

ARCH CAPITAL GROUP LTD.  
Form 10-Q  
May 09, 2018  
Table of Contents

---

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

FORM 10-Q  
 QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended March 31, 2018

Or

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

Commission file number: 001-16209

ARCH CAPITAL GROUP LTD.  
(Exact name of registrant as specified in its charter)

Bermuda  
(State or other jurisdiction of incorporation or organization)

Not applicable  
(I.R.S. Employer Identification No.)

Waterloo House, Ground Floor  
100 Pitts Bay Road, Pembroke HM 08, Bermuda  
(Address of principal executive offices)

(441) 278-9250  
(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  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  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 the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act. Large accelerated Filer  Accelerated Filer  Non-accelerated Filer  Smaller reporting company  Emerging growth company

If an emerging growth company, indicate by check mark if the Registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes  No

Edgar Filing: ARCH CAPITAL GROUP LTD. - Form 10-Q

As of May 4, 2018, there were 135,775,651 common shares, \$0.0033 par value per share, of the registrant outstanding.

---

---

Table of Contents

ARCH CAPITAL GROUP LTD.

INDEX TO FORM 10-Q

	Page No.
PART I	
<u>Financial Information</u>	<u>2</u>
Item 1. <u>Consolidated Financial Statements</u>	<u>4</u>
Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	<u>41</u>
Item 3. <u>Quantitative and Qualitative Disclosures About Market Risk</u>	<u>63</u>
Item 4. <u>Controls and Procedures</u>	<u>63</u>
PART II	
<u>Other Information</u>	<u>64</u>
Item 1. <u>Legal Proceedings</u>	<u>64</u>
Item 1A. <u>Risk Factors</u>	<u>64</u>
Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	<u>64</u>
Item 5. <u>Other Information</u>	<u>65</u>
Item 6. <u>Exhibits</u>	<u>65</u>
<u>Signatures</u>	<u>66</u>

ARCH CAPITAL 1 2018 FIRST QUARTER FORM 10-Q

---

Table of Contents

PART I. FINANCIAL INFORMATION

Cautionary Note Regarding Forward-Looking Statements

The Private Securities Litigation Reform Act of 1995 (“PSLRA”) provides a “safe harbor” for forward-looking statements. This report or any other written or oral statements made by or on behalf of us may include forward-looking statements, which reflect our current views with respect to future events and financial performance. All statements other than statements of historical fact included in or incorporated by reference in this report are forward-looking statements. Forward-looking statements, for purposes of the PSLRA or otherwise, can generally be identified by the use of forward-looking terminology such as “may,” “will,” “expect,” “intend,” “estimate,” “anticipate,” “believe” or “continue” or similar statements of a future or forward-looking nature or their negative or variations or similar terminology.

Forward-looking statements involve our current assessment of risks and uncertainties. Actual events and results may differ materially from those expressed or implied in these statements. Important factors that could cause actual events or results to differ materially from those indicated in such statements are discussed below and elsewhere in this report and in our periodic reports filed with the Securities and Exchange Commission (the “SEC”), and include:

- our ability to successfully implement our business strategy during “soft” as well as “hard” markets;
- acceptance of our business strategy, security and financial condition by rating agencies and regulators, as well as by brokers and our insureds and reinsureds;
- the integration of United Guaranty Corporation and any other businesses we have acquired or may acquire into our existing operations;
- our ability to maintain or improve our ratings, which may be affected by our ability to raise additional equity or debt financings, by ratings agencies’ existing or new policies and practices, as well as other factors described herein;
- general economic and market conditions (including inflation, interest rates, unemployment, housing prices, foreign currency exchange rates, prevailing credit terms and the depth and duration of a recession) and conditions specific to the reinsurance and insurance markets (including the length and magnitude of the current “soft” market) in which we operate;
- competition, including increased competition, on the basis of pricing, capacity (including alternative sources of capital), coverage terms, or other factors;
- developments in the world’s financial and capital markets and our access to such markets;
- our ability to successfully enhance, integrate and maintain operating procedures (including information technology) to effectively support our current and new business;
- the loss of key personnel;
- accuracy of those estimates and judgments utilized in the preparation of our financial statements, including those related to revenue recognition, insurance and other reserves, reinsurance recoverables, investment valuations, intangible assets, bad debts, income taxes, contingencies and litigation, and any determination to use the deposit method of accounting, which for a relatively new insurance and reinsurance company, like our company, are even more difficult to make than those made in a mature company since relatively limited historical information has been reported to us through March 31, 2018;
- greater than expected loss ratios on business written by us and adverse development on claim and/or claim expense liabilities related to business written by our insurance and reinsurance subsidiaries;
- severity and/or frequency of losses;
- claims for natural or man-made catastrophic events or severe economic events in our insurance, reinsurance and mortgage businesses could cause large losses and substantial volatility in our results of operations;
- acts of terrorism, political unrest and other hostilities or other unforecasted and unpredictable events;
- availability to us of reinsurance to manage our gross and net exposures and the cost of such reinsurance;
- the failure of reinsurers, managing general agents, third party administrators or others to meet their obligations to us;
- the timing of loss payments being faster or the receipt of reinsurance recoverables being slower than anticipated by us;

