HCC INSURANCE HOLDINGS INC/DE/
Form 10-K
March 01, 2010

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

Form 10-K

þ	**ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934.**
o	**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934.**
	For the fiscal year ended December 31, 2009

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)

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class:	**Name of Each Exchange on Which Registered:**
Common Stock, $1.00 par Value	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act: NONE

Indicate by check mark if the registrant is a well-known seasoned issuer as defined in Rule 405 of the Securities Act. Yes þ No o

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act. Yes o No þ

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 o

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). o Yes o No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§ 229.405 of this chapter) is not contained herein and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. o

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 definition 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 o Non-accelerated filer o Smaller reporting company o

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

The aggregate market value on June 30, 2009 (the last business day of the registrant s most recently completed second fiscal quarter) of the voting stock held by non-affiliates of the registrant was approximately $2.7 billion. For purposes of the determination of the above-stated amount, only Directors and executive officers are presumed to be affiliates, but neither the registrant nor any such person concede that they are affiliates of the registrant.

The number of shares outstanding of the registrant s Common Stock, $1.00 par value, at February 19, 2010 was 114.6 million.

DOCUMENTS INCORPORATED BY REFERENCE:

Information called for in Part III of this Form 10-K is incorporated by reference to the registrant s definitive Proxy Statement to be filed within 120 days of the close of the registrant s fiscal year in connection with the registrant s annual meeting of shareholders.

HCC INSURANCE HOLDINGS, INC.

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FORWARD-LOOKING STATEMENTS

This report on Form 10-K 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 growth of our business and operations, business strategy, competitive strengths, goals, plans, future capital expenditures 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 expressions, we are making forward-looking statements.

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

- *the effects of catastrophic losses,*
- *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 the credit market downturn and subprime market exposures,*
- *the effects of emerging claim and coverage issues,*
- *the effects of extensive governmental regulation of the insurance industry,*
- *potential credit risk with brokers,*
- *the effects of industry consolidation,*
- *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,*
- *changes in our assigned financial strength ratings,*
- *our ability to raise capital and funds for liquidity in the future,*
- *attraction and retention of qualified employees,*

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

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,

failures or constraints of our information technology systems,

potential changes to the country s health care delivery system,

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- *the effect, if any, of climate change, on the risks we insure,*
- *change of control, and*
- *difficulties with outsourcing relationships.*

We describe these risks and uncertainties in greater detail in Item 1A, Risk Factors.

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, 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 that 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 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.

PART I

Item 1. *Business*

Business Overview

HCC Insurance Holdings, Inc. is a Delaware corporation, which was formed in 1991. Its predecessor corporation was formed in 1974. Our principal executive offices are located at 13403 Northwest Freeway, Houston, Texas 77040, and our telephone number is (713) 690-7300. We maintain an Internet website at *www.hcc.com.* The reference to our Internet website address in this Report does not constitute the incorporation by reference of the information contained at the website in this Report. We will make available, free of charge through publication on our Internet website, a copy of our Annual Report on Form 10-K and quarterly reports on Form 10-Q and any current reports on Form 8-K or amendments to those reports, filed with or furnished to the Securities and Exchange Commission (SEC) as soon as reasonably practicable after we have filed or furnished such materials with the SEC.

As used in this report, unless otherwise required by the context, the terms we, us and our refer to HCC Insurance Holdings, Inc. and its consolidated subsidiaries and the term HCC refers only to HCC Insurance Holdings, Inc. All trade names or trademarks appearing in this report are the property of their respective holders.

We provide specialized property and casualty, surety, and group life, accident and health insurance coverages and agency services to commercial customers and individuals. We concentrate our activities in selected, narrowly defined, specialty lines of business. We operate primarily in the United States, the United Kingdom, Spain and Ireland. Some of our operations have a broader international scope. We underwrite on both a direct basis, where we insure a risk in exchange for a premium, and on a reinsurance (assumed) basis, where we insure all or a portion of another, or ceding, insurance company s risk in exchange for all or a portion of the ceding insurance company s premium for the risk. We market our products both directly to customers and through a network of independent and affiliated brokers, producers, agents and third party administrators.

Since our founding, we have been consistently profitable, generally reporting annual increases in total revenue and shareholders equity. During the period 2005 through 2009, we had an average statutory combined ratio of 86.5% versus the less favorable 98.7% (source: A.M. Best Company, Inc.) recorded by the U.S. property and casualty insurance industry overall. During the period 2005 through 2009, our gross written premium increased from $2.0 billion to $2.6 billion, an increase of 26%, while net written premium increased 36% from $1.5 billion to $2.0 billion. During this period, our revenue increased from $1.6 billion to $2.4 billion, an increase of 45%. During the period December 31, 2005 through December 31, 2009, our shareholders equity increased 78% from $1.7 billion to $3.0 billion and our assets increased 26% from $7.0 billion to $8.8 billion.

Our insurance companies and Lloyd s of London syndicates are risk-bearing and focus their underwriting activities on providing insurance and/or reinsurance in the following lines of business:

- Diversified financial products
- Group life, accident and health
- Aviation
- London market account

Other specialty lines

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Our insurance companies have strong financial strength ratings. Standard & Poor s Corporation, Fitch Ratings, Moody s Investors Service, Inc. and A.M. Best Company, Inc. are internationally recognized independent rating agencies. These financial strength ratings are intended to provide an independent opinion of an insurer s ability to meet its obligations to policyholders and are not evaluations directed at investors. Our financial strength ratings as of December 31, 2009 were as follows:

Companies	Standard & Poor s	Fitch Ratings	Moody s	A.M. Best
Domestic insurance companies				
American Contractors Indemnity Company	AA	AA		A
Avemco Insurance Company	AA	AA		A+
HCC Life Insurance Company	AA	AA	A1	A+
HCC Specialty Insurance Company	AA	AA		A+
Houston Casualty Company	AA	AA	A1	A+
Perico Life Insurance Company		AA		A
U.S. Specialty Insurance Company	AA	AA	A1	A+
United States Surety Company	AA	AA		A
International insurance companies				
HCC International Insurance Company	AA			
HCC Europe	AA			
HCC Reinsurance Company	AA			

Standard & Poor s AA (Very Strong) rating is the 3rd highest of their 23 ratings. Fitch Ratings AA (Very Strong) is the 3rd highest of their 21 ratings. Moody s A1 (Good Security) is the 5th highest of their 21 ratings. A.M. Best s A+ (Superior) is the 2nd highest and A (Excellent) is the 3rd highest of their 16 ratings.

Lloyd s of London, the insurance market through which our two Lloyd s syndicates operate, is composed of numerous managing agents that run independent underwriting syndicates. Participants in each syndicate provide a specified amount of capital to support the syndicate s business. If needed, any shortfall in a syndicate s capital is supported by Lloyd s Central Fund. Lloyd s of London is rated A+ by Fitch Ratings and Standard & Poor s and A by A.M. Best.

Our underwriting agencies underwrite on behalf of our insurance companies and, in certain situations, for other unaffiliated insurance companies. They receive fees for these services and do not bear any of the insurance risk of the companies for which they underwrite. Our underwriting agencies generate the majority of their revenue based on fee income. The agencies specialize in the following types of business: contingency (including contest indemnification, event cancellation and weather coverages); directors and officers liability; individual disability (for athletes and other high profile individuals); kidnap and ransom; employment practices liability; errors and omissions liability (known as professional indemnity outside the United States); public entity; various financial products; short-term medical; fidelity, difference in conditions (earthquake) and other specialty business. Our principal underwriting agencies are G.B. Kenrick & Associates, HCC Global Financial Products, HCC Indemnity Guaranty Agency, HCC Specialty Underwriters, HCC Medical Insurance Services, LLC, Professional Indemnity Agency, RA&MCO Insurance Services and HCC Underwriting Agency, Ltd. (UK).

Our Strategy

Our business philosophy is to maximize underwriting profits while limiting risk in order to preserve shareholders equity and maximize earnings. We concentrate our insurance writings in selected specialty lines of business in which we believe we can achieve an underwriting profit. We also rely on our experienced underwriting personnel and our access to and expertise in the reinsurance marketplace to achieve our strategic

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objectives. We market our insurance products both directly to customers and through affiliated and independent brokers, agents, producers and third party administrators.

The property and casualty insurance industry and individual lines of business within the industry are cyclical. There are times, particularly when there is excess capital in the industry or underwriting results have been good, in which a large number of companies offer insurance on certain lines of business, causing premium rates and premiums written by companies to trend downward (a soft market). During other times, insurance companies limit their writings in certain lines of business due to lack of capital or following periods of excessive losses. This results in an increase in premium rates and premiums for those companies that continue to write insurance in those lines of business (a hard market).

In our insurance operations, we believe our operational flexibility, which permits us to shift the focus of our insurance underwriting activity among our various lines of business, allows us to implement a strategy of emphasizing more profitable lines of business during periods of increased premium rates and de-emphasizing less profitable lines of business during periods of increased competition.

Following a period in which premium rates rose substantially, premium rates in several of our lines of business became more competitive during the past six years. The rate decreases were more gradual than the prior rate increases; thus, our underwriting activities remain profitable. During the past several years, we expanded our underwriting activities and increased our retentions in lines of business with favorable expected profitability. We were able to accomplish this due to the increased diversification provided by our overall book of business and due to our increased capital strength. These higher retention levels increased our net written and earned premium and have resulted in additional underwriting profits, investment income and net earnings.

Through reinsurance, our insurance companies and syndicates may transfer or cede all or part of the risk we have underwritten to a reinsurance company in exchange for all or part of the premium we receive in connection with the risk. We purchase reinsurance to limit the net loss to our insurance companies and syndicates from both individual and catastrophic risks. The amount of reinsurance we purchase varies depending on, among other things, the particular risks inherent in the policies underwritten; the pricing, coverage and terms of the reinsurance; and the competitive conditions within the relevant line of business.

When we decide to retain more underwriting risk in a particular line of business, we do so with the intention of retaining a greater portion of any underwriting profits. In this regard, we may purchase less proportional or quota share reinsurance, thus accepting more of the risk but possibly replacing it with specific excess of loss reinsurance, in which we transfer to reinsurers both premium and losses on a non-proportional basis for individual and catastrophic occurrence risks above a retention point. Additionally, we may obtain facultative reinsurance protection on individual risks. In some cases, we may choose not to purchase reinsurance in a line of business in which we believe there has been a favorable loss history, our policy limits are relatively low and we determine there is a low likelihood of catastrophe exposure.

We also acquire businesses and hire new underwriting teams that we believe present opportunities for future profits and enhancement of our business. We expect to continue to acquire complementary businesses and add underwriting teams. We believe that we can enhance acquired businesses and platforms for new underwriting teams with our infrastructure, ratings and financial strength.

Our business plan is shaped by our underlying business philosophy, which is to maximize underwriting profit and net earnings while limiting risk and preserving and achieving long-term growth of shareholders equity. As a result, our primary objective is to increase net earnings rather than market share or gross written premium.

In our ongoing operations, we will continue to:

- emphasize the underwriting of lines of business in which there is an anticipation of underwriting profits based on various factors, including premium rates, the availability and cost of reinsurance, policy terms and conditions, and market conditions,
- maintain a highly non-correlated portfolio of business,

limit our insurance companies aggregate net loss exposure from a catastrophic loss through the control of aggregate limits written, the use of reinsurance for those lines of business exposed to such losses and diversification into lines of business not exposed to such losses, and

consider the potential acquisition of specialty insurance operations and the hiring of underwriting teams.

