ 24,373	$
Property and casualty	19,444	7,258	
TOTAL COMMISSION INCOME	$ 42,797	$ 31,631	$

(5) EARNINGS PER SHARE

Basic earnings per share is based on the weighted average number of common shares outstanding during the period divided into net earnings. Diluted earnings per share is based on the weighted average number of common shares outstanding plus the potential common shares outstanding during the period divided into net earnings. Outstanding common stock options, when dilutive, are considered to be potential common shares for the purpose of the diluted calculation. The treasury stock method is used to calculate potential common shares due to options. Contingent shares to be issued are included in the earnings per share computation when the underlying conditions for issuance have been met.

The following table provides a reconciliation of the denominators used in the earnings per share calculations:

	For the nine months ended September 30, 2003	2002	For the thre Septe 2003
Net earnings	$ 103,288	$ 74,333	$ 38,351
Reconciliation of shares outstanding:			
Shares of common stock outstanding at period end	63,805	62,294	63,805
Effect of common shares issued during the period	(727)	(176)	(88
Common shares contractually issuable in the future	--	52	--
Weighted average common shares outstanding	63,078	62,170	63,717
Additional dilutive effect of outstanding options (as determined by the application of the treasury stock method)	1,028	671	1,168
Weighted average shares and potential common shares outstanding	64,106	62,841	64,885
Anti-dilutive shares not included in computation	352	415	--

HCC Insurance Holdings, Inc. and Subsidiaries

Notes to Condensed Consolidated Financial Statements

(unaudited, in thousands, except per share data, continued)

(6) NOTES PAYABLE

The table below shows the composition of our notes payable as shown in our condensed consolidated balance sheets.

	September 30, 2003	December 31, 2
1.3% Convertible notes	$ 125,000	$
2% Convertible notes	172,451	172,4
$200 million revolving loan facility	--	53,0

(unaudited, in thousands, except per share data, continued)

Other debt	13,054	4,5
TOTAL NOTES PAYABLE	$ 310,505	$ 230,0

In a public offering on March 25, 2003, we sold an aggregate $125.0 million principal amount of 1.3% convertible notes due in 2023. Each one thousand dollar principal amount of notes is convertible into 29.4377 shares of our common stock, which represents an initial conversion price of $33.97 per share. The initial conversion price is subject to change under certain conditions. Interest is to be paid by us on April 1 and October 1 each year, commencing October 1, 2003. Holders may surrender notes for conversion into shares of our common stock if, as of the last day of the preceding calendar quarter, the closing sale price of our common stock for at least 20 consecutive trading days during the period of 30 consecutive trading days ending on the last trading day of that quarter is more than 130% ($44.16 per share) of the conversion price per share of our common stock. We can redeem the notes for cash at any time on or after April 4, 2009. Holders of the notes may require us to repurchase the notes on April 1, 2009, 2014 and 2019 at a price equal to the principal amount of the notes plus accrued and unpaid interest. If the holders require us to repurchase these notes, we may choose to pay the purchase price in cash, in shares of our common stock, or in a combination thereof. We paid $3.2 million in underwriting discounts and expenses in connection with this offering. The underwriting discounts and expenses are being amortized from the issue date until April 1, 2009. We used $66.0 million of the proceeds from this offering to pay down existing indebtedness under our bank facility, while the remainder was used to assist in financing acquisitions and strategic investments and for general corporate purposes.

(7) SUPPLEMENTAL INFORMATION

	For the nine months ended September 30, 2003	2002	For the S 2003
Interest paid	$ 5,744	$ 4,568	$ 3,02
Income tax paid	54,000	23,045	21,89
Comprehensive income	107,510	90,921	35,72
Ceding commissions netted with policy acquisition costs	151,572	102,822	53,49

(8) COMMITMENTS AND CONTINGENCIES

In addition to the matters discussed in Note (3) Reinsurance, we are party to numerous lawsuits and other proceedings that arise in the normal course of our business. Many of such lawsuits and other proceedings involve claims under policies that we underwrite as an insurer or reinsurer, the liabilities for which, we believe, have been adequately included in our loss reserves. Also, from time to time, we are a party to lawsuits and other proceedings which relate to disputes over contractual relationships with third parties, or which involve alleged errors and omissions on the part of our subsidiaries. In addition, we are presently engaged in litigation initiated by the appointed liquidator of a former reinsurer concerning payments made to us prior to the date of the appointment of the liquidator. The disputed payments were made by the now insolvent reinsurer in connection with a commutation agreement. Our understanding is that such litigation is one of a number of similar actions brought by the liquidator. We intend to vigorously contest the action. We do not believe the resolution of any of these matters, some of which include allegations of damages of material amounts, will have a material adverse effect on our financial condition, results of operations or cash flows.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS

During the past year we completed four acquisitions. The results of operations of these entities are included in our condensed consolidated financial statements beginning on the effective date of each acquisition. Thus, our condensed consolidated statements of earnings and cash flows do not contain any activity generated by these entities for periods prior to their acquisition.

Results of Operations

Nine months ended September 30, 2003 versus nine months ended September 30, 2002

Total revenue increased 45% to $700.6 million for the first nine months of 2003 from $483.3 million for the same period in 2002. The revenue increase resulted from premium rate increases, acquisitions and increased business in all segments. Subsidiaries acquired during the past year accounted for $73.4 million in revenue during the first nine months of 2003.

Net investment income increased 26% to $34.9 million for the first nine months of 2003 from $27.8 million for the same period in 2002. This increase was due to the higher level of invested assets resulting primarily from cash flow generated by operating activities and from the insurance company we acquired in December, 2002. Cash flow from operating activities was $325.9 million for the first nine months of 2003 compared to $122.8 million for the same period in 2002, continuing a trend of increasing operating cash flow that began in 2002. The majority of the increase in cash flow from operations results from increased earnings and net premium flow, less paid losses and loss adjustment costs, into our insurance companies. We expect the positive cash flow provided by operating activities to continue, most of which will increase invested assets and thus the related investment income. If market interest rates were to rise, the growth in investment income would be accelerated as our current portfolio has a relatively short average duration and would be available to be invested on a longer term basis to take advantage of higher rates. For the first nine months of 2003 our annualized, weighted average, tax equivalent yield was 4.0% compared to 4.5% for the same period in 2002.

Compensation expense increased to $84.2 million during the first nine months of 2003 from $58.7 million for the same period in 2002. Subsidiaries acquired during the past year accounted for $19.6 million of the increase. Most of the remaining increase is due to larger bonus and incentive compensation accruals, based on increased earnings.

Other operating expense increased to $45.2 million during the first nine months of 2003 compared to $36.6 million in 2002. Again most of the increase, $9.8 million, is due to subsidiaries acquired during the past year. Currency gains amounted to $1.7 million during the first nine months of 2003 compared to gains of $0.5 million during the same period in 2002. During 2003 there was a one-time currency gain of $1.3 million from the settlement of an advance of funds to an unaffiliated entity. During the first nine months of 2003 our insurance company subsidiaries incurred unusually high special assessments of $6.0 million from certain states and state agencies compared to $1.8 million during the same period in 2002. Assessments of this magnitude are not expected in the future.

Interest expense was $5.5 million for the first nine months of 2003 compared to $6.9 million for the same period in 2002. Included in the 2002 amount is $2.9 million representing the amortization of underwriting discounts and expenses, which were fully amortized in 2002, related to the issuance of our 2% convertible notes compared to $0.3 million in 2003 related to our 1.3% convertible notes, which were issued in March 2003. Partially offsetting the decrease in amortization is the $0.6 million in interest expense on mortgage debt from a real estate partnership we are now consolidating with our adoption of Financial Accounting Standards Board Interpretation ("FIN") No. 46 during 2003 and an additional $0.8 million interest expense from our 1.3% convertible notes.

Income tax expense was $58.9 million for the first nine months of 2003 compared to $41.0 million for the same period in 2002. Our effective tax rate was 36.3% in the 2003 period compared to 35.6% in 2002. The increased rate results from tax-exempt interest income being a lower percentage of consolidated pre-tax earnings as well as immaterial adjustments made to refine our various tax accrual amounts.

Net earnings increased 39% to $103.3 million, or $1.61 per diluted share, for the first nine months of 2003 from $74.3 million, or $1.18 per diluted share, for the same period in 2002. The increase in net earnings resulted from continuing good margins on increasing revenue and the effect of acquisitions consummated during the past year.

As of September 30, 2003, total assets exceeded $4.6 billion, shareholders' equity exceeded $1.0 billion for the first time and book value per share was $15.77, up 11% from $14.15 as of December 31, 2002.