Table of Contents

our investment performance, including legislative or regulatory developments that may adversely affect the fair value of our investments;

changes in general economic conditions, including new or continued sovereign debt concerns in Eurozone countries or downgrades of U.S. securities by credit rating agencies, which could affect our business, financial condition and results of operations;

the volatility of our shareholders' equity from foreign currency fluctuations, which could increase due to us not matching portions of our projected liabilities in foreign currencies with investments in the same currencies;

losses relating to aviation business and business produced by a certain managing underwriting agency for which we may be liable to the purchaser of our prior reinsurance business or to others in connection with the May 5, 2000 asset sale described in our periodic reports filed with the SEC;

changes in accounting principles or policies or in our application of such accounting principles or policies;

changes in the political environment of certain countries in which we operate or underwrite business;

statutory or regulatory developments, including as to tax policy and matters and insurance and other regulatory matters such as the adoption of proposed legislation that would affect Bermuda-headquartered companies and/or Bermuda-based insurers or reinsurers and/or changes in regulations or tax laws applicable to us, our subsidiaries, brokers or customers, including the Tax Cuts and Jobs Act of 2017; and

the other matters set forth under Item 1A "Risk Factors", Item 7 "Management's Discussion and Analysis of Financial Condition and Results of Operations" and other sections of our Annual Report on Form 10-K for the year ended December 31, 2017, as well as the other factors set forth in our other documents on file with the SEC, and management's response to any of the aforementioned factors.

All subsequent written and oral forward-looking statements attributable to us or persons acting on our behalf are expressly qualified in their entirety by these cautionary statements. The foregoing review of important factors should not be construed as exhaustive and should be read in conjunction with other cautionary statements that are included herein or elsewhere. We undertake no obligation to publicly update or revise any forward-looking statement, whether as a result of new information, future events or otherwise.

ARCH CAPITAL 3 2018 FIRST QUARTER FORM 10-Q

---

Table of Contents

---

**ITEM 1. CONSOLIDATED FINANCIAL STATEMENTS**

---

	Page No.
<u>Report of Independent Registered Public Accounting Firm</u>	<u>5</u>
<u>Consolidated Balance Sheets</u> March 31, 2018 (unaudited) and December 31, 2017	<u>6</u>
<u>Consolidated Statements of Income</u> For the three month periods ended March 31, 2018 and 2017 (unaudited)	<u>7</u>
<u>Consolidated Statements of Comprehensive Income</u> For the three month periods ended March 31, 2018 and 2017 (unaudited)	<u>8</u>
<u>Consolidated Statements of Changes in Shareholders' Equity</u> For the three month periods ended March 31, 2018 and 2017 (unaudited)	<u>9</u>
<u>Consolidated Statements of Cash Flows</u> For the three month periods ended March 31, 2018 and 2017 (unaudited)	<u>10</u>
Notes to Consolidated Financial Statements (unaudited)	
<u>Note 1 - General</u>	<u>11</u>
<u>Note 2 - Recent Accounting Pronouncements</u>	<u>11</u>
<u>Note 3 - Variable Interest Entities and Noncontrolling Interests</u>	<u>12</u>
<u>Note 4 - Earnings Per Common Share</u>	<u>14</u>
<u>Note 5 - Segment Information</u>	<u>15</u>
<u>Note 6 - Reserves for Losses and Loss Adjustment Expenses</u>	<u>18</u>
<u>Note 7 - Investment Information</u>	<u>20</u>
<u>Note 8 - Fair Value</u>	<u>25</u>
<u>Note 9 - Derivative Instruments</u>	<u>30</u>
<u>Note 10 - Commitments and Contingencies</u>	<u>31</u>
<u>Note 11 - Share Transactions</u>	<u>31</u>
<u>Note 12 - Other Comprehensive Income (Loss)</u>	<u>32</u>
<u>Note 13 - Guarantor Financial Information</u>	<u>33</u>
<u>Note 14 - Income Taxes</u>	<u>39</u>
<u>Note 15 - Legal Proceedings</u>	<u>39</u>
<u>Note 16 - Subsequent Events</u>	<u>39</u>