Industry Segment and Geographic Information

Financial information concerning our operations by industry segment and geographic data is included in the Consolidated Financial Statements and Notes thereto.

Acquisitions

We have made a series of acquisitions that have furthered our overall business strategy. Our major transactions during the last three years are described below:

On January 2, 2008, we acquired HCC Medical Insurance Services, LLC (formerly MultiNational Underwriters, LLC), an underwriting agency located in Indianapolis, Indiana, for cash consideration of $42.7 million and possible additional cash consideration depending upon future underwriting profit levels. This agency writes domestic and international short-term medical insurance through Syndicate 4141 at Lloyd s of London.

In the fourth quarter of 2008, we acquired four underwriting agencies for total consideration of $29.9 million. On October 1, 2008, we acquired the Criminal Justice division of U.S. Risk Insurance Brokers. Rebranded Pinnacle Underwriting Partners, this newly established underwriting agency, located in Scottsdale, Arizona, serves the private detention and security industry. On November 1, 2008, we acquired Cox Insurance Group, a medical stop-loss managing general underwriter covering the midwestern United States. On December 1, 2008, we acquired Arrowhead Public Risk, a division of Arrowhead General Insurance Agency, Inc., a managing general agency based in Richmond, Virginia, specializing in risk management for the public entity sector. On December 31, 2008, we acquired VMGU Insurance Agency, a leading underwriter of the lumber, building materials, forest products and woodworking industries, based in Waltham, Massachusetts.

On February 27, 2009, we acquired Surety Company of the Pacific, a leading California writer of license and permit bonds in the western United States, headquartered in Encino, California.

We continue to evaluate acquisition opportunities, and we may complete additional acquisitions during 2010. Any future acquisitions will be designed to expand and strengthen our existing lines of business or to provide access to additional specialty sectors, which we expect to contribute to our overall growth.

Insurance Company Operations

Lines of Business

We underwrite business produced through affiliated underwriting agencies, through independent brokers, producers and third party administrators, and by direct marketing efforts. We also write facultative or individual account reinsurance, as well as some treaty reinsurance business. This table shows our insurance companies total premium written, otherwise known as gross written premium, by line of business and the percentage of each line to total gross written premium (dollars in thousands).

	2009		2008		2007	
Diversified financial products	$ 1,147,913	45%	$ 1,051,722	42%	$ 963,355	39%
Group life, accident and health	846,041	33	829,903	33	798,684	33
Aviation	176,073	7	185,786	8	195,809	8
London market account	186,603	7	175,561	7	213,716	9
Other specialty lines	203,009	8	251,021	10	280,040	11
Discontinued lines of business	152		4,770		(425)	
Total gross written premium	$ 2,559,791	100%	$ 2,498,763	100%	$ 2,451,179	100%

This table shows our insurance companies actual premium retained, otherwise known as net written premium, by line of business and the percentage of each line to total net written premium (dollars in thousands).

	2009		2008		2007	
Diversified financial products	$ 915,595	45%	$ 872,007	42%	$ 771,648	39%
Group life, accident and health	796,778	39	789,479	38	759,207	38
Aviation	124,336	6	136,019	7	145,761	7
London market account	102,407	5	107,234	5	118,241	6
Other specialty lines	107,047	5	151,120	8	191,151	10
Discontinued lines of business	126		4,759		(399)	
Total net written premium	$ 2,046,289	100%	$ 2,060,618	100%	$ 1,985,609	100%

This table shows our insurance companies net written premium as a percentage of gross written premium, otherwise referred to as percentage retained, for our lines of business.

	2009	2008	2007
Diversified financial products	80%	83%	80%
Group life, accident and health	94	95	95
Aviation	71	73	74
London market account	55	61	55
Other specialty lines	53	60	68
Consolidated percentage retained	80%	82%	81%

Diversified Financial Products

We underwrite a variety of financial insurance risks in our diversified financial products line of business. These risks include:

- directors and officers liability
- employment practices liability
- errors and omissions liability
- surety and credit
- fidelity
- various financial products

We began to underwrite this line of business through a predecessor company in 1977. Our insurance companies started participating in this business in 2001. We have substantially increased our level of business through the acquisition of a number of agencies and insurance companies that operate in this line of business, both domestically and internationally. Each of the acquired entities has significant experience in its respective specialty within this line of business. We have also formed entities developed around teams of experienced underwriters that offer these products.

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In 2002 and 2003, following several years of insurance industry losses, significant rate increases were experienced throughout our diversified financial products line of business, particularly directors and officers liability, which we began underwriting in 2002. We benefited greatly from these improved conditions despite the fact that we had not been involved in the past losses. Rates softened between 2004 and 2009 for some of the products in this line, but some of the products had rate increases in 2008 and 2009. Our underwriting margins remain profitable. There is also considerable investment income derived from diversified financial products due to the extended periods involved in any claims resolution. Although individual losses in the directors and officers public company liability business and portions of our U.S. errors and omissions business may have potential severity, the remainder of the diversified financial products business is less volatile with relatively low limits.

Group Life, Accident and Health

We write medical stop-loss business through HCC Life Insurance Company and Perico Life Insurance Company. Our medical stop-loss insurance provides coverages to companies, associations and public entities that elect to self-insure their employees medical coverage for losses within specified levels, allowing them to manage the risk of excessive health insurance exposure by limiting aggregate and specific losses to a predetermined amount. We first began writing this business through a predecessor company in 1980. Our insurance companies started participating in this business in 1997. This line of business has grown both organically and through acquisitions. We are considered a market leader in medical stop-loss insurance. We also underwrite a small program of group life insurance, offered to our insureds as a complement to our medical stop-loss products.

Premium rates for medical stop-loss business rose substantially beginning in 2000 and, although competition has increased in recent years, underwriting results have remained profitable. Premium rate increases together with deductible increases are still adequate to cover medical cost trends. Medical stop-loss business has relatively low limits, a low level of catastrophe exposure, a generally predictable result and a short time span between the writing of premium, the reporting of claims and the payment of claims. We currently buy no reinsurance for this line of business.

Our risk management business is composed of HMO and medical excess risks. This business has relatively low limits and a low level of catastrophe exposure. The business is competitive, but remains profitable.

We began writing occupational accident insurance in 1996. This business is currently written through U.S. Specialty Insurance Company. These products have relatively low limits, a relatively low level of catastrophe exposure and a generally predictable result.

With the acquisition of HCC Medical Insurance Services, LLC, we began writing short-term domestic and international medical insurance that covers individuals or groups when there is a lapse in coverage or when traveling internationally. This business has relatively low limits and the term is generally of short duration. This business is primarily produced on an internet platform.

Aviation

We are a market leader in the general aviation insurance industry insuring aviation risks, both domestically and internationally. Types of aviation business we insure include:

- antique and vintage military aircraft
- cargo operators
- commuter airlines

corporate aircraft

fixed base operations

military law enforcement aircraft

private aircraft owners

rotor wing aircraft

We offer coverages that include hulls, engines, avionics and other systems, liabilities, cargo and other ancillary coverages. We generally do not insure major airlines and major manufacturers. Insurance claims related to general aviation business tend to be seasonal, with the majority of the claims being incurred during warm weather months.

We are one of the largest writers of personal aircraft insurance in the United States. Our aviation gross premium has remained relatively stable since 1998, but it has decreased slightly in 2007 through 2009 due to competition and decreasing rates, principally in the domestic business. We have generally increased our retentions since 1998 as this business is predominantly written with small limits and has generally predictable results.

London Market Account

Our London market account business consists of marine, energy, property, and accident and health business and has been primarily underwritten by Houston Casualty Company s London branch office. During 2006, we began to utilize HCC International Insurance Company to underwrite the non-U.S. based risks for this line of business. Beginning in 2009, we have utilized our Lloyd s of London Syndicate 4141 to write certain of this business. We expect to increase the use of that platform in the future.

This line includes a significant portion of our catastrophe exposures. We have underwritten these risks for more than 15 years, increasing or decreasing our premium volume depending on market conditions, which can be very volatile in this line. The following table presents the details of net premium written within the London market account line of business (in thousands).

	2009	**2008**	**2007**
Marine	$ 14,373	$ 14,413	$ 30,685
Energy	43,807	44,554	45,962
Property	22,941	28,827	19,856
Accident and health	21,286	19,440	21,738
Total London market account net written premium	$ 102,407	$ 107,234	$ 118,241

Marine

We underwrite marine risks for ocean-going vessels including hull, protection and indemnity, liabilities and cargo. We have underwritten marine risks since 1984 in varying amounts depending on market conditions.

Energy

In our energy business, we underwrite physical damage, business interruption and other ancillary coverages. We have been underwriting both onshore and offshore energy risks since 1988. This business includes but is not limited to:

drilling rigs

gas production and gathering platforms

natural gas facilities

petrochemical plants

pipelines

refineries

The market was soft for this business and rates were at relatively low levels from the late 1990 s through 2004. During this period, we underwrote the business selectively and also bought large amounts of facultative reinsurance to protect our exposure to risk. Hurricane Ivan produced large energy losses to the industry in 2004 and both Hurricane Katrina and Rita produced large losses to the industry in 2005. A very hard market developed for underwriting year 2006, with large rate increases and restrictive policy terms, including imposition of aggregate named windstorm limits in vulnerable areas, rather than just occurrence limits. We had ample capacity to increase our business in this line, and did so due to the attractive prices and terms in 2006 for taking the additional underwriting risk. After a very profitable 2006, prices weakened in 2007 and 2008, but at levels we still considered reasonable, and we generally maintained our book at similar exposure levels as in 2006. In 2008, Hurricane Ike produced large losses to the industry, which resulted in another upswing in pricing in 2009. Although we had growth in premium due to the rising rates in 2009, the growth was limited due to policyholders choosing to self insure portions of their insurance programs that they formerly insured. During the large catastrophe period of 2004   2008, we were able to generate profits from the business due to the individual hurricane losses remaining within our expectations and within the excess of loss reinsurance purchased by us to cover such events.

Property

We underwrite property business specializing in risks of large, often multinational, corporations, covering a variety of commercial properties, which include but are not limited to:

factories	office buildings
hotels	retail locations
industrial plants	utilities

We have written property business since 1986, including business interruption, physical damage and catastrophe risks, such as flood and earthquake. Rates increased significantly following September 11, 2001, but trended downward by 2005 despite the hurricane activity in 2004. Massive losses from hurricanes in 2005 resulted in substantial rate increases, but due to over capacity, policy conditions have remained unchanged, unlike energy risks. Accordingly, we substantially reduced our involvement in policies with coastal exposures in the Florida and U.S. Gulf Coast regions. We continue to buy substantial catastrophe reinsurance, unlike many industry participants, which was shown to be adequate during 2004 and 2005 when large amounts of industry capital were lost. While the hurricane activity seriously affected our earnings in the third quarters of 2004 and 2005, we still were able to produce record annual earnings in those years. This business was profitable in 2006, 2007 and 2009 as there were no significant catastrophe losses, and in 2008 despite the losses from two hurricanes.

In the fourth quarter of 2009, we added an underwriting team to write property treaty reinsurance.

Accident and Health

We began writing London market accident and health risks in 1996, including trip accident, medical and disability. Due to past experience and other market factors, we significantly decreased premiums starting in 2004, and our business is now much more stable and profitable.