SEGMENTS

Insurance Companies

The following tables provide information by line of business (amounts in thousands):

	Gross written	Net Written	N Ear

	premium	Premium	Pre
For the nine months ended September 30, 2003:			
Group life, accident and health	$ 426,162	$ 233,589	$
Diversified financial products	400,190	134,417	
London market account	189,062	135,941	
Aviation	165,280	75,765	
Other specialty lines of business	87,393	72,641	
	1,268,087	652,353	
Discontinued lines of business	31,680	13,774	
TOTALS	$ 1,299,767	$ 666,127	$

Expense

Combined

For the nine months ended September 30, 2002:			
Group life, accident and health	$ 378,563	$ 176,519	$
Diversified financial products	113,830	28,730	
London market account	162,399	91,954	
Aviation	153,908	75,741	
Other specialty lines of business	$ 16,454	$ 13,253	$
	825,154	386,197	
Discontinued lines of business	26,930	16,031	
TOTALS	$ 852,084	$ 402,228	$

Expense

Combined

Gross written premium increased 53% to $1.3 billion for the first nine months of 2003 from $852.1 million for the same period in 2002. All of the lines of business showed some increase as a result of higher premium rates as well as organic growth. The largest growth was in the diversified financial products line of business, which our insurance companies began writing in 2002. Net written premium for the first nine months of 2003 increased 66% to $666.1 million and net earned premium increased 48% to $535.4 million for the same reasons plus an increase in retentions in selected areas. The increase in premium is expected to continue into 2004.

The table below shows the composition of net incurred loss and loss adjustment expense for the nine months ended September 30, 2003 and 2002 (amounts in thousands):

2003

	Amount	Loss Ratio
Deficiency / (redundancy)	$ 10,447	1.9%
All other incurred loss and loss adjustment expense	328,618	61.4
Net incurred loss and loss adjustment expense	$ 339,065	63.3%

The net loss ratio in the diversified financial products line of business increased in 2003 as a result of a change in the mix of business to components with a somewhat higher loss ratio. The London market account's net loss ratio was negatively affected in 2003 due to an increase in reserves in the accident and health category, some of which was adverse development from prior accident years. The net loss ratio in the aviation line of business increased due to unusually good loss experience in 2002 compared to a more expected loss ratio in 2003. Loss experience in the other specialty lines improved in 2003 compared to the prior year as experience approached its expected level. The loss ratio in the discontinued lines of business increased in the first nine months of 2003 following reserve additions resulting from our ongoing review of outstanding claims.

For the nine months ended September 30, the gross loss ratio was 71.7% in 2003 compared to 61.5% in 2002. During the first nine months of 2003, we increased our gross losses by $76.1 million on certain assumed accident and health reinsurance contracts reported in the discontinued line of business due to our processing of additional information received and our continuing evaluation of reserves related to this business. Also during the 2003 period, we incurred a $30.0 million gross loss on a large warehouse fire and reduced gross losses on another discontinued program by $14.3 million based on revised current information. During the first nine months of 2002, we reduced our gross losses from the September 11 terrorist attacks by $21.5 million and our gross loss from Total Oil Company loss by $14.0 million to its ultimate settlement amount. As all these losses were substantially reinsured, there was no material effect on our net losses. The table below shows the composition of gross incurred loss and loss adjustment expense for the nine months ended September 30, 2003 and 2002 (amounts in thousands):

23

	2003	
	Amount	Loss Ratio
September 11 terrorist attacks	$ --	--%
Total Oil Company loss	--	--
Accident and health adjustment	76,115	7.0
Discontinued program adjustment	(14,332)	(1.3)
Large warehouse fire	30,000	2.8
All other incurred loss and loss adjustment expense	680,936	63.2
Gross incurred loss and loss		

adjustment expense	$ 772,719	71.7%

Policy acquisition costs, which are net of commissions on reinsurance ceded, increased to $64.5 million during the first nine months of 2003, from $44.5 million in the same period in 2002. This increase is in proportion to the increase in net earned premium.

Net earnings of our insurance companies increased to $61.1 million in the first nine months of 2003 from $48.0 million for the same period in 2002 due to increased premium volume from rate increases, organic growth and continuing profitable underwriting results somewhat offset by unusually high special assessments from certain states and state agencies during the first nine months of 2003.