ARCH CAPITAL 4 2018 FIRST QUARTER FORM 10-Q

---

Table of Contents

Report of Independent Registered Public Accounting Firm

To the Board of Directors and Shareholders of Arch Capital Group Ltd.:

Results of Review of Financial Statements

We have reviewed the accompanying consolidated balance sheet of Arch Capital Group Ltd. and its subsidiaries as of March 31, 2018, and the related consolidated statements of income, comprehensive income, changes in shareholders' equity and cash flows for the three-month periods ended March 31, 2018 and March 31, 2017 including the related notes (collectively referred to as the "interim financial statements"). Based on our reviews, we are not aware of any material modifications that should be made to the accompanying interim financial statements for them to be conformity with accounting principles generally accepted in the United States of America.

We have previously audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheet of the Company as of December 31, 2017, and the related consolidated statements of income, comprehensive income, changes in shareholders' equity, and cash flows for the year then ended (not presented herein), and in our report dated February 28, 2018, we expressed an unqualified opinion on those consolidated financial statements. In our opinion, the information set forth in the accompanying consolidated balance sheet as of December 31, 2017, is fairly stated, in all material respects in relation to the consolidated balance sheet from which it has been derived.

Basis for Review Results

These interim financial statements are the responsibility of the Company's management. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) ("PCAOB") and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB. We conducted our review in accordance with the standards of the PCAOB. A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with the standards of the PCAOB, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

/s/ PricewaterhouseCoopers LLP  
New York, NY  
May 9, 2018

ARCH CAPITAL 5 2018 FIRST QUARTER FORM 10-Q

---

Table of ContentsARCH CAPITAL GROUP LTD. AND SUBSIDIARIES  
CONSOLIDATED BALANCE SHEETS

(U.S. dollars in thousands, except share data)

	(Unaudited)	
	March 31, 2018	December 31, 2017
Assets		
Investments:		
Fixed maturities available for sale, at fair value (amortized cost: \$14,469,013 and \$13,869,460)	\$14,348,941	\$13,876,003
Short-term investments available for sale, at fair value (amortized cost: \$966,722 and \$1,468,955)	967,389	1,469,042
Collateral received under securities lending, at fair value (amortized cost: \$367,034 and \$476,605)	367,043	476,615
Equity securities, at fair value	543,650	495,804
Other investments available for sale, at fair value (cost: \$0 and \$198,163)	—	264,989
Investments accounted for using the fair value option	4,119,139	4,216,237
Investments accounted for using the equity method	1,394,548	1,041,322
Total investments	21,740,710	21,840,012
Cash	680,891	606,199
Accrued investment income	106,114	113,133
Securities pledged under securities lending, at fair value (amortized cost: \$356,518 and \$463,181)	358,152	464,917
Premiums receivable	1,375,080	1,135,249
Reinsurance recoverable on unpaid and paid losses and loss adjustment expenses	2,510,119	2,540,143
Contractholder receivables	2,002,469	1,978,414
Ceded unearned premiums	996,772	926,611
Deferred acquisition costs	596,264	535,824
Receivable for securities sold	217,224	205,536
Goodwill and intangible assets	626,004	652,611
Other assets	922,156	1,053,009
Total assets	\$32,131,955	\$32,051,658