Our London market account is reinsured principally on an excess of loss basis. We closely monitor catastrophe exposure, most of which occurs in our London market account, and purchase reinsurance to limit our net exposure to a level such that any one loss is not expected to impact our capital or exceed our net earnings in the affected quarter. Previous catastrophe losses, net of reinsurance, from Hurricane Andrew in 1992, the Northridge Earthquake in 1994, the terrorist attacks on September 11, 2001, and the hurricanes of 2004, 2005 and 2008 did not exceed our net earnings in the quarter when each occurred.

Other Specialty Lines

In addition to the above, we underwrite various other specialty lines of business, including different types of property and liability business, such as event cancellation, contingency, public entity and U.K. liability. We had an assumed quota share contract for surplus lines business that expired in March 2008. Individual premiums by type of business are not material to the Other Specialty Lines line of business.

Insurance Companies and Lloyd s of London Syndicates

Houston Casualty Company

Houston Casualty Company is our largest insurance company subsidiary. It is domiciled in Texas and insures risks worldwide. Houston Casualty Company underwrites business produced by independent agents and brokers, affiliated underwriting agencies, reinsurance brokers, and other insurance and reinsurance companies. Houston Casualty Company writes diversified financial products, aviation, London market account and other specialty lines of business. Houston Casualty Company s 2009 gross written premium, including Houston Casualty Company-London, its United Kingdom branch, was $539.4 million.

Houston Casualty Company-London

Houston Casualty Company operates a branch office in London, England, in order to more closely align its underwriting operations with the London market, a historical focal point for some of the business that it underwrites. In 2006, we focused the underwriting activities of Houston Casualty Company-London s office on risks based in the United States but written in the London market. We began to use HCC International Insurance Company as a platform for much of the European and other international risks previously underwritten by Houston Casualty Company-London.

HCC International Insurance Company

HCC International Insurance Company PLC writes diversified financial products business, primarily surety, credit and professional indemnity products, and non-United States based London market account risks. HCC International Insurance Company has been in operation since 1982 and is domiciled in the United Kingdom. HCC International Insurance Company s 2009 gross written premium was $231.0 million. We intend to continue to expand the underwriting activities of HCC International Insurance Company and to use it as an integral part of a European platform for our international insurance operations.

Lloyd s of London Syndicates

We currently participate in Lloyd s of London Syndicate 4040, which writes business included in our other specialty lines of business, and Lloyd s of London Syndicate 4141, which writes business in our diversified financial products, London market account and group life, accident and health lines of business. These syndicates are managed by HCC Underwriting Agency, Ltd. (UK). Syndicate 4040 will merge into Syndicate 4141 in 2013, after the 2009 year of account is closed in accordance with Lloyd s rules. We expect to use our Lloyd s platform and the licenses it affords us to write business unique to Lloyd s and business in countries where our other insurance companies are not currently licensed.

HCC Europe

Houston Casualty Company Europe, Seguros y Reaseguros, S.A. is a Spanish insurer. It underwrites diversified financial products business. HCC Europe has been an issuing carrier for diversified financial products business underwritten by affiliated underwriting agencies. Beginning in 2010, this business will be underwritten by HCC International Insurance Company. HCC Europe has been in operation since 1978. HCC Europe s gross written premium in 2009 was $115.8 million.

HCC Reinsurance Company

HCC Reinsurance Company Limited is a Bermuda-domiciled reinsurance company that writes assumed reinsurance from our insurance companies and a limited amount of direct insurance. HCC Reinsurance Company is an issuing carrier for diversified financial products business underwritten by our underwriting agency, HCC Indemnity Guaranty. HCC Reinsurance Company s gross written premium in 2009 was $122.8 million.

U.S. Specialty Insurance Company

U.S. Specialty Insurance Company is a Texas-domiciled property and casualty insurance company. It primarily writes diversified financial products, aviation and accident and health business. U.S. Specialty Insurance Company acts as an issuing carrier for certain business underwritten by our underwriting agencies. U.S. Specialty Insurance Company s gross written premium in 2009 was $656.5 million.

HCC Life Insurance Company

HCC Life Insurance Company is an Indiana-domiciled life insurance company. It operates as primarily a larger group life, accident and health insurer. Its primary products are medical stop-loss and medical excess business. This business is primarily produced by unaffiliated agents, brokers and third party administrators. HCC Life Insurance Company s gross written premium in 2009 was $674.8 million.

Perico Life Insurance Company

Perico Life Insurance Company is a Delaware-domiciled life insurance company. Perico Life Insurance Company now operates as primarily a small group life, accident and health insurer. Its principal product is medical stop-loss business. Perico Life Insurance Company s 2009 gross written premium was $84.1 million.

Avemco Insurance Company

Avemco Insurance Company is a Maryland-domiciled property and casualty insurer and operates as a direct market underwriter of general aviation business. It has also been an issuing carrier for accident and health business and some other lines of business underwritten by our underwriting agencies and a previously affiliated underwriting agency. Avemco Insurance Company s gross written premium in 2009 was $40.9 million.

American Contractors Indemnity Company

American Contractors Indemnity Company is a California-domiciled surety company. It writes court, specialty contract, license and permit, and bail bonds. American Contractors Indemnity Company has been in operation since 1990 and operates as a part of our HCC Surety Group. American Contractors Indemnity Company s 2009 gross written premium was $101.4 million.

United States Surety Company

United States Surety Company is a Maryland-domiciled surety company that has been in operation since 1996. It writes contract bonds and operates as a part of our HCC Surety Group. United States Surety Company s 2009 gross written premium was $22.2 million.

HCC Specialty Insurance Company

HCC Specialty Insurance Company is an Oklahoma-domiciled property and casualty insurance company in operation since 2002. It writes diversified financial products and other specialty lines of business produced by affiliated underwriting agencies. HCC Specialty Insurance Company s gross written premium in 2009 was $20.5 million and was 100% ceded to Houston Casualty Company.

Underwriting Agency Operations

Historically, we have acquired underwriting agencies with seasoned books of business and experienced underwriters. These agencies control the distribution of their business. After we acquire an agency, we generally begin to write some or all of its business through our insurance companies, and, in some cases, the insurance companies reinsure some of the business with unaffiliated reinsurers. We have consolidated certain of our underwriting agencies with our insurance companies when our retention of their business approached 100%. We plan to continue this process in the future.

Our underwriting agencies act on behalf of affiliated and unaffiliated insurance companies and provide insurance underwriting management and claims administration services. Our underwriting agencies do not assume any insurance or reinsurance risk themselves and generate revenues based entirely on fee income and profit commissions. These subsidiaries are in a position to direct and control business they produce. Our insurance companies serve as policy issuing companies for the majority of the business written by our underwriting agencies. If an unaffiliated insurance company serves as the policy issuing company, our insurance companies may reinsure all or part of the business. Our underwriting agencies generated total revenue in 2009 of $182.1 million.

Professional Indemnity Agency

Professional Indemnity Agency, Inc., based in Mount Kisco, New York and with operations in San Francisco and San Diego, California, Concord, California, Richmond, Virginia, Scottsdale, Arizona and Auburn Hills, Michigan, acts as an underwriting manager for diversified financial products specializing in directors and officers liability, errors and omissions liability, kidnap and ransom, employment practice liability, public entity, fidelity, difference in conditions (earthquake) and other specialty lines of business on behalf of affiliated and unaffiliated insurance companies. It has been in operation since 1977.

HCC Specialty Underwriters

HCC Specialty Underwriters Inc., with its home office in Wakefield, Massachusetts and a branch office in London, England, acts as an underwriting manager for sports disability, contingency, film production, and other group life, accident and health and specialty lines of business on behalf of affiliated and unaffiliated insurance companies. It has been in operation since 1982.

HCC Global Financial Products

HCC Global Financial Products, LLC acts as an underwriting manager for diversified financial products, specializing in directors and officers liability business on behalf of affiliated insurance companies. It has been in operation since 1999, underwriting domestic business from Farmington, Connecticut, Jersey City, New Jersey and Houston, Texas and international business from Barcelona, Spain, London, England, and Miami, Florida.

HCC Indemnity Guaranty Agency

HCC Indemnity Guaranty Agency, Inc. is an underwriting agency based in New York, New York, specializing in writing insurance and reinsurance related to various financial products. It writes on behalf of affiliated insurance companies. It has been in operation since 2004.

HCC Underwriting Agency

HCC Underwriting Agency, Ltd. (UK) is a managing agent for two Lloyd s of London syndicates, Syndicates 4040 and 4141. HCC Underwriting Agency, Ltd. (UK) has been in operation since 2004.

HCC Medical Insurance Services

HCC Medical Insurance Services, LLC, based in Indianapolis, Indiana, is an underwriting agency specializing in domestic and international short-term medical insurance, which is written principally through an internet platform. The domestic business is written on behalf of one of our domestic insurance companies and the international business is written by Lloyd s of London Syndicate 4141.

Other Operations

In the past, we invested in insurance related entities, had a trading portfolio of securities and issued a mortgage guaranty contract, which was accounted for utilizing deposit accounting. We have sold the trading portfolio and the investments and have commuted the mortgage guaranty contract. The income and gains and losses from these items are included in other operating income, together with other miscellaneous income and income related to two mortgage impairment insurance contracts which, while written as insurance policies, receive accounting treatment as derivative financial instruments.

Other operating income was $34.4 million in 2009, $9.6 million in 2008 and $43.5 million in 2007, and varied considerably from period to period depending on the amount of trading, investment or disposition activity and, in 2009, from the commutation.

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Operating Ratios

Premium to Surplus Ratio

Our insurance companies are subject to regulation and supervision by the jurisdictions in which they do business. Statutory accounting is generally based on a liquidation concept with the intent to protect the policyholders. This table shows the ratio of statutory gross written premium and net written premium to statutory policyholders surplus for our property and casualty insurance companies (dollars in thousands):

	2009	2008	2007	2006	2005
Gross written premium	$ 2,568,609	$ 2,510,612	$ 2,460,498	$ 2,243,843	$ 2,049,116
Net written premium	2,052,309	2,064,091	1,985,641	1,812,896	1,495,931
Policyholders surplus	2,103,892	1,852,684	1,744,889	1,342,054	1,110,268
Gross written premium ratio	122.1%	135.5%	141.0%	167.2%	184.6%
Gross written premium industry average(1)	*	180.5%	160.7%	171.0%	192.7%
Net written premium ratio	97.5%	111.4%	113.8%	135.1%	134.7%
Net written premium industry average(1)	82.2%**	93.5%	84.2%	90.4%	99.8%

(1) Source: A.M. Best Company, Inc.

* Not available

** Estimated by A.M. Best Company, Inc.

While there is no statutory requirement regarding a permissible premium to policyholders surplus ratio, guidelines established by the National Association of Insurance Commissioners provide that a property and casualty insurer s annual statutory gross written premium should not exceed 900% and net written premium should not exceed 300% of its policyholders surplus. However, industry and rating agency guidelines place these ratios at 300% and 200%, respectively. Our property and casualty insurance companies have maintained ratios lower than such guidelines.