Underwriting Agencies

Management fees increased 38% to $79.0 million for the first nine months of 2003 compared to $57.1 million for the same period in 2002. This increase resulted from both acquisitions made during the past year and our existing underwriting agencies, which are seeing growth in several areas. Net earnings in this segment increased to $33.0 million in the first nine months of 2003 from $17.6 million in 2002 for the same reasons. We expect growth to continue into 2004.

Intermediaries

Commission income increased 35% to $42.8 million for the first nine months of 2003 compared to $31.6 million for the same period in 2002. The growth resulted principally from acquisitions made during the past year. Net earnings of our intermediaries increased to $10.0 million for the first nine months of 2003 compared to $7.1 million for the same period of 2002 for the same reasons. We expect growth to continue into 2004.

Other Operations

The other operations segment saw an increase in revenue and segment net income due to income from our strategic investment in Argonaut Group, Inc. made in March 2003 and gains in our strategic investment and trading accounts. Also, segment revenue increased as a result of the initial consolidation of a real estate partnership to comply with FIN No. 46. Period to period comparisons may vary substantially depending on strategic investments, trading activities or dispositions in any given period.

Corporate

The decrease in segment earnings between periods resulted from the difference in intersegment income tax adjustments and the adjustment of certain accruals to their ultimate liability, which positively affected the 2002 period. There was also an increase in compensation expense during 2003, offsetting reduced net interest expense and currency conversion gains.

Quarter ended September 30, 2003 versus quarter ended September 30, 2002

Total revenue increased 42% to $248.6 million for the third quarter of 2003 from $175.7 million for the same period in 2002. The revenue increase resulted from premium rate increases and increased business in all segments. Subsidiaries acquired during the past year accounted for $28.0 million in revenue during the third quarter of 2003.

Net investment income increased 22% to $12.0 million for the third quarter of 2003 from $9.8 million for the same period in 2002. This increase was due to the higher level of invested assets resulting primarily from cash flow generated by operating activities and from the insurance company we acquired in December, 2002. Cash flow from operating activities was $126.6 million for the third quarter of 2003 compared to $76.1 million for the same period in 2002, continuing a trend of increasing operating cash flow that began in 2002. The majority of the increase in cash flow from operations results from increased earnings and net premium flow, less paid losses and loss adjustment costs, into our insurance companies. We expect the positive cash flow provided by operating activities to continue, most of which will increase invested assets and thus the related investment income. If market interest rates were to rise, the growth in investment income would be accelerated as our current portfolio has a relatively short average duration and would be available to be invested on a longer term basis to take advantage of higher rates. For the third quarter of 2003 our annualized, weighted average, tax equivalent yield was 3.8% compared to 4.6% for the same period in 2002.

Compensation expense increased to $29.1 million during the third quarter of 2003 from $19.2 million for the same period in 2002. Subsidiaries acquired during the past year accounted for $7.8 million of the increase.

Other operating expense increased to $15.5 million during the third quarter of 2003 compared to $12.6 million in 2002. The increase is due principally to subsidiaries acquired during the past year.

Interest expense was $1.9 million for the third quarter of 2003 compared to $2.1 million for the same period in 2002. Included in the 2002 amount is $0.7 million representing the amortization of underwriting discounts and expenses, which were fully amortized in 2002, related to the issuance of our 2% convertible notes compared to $0.1 million in 2003 related to our 1.3% convertible notes, which were issued in March 2003. Partially offsetting the decrease in amortization is the $0.2 million in interest expense on mortgage debt from a real estate partnership we are now consolidating with our adoption of FIN No. 46 during 2003 and an additional $0.4 million interest expense from our 1.3% convertible notes.

Income tax expense was $21.7 million for the third quarter of 2003 compared to $13.5 million for the same period in 2002. Our effective tax rate was 36.1% in the 2003 quarter compared to 35.7% in 2002. The increased rate results primarily from tax-exempt interest income being a lower percentage of consolidated pre-tax earnings.

Net earnings increased 58% to $38.4 million, or $0.59 per diluted share, for the third quarter of 2003 from $24.3 million, or $0.39 per diluted share, for the same period in 2002. The increase in net earnings resulted from continuing good margins on increasing revenue and the effect of acquisitions consummated during the past year.