Combined Ratio GAAP

The underwriting experience of a property and casualty insurance company is indicated by its combined ratio. The GAAP combined ratio is a combination of the loss ratio (the ratio of incurred losses and loss adjustment expenses to net earned premium) and the expense ratio (the ratio of policy acquisition costs and other underwriting expenses, net of ceding commissions, to net earned premium). We calculate the GAAP combined ratio using financial data derived from the combined financial statements of our insurance company subsidiaries reported under accounting principles generally accepted in the United States of America (generally accepted accounting principles or GAAP). Our insurance companies GAAP loss ratios, expense ratios and combined ratios are shown in the following table:

	2009	2008	2007	2006	2005

Loss ratio	59.7%	60.4%	59.6%	59.2%	67.1%
Expense ratio	25.2	25.0	23.8	25.0	26.1
Combined ratio GAAP	84.9%	85.4%	83.4%	84.2%	93.2%

Combined Ratio Statutory

The statutory combined ratio is a combination of the loss ratio (the ratio of incurred losses and loss adjustment expenses to net earned premium) and the expense ratio (the ratio of policy acquisition costs and other underwriting expenses, net of ceding commissions, to net written premium). We calculate the statutory combined ratio using financial data derived from the combined financial statements of our insurance company subsidiaries reported in accordance with statutory accounting principles. Our insurance companies statutory loss ratios, expense ratios and combined ratios are shown in the following table:

	2009	**2008**	**2007**	**2006**	**2005**
Loss ratio	60.7%	60.8%	60.6%	60.0%	67.1%
Expense ratio	25.7	24.3	23.9	24.0	25.5
Combined ratio Statutory	86.4%	85.1%	84.5%	84.0%	92.6%
Industry average	100.6%*	103.9%	95.7%	92.5%	100.7%

* Estimated by A.M. Best Company, Inc.

The statutory ratio data is not intended to be a substitute for results of operations in accordance with GAAP. We believe including this information is useful to allow a comparison of our operating results with those of other companies in the insurance industry. The source of the industry average is A.M. Best Company, Inc. A.M. Best Company, Inc. reports insurer performance based on statutory financial data to provide more standardized comparisons among individual companies and to provide overall industry performance. This data is not an evaluation directed at investors.

Reserves

Our net loss and loss adjustment expense reserves are composed of reserves for reported losses and reserves for incurred but not reported losses (which include provisions for potential movement in reported losses, as well as for claims that have occurred but have not yet been reported to us). Reinsurance recoverables offset our gross reserves based upon the contractual terms of our reinsurance agreements. Reserves are recorded by product line and are undiscounted, except for reserves related to acquisitions.

The process of estimating our loss and loss adjustment expense reserves involves a considerable degree of judgment by management and is inherently uncertain. The recorded reserves represent management s best estimate of unpaid loss and loss adjustment expense by line of business. Because we provide insurance coverage in specialized lines of business that often lack statistical stability, management considers many factors and not just actuarial point estimates in determining ultimate expected losses and the level of net reserves required and recorded.

To record reserves on our lines of business, we utilize expected loss ratios, which management selects based on the following:

information used to price the applicable policies,

historical loss information where available,

any public industry data for that line or similar lines of business,

an assessment of current market conditions, and a claim-by-claim review by management, where actuarially homogenous data is unavailable.

Management also considers the point estimates and ranges calculated by our actuaries, together with input from our experienced underwriting and claims personnel. Our actuaries utilize standard actuarial techniques in making their actuarial point estimates. These techniques require a high degree of judgment, and changing conditions can cause fluctuations in the reserve estimates. Because of the nature and complexities of the specialized types of business we insure, management may give greater weight to the expectations of our underwriting and claims personnel, who often perform a claim by claim review, rather than to the actuarial estimates. However, we utilize the actuarial point and range estimates to monitor the adequacy and reasonableness of our recorded reserves.

Each quarter, management compares recorded reserves to the most recent actuarial point estimate and range for each line of business. If the recorded reserves vary significantly from the actuarial point estimate, management determines the reasons for the variances and may adjust the reserves up or down to an amount that, in management s judgment, is adequate based on all of the facts and circumstances considered, including the actuarial point estimates. We believe that our review process is effective, such that any required changes are recognized in the period of change as soon as the need for the change is evident. Our total consolidated net reserves have consistently been above the total actuarial point estimate but within the actuarial range.

With the exception of 2004, our net reserves historically have shown favorable development except for the effects of losses from commutations, which we have completed in the past and may negotiate in the future. Commutations can produce adverse prior year development since, under generally accepted accounting principles, any excess of undiscounted reserves assumed over assets received must be recorded as a loss at the time the commutation is completed. Economically, the loss generally represents the discount for the time value of money that will be earned over the payout of the reserves; thus, the loss may be recouped as investment income is earned on the assets received. Based on our reserving techniques and our past results, we believe that our net reserves are adequate.

The reserving process is intended to reflect the impact of inflation and other factors affecting loss payments by taking into account changes in historical payment patterns and perceived trends. There is no precise method for the subsequent evaluation of the adequacy of the consideration given to inflation, or to any other specific factor, or to the way one factor may impact another.

We underwrite risks that are denominated in a number of foreign currencies and, therefore, maintain loss reserves with respect to these policies in the respective currencies. These reserves are subject to exchange rate fluctuations, which may have an effect on our net earnings. Generally, we match the reserves denominated in foreign currencies with assets denominated in the same currency resulting in a natural economic hedge that mitigates the effects of exchange rate fluctuation.

The loss development triangles show changes in our reserves in subsequent years from the prior loss estimates, based on experience at the end of each succeeding year, on the basis of generally accepted accounting principles. The estimate is increased or decreased as more information becomes known about the frequency and severity of losses for individual years. A redundancy means the original estimate was higher than the current estimate; a deficiency means that the current estimate is higher than the original estimate.

The first line of each loss development triangle presents, for the years indicated, our gross or net reserve liability, including the reserve for incurred but not reported losses. The first section of each table shows, by year, the cumulative amounts of loss and loss adjustment expense paid at the end of each succeeding year. The second section sets forth the re-estimates in later years of incurred losses, including payments, for the years indicated. The cumulative redundancy (deficiency) represents, at the date indicated, the difference between the latest re-estimated liability and the reserves as originally estimated.

This loss development triangle shows development in loss reserves on a gross basis (in thousands):

9	2008	2007	2006	2005	2004	2003	2002	2001
,309	$ 3,415,230	$ 3,227,080	$ 3,097,051	$ 2,813,720	$ 2,089,199	$ 1,525,313	$ 1,158,915	$ 1,132,258
	24,897	57,028	48,119	26,088	6,113		5,587	
,309	3,440,127	3,284,108	3,145,170	2,839,808	2,095,312	1,525,313	1,164,502	1,132,258
	887,040	902,352	797,217	689,126	511,766	396,077	418,809	390,232
		1,305,179	1,260,672	1,077,954	780,130	587,349	548,941	612,129
			1,527,443	1,385,011	993,655	772,095	659,568	726,805
				1,578,970	1,144,350	866,025	823,760	803,152
					1,231,166	1,002,058	886,458	921,920
						1,092,558	1,003,780	1,009,049
							1,078,739	1,101,393
								1,167,307
,309	3,440,127	3,284,108	3,145,170	2,839,808	2,095,312	1,525,313	1,164,502	1,132,258
	3,349,692	3,244,195	3,054,549	2,836,507	2,124,584	1,641,426	1,287,003	1,109,098
		3,070,059	2,966,388	2,725,035	2,118,416	1,666,931	1,393,143	1,241,261
			2,784,998	2,657,565	2,031,246	1,690,729	1,464,448	1,384,608
				2,518,263	2,008,590	1,619,744	1,506,360	1,455,046
					1,943,902	1,639,621	1,453,674	1,480,193
						1,617,970	1,467,540	1,433,630
							1,463,702	1,462,481
								1,452,706
	$ 90,435	$ 214,049	$ 360,172	$ 321,545	$ 151,410	$ (92,657)	$ (299,200)	$ (320,448)

The gross redundancies reflected in the above table for 2004 through 2008 resulted primarily from the following activity:

Excluding certain business described below, during 2009, 2008 and 2007, we recorded favorable development of $175.2 million, $106.2 million and $44.1 million, respectively. Most of this was from the 2002 2006 underwriting years in: 1) our diversified financial products line of business, primarily in our directors and officers liability, U.K. professional indemnity and U.S. surety products, 2) our London market account, which includes redundancies on the 2005 hurricanes, and 3) an assumed quota share program reported in our other specialty line of business. These changes primarily affected the 2003 through 2007 accident years.

As part of our 2009 reserve review, we re-estimated our exposure on our directors and officers liability business for the 2007 underwriting year, which resulted in $84.8 million of additional reserves in the 2007 and 2008 accident years.

During 2008, we recorded adverse development of $34.1 million on certain run-off assumed accident and health reinsurance business reported in our discontinued lines of business due to our continuing evaluation of reserves, primarily on the 2000 accident year. During 2007, we recorded favorable development of $46.5 million on the same run-off accident and health business. The combined effect of these entries was favorable development of $12.4 million.

The gross deficiencies reflected in the above table for 1999 through 2003 resulted from the following:

During 2005, 2004 and 2003, we recorded $49.8 million, $127.7 million and $132.9 million, respectively, in gross losses on certain run-off assumed accident and health reinsurance business

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reported in our discontinued lines of business, due to our processing of additional information received and our continuing evaluation of reserves on this business. Collectively, these transactions primarily affected the 1999, 2000 and 2001 accident years.

The 2000 and 1999 years were also adversely affected by late reporting of loss information received during 2001 for certain other discontinued business.

The gross reserves in the discontinued lines of business, particularly with respect to run-off assumed accident and health reinsurance business, produced substantial adverse development from 2003 through 2005. This assumed accident and health reinsurance is primarily excess coverage for large losses related to workers compensation policies. Losses tend to develop and affect excess covers considerably after the original loss was incurred. Additionally, certain primary insurance companies that we reinsured have experienced financial difficulty and some of them are in liquidation, with guaranty funds now responsible for administering the business. Losses related to this business are historically late reporting. While we attempt to anticipate these conditions in setting our gross reserves, we have only been partially successful to date, and there could be additional adverse development in these reserves in the future. The gross losses that have developed adversely have been substantially reinsured and, therefore, the net effects have been much less.

The following table provides a reconciliation of the gross liability for loss and loss adjustment expense payable on the basis of generally accepted accounting principles (in thousands):

	2009	2008	2007
Gross reserves for loss and loss adjustment expense payable at beginning of year	$ 3,415,230	$ 3,227,080	$ 3,097,051
Gross reserve additions from acquired businesses	37,839	32,131	826
Foreign currency adjustment	31,844	(102,777)	34,202
Incurred loss and loss adjustment expense:			
Provision for loss and loss adjustment expense for claims occurring in current year	1,579,331	1,707,538	1,443,031
Decrease in estimated loss and loss adjustment expense for claims occurring in prior years*	(90,435)	(72,044)	(90,621)
Incurred loss and loss adjustment expense	1,488,896	1,635,494	1,352,410
Loss and loss adjustment expense payments for claims occurring during:			
Current year	594,460	474,346	460,192
Prior years	887,040	902,352	797,217
Loss and loss adjustment expense payments	1,481,500	1,376,698	1,257,409
Gross reserves for loss and loss adjustment expense payable at end of year	$ 3,492,309	$ 3,415,230	$ 3,227,080

*

Changes in loss and loss adjustment expense reserves for losses occurring in prior years reflect the gross effect of the resolution of losses for other than the reserve value and the subsequent adjustments of loss reserves.

The activities that caused the 2004 2008 redundancies reported in the gross triangle and explained previously are the same activities that caused the gross redundant development for 2007 through 2009 reported in the above reconciliation.

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This loss development triangle shows development in loss reserves on a net basis (in thousands):

9	2008	2007	2006	2005	2004	2003	2002	2001	2
,840	$ 2,416,271	$ 2,342,800	$ 2,108,961	$ 1,533,433	$ 1,059,283	$ 705,200	$ 458,702	$ 313,097	$ 2
	23,498	52,551	44,410	24,318	5,777		5,587		
,840	2,439,769	2,395,351	2,153,371	1,557,751	1,065,060	705,200	464,289	313,097	2
	618,699	687,675	556,096	222,336	172,224	141,677	115,669	126,019	1
		940,636	858,586	420,816	195,663	135,623	152,674	131,244	1
			1,013,122	588,659	337,330	124,522	115,214	163,808	1
				702,072	424,308	217,827	88,998	93,405	1
					495,642	313,315	155,708	59,936	1
						376,903	242,904	125,311	1
							301,828	186,224	1
								236,299	2
									2

5,840	2,439,769	2,395,351	2,153,371	1,557,751	1,065,060	705,200	464,289	313,097	2
	2,386,245	2,342,033	2,126,974	1,551,225	1,090,454	735,678	487,403	306,318	2
		2,223,731	2,042,277	1,524,732	1,089,732	770,497	500,897	338,194	2
			1,917,156	1,450,866	1,083,749	792,099	571,403	366,819	2
				1,367,143	1,046,110	808,261	585,741	418,781	2
					1,018,235	794,740	613,406	453,537	2
						792,896	597,666	462,157	3
							602,546	455,279	3
								452,221	3
									3
	$ 53,524	$ 171,620	$ 236,215	$ 190,608	$ 46,825	$ (87,696)	$ (138,257)	$ (139,124)	$

The net redundancies reflected in the above table for 2004 through 2008 resulted primarily from the following:

During 2009, 2008 and 2007, we recorded favorable development of $53.5 million, $82.4 millino and $26.4 million, respectively. Most of this was from the 2002 2006 underwriting years in: 1) our diversified financial products line of business, primarily in our directors and officers liability, U.K. professional indemnity and U.S. surety products, 2) our London market account, which includes redundancies on the 2005 hurricanes, and 3) an assumed quota share program reported in our other specialty line of business. These changes primarily affected the 2003 through 2007 accident years. As part of our 2009 reserve review, we re-estimated our exposure on our directors and officers liability 2007 underwriting year, which resulted in additional reserves for the 2007 and 2008 accident years.

Reserve reductions in 2006 on prior years hurricanes and aviation, affecting primarily the 2004 and 2005 accident years.

The net deficiencies reflected in the above table for 1999 through 2003 resulted primarily from activity on certain run-off assumed accident and health business reported in our discontinued lines of business, as follows:

Commutation charges of $20.2 million, $26.0 million and $28.8 million recorded in 2006, 2005 and 2003, respectively.

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Reserve strengthening of $27.3 million in 2004 to bring net reserves for this discontinued line of business above our actuarial point estimate.

Collectively, these transactions primarily affected the 1999, 2000 and 2001 accident years.

The table below provides a reconciliation of the liability for loss and loss adjustment expense payable, net of reinsurance ceded, on the basis of generally accepted accounting principles (in thousands):

	2009	2008	2007
Net reserves for loss and loss adjustment expense payable at beginning of year	$ 2,416,271	$ 2,342,800	$ 2,108,961
Net reserve additions from acquired businesses	36,522	29,053	742
Foreign currency adjustment	25,067	(82,677)	27,304
Incurred loss and loss adjustment expense:			
Provision for loss and loss adjustment expense for claims occurring in current year	1,269,283	1,294,244	1,210,344
Decrease in estimated loss and loss adjustment expense for claims occurring in prior years*	(53,524)	(82,371)	(26,397)
Incurred loss and loss adjustment expense	1,215,759	1,211,873	1,183,947
Loss and loss adjustment expense payments for claims occurring during:			
Current year	519,080	397,103	422,058
Prior years	618,699	687,675	556,096
Loss and loss adjustment expense payments	1,137,779	1,084,778	978,154
Net reserves for loss and loss adjustment expense payable at end of year	$ 2,555,840	$ 2,416,271	$ 2,342,800

* Changes in loss and loss adjustment expense reserves for losses occurring in prior years reflect the net effect of the resolution of losses for other than the reserve value and the subsequent adjustments of loss reserves.

The activities that caused the 2004 2008 redundancies reported in the net triangle and explained previously are the same activities that caused the net redundant development for 2007 through 2009 reported in the above reconciliation.

Deficiencies and redundancies in the reserves occur as we continually review our loss reserves with our actuaries, increasing or reducing loss reserves as a result of such reviews and as losses are finally settled and claims exposures are reduced. We believe we have provided for all material net incurred losses.

We write directors and officers liability, errors and omission liability and fiduciary liability coverages for public and private companies and not-for-profit organizations. Certain of this business is written for financial institutions that have potential exposure to shareholder lawsuits as a result of the current economic environment during the last few years. We also write trade credit business for policyholders who have credit and political risk exposure. We continue to closely monitor our exposure to subprime and credit market related issues. Based on our present knowledge, we believe our ultimate losses from these coverages will be contained within our current overall loss reserves for this business.

We have no material exposure to asbestos claims or environmental pollution losses. Our largest insurance company subsidiary only began writing business in 1981, and its policies normally contain pollution exclusion clauses that limit pollution coverage to sudden and accidental losses only, thus excluding intentional dumping and seepage claims. Policies issued by our other insurance company subsidiaries do not have significant environmental exposures because of the types of risks covered.

Enterprise Risk Management

Our Enterprise Risk Management (ERM) process provides us with a structured approach to identify, manage, report and respond to downside risks or threats, as well as business opportunities. This process enables us to assess risks in a more consistent and transparent manner, resulting in improved recognition, management and monitoring of risk. The key objectives of our ERM process are to support our decision making and to promote a culture of risk awareness throughout the organization, thereby allowing us to grow shareholders equity and preserve capital, while achieving a consistent return on average equity.

Our ERM initiative is supported by the Enterprise Risk Oversight Committee of our Board of Directors. Our internal risk management functions are led by a Corporate Vice President of our Enterprise Risk Management Department, who reports to the President and Chief Executive Officer, A Risk Committee that reports to the President and Chief Executive Officer assists the Board in risk assessment.

We use a variety of methods and tools company-wide in our risk assessment and management efforts. Our key methods and tools include: 1) underwriting risk management, where underwriting authority limits are set, 2) natural catastrophe risk management, where a variety of catastrophe modeling techniques, both internal and external, are used to monitor loss exposures, 3) a Reinsurance Security Policy Committee, which is responsible for monitoring reinsurers, reinsurance recoverable balances and changes in a reinsurer s financial condition, 4) investment risk management, where the Investment and Finance Committee of our Board of Directors provides oversight of our capital and financial resources, and our investment policies, strategies, transactions and investment performance, and 5) the use of outside experts to perform scenario testing, where deemed beneficial. We plan to continue to invest in resources and technology to support our ERM process.

Regulation

The business of insurance is extensively regulated by the government. At this time, the insurance business in the United States is regulated primarily by the individual states. Additional federal regulation of the insurance industry may occur in the future.

Our business depends on our compliance with applicable laws and regulations and our ability to maintain valid licenses and approvals for our operations. We devote a significant effort to obtain and maintain our licenses and to comply with the diverse and complex regulatory structure. In all jurisdictions, the applicable laws and regulations are subject to amendment or interpretation by regulatory authorities. Generally, regulatory authorities are vested with broad discretion to grant, renew and revoke licenses and approvals and to implement regulations governing the business and operations of insurers, insurance agents, brokers and third party administrators.

Insurance Companies

Our insurance companies are subject to regulation and supervision by the states and by other jurisdictions in which they do business. Regulation by the states varies, but generally involves regulatory and supervisory powers exercised by a state insurance official. In the United States, the regulation and supervision of our insurance operations primarily entails:

- approval of policy forms and premium rates,
- licensing of insurers and their agents,
- periodic examinations of our operations and finances,

prescription of the form and content of records of financial condition to be filed with the regulatory authority,

required levels of deposits for the benefit of policyholders,

requiring certain methods of accounting,

requiring reserves for unearned premium, losses and other purposes, restrictions on the ability of our insurance companies to pay dividends,

restrictions on the nature, quality and concentration of investments,

restrictions on transactions between insurance companies and their affiliates,

restrictions on the size of risks insurable under a single policy, and

standards of solvency, including risk-based capital measurement (which is a measure developed by the National Association of Insurance Commissioners and used by state insurance regulators to identify insurance companies that potentially are inadequately capitalized).

In the United States, state insurance regulations are intended primarily for the protection of policyholders rather than shareholders. The state insurance departments monitor compliance with regulations through periodic reporting procedures and examinations. The quarterly and annual financial reports to the state insurance regulators utilize statutory accounting principles, which are different from the generally accepted accounting principles we use in our reports to shareholders. Statutory accounting principles, in keeping with the intent to assure the protection of policyholders, are generally based on a liquidation concept, while generally accepted accounting principles are based on a going-concern concept.

In the United States, state insurance regulators classify direct insurance companies and some individual lines of business as admitted (also known as licensed) insurance or non-admitted (also known as surplus lines) insurance. Surplus lines insurance is offered by non-admitted companies on risks that are not insured in the particular state by admitted companies. All surplus lines insurance is required to be written through licensed surplus lines insurance brokers, who are required to be knowledgeable of and to follow specific state laws prior to placing a risk with a surplus lines insurer. Our insurance companies offer products on both an admitted and surplus lines basis.

U.S. state insurance regulations also affect the payment of dividends and other distributions by insurance companies to their shareholders. Generally, insurance companies are limited by these regulations in the payment of dividends above a specified level. Dividends in excess of those thresholds are extraordinary dividends and are subject to prior regulatory approval. Many states require prior regulatory approval for all dividends.

In the United Kingdom, the Financial Services Authority supervises all securities, banking and insurance businesses, including Lloyd s of London. The Financial Services Authority oversees compliance with established periodic auditing and reporting requirements, risk assessment reviews, minimum solvency margins, dividend restrictions, restrictions governing the appointment of key officers, restrictions governing controlling ownership interests and various other requirements. All of our United Kingdom operations, including Houston Casualty Company-London, are authorized and regulated by the Financial Services Authority.

HCC Europe is domiciled in Spain and operates on the equivalent of an admitted basis throughout the European Union. HCC Europe s primary regulator is the Spanish General Directorate of Insurance and Pension Funds of the Ministry of the Economy and Treasury (Dirección General de Seguros y Fondos de Pensiones del Ministerio de Economía y Hacienda).

Underwriting Agencies

In addition to the regulation of insurance companies, the states impose licensing and other requirements on the underwriting agency and service operations of our other subsidiaries. These regulations relate primarily to:

advertising and business practice rules,

contractual requirements,

financial security,

licensing as agents, brokers, reinsurance brokers, managing general agents or third party administrators, limitations on authority, and

recordkeeping requirements.