As of September 30, 2003, total assets exceeded $4.6 billion, shareholders' equity exceeded $1.0 billion for the first time and book value per share was $15.77, up from $15.21 as of June 30, 2003.

SEGMENTS

Insurance Companies

The following tables provide information by line of business (amounts in thousands):

	Gross written premium	Net Written Premium	Ea Pr
For the three months ended September 30, 2003:			
Group life, accident and health	$ 142,680	$ 76,236	$
Diversified financial products	149,764	52,203	
London market account	48,910	33,387	
Aviation	56,320	24,561	
Other specialty lines of business	41,337	33,935	
	439,011	220,322	
Discontinued lines of business	4,029	2,213	
TOTALS	$ 443,040	$ 222,535	$
			Expense
			Combined
FOR THE THREE MONTHS ENDED SEPTEMBER 30, 2002:			
Group life, accident and health	$ 132,904	$ 69,491	$
Diversified financial products	55,461	13,597	
London market account	46,346	30,015	
Aviation	49,804	23,687	
Other specialty lines of business	6,570	4,288	
	291,085	141,078	
Discontinued lines of business	7,379	3,488	
TOTALS	$ 298,464	$ 144,566	$
			Expense
			Combined

Gross written premium increased 48% to $443.0 million for the third quarter of 2003 from $298.5 million for the same period in 2002. All of the lines of business showed some increase as a result of higher premium rates as well as organic growth. The largest growth was in the diversified financial products line of business, which our insurance companies began writing in 2002. Net written premium for the third quarter of 2003 increased 54% to $222.5 million and net earned premium increased 39% to $189.4 million for the same reasons plus an increase in retentions in selected areas. The increase in premium is expected to continue into 2004.

The table below shows the composition of net incurred loss and loss adjustment expense for the three months ended September 30, 2003 and 2002 (amounts in thousands):

	2003		
	Amount	Loss Ratio	
Deficiency / (redundancy)	$ 617	0.3%	$
All other incurred loss and loss adjustment expense	118,336	62.5	
Net incurred loss and loss adjustment expense	$ 118,953	62.8%	$

The net loss ratio in the diversified financial products line of business decreased in 2003 as a result of a change in the mix of business. The London market account's net loss ratio was negatively affected in 2003 due to an increase in reserves in the accident and health category, some of which was adverse development from prior accident years. The net loss ratio in the aviation line of business increased due to unusually good loss experience in 2002 compared to a more expected loss ratio in 2003. Loss experience in the other specialty lines improved in 2003 compared to the prior year, as experience approached its expected level. The loss ratio in the discontinued lines of business remains high following reserve additions resulting from our ongoing review of outstanding claims.

For the third quarter, the gross loss ratio was 69.6% in 2003 compared to 64.1% in 2002. During the third quarter of 2003, we incurred a $30.0 million gross loss on a large warehouse fire and reduced gross losses on a discontinued program by $14.3 million based on revised current information. During the third quarter of 2002, we reduced our gross losses from the Total Oil Company loss by $14.0 million to its ultimate settlement amount. As all these losses were substantially reinsured, there was no material effect on our net losses. The table below shows the composition of gross incurred loss and loss adjustment expense for the three months ended September 30, 2003 and 2002 (amounts in thousands):

	2003		
	Amount	Loss Ratio	
Total Oil Company loss	$ --	--%	$
Discontinued program adjustment	(14,332)	(3.7)	
Large warehouse fire	30,000	7.8	
All other incurred loss and loss adjustment expense	252,479	65.5	

Gross incurred loss and loss adjustment expense	$ 268,147	69.6%	$

Policy acquisition costs, which are net of commissions on reinsurance ceded, increased to $23.1 million during the third quarter of 2003, from $18.9 million in the same period in 2002. This increase is in proportion to the increase in net earned premium.

Net earnings of our insurance companies increased to $21.9 million in the third quarter of 2003 from $15.0 million for the same period in 2002 due to increased premium volume from rate increases, organic growth and continuing profitable underwriting results.

Underwriting Agencies

Management fees increased 63% to $29.4 million for the third quarter of 2003 compared to $18.1 million for the same period in 2002. This increase resulted from both acquisitions made during the past year and our existing underwriting agencies, which are seeing growth in several areas. Net earnings in this segment increased to $12.0 million in the third quarter of 2003 from $5.9 million in 2002 for the same reasons. We expect growth to continue into 2004.