Statutory Accounting Principles

The principal differences between statutory accounting principles for our domestic insurance company subsidiaries and generally accepted accounting principles, the method by which we report our consolidated financial results to our shareholders, are as follows:

a liability is recorded for certain reinsurance recoverables under statutory accounting principles whereas, under generally accepted accounting principles, there is no such provision unless the recoverables are deemed to be doubtful of collection,

certain assets that are considered non-admitted assets are eliminated from a balance sheet prepared in accordance with statutory accounting principles, but are included in a balance sheet prepared in accordance with generally accepted accounting principles,

only some of the deferred tax asset is recognized under statutory accounting principles,

fixed income investments classified as available for sale are recorded at fair value for generally accepted accounting principles and at amortized cost under statutory accounting principles,

outstanding losses and unearned premium are reported on a gross basis under generally accepted accounting principles and on a net basis under statutory accounting principles, and

under statutory accounting principles, policy acquisition costs are expensed as incurred and, under generally accepted accounting principles, such costs are deferred and amortized to expense as the related premium is earned.

Our international insurance company subsidiaries accounting principles are prescribed by regulatory authorities in each country. The prescribed principles do not vary significantly from generally accepted accounting principles.

Insurance Holding Company Acts

Because we are an insurance holding company, we are subject to the insurance holding company system regulatory requirements of a number of states. Under these regulations, we are required to report information regarding our capital structure, financial condition and management. We are also required to provide prior notice to, or seek the prior approval of, insurance regulatory authorities of certain agreements and transactions between our affiliated companies. These agreements and transactions must satisfy certain regulatory requirements.

Assessments

Many states require insurers licensed to do business in the state to bear a portion of the loss suffered by some insureds as a result of the insolvency of other insurers or to bear a portion of the cost of insurance for high-risk or otherwise uninsured individuals. Depending upon state law, insurers can be assessed an amount that is generally limited to between 1% and 2% of premiums written for the relevant lines of insurance in that state. Part of these payments may be recoverable through premium rates, premium tax credits or policy surcharges. Significant increases in assessments could limit the ability of our insurance subsidiaries to recover such assessments through tax credits or other means. In addition, there have been some legislative efforts to limit policy surcharges or repeal the tax offset provisions. We cannot predict the extent to which such assessments may increase or whether there may be limits imposed on our ability to recover or offset such assessments.

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Insurance Regulations Concerning Change of Control

Many state insurance regulatory laws contain provisions that require advance approval by state agencies of any change of control of an insurance company that is domiciled or, in some cases, has substantial business in that state. Control is generally presumed to exist through the ownership of 10% or more of the voting securities of a domestic insurance company or of any company that controls a domestic insurance company. HCC owns, directly or indirectly, all of the shares of stock of insurance companies domiciled in a number of states. Any purchaser of shares of common stock representing 10% or more of the voting power of our common stock will be presumed to have acquired control of our domestic insurance subsidiaries unless, following application by that purchaser, the relevant state insurance regulators determine otherwise. Any transaction that would constitute a change in control of any of our individual insurance subsidiaries would generally require prior approval by the insurance departments of the states in which the insurance subsidiary is domiciled. Also, one of our insurance subsidiaries is domiciled in the United Kingdom and another in Spain. Insurers in those countries are also subject to change of control restrictions under their individual regulatory frameworks. These requirements may deter or delay possible significant transactions in our common stock or the disposition of our insurance companies to third parties, including transactions which could be beneficial to our shareholders.

Risk-Based Capital

The National Association of Insurance Commissioners has developed a formula for analyzing insurance companies called risk-based capital. The risk-based capital formula is intended to establish minimum capital thresholds that vary with the size and mix of an insurance company s business and assets. It is designed to identify companies with capital levels that may require regulatory attention. At December 31, 2009, each of our domestic insurance companies total adjusted capital was significantly in excess of the authorized control level risk-based capital.

Insurance Regulatory Information System

The National Association of Insurance Commissioners has developed a rating system, the Insurance Regulatory Information System, primarily intended to assist state insurance departments in overseeing the financial condition of all insurance companies operating within their respective states. The Insurance Regulatory Information System consists of eleven key financial ratios that address various aspects of each insurer s financial condition and stability. Our insurance companies Insurance Regulatory Information System ratios generally fall within the usual prescribed ranges.

Terrorism Risk Insurance Act

The Federal Terrorism Risk Insurance Act (TRIA) was initially enacted in 2002 for the purpose of ensuring the availability of insurance coverage for certain acts of terrorism, as defined in the TRIA. The Terrorism Risk Insurance Extension Act of 2005 extended TRIA through December 31, 2007. In 2007, the President signed into law the Terrorism Risk Insurance Program Reauthorization Act of 2007 (Reauthorization Act). The Reauthorization Act extends the program through December 31, 2014. A major provision of the Reauthorization Act is the revision of the definition of Act of Terrorism to remove the requirement that the act of terrorism be committed by an individual acting on behalf of any foreign person or foreign interest in order to be certified under the Reauthorization Act. The Reauthorization Act sets the Federal share of compensation (subject to a $100.0 million program trigger) for program years 2008 2014 at 85%, excess of our retention level, up to the maximum annual liability cap of $100.0 billion.

Under the Reauthorization Act, we are required to offer terrorism coverage to our commercial policyholders in certain lines of business, for which we may, when warranted, charge an additional premium. The policyholders may or may not accept such coverage. The Reauthorization Act also established a deductible that each insurer would have to meet before Federal reimbursement would occur. For 2010, our deductible is approximately $122.7 million.

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Legislative Initiatives

In recent years, state legislatures have considered or enacted laws that modify and, in many cases, increase state authority to regulate insurance companies and insurance holding company systems. State insurance regulators are members of the National Association of Insurance Commissioners, which seeks to promote uniformity of and to enhance the state regulation of insurance. In addition, the National Association of Insurance Commissioners and state insurance regulators, as part of the National Association of Insurance Commissioners state insurance department accreditation program and in response to new federal laws, have re-examined existing state laws and regulations. Specifically they focused on insurance company investments, issues relating to the solvency of insurance companies, licensing and market conduct issues, streamlining agent licensing and policy form approvals, adoption of privacy rules for handling policyholder information, interpretations of existing laws, the development of new laws and the definition of extraordinary dividends.

In recent years, a variety of measures have been proposed at the federal level to reform the current process of Federal and state regulation of the financial services industries in the United States, which include the banking, insurance and securities industries. These measures, which are often referred to as financial services modernization, have as a principal objective the elimination or modification of regulatory barriers to cross-industry combinations involving banks, securities firms and insurance companies. Also, the Federal government has from time to time considered whether to impose overall federal regulation of insurers. If so, we believe state regulation of the insurance business would likely continue. This could result in an additional layer of federal regulation. In addition, some insurance industry trade groups are actively lobbying for legislation that would allow an option for a separate Federal charter for insurance companies. The full extent to which the Federal government could decide to directly regulate the business of insurance has not been determined by lawmakers.

State regulators in many states have initiated or are participating in industry-wide investigations of sales and marketing practices in the insurance industry. Such investigations have resulted in restitution and settlement payments by some companies and criminal charges against some individuals. The investigations have led to changes in the structure of compensation arrangements, the offering of certain products and increased transparency in the marketing of many insurance products. We have cooperated fully with any such investigations and, based on presently available information, do not expect any adverse results from such investigations.

We do not know at this time the full extent to which these Federal or state legislative or regulatory initiatives will or may affect our operations and no assurance can be given that they would not, if adopted, have a material adverse effect on our business or our results of operations.

Employees

At December 31, 2009, we had 1,864 employees. Of this number, 965 are employed by our insurance companies, 616 are employed by our underwriting agencies and 283 are employed at the corporate headquarters and elsewhere. We are not a party to any collective bargaining agreement and have not experienced work stoppages or strikes as a result of labor disputes. We consider our employee relations to be good.

Item 1A. ***Risk Factors***

Risks Relating to our Industry

Because we are a property and casualty insurer, our business may suffer as a result of unforeseen catastrophic losses.

Property and casualty insurers are subject to claims arising from catastrophes. Catastrophic losses have had a significant impact on our historical results. Catastrophes can be caused by various events, including hurricanes, tsunamis, windstorms, earthquakes, hailstorms, explosions, flooding, severe winter weather and fires and may include man-made events, such as terrorist attacks. The incidence, frequency and severity of catastrophes are inherently unpredictable. Some scientists believe that in recent years, changing climate

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conditions have added to the unpredictability and frequency of natural disasters. The extent of losses from a catastrophe is a function of both the total amount of insured exposure in the area affected by the event and the severity of the event. Insurance companies are not permitted to reserve for a catastrophe until it has occurred. Catastrophes can cause losses in a variety of our property and casualty lines, and most of our past catastrophe-related claims have resulted from hurricanes and earthquakes; however, we experienced a significant loss as a result of the September 11, 2001 terrorist attack. Most of our exposure to catastrophes comes from our London market account. Although we typically purchase reinsurance protection for risks we believe bear a significant level of catastrophe exposure, the nature or magnitude of losses attributed to a catastrophic event or events may result in losses that exceed our reinsurance protection. It is therefore possible that a catastrophic event or multiple catastrophic events could have a material adverse effect on our financial position, results of operations and liquidity.

The insurance and reinsurance business is historically cyclical, and we expect to experience periods with excess underwriting capacity and unfavorable premium rates, which could cause our results to fluctuate.

The insurance and reinsurance business historically has been a cyclical industry characterized by periods of intense price competition due to excessive underwriting capacity, as well as periods when shortages of capacity permitted an increase in pricing and, thus, more favorable premium levels. An increase in premium levels is often, over time, offset by an increasing supply of insurance and reinsurance capacity, either by capital provided by new entrants or by the commitment of additional capital by existing insurers or reinsurers, which may cause prices to decrease. Any of these factors could lead to a significant reduction in premium rates, less favorable policy terms and fewer opportunities to underwrite insurance risks, which could have a material adverse effect on our results of operations and cash flows. In addition to these considerations, changes in the frequency and severity of losses suffered by insureds and insurers may affect the cycles of the insurance and reinsurance business significantly. These factors may also cause the price of our common stock to be volatile.

Our loss reserves are based on an estimate of our future liability, which may prove to be inadequate.

We maintain loss reserves to cover our estimated liability for unpaid losses and loss adjustment expenses, including legal and other fees, for reported and unreported claims incurred at the end of each accounting period. Reserves do not represent an exact calculation of liability. Rather, reserves represent an estimate of what we expect the ultimate settlement and administration of claims will cost. These estimates, which generally involve actuarial projections, are based on our assessment of facts and circumstances then known, as well as estimates of future trends in severity of claims, frequency of claims, judicial theories of liability and other factors. These variables are affected by both internal and external events that could increase our exposure to losses, including changes in claims handling procedures, inflation, climate change, judicial trends, and legislative changes. Current events, such as the recent subprime issues, the state of the financial markets, the economic downturn and the severe decline in equity markets, may result in an increase in the number of claims and the severity of the claims reported, particularly in lines of business such as directors and officers liability, errors and omissions liability and trade credit insurance. Many of these items are not directly quantifiable in advance. Additionally, there may be a significant reporting delay between the occurrence of the insured event and the time it is reported to us. The inherent uncertainties of estimating reserves are greater for certain types of liabilities, particularly those in which the various considerations affecting the type of claim are subject to change and in which long periods of time may elapse before a definitive determination of liability is made. Reserve estimates are continually refined in a regular and ongoing process as experience develops and further claims are reported and settled. Adjustments to reserves are reflected in our results of operations in the periods in which such estimates are changed. Because setting reserves is inherently uncertain, there can be no assurance that current reserves will prove adequate in light of subsequent events, particularly in volatile economic times now being experienced and the often related changes in behavior of claimants and policyholders, including an increase in fraudulent reporting of exposures and/or losses, reduced maintenance of insured properties or increased frequency of small claims. If actual claims prove to be greater than our reserves, our financial position, results of operations and liquidity may be materially adversely affected.

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We may be impacted by claims relating to the recent credit market downturn and subprime insurance exposures.

We write corporate directors and officers liability, errors and omissions liability and other insurance coverages for financial institutions and financial services companies. We also write trade credit business for policyholders who have credit and political risk. The recent financial downturn has had an impact on this segment of the industry. As a result, this industry segment has been the subject of heightened scrutiny and, in some cases, investigations by regulators with respect to the industry s actions. These events may give rise to increased claims litigation, including class action suits, which may involve our insureds. To the extent that the frequency or severity of claims relating to these events exceeds our current estimates used for establishing reserves, it could increase our exposure to losses from such claims and could have a material adverse effect on our financial condition and results of operations.

The effects of emerging claim and coverage issues on our business are uncertain.

As industry practices and legal, judicial, social and other environmental conditions change, unexpected and unintended liability for claims and coverage may emerge. These changing conditions may adversely affect our business by either extending coverage beyond our underwriting intent or by increasing the number or size of claims. In some instances, these changes may not become apparent until some time after we have issued insurance or reinsurance contracts that are affected by the changes. As a result, the full extent of liability under our insurance or reinsurance contracts may not be known for many years after a contract is issued and our financial position and results of operations may be materially adversely affected.

We are subject to extensive governmental regulation.

We are subject to extensive governmental regulation and supervision. Our business depends on compliance with applicable laws and regulations and our ability to maintain valid licenses and approvals for our operations. Most insurance regulations are designed to protect the interests of policyholders rather than shareholders and other investors. In the United States, this regulation is generally administered by departments of insurance in each state in which we do business and includes a comprehensive framework of oversight of our operations and review of our financial position. U.S. Federal legislation may lead to additional federal regulation of the insurance industry in the coming years. Also, foreign governments regulate our international operations. Each foreign jurisdiction has its own unique regulatory framework that applies to our operations in that jurisdiction. Regulatory authorities have broad discretion to grant, renew or revoke licenses and approvals. Regulatory authorities may deny or revoke licenses for various reasons, including the violation of regulations. In some instances, we follow practices based on our interpretations of regulations, or those we believe to be generally followed by the industry, which ultimately may be different from the requirements or interpretations of regulatory authorities. If we do not have the requisite licenses and approvals and do not comply with applicable regulatory requirements, the insurance regulatory authorities could preclude or temporarily suspend us from carrying on some or all of our activities or otherwise penalize us. That type of action could have a material adverse effect on our results of operations. Also, changes in the level of regulation of the insurance industry (whether federal, state or foreign), or changes in laws or regulations themselves or interpretations by regulatory authorities, could have a material adverse effect on our business. Virtually all states require insurers licensed to do business in that state to bear a portion of the loss suffered by some insureds as the result of impaired or insolvent insurance companies. In addition, states have from time to time passed legislation that has the effect of limiting the ability of insurers to manage catastrophe risk, such as legislation limiting insurers ability to increase rates and prohibiting insurers from withdrawing from catastrophe-exposed areas. The effect of these arrangements could materially adversely affect our results of operations.

The extreme turmoil in the financial markets, combined with a new Congress and Presidential administration in the U.S. has increased the likelihood of changes in the way the financial services industry is regulated and how health care insurance is provided. It is possible that insurance regulation will be drawn into this process, and that federal regulatory initiatives in the insurance industry could emerge and new regulations could be implemented, possibly on an expedited basis. The future impact of any such initiatives and any resulting regulations on our results of operations or our financial condition cannot be determined at this time.

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The European Union is phasing in a new regulatory regime for the regulation of financial services known as Solvency II , which is built on a risk-based approach to setting capital requirements for insurers and reinsurers. Solvency II is expected to be implemented in 2012. We could be impacted by the implementation of Solvency II, depending on the costs associated with implementation by each EU country, any increased capitalization requirements applicable to us and any costs associated with adjustments to our operations.

Our reliance on brokers subjects us to their credit risk.

In accordance with industry practice, we generally pay amounts owed on claims under our insurance and reinsurance contracts to brokers, and these brokers, in turn, pay these amounts to the clients that have purchased insurance or reinsurance from us. Although the law is unsettled and depends upon the facts and circumstances of the particular case, in some jurisdictions, if a broker fails to make such a payment, we might remain liable to the insured or ceding insurer for the deficiency. Conversely, in certain jurisdictions, when the insured or ceding insurer pays premiums for these policies to brokers for payment over to us, these premiums might be considered to have been paid and the insured or ceding insurer will no longer be liable to us for those amounts, whether or not we have actually received the premiums from the broker. Consequently, we assume a degree of credit risk associated with brokers with whom we transact business. However, due to the unsettled and fact-specific nature of the law, we are unable to quantify our exposure to this risk.

Consolidation in the insurance industry could adversely impact us.

Insurance industry participants may seek to consolidate through mergers and acquisitions. Continued consolidation within the insurance industry will further enhance the already competitive underwriting environment as we would likely experience more robust competition from larger, better capitalized competitors. These consolidated entities may use their enhanced market power and broader capital base to take business from us or to drive down pricing, which could adversely affect our operations.

Risks Relating to our Business

Our inability to accurately assess underwriting risk could reduce our net earnings.

Our underwriting success is dependent on our ability to accurately assess the risks associated with the business on which the risk is retained. We rely on the experience of our underwriting staff in assessing these risks. If we fail to assess accurately the risks we retain, we may fail to establish appropriate premium rates and our reserves may be inadequate to cover our losses, which could reduce our net earnings. The underwriting process is further complicated by our exposure to unpredictable developments, including earthquakes, weather-related events and other natural catastrophes, as well as war and acts of terrorism and those that may result from the current volatility in the financial markets and the economic downturn.

Retentions in various lines of business expose us to potential losses.

We retain risk for our own account on business underwritten by our insurance companies. The determination to reduce the amount of reinsurance we purchase or not to purchase reinsurance for a particular risk or line of business is based on a variety of factors including market conditions, pricing, availability of reinsurance, the level of our capital and our loss history. Such determinations have the effect of increasing our financial exposure to losses associated with such risks or in such line of business, and in the event of significant losses associated with such risks or lines of business, could have a material adverse effect on our financial position, results of operations and cash flows.

If we are unable to purchase adequate reinsurance protection for some of the risks we have underwritten, we will be exposed to any resulting unreinsured losses.

We purchase reinsurance for a portion of the risks underwritten by our insurance companies, especially volatile and catastrophe-exposed risks. Market conditions beyond our control determine the availability and cost of the reinsurance protection we purchase. In addition, the historical results of reinsurance programs and the availability of capital also affect the availability of reinsurance. Our reinsurance facilities are generally subject to annual renewal. We cannot assure that we can maintain our current reinsurance facilities or that we can obtain other reinsurance facilities in adequate amounts and at favorable rates. Further, we cannot determine what effect catastrophic losses will have on the reinsurance market in general and on our ability to obtain reinsurance in adequate amounts and, in particular, at favorable rates. If we are unable to renew or to obtain new reinsurance facilities on acceptable terms, either our net exposures would increase or, if we are unwilling to bear such an increase in exposure, we would have to reduce the level of our underwriting commitments, especially in catastrophe-exposed risks. Either of these potential developments could have a material adverse effect on our financial position, results of operations and cash flows.

If the companies that provide our reinsurance do not pay all of our claims, we could incur severe losses.

We purchase reinsurance by transferring, or ceding, all or part of the risk we have assumed as a direct insurer to a reinsurance company in exchange for all or part of the premium we receive in connection with the risk. Through reinsurance, we have the contractual right to collect the amount reinsured from our reinsurers. Although reinsurance makes the reinsurer liable to us to the extent the risk is transferred or ceded to the reinsurer, it does not relieve us, the reinsured, of our full liability to our policyholders. Accordingly, we bear credit risk with respect to our reinsurers. We cannot assure that our reinsurers will pay all of our reinsurance claims, or that they will pay our claims on a timely basis. Additionally, catastrophic losses from multiple direct insurers may accumulate within the more concentrated reinsurance market and result in claims that adversely impact the financial condition of such reinsurers and thus their ability to pay such claims. Further, additional adverse developments in the capital markets could affect our reinsurers ability to meet their obligations to us. If we become liable for risks we have ceded to reinsurers or if our reinsurers cease to meet their obligations to us, because they are in a weakened financial position as a result of incurred losses or otherwise, our financial position, results of operations and cash flows could be materially adversely affected.

As a direct insurer, we may have significant exposure for terrorist acts.

To the extent that reinsurers have excluded coverage for terrorist acts or have priced such coverage at rates that we believe are not practical, we, in our capacity as a direct insurer, do not have reinsurance protection and are exposed for potential losses as a result of any terrorist acts. To the extent an act of terrorism is certified by the Secretary of Treasury, we may be covered under the Terrorism Risk Insurance Program Reauthorization Act of 2007, for up to 85% of our losses in 2010 up to the maximum amount set out in the Reauthorization Act. However, any such coverage would be subject to a mandatory deductible. Our deductible under the Reauthorization Act during 2010 is approximately $122.7 million.

In some jurisdictions outside of the United States, where we also have exposure to a loss from an act of terrorism, we have limited access to other government programs that may mitigate our exposure. If we become liable for risks that are not covered under the Reauthorization Act, our financial position, results of operations and cash flows could be materially adversely affected. In addition, because this law is relatively new and its interpretation is untested, there may be uncertainty as to how it will be applied to specific circumstances.

We may be unsuccessful in competing against larger or more well-established business rivals.

In our specialty insurance operations, we compete in narrowly-defined niche classes of business such as the insurance of private aircraft (aviation), directors and officers liability (diversified financial products), employer sponsored, self-insured medical plans (medical stop-loss), errors and omissions liability (diversified financial products) and surety (diversified financial products), as distinguished from such general lines of business as automobile or homeowners insurance. We compete with a large number of other companies in our selected lines of business, including: Lloyd s of London, ACE and XL in our London market business; American International Group and U.S. Aviation Insurance Group (a subsidiary of Berkshire Hathaway, Inc.) in our aviation line of business; United

Health and Symetra Financial Corp. in our group life, accident and health business; and American International Group, The Chubb Corporation, ACE, St. Paul Travelers and XL in our diversified financial products business. We face competition from specialty insurance companies, standard insurance companies and underwriting agencies, as well as from diversified financial services companies that are larger than we are and that have greater financial, marketing and other resources than we do. Some of these competitors also have longer experience and more market recognition than we do in certain lines of business. Furthermore, due to continuing volatility in the financial markets and related negative economic impact, the U.S. government has intervened in the operations of some of our competitors, which could lead to increased competition on uneconomic terms in certain of our lines of business. In addition to competition in the operation of our business, we face competition from a variety of sources in attracting and retaining qualified employees. We cannot assure you that we will maintain our current competitive position in the markets in which we operate, or that we will be able to expand our operations into new markets. If we fail to do so, our results of operations and cash flows could be materially adversely affected.