Intermediaries

Commission income increased 39% to $14.4 million for the third quarter of 2003 compared to $10.4 million for the same period in 2002. The growth resulted principally from acquisitions made during the past year. Net earnings of our intermediaries increased to $4.0 million for the third quarter of 2003 compared to $2.9 million for the same period of 2002 for the same reasons. We expect growth to continue in 2004.

Other Operations

The other operations segment saw an increase in revenue and segment net income due to income from our strategic investment in Argonaut Group, Inc. made in March 2003 and gains in our strategic investment and trading accounts. Also, segment revenue increased as a result of the initial consolidation of a real estate partnership to comply with FIN No. 46. Period to period comparisons may vary substantially depending on strategic investments, trading activities or dispositions in any given period.

Corporate

The decrease in segment earnings between periods resulted from differences in compensation and income tax expense.

Liquidity and Capital Resources

We receive substantial cash from premiums, reinsurance recoverables, management fees and commission income and, to a lesser extent, investment income and proceeds from sales and redemptions of investments and other assets. Our principal cash outflows are for the payment of claims and loss adjustment expenses, payment of premiums to reinsurers, purchase of investments, debt service, policy acquisition costs, operating expenses, income and other taxes and dividends. Variations in operating cash flows can occur due to timing differences in either the payment of claims and the collection of related recoverables or the collection of receivables and the payment of related payable amounts.

We maintain a substantial level of cash and liquid short-term investments which are used to meet anticipated payment obligations. Our consolidated cash and investment portfolio increased $334.3 million, or 28% , during the first nine months of 2003 and totaled $1.5 billion as of September 30, 2003, of which $455.4 million was cash and short-term investments. The increase in investments resulted from the positive operating cash flows.

In a public offering on March 25, 2003, we sold an aggregate $125.0 million principal amount of 1.3% convertible notes due in 2023. Each one thousand dollar principal amount of notes is convertible into 29.4377 shares of our common stock, which represents an initial conversion price of $33.97 per share. The initial conversion price is subject to change under certain conditions. Interest is to be paid by us on April 1 and October 1 each year, commencing October 1, 2003. Holders may surrender notes for conversion into shares of our common stock if, as of the last day of the preceding calendar quarter, the closing sale price of our common stock for at least 20

consecutive trading days during the period of 30 consecutive trading days ending on the last trading day of that quarter is more than 130% ($44.16 per share) of the conversion price per share of our common stock. We can redeem the notes for cash at any time on or after April 4, 2009. Holders of the notes may require us to repurchase the notes on April 1, 2009, 2014 and 2019 at a price equal to the principal amount of the notes plus accrued and unpaid interest. If the holders require us to repurchase these notes, we may choose to pay the purchase price in cash, in shares of our common stock, or in a combination thereof. We paid $3.2 million in underwriting discounts and expenses in connection with this offering. The underwriting discounts and expenses are being amortized from the issue date until April 1, 2009. We used $66.0 million of the proceeds from this offering to pay down existing indebtedness under our bank facility, while the remainder was used to assist in financing acquisitions and strategic investments and for general corporate purposes.

Reinsurance recoverables increased during the first nine months of 2003 due principally to the increase in reinsurance recoverables on incurred but not reported losses. A significant portion of this increase comes from the diversified financial products line of business, new in 2002, which is more heavily reinsured than our other lines of business. The increase in gross losses on certain assumed contracts in the discontinued line of business also contributed to the increase. The increase in reinsurance recoverable on outstanding losses results principally from a $30.0 million loss incurred in the third quarter of 2003 which was substantially reinsured.

We have a reserve of $11.9 million as of September 30, 2003 for potential collectibility issues and associated expenses related to reinsurance recoverables. The adverse economic environment in the worldwide insurance industry, the decline in the market value of investments in equity securities and the terrorist attacks on September 11, 2001 have placed great pressure on certain reinsurers and the results of their operations. Ultimately, these conditions could affect reinsurers' solvency. Historically, there have been insolvencies following a period of competitive pricing in the industry. We limit our exposure by holding funds, letters of credit or other security such that net balances due are significantly less than the gross balances shown in our condensed consolidated balance sheets. While we believe that the reserve is adequate based on currently available information, conditions may change or additional information might be obtained which may result in a future change in the reserve. We periodically review our financial exposure to the reinsurance market and the level of our reserve and continue to take actions in an attempt to mitigate our exposure to possible loss.

A number of reinsurers have delayed or suspended the payment of amounts recoverable under certain reinsurance contracts to which we are a party. Such delays have affected, although not materially to date, the investment income of our insurance companies, but not to any extent their liquidity. In some instances, the reinsurers have withheld payment without reference to a substantive basis for the delay or suspension. In other cases, the reinsurers have claimed they are not liable for payment to us of all or part of the amounts due under the applicable reinsurance agreement. We believe these claims are substantially without merit and expect to collect the full amounts recoverable. We are currently in negotiations with most of these parties, but if such negotiations do not result in a satisfactory resolution of the matters in question, we may seek or be involved in a judicial or arbitral determination of these matters. In some cases, the final resolution of such disputes through arbitration or litigation may extend over several years. In this regard, as of September 30, 2003, our insurance companies had initiated one litigation proceeding against reinsurers. As of such date, our insurance companies had an aggregate amount of $6.1 million which had not been paid to us under the agreements and we estimate that there could be up to an additional $7.7 million of incurred losses and loss expenses and other balances which could become due under the subject agreements.

We believe that our operating cash flows, short-term investments, bank facility and shelf registration on file with the United States Securities and Exchange Commission will provide sufficient sources of liquidity to meet our operating needs for the foreseeable future.

Critical Accounting Policies

We have made no changes in our methods of application of our critical accounting policies from the information provided in our Annual Report on Form 10-K for the year ended December 31, 2002.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

There have been no material changes in market risk from the information provided in Item 7A. "Quantitative and Qualitative Disclosures About Market Risk" in our Annual Report on Form 10-K for the year ended December 31, 2002.

ITEM 4. CONTROLS AND PROCEDURES

a. Evaluation of disclosure controls and procedures.

Within the 90 days prior to the date of this report, we carried out an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures pursuant to Exchange Act Rule 13a-15. This evaluation was performed under the supervision of, and with the participation of, our management, including the Chief Executive Officer and Chief Financial Officer. Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures are effective in timely alerting them to material information relating to HCC Insurance Holdings, Inc. and its subsidiaries required to be included in our periodic SEC filings.

b. Changes in internal controls.

There have been no changes in our internal controls or in other factors which could materially affect internal controls over financial reporting subsequent to the date we carried out our evaluation.

PART II - OTHER INFORMATION

Item 1. Legal Proceedings

In addition to the matters discussed in Note (3) Reinsurance, we are party to numerous lawsuits and other proceedings that arise in the normal course of our business. Many of such lawsuits and other proceedings involve claims under policies that we underwrite as an insurer or reinsurer, the liabilities for which, we believe, have been adequately included in our loss reserves. Also, from time to time, we are a party to lawsuits and other proceedings which relate to disputes over contractual relationships with third parties, or which involve alleged errors and omissions on the part of our subsidiaries. In addition, we are presently engaged in litigation initiated by the appointed liquidator of a former reinsurer concerning payments made to us prior to the date of the appointment of the liquidator. The disputed payments were made by the now insolvent reinsurer in connection with a commutation agreement. Our understanding is that such litigation is one of a number of similar actions brought by the liquidator. We intend to vigorously contest the action. We do not believe the resolution of any of these matters, some of which include allegations of damages of material amounts, will have a material adverse effect on our financial condition, results of operations or cash flows.

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits

31.1 Certification by Chief Executive Officer.
31.2 Certification by Chief Financial Officer.
32.1 Certification with respect to quarterly report.

(b) Reports on Form 8-K

During the third quarter we did not file any reports on Form 8-K. On August 7, 2003, we furnished a report on Form 8-K including our announcement of financial results for the second quarter of 2003.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

HCC Insurance Holdings, Inc.
(Registrant)

November 14, 2003	/s/ Stephen L. Way
(Date)	Stephen L. Way, Chairman of the Board Chief Executive Officer and President
November 14, 2003	/s/ Edward H. Ellis, Jr.
(Date)	Edward H. Ellis, Jr., Executive Vice President and Chief Financial Officer

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INDEX TO EXHIBITS

EXHIBIT NUMBER	DESCRIPTION
31.1	Certification by Chief Executive Officer.
31.2	Certification by Chief Financial Officer.
32.1	Certification with respect to quarterly report.