If rating agencies downgrade our financial strength ratings, our business and competitive position in the industry may suffer.

Ratings have become an increasingly important factor in establishing the competitive position of insurance companies. Our insurance companies are rated by Standard & Poor s Corporation, Fitch Ratings, Moody s Investors Service, Inc. and A.M. Best Company, Inc. The financial strength ratings reflect their opinions of an insurance company s and insurance holding company s financial strength, operating performance, strategic position and ability to meet its obligations to policyholders and are not evaluations directed to investors. Our ratings are subject to periodic review by those entities, and the continuation of those ratings at current levels cannot be assured. If our ratings are reduced from their current levels, it could affect our ability to compete for high quality business and, thus, our financial position and results of operations could be adversely affected.

We may require additional capital or funds for liquidity in the future, which may not be available or may only be available on unfavorable terms.

Our future capital and liquidity requirements depend on many factors, including our ability to write new business successfully, to establish premium rates and reserves at levels sufficient to cover losses, and to maintain our current line of credit. We may need to raise additional funds through financings or curtail our growth and reduce our assets. Any equity or debt financing, if available at all in this period of stress in the financial markets, may be on terms that are not favorable to us. In the case of equity financings, dilution to our shareholders could result and, in any case, such securities may have rights, preferences and privileges that are senior to those of our common stock. If we cannot obtain adequate capital or funds for liquidity on favorable terms or at all, our business, results of operations and liquidity could be adversely affected. We may also be pre-empted from making acquisitions.

Standard & Poor s Corporation, Fitch Ratings, Moody s Investors Service, Inc. and A.M. Best Company rate our credit strength. If our credit ratings are reduced, it might significantly impede our ability to raise capital and borrow money, which could materially affect our business, results of operations and liquidity.

We may be unable to attract and retain qualified employees.

We depend on our ability to attract and retain experienced underwriting talent and other skilled employees who are knowledgeable about our business. Certain of our senior underwriters and other skilled employees have employment agreements that are for definite terms, and there is no assurance we will retain these employees beyond the current terms of their agreements. If the quality of our underwriting team and other personnel decreases, we may be unable to maintain our current competitive position in the specialized markets in which we operate and be unable to expand our operations into new markets, which could materially adversely affect our business.

We invest a significant amount of our assets in securities that have experienced market fluctuations, which may greatly reduce the value of our investment portfolio, reduce investment income or generate realized investment losses.

At December 31, 2009, $4.6 billion of our $5.5 billion investment portfolio was invested in fixed income securities. The fair value of these fixed income securities and the related investment income fluctuate depending on general economic and market conditions, including the continuing volatilities in the market and economy as a whole. For our fixed income securities, the fair value generally increases or decreases in an inverse relationship with fluctuations in interest rates, while net investment income realized by us from future investments in fixed income securities will generally increase or decrease with interest rates. Mortgage-backed and other asset-backed securities may have different net investment income and/or cash flows from those anticipated at the time of investment. These securities have prepayment risk when there is a risk that the timing of cash flows that result from the repayment of principal might occur earlier than anticipated because of declining interest rates or extension risk when cash flows may be received later than anticipated because of rising interest rates. For mortgage-backed securities, credit risk exists if mortgagees default on the underlying mortgages. Notwithstanding the relatively low historical rates of default on many of these obligations, during an economic downturn, our municipal bond portfolio could be subject to a higher risk of default or impairments due to declining municipal tax bases and revenue. Although we maintain an investment grade portfolio (97% are rated A or better), all of our fixed income securities are subject to credit risk. If any of the issuers of our fixed income securities suffer financial setbacks, the ratings on the fixed income securities could fall (with a concurrent fall in fair value) and, in a worst case scenario, the issuer could default on its financial obligations. If the issurer defaults, we could have realized losses associated with the impairment of the securities.

The impact of market fluctuations affects our financial statements. Because the majority of our fixed income securities are classified as available for sale, changes in the fair value of our securities are reflected in our other comprehensive income. Similar treatment is not available for liabilities. Therefore, interest rate fluctuations could adversely affect our financial position. Unrealized pretax net investment gains (losses) on investments in fixed income securities were $141.7 million in 2009, $(10.4) million in 2008 and $26.7 million in 2007.

In 2007 and 2008 and continuing in 2009, the financial markets and the economy have been severely affected by various events. This has impacted interest rates and has caused large writedowns in other companies financial instruments either due to the market fluctuations or the impact of the events on the debtors financial condition. The continuing turmoil in the financial markets and the economy could adversely affect the valuation of our investments and cause us to have to record other-than-temporary impairment losses on our investments, which could have a material adverse effect on our financial position and result of operations.

Our strategy of acquiring other companies for growth may not succeed.

Our strategy for growth includes growing through acquisitions of insurance industry related companies. This strategy presents risks that could have a material adverse effect on our business and financial performance, including:

- the diversion of our management s attention,
- our ability to assimilate the operations and personnel of the acquired companies,
- the contingent and latent risks associated with the past operations of, and other unanticipated problems arising in, the acquired companies,
- the need to expand management, administration and operational systems, and
- increased competition for suitable acquisition opportunities and qualified employees.

We cannot predict whether we will be able to find suitable acquisition targets nor can we predict whether we would be able to acquire these additional companies on terms favorable to us or if we will be able to successfully integrate the acquired operations into our business. We do not know if we will realize any anticipated benefits of completed acquisitions or if there will be substantial unanticipated costs associated with new acquisitions. In addition, future acquisitions by us may result in potentially dilutive issuances of our equity securities, the incurrence of additional debt and/or the recognition of potential impairment of goodwill and other intangible assets. Each of these factors could materially adversely affect our financial position and results of operations.

We are exposed to goodwill impairment risk as part of our business acquisition strategy.

We have recorded goodwill in connection with the majority of our business acquisitions. We are required to perform goodwill impairment tests at least annually and whenever events or circumstances indicate that the carrying value may not be recoverable from estimated future cash flows. As a result of our annual and other periodic evaluations, we may determine that a portion of the goodwill carrying value needs to be written down to fair value, which could materially adversely affect our financial position and results of operations.

We are an insurance holding company and, therefore, may not be able to receive dividends in needed amounts from our subsidiaries.

Historically, we have had sufficient cash flow from our non-insurance company subsidiaries to meet our corporate cash flow requirements for paying principal and interest on outstanding debt obligations, dividends to shareholders and corporate expenses. However, in the future we may rely on dividends from our insurance companies to meet these requirements. The payment of dividends by our insurance companies is subject to regulatory restrictions and will depend on the surplus and future earnings of these subsidiaries, as well as the regulatory restrictions. As a result, should our other sources of funds prove to be inadequate, we may not be able to receive dividends from our insurance companies at times and in amounts necessary to meet our obligations, which could materially adversely affect our financial position and liquidity.

Because we operate internationally, fluctuations in currency exchange rates may affect our receivable and payable balances and our reserves.

We underwrite insurance coverages that are denominated in a number of foreign currencies, and we establish and maintain our loss reserves with respect to these policies in their respective currencies. We hold assets denominated in comparable foreign currencies to economically hedge the foreign currency risk related to these reserves and other liabilities denominated in foreign currencies. Our net earnings could be adversely affected by exchange rate fluctuations if we do not hold offsetting positions. Our principal area of exposure relates to fluctuations in exchange rates between the major European currencies (particularly the British pound sterling and the Euro) and the U.S. dollar. Consequently, a change in the exchange rate between the U.S. dollar and the British pound sterling or the Euro could have a materially adverse effect on our results of operations.

Our information technology systems may fail or suffer a loss of security, which could adversely affect our business.

Our business is highly dependent upon the successful and uninterrupted functioning of our computer systems. We rely on these systems to perform actuarial and other modeling functions necessary for writing business, to process our premiums and policies, to process and make claims payments, and to prepare all of our management and external financial statements and information. The failure of these systems could interrupt our operations. In addition, in the event of a disaster such as a natural catastrophe, an industrial accident, a blackout, a computer virus, a terrorist attack or war, our systems may be inaccessible for an extended period of time. These systems failures or disruptions could result in a material adverse effect on our business results.

In addition, a security breach of our computer systems could damage our reputation or result in liability. We retain confidential information regarding our business dealings in our computer systems. We may be required to spend significant capital and other resources to protect against security breaches or to alleviate problems caused by such breaches. It is critical that these facilities and infrastructure remain secure. Despite the implementation of security measures, this infrastructure may be vulnerable to physical break-ins, computer viruses, programming errors, attacks by third parties or similar disruptive problems. In addition, we could be subject to liability if hackers were able to penetrate our network security or otherwise misappropriate confidential information.

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The administration in Washington, D.C. is a proponent of potential changes in the country s health care delivery system.

The administration is Washington, D.C. has as one of its key goals to significantly increase the percentage of the population that is covered for health care costs. This may result in significant changes in our health care delivery system in the United States. The type and scope of changes, if any, are not known at this time, but, if changes are made, they could have a material adverse effect on the volume and profitability of our medical stop-loss, medical excess and short-term medical insurance products.

We may not be able to delay or prevent an inadequate or coercive offer for change in control and regulatory rules and required approvals might delay or deter a favorable change of control.

Our certificate of incorporation and bylaws do not have provisions that could make it more difficult for a third party to acquire a majority of our outstanding common stock. As a result, we may be more susceptible to an inadequate or coercive offer that could result in a change in control than a company whose charter documents have provisions that could delay or prevent a change in control.

Many state insurance regulatory laws contain provisions that require advance approval by state agencies of any change of control of an insurance company that is domiciled or, in some cases, has substantial business in that state. Control is generally presumed to exist through the ownership of 10% or more of the voting securities of a domestic insurance company or of any company that controls a domestic insurance company. We own, directly or indirectly, all of the shares of stock of insurance companies domiciled in a number of states. Any purchaser of shares of common stock representing 10% or more of the voting power of our common stock will be presumed to have acquired control of our domestic insurance subsidiaries unless, following application by that purchaser, the relevant state insurance regulators determine otherwise. Any transactions that would constitute a change in control of any of our individual insurance subsidiaries would generally require prior approval by the insurance departments of the states in which the insurance subsidiary is domiciled. Also, one of our insurance subsidiaries is domiciled in the United Kingdom and another in Spain. Insurers in those countries are also subject to change of control restrictions under their individual regulatory frameworks. These requirements may deter or delay possible significant transactions in our common stock or the disposition of our insurance companies to third parties, including transactions that could be beneficial to our shareholders.

If we experience difficulties with outsourcing relationships, our ability to conduct our business might be negatively impacted.

We outsource certain business and administrative functions to third parties and may do so increasingly in the future. If we fail to develop and implement our outsourcing strategies or our third party providers fail to perform as anticipated, we may experience operational difficulties, increased costs and a loss of business that may have a material adverse effect on our results of operations or financial condition. By outsourcing certain business and administrative functions to third parties, we may be exposed to enhanced risk of data security breaches. Any breach of data security could damage our reputation and/or result in monetary damages, which, in turn, could have a material adverse effect on our results of operations or financial condition.

Item 1B. *Unresolved Staff Comments*

None.

Item 2. *Properties*

Our principal and executive offices are located in Houston, Texas, in buildings owned by Houston Casualty Company. We also maintain offices in approximately 50 locations elsewhere in the United States, the United Kingdom, Spain and Ireland. The majority of these additional locations are in leased facilities.

Our principal office facilities are as follows: