

ARCH CAPITAL GROUP LTD.  
Form 10-Q  
August 08, 2018  
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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

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

For the quarterly period ended June 30, 2018

Or

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

Commission file number: 001-16209

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

Bermuda Not applicable  
(State or other jurisdiction of incorporation or organization) (I.R.S. Employer Identification No.)

Waterloo House, Ground Floor  
100 Pitts Bay Road, Pembroke HM 08, Bermuda (441) 278-9250  
(Address of principal executive offices) (Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act. Large accelerated Filer  Accelerated Filer  Non-accelerated Filer  Smaller reporting company  Emerging growth company

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

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

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As of August 3, 2018, there were 405,299,490 common shares, \$0.0011 par value per share, of the registrant outstanding.

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PART I. FINANCIAL INFORMATION

Cautionary Note Regarding Forward-Looking Statements

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

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

- our ability to successfully implement our business strategy during “soft” as well as “hard” markets;
- acceptance of our business strategy, security and financial condition by rating agencies and regulators, as well as by brokers and our insureds and reinsureds;
- the integration of any businesses we have acquired or may acquire into our existing operations;
- our ability to maintain or improve our ratings, which may be affected by our ability to raise additional equity or debt financings, by ratings agencies’ existing or new policies and practices, as well as other factors described herein;
- general economic and market conditions (including inflation, interest rates, unemployment, housing prices, foreign currency exchange rates, prevailing credit terms and the depth and duration of a recession) and conditions specific to the reinsurance and insurance markets (including the length and magnitude of the current “soft” market) in which we operate;
- competition, including increased competition, on the basis of pricing, capacity (including alternative sources of capital), coverage terms, or other factors;
- developments in the world’s financial and capital markets and our access to such markets;
- our ability to successfully enhance, integrate and maintain operating procedures (including information technology) to effectively support our current and new business;
- the loss of key personnel;
- accuracy of those estimates and judgments utilized in the preparation of our financial statements, including those related to revenue recognition, insurance and other reserves, reinsurance recoverables, investment valuations, intangible assets, bad debts, income taxes, contingencies and litigation, and any determination to use the deposit method of accounting, which for a relatively new insurance and reinsurance company, like our company, are even more difficult to make than those made in a mature company since relatively limited historical information has been reported to us through June 30, 2018;
- greater than expected loss ratios on business written by us and adverse development on claim and/or claim expense liabilities related to business written by our insurance and reinsurance subsidiaries;
- severity and/or frequency of losses;
- claims for natural or man-made catastrophic events or severe economic events in our insurance, reinsurance and mortgage businesses could cause large losses and substantial volatility in our results of operations;
- acts of terrorism, political unrest and other hostilities or other unforecasted and unpredictable events;
- availability to us of reinsurance to manage our gross and net exposures and the cost of such reinsurance;
- the failure of reinsurers, managing general agents, third party administrators or others to meet their obligations to us;
- the timing of loss payments being faster or the receipt of reinsurance recoverables being slower than anticipated by us;
- our investment performance, including legislative or regulatory developments that may adversely affect the fair value of our investments;

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

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

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

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

a disruption caused by cyber-attacks or other technology breaches or failures on us or our business partners and service providers, which could negatively impact our business and/or expose us to litigation;

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

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

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

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**ITEM 1. CONSOLIDATED FINANCIAL STATEMENTS**

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Report of Independent Registered Public Accounting Firm

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

Results of Review of Financial Statements

We have reviewed the accompanying consolidated balance sheet of Arch Capital Group Ltd. and its subsidiaries as of June 30, 2018, and the related consolidated statements of income and of comprehensive income for the three-month and six-month periods ended June 30, 2018 and June 30, 2017, and the consolidated statements of changes in shareholders' equity and cash flows for the six-month periods ended June 30, 2018 and June 30, 2017 including the related notes (collectively referred to as the "interim financial statements"). Based on our reviews, we are not aware of any material modifications that should be made to the accompanying interim financial statements for them to be conformity with accounting principles generally accepted in the United States of America.

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

Basis for Review Results

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

/s/ PricewaterhouseCoopers LLP

PricewaterhouseCoopers LLP

New York, NY

August 8, 2018

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CONSOLIDATED BALANCE SHEETS

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

	(Unaudited)	
	June 30, 2018	December 31, 2017
Assets		
Investments:		
Fixed maturities available for sale, at fair value (amortized cost: \$14,293,121 and \$13,869,460)	\$14,128,989	\$13,876,003
Short-term investments available for sale, at fair value (amortized cost: \$1,096,532 and \$1,468,955)	1,096,798	1,469,042
Collateral received under securities lending, at fair value (amortized cost: \$236,948 and \$476,605)	236,956	476,615
Equity securities, at fair value	534,482	495,804
Other investments available for sale, at fair value (cost: \$0 and \$198,163)	—	264,989
Investments accounted for using the fair value option	4,111,611	4,216,237
Investments accounted for using the equity method	1,428,582	1,041,322
Total investments	21,537,418	21,840,012
Cash	526,628	606,199
Accrued investment income	114,307	113,133
Securities pledged under securities lending, at fair value (amortized cost: \$229,857 and \$463,181)	230,064	464,917
Premiums receivable	1,351,310	1,135,249
Reinsurance recoverable on unpaid and paid losses and loss adjustment expenses	2,727,303	2,540,143
Contractholder receivables	2,044,322	1,978,414
Ceded unearned premiums	1,014,663	926,611
Deferred acquisition costs net	569,817	535,824
Receivable for securities sold	143,809	205,536
Goodwill and intangible assets	593,008	652,611
Other assets	1,000,471	1,053,009
Total assets	\$31,853,120	\$32,051,658
Liabilities		
Reserve for losses and loss adjustment expenses	\$11,424,337	\$11,383,792
Unearned premiums	3,833,540	3,622,314
Reinsurance balances payable	411,082	323,496
Contractholder payables	2,044,322	1,978,414
Collateral held for insured obligations	257,396	240,183
Senior notes	1,733,211	1,732,884
Revolving credit agreement borrowings	572,289	816,132
Securities lending payable	236,948	476,605
Payable for securities purchased	356,583	449,186
Other liabilities	752,399	782,717
Total liabilities	21,622,107	21,805,723
Commitments and Contingencies		
Redeemable noncontrolling interests	206,105	205,922



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Shareholders' Equity		
Non-cumulative preferred shares	780,000	872,555
Convertible non-voting common equivalent preferred shares	—	489,627
Common shares (\$0.0011 par, shares issued: 569,458,341 and 549,872,226)	633	611
Additional paid-in capital	1,760,606	1,230,617
Retained earnings	9,083,202	8,562,889
Accumulated other comprehensive income (loss), net of deferred income tax	(194,157 )	118,044
Common shares held in treasury, at cost (shares: 164,021,704 and 156,938,409)	(2,266,529 )	(2,077,741 )
Total shareholders' equity available to Arch	9,163,755	9,196,602
Non-redeemable noncontrolling interests	861,153	843,411
Total shareholders' equity	10,024,908	10,040,013
Total liabilities, noncontrolling interests and shareholders' equity	\$31,853,120	\$32,051,658

See Notes to Consolidated Financial Statements

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## ARCH CAPITAL GROUP LTD. AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF INCOME

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

	(Unaudited) Three Months Ended June 30,		(Unaudited) Six Months Ended June 30,	
	2018	2017	2018	2017
<b>Revenues</b>				
Net premiums written	\$1,298,896	\$1,248,695	\$2,711,440	\$2,524,955
Change in unearned premiums	37,867	(7,821)	(139,778)	(167,064)
Net premiums earned	1,336,763	1,240,874	2,571,662	2,357,891
Net investment income	135,668	111,124	262,392	228,998
Net realized gains (losses)	(76,611)	21,735	(187,609)	55,888
Other-than-temporary impairment losses	(470)	(1,730)	(632)	(3,537)
Less investment impairments recognized in other comprehensive income, before taxes	—	—	—	—
Net impairment losses recognized in earnings	(470)	(1,730)	(632)	(3,537)
Other underwriting income	3,874	4,822	9,223	9,455
Equity in net income (loss) of investment funds accounted for using the equity method	8,472	32,706	36,541	80,794
Other income (loss)	3,113	(1,994)	3,187	(2,776)
Total revenues	1,410,809	1,407,537	2,694,764	2,726,713
<b>Expenses</b>				
Losses and loss adjustment expenses	726,153	689,860	1,363,013	1,242,430
Acquisition expenses	202,838	190,436	394,214	372,725
Other operating expenses	176,181	169,981	351,196	344,700
Corporate expenses	22,512	24,876	37,824	52,668
Amortization of intangible assets	26,472	30,824	53,208	62,118
Interest expense	30,344	28,749	60,980	57,425
Net foreign exchange (gains) losses	(53,706)	39,543	(33,985)	58,947
Total expenses	1,130,794	1,174,269	2,226,450	2,191,013
Income before income taxes	280,015	233,268	468,314	535,700
Income tax expense	(23,668)	(34,169)	(45,583)	(62,566)
Net income	\$256,347	\$199,099	\$422,731	\$473,134
Net (income) loss attributable to noncontrolling interests	(12,701)	(13,932)	(28,662)	(34,840)
Net income available to Arch	243,646	185,167	394,069	438,294
Preferred dividends	(10,403)	(11,349)	(20,840)	(22,567)
Loss on redemption of preferred shares	—	—	(2,710)	—
Net income available to Arch common shareholders	\$233,243	\$173,818	\$370,519	\$415,727
<b>Net income per common share and common share equivalent</b>				
Basic	\$0.58	\$0.43	\$0.91	\$1.03
Diluted	\$0.56	\$0.42	\$0.89	\$1.00
<b>Weighted average common shares and common share equivalents outstanding</b>				

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Basic	404,800,421	403,459,992	406,162,508	402,786,129
Diluted	413,111,205	417,733,938	415,460,756	417,421,896

See Notes to Consolidated Financial Statements

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ARCH CAPITAL GROUP LTD. AND SUBSIDIARIES  
 CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME  
 (U.S. dollars in thousands)

	(Unaudited) Three Months Ended June 30,		(Unaudited) Six Months Ended June 30,	
	2018	2017	2018	2017
Comprehensive Income				
Net income	\$256,347	\$199,099	\$422,731	\$473,134
Other comprehensive income (loss), net of deferred income tax				
Unrealized appreciation (decline) in value of available-for-sale investments:				
Unrealized holding gains (losses) arising during period	(85,271 )	92,969	(251,948 )	193,761
Reclassification of net realized (gains) losses, net of income taxes, included in net income	36,643	(17,224 )	99,104	(22,268 )
Foreign currency translation adjustments	(12,595 )	18,297	(11,313 )	21,421
Comprehensive income	195,124	293,141	258,574	666,048
Net (income) loss attributable to noncontrolling interests	(12,701 )	(13,932 )	(28,662 )	(34,840 )
Other comprehensive (income) loss attributable to noncontrolling interests	1,077	76	1,750	68
Comprehensive income available to Arch	\$183,500	\$279,285	\$231,662	\$631,276

See Notes to Consolidated Financial Statements

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ARCH CAPITAL GROUP LTD. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY  
(U.S. dollars in thousands)

	(Unaudited)	
	Six Months Ended	
	June 30,	
	2018	2017
Non-cumulative preferred shares		
Balance at beginning of year	\$872,555	\$772,555
Preferred shares redeemed	(92,555	) —
Balance at end of period	780,000	772,555
Convertible non-voting common equivalent preferred shares		
Balance at beginning of year	489,627	1,101,304
Preferred shares converted to common shares	(489,627	) (611,677 )
Balance at end of period	—	489,627
Common shares		
Balance at beginning of year	611	582
Common shares issued, net	22	27
Balance at end of period	633	609
Additional paid-in capital		
Balance at beginning of year	1,230,617	531,687
Preferred shares converted to common shares	489,608	611,653
Reversal of issue costs on preferred shares redeemed	2,710	—
All other	37,671	53,544
Balance at end of period	1,760,606	1,196,884
Retained earnings		
Balance at beginning of year	8,562,889	7,996,701
Cumulative effect of an accounting change (see Note 2)	149,794	(314 )
Balance at beginning of year, as adjusted	8,712,683	7,996,387
Net income	422,731	473,134
Net (income) loss attributable to noncontrolling interests	(28,662	) (34,840 )
Preferred share dividends	(20,840	) (22,567 )
Loss on redemption of preferred shares	(2,710	) —
Balance at end of period	9,083,202	8,412,114
Accumulated other comprehensive income (loss), net of deferred income tax		
Balance at beginning of year	118,044	(114,541 )
Unrealized appreciation (decline) in value of available-for-sale investments, net of deferred income tax:		
Balance at beginning of year	157,400	(27,641 )
Cumulative effect of an accounting change (see Note 2)	(149,794	) —
Balance at beginning of year, as adjusted	7,606	(27,641 )
Unrealized holding gains (losses) arising during period, net of reclassification adjustment	(152,844	) 171,493
Unrealized holding gains (losses) arising during period attributable to noncontrolling interests	1,885	—

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Balance at end of period	(143,353	) 143,852
Foreign currency translation adjustments, net of deferred income tax:		
Balance at beginning of year	(39,356	) (86,900 )
Foreign currency translation adjustments	(11,313	) 21,421
Foreign currency translation adjustments attributable to noncontrolling interests	(135	) 68
Balance at end of period	(50,804	) (65,411 )
Balance at end of period	(194,157	) 78,441
Common shares held in treasury, at cost		
Balance at beginning of year	(2,077,741	) (2,034,570 )
Shares repurchased for treasury	(188,788	) (16,773 )
Balance at end of period	(2,266,529	) (2,051,343 )
Total shareholders' equity available to Arch	9,163,755	8,898,887
Non-redeemable noncontrolling interests	861,153	877,456
Total shareholders' equity	\$10,024,908	\$9,776,343

See Notes to Consolidated Financial Statements

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ARCH CAPITAL GROUP LTD. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
(U.S. dollars in thousands)

	(Unaudited)	
	Six Months Ended	
	June 30,	
	2018	2017
Operating Activities		
Net income	\$422,731	\$ 473,134
Adjustments to reconcile net income to net cash provided by operating activities:		
Net realized (gains) losses	177,442	(74,985 )
Net impairment losses recognized in earnings	632	3,537
Equity in net income or loss of investment funds accounted for using the equity method and other income or loss	(13,543 )	(47,529 )
Amortization of intangible assets	53,208	62,118
Share-based compensation	35,419	42,739
Changes in:		
Reserve for losses and loss adjustment expenses, net of unpaid losses and loss adjustment expenses recoverable	(77,891 )	180,342
Unearned premiums, net of ceded unearned premiums	139,778	167,064
Premiums receivable	(236,950 )	(222,498 )
Deferred acquisition costs	(35,111 )	(53,553 )
Reinsurance balances payable	88,961	50,112
Other items, net	(57,790 )	(46,946 )
Net cash provided by operating activities	496,886	533,535
Investing Activities		
Purchases of fixed maturity investments	(16,867,570)	(19,899,326)
Purchases of equity securities	(679,663 )	(400,155 )
Purchases of other investments	(1,017,147 )	(883,704 )
Proceeds from sales of fixed maturity investments	16,090,543	19,611,680
Proceeds from sales of equity securities	622,068	473,064
Proceeds from sales, redemptions and maturities of other investments	773,298	614,494
Proceeds from redemptions and maturities of fixed maturity investments	511,448	447,941
Net settlements of derivative instruments	4,498	(5,984 )
Net sales (purchases) of short-term investments	451,901	(445,203 )
Change in cash collateral related to securities lending	176,304	175,693
Purchases of fixed assets	(13,242 )	(11,103 )
Other	49,961	33,488
Net cash provided by (used for) investing activities	102,399	(289,115 )
Financing Activities		
Redemption of preferred shares	(92,555 )	—
Purchases of common shares under share repurchase program	(173,575 )	—
Proceeds from common shares issued, net	(13,851 )	(6,838 )
Proceeds from borrowings	130,579	—
Repayments of borrowings	(373,000 )	(72,000 )
Change in cash collateral related to securities lending	(176,304 )	(175,693 )
Dividends paid to redeemable noncontrolling interests	(8,994 )	(8,994 )
Other	(4,489 )	(41,698 )
Preferred dividends paid	(20,840 )	(22,567 )

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Net cash provided by (used for) financing activities			(733,029 )	(327,790 )
Effects of exchange rate changes on foreign currency cash and restricted cash			(10,431 )	9,616
Increase (decrease) in cash and restricted cash			(144,175 )	(73,754 )
Cash and restricted cash, beginning of year			727,284	969,569
Cash and restricted cash, end of period			\$583,109	\$ 895,815
Reconciliation of cash and restricted cash within the Consolidated Balance Sheets:				
	June 30, 2018	December 31, 2017		
Cash	\$ 526,628	\$ 606,199		
Restricted cash (included in 'other assets')	\$ 56,481	\$ 121,085		
Cash and restricted cash	\$ 583,109	\$ 727,284		

See Notes to Consolidated Financial Statements

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ARCH CAPITAL GROUP LTD. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

1. General

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Arch Capital Group Ltd. (“Arch Capital”) is a Bermuda public limited liability company which provides insurance, reinsurance and mortgage insurance on a worldwide basis through its wholly-owned subsidiaries. As used herein, the “Company” means Arch Capital and its subsidiaries. The Company’s consolidated financial statements include the results of Watford Holdings Ltd. and its wholly owned subsidiaries. See Note 11.

The interim consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America (“GAAP”). All significant intercompany transactions and balances have been eliminated in consolidation. The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ materially from those estimates and assumptions. In the opinion of management, the accompanying unaudited interim consolidated financial statements reflect all adjustments (consisting of normally recurring accruals) necessary for a fair statement of results on an interim basis. The results of any interim period are not necessarily indicative of the results for a full year or any future periods. Certain information and footnote disclosures normally included in financial statements prepared in accordance with GAAP have been condensed or omitted; however, management believes that the disclosures are adequate to make the information presented not misleading. This report should be read in conjunction with the Company’s Annual Report on Form 10-K for the year ended December 31, 2017 (“2017 Form 10-K”), including the Company’s audited consolidated financial statements and related notes.

The Company has reclassified the presentation of certain prior year information to conform to the current presentation. Such reclassifications had no effect on the Company’s net income, comprehensive income, shareholders’ equity or cash flows. Tabular amounts are in U.S. Dollars in thousands, except share amounts, unless otherwise noted.

2. Recent Accounting Pronouncements

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Recently Issued Accounting Standards Adopted

The Company adopted ASU 2016-01, “Financial Instruments - Overall (Subtopic 825-10) - Recognition and Measurement of Financial Assets and Financial Liabilities,” which enhances the

reporting model for financial instruments and provides improved financial information to readers of the financial statements. Among other provisions focused on improving the recognition and measurement of financial instruments, the ASU significantly changes the income statement impact of equity instruments and the recognition of changes in fair value of financial liabilities attributable to an entity's own credit risk when the fair value option is elected. The ASU requires equity instruments that do not result in consolidation and are not accounted for under the equity method to be measured at fair value with any changes in fair value recognized in net income rather than other comprehensive income. Upon adoption of this ASU, the Company recorded a cumulative effect adjustment of \$149.8 million in retained earnings and an offsetting decrease in accumulated other comprehensive income. The adoption of this ASU did not have a material impact on the Company's financial position, cash flows, or total comprehensive income, but may increase volatility in the Company's results of operations in future periods.

The Company adopted Financial Accounting Standards Board (“FASB”) Accounting Standard Update (“ASU”) 2014-09, “Revenue from Contracts with Customers (Topic 606),” which creates a new comprehensive revenue recognition standard that serves as a single source of revenue guidance for all companies in all industries. The guidance applies to all companies that either enter into contracts with customers to transfer goods or services or enter into contracts for the transfer of non-financial assets, unless those contracts are within the scope of other standards, such as insurance contracts or financial instruments. The ASU also requires enhanced disclosures about revenue. The Company adopted

the ASU using the modified retrospective method, whereby the cumulative effect of adoption was recognized as an adjustment to retained earnings at the date of initial application. The impact of the adoption of this ASU was not material, mostly because the accounting for insurance contracts is outside of the scope of ASU 2014-09.

The Company adopted ASU 2016-18, "Statement of Cash Flows (Topic 230) - Restricted Cash," which requires that restricted cash and restricted cash equivalents be included with cash and cash equivalents in the reconciliation of beginning and ending cash on the statements of cash flows. As a result, transfers between cash and cash equivalents and restricted cash and restricted cash equivalents will no longer be presented on the statement of cash flows. The revised presentation required in this ASU is reflected in the Company's consolidated statements of cash flows for both periods presented. The adoption of this ASU did not have any effect on the Company's results of operations, financial position or comprehensive income.

Recently Issued Accounting Standards Not Yet Adopted

For information regarding accounting standards that the Company has not yet adopted, see note 3(q), "Significant

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ARCH CAPITAL GROUP LTD. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

Accounting Policies—Recent Accounting Pronouncements,” of the notes to consolidated financial statements in the Company’s 2017 Form 10-K.

3. Share Transactions

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Three-For-One Common Share Split

In May 2018, shareholders approved a proposal to amend the memorandum of association by sub-dividing the authorized common shares of Arch Capital to effect a three-for-one split of Arch Capital’s common shares. The share split changed the Company’s authorized common shares to 1.8 billion common shares (600 million previously), with a par value of \$.0011 per share (\$.0033 previously). Information pertaining to the composition of the Company’s shareholders’ equity accounts, shares and earnings per share has been retroactively restated in the accompanying financial statements and notes to the consolidated financial statements to reflect the share split.

Share-Based Compensation

During the 2018 second quarter, the Company granted 2,199,656 stock options, 1,264,931 restricted shares and units and 705,345 performance shares and units to certain employees and directors with weighted average grant-date fair values of \$7.43, \$26.56 and \$24.65, respectively. During the 2017 second quarter, the Company granted 1,477,398 stock options and 1,534,908 restricted shares and units to certain employees and directors with weighted average grant-date fair values of \$8.22 and \$32.09, respectively. The stock options were valued at the grant date using the Black-Scholes option pricing model. Such values are being amortized over the respective substantive vesting period. For awards granted to retirement-eligible employees where no service is required for the employee to retain the award, the grant date fair value is immediately recognized as compensation expense at the grant date because the employee is able to retain the award without continuing to provide service. For employees near retirement eligibility, attribution of compensation cost is recognized over the period from the grant date to the retirement eligibility date.

Share Repurchases

The board of directors of Arch Capital has authorized the investment in Arch Capital’s common shares through a share repurchase program. Since the inception of the share repurchase program, Arch Capital has repurchased 382.2 million common shares for an aggregate purchase price of \$3.86 billion. For the six months ended June 30, 2018, Arch Capital repurchased 6,522,645 shares under the share repurchase program with an aggregate purchase price of \$173.6 million. Arch Capital did not repurchase any shares under the share repurchase program during the six months ended June 30, 2017. At June 30, 2018, \$272.9 million of share repurchases were available under the program, which may be effected from time to time in open market or privately negotiated transactions through December 31, 2019. The timing and amount of the repurchase transactions under this program will depend on a variety of factors, including market conditions and corporate and regulatory considerations.

Conversion of Convertible Non-Voting Common Equivalent Preferred Shares

In March 2018, Arch Capital completed an underwritten public secondary offering of 17,022,600 common shares (split adjusted) by American International Group, Inc. (“AIG”) following transfer of 567,420 Series D convertible non-voting common equivalent preferred shares (“Series D Preferred Shares”). Proceeds from the sale of common shares pursuant to the public offering were received by AIG. At June 30, 2018, no Series D Preferred Shares were outstanding.

Series C Preferred Shares

On January 2, 2018, Arch Capital redeemed all outstanding 6.75% Series C non-cumulative preferred shares. The preferred shares were redeemed at a redemption price equal to \$25 per share, plus all declared and unpaid dividends to (but excluding) the redemption date. In accordance with GAAP, following the redemption, original issuance costs related to such shares have been removed from additional paid-in capital and recorded as a “loss on redemption of preferred shares.” Such adjustment had no impact on total shareholders’ equity or cash flows.



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## ARCH CAPITAL GROUP LTD. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

## 4. Earnings Per Common Share

The following table sets forth the computation of basic and diluted earnings per common share:

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2018	2017	2018	2017
Numerator:				
Net income	\$256,347	\$199,099	\$422,731	\$473,134
Amounts attributable to noncontrolling interests	(12,701 )	(13,932 )	(28,662 )	(34,840 )
Net income available to Arch	243,646	185,167	394,069	438,294
Preferred dividends	(10,403 )	(11,349 )	(20,840 )	(22,567 )
Loss on redemption of preferred shares	—	—	(2,710 )	—
Net income available to Arch common shareholders	\$233,243	\$173,818	\$370,519	\$415,727
Denominator:				
Weighted average common shares outstanding	404,800,42	369,027,702	399,485,135	366,436,407
Series D preferred shares (1)	—	34,432,290	6,677,373	36,349,722
Weighted average common shares and common share equivalents outstanding — basic	404,800,42	403,459,992	406,162,508	402,786,129
Effect of dilutive common share equivalents:				
Nonvested restricted shares	1,575,749	4,448,889	1,837,356	4,670,889
Stock options (2)	6,735,035	9,825,057	7,460,892	9,964,878
Weighted average common shares and common share equivalents outstanding — diluted	413,111,205	417,733,938	415,460,756	417,421,896
Earnings per common share:				
Basic	\$0.58	\$0.43	\$0.91	\$1.03
Diluted	\$0.56	\$0.42	\$0.89	\$1.00

(1) Such shares are convertible non-voting common equivalent preferred shares issued in connection with the UGC acquisition. See Note 3.

Certain stock options were not included in the computation of diluted earnings per share where the exercise price of the stock options exceeded the average market price and would have been anti-dilutive or where, when applying the treasury stock method to in-the-money options, the sum of the proceeds, including unrecognized compensation, exceeded the average market price and would have been anti-dilutive. For the 2018 second quarter and 2017 second quarter, the number of stock options excluded were 5,350,733 and 1,499,997, respectively. For the six months ended June 30, 2018 and 2017, the number of stock options excluded were 5,372,789 and 2,292,228, respectively.

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ARCH CAPITAL GROUP LTD. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

5. Segment Information

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The Company classifies its businesses into three underwriting segments — insurance, reinsurance and mortgage — and two other operating segments — ‘other’ and corporate (non-underwriting). The Company determined its reportable segments using the management approach described in accounting guidance regarding disclosures about segments of an enterprise and related information. The accounting policies of the segments are the same as those used for the preparation of the Company’s consolidated financial statements. Intersegment business is allocated to the segment accountable for the underwriting results.

The Company’s insurance, reinsurance and mortgage segments each have managers who are responsible for the overall profitability of their respective segments and who are directly accountable to the Company’s chief operating decision makers, the President and Chief Executive Officer of Arch Capital, and the Chief Financial Officer of Arch Capital. The chief operating decision makers do not assess performance, measure return on equity or make resource allocation decisions on a line of business basis. Management measures segment performance for its three underwriting segments based on underwriting income or loss. The Company does not manage its assets by underwriting segment, with the exception of goodwill and intangible assets, and, accordingly, investment income is not allocated to each underwriting segment.

The insurance segment consists of the Company’s insurance underwriting units which offer specialty product lines on a worldwide basis. Product lines include: construction and national accounts; excess and surplus casualty; lenders products; professional lines; programs; property, energy, marine and aviation; travel, accident and health; and other (consisting of alternative markets, excess workers’ compensation and surety business).

The reinsurance segment consists of the Company’s reinsurance underwriting units which offer specialty product lines on a worldwide basis. Product lines include: casualty; marine and aviation; other specialty; property catastrophe; property excluding property catastrophe (losses on a single risk, both excess of loss and pro rata); and other (consisting of life reinsurance, casualty clash and other).

The mortgage segment includes the Company’s U.S. and international mortgage insurance and reinsurance operations as well as government sponsored enterprise (“GSE”) credit-risk sharing transactions. Arch Mortgage Insurance Company and United Guaranty Residential Insurance Company (combined “Arch MI U.S.”) are approved as eligible mortgage insurers by Federal National Mortgage Association (“Fannie Mae”) and Federal Home Loan Mortgage Corporation (“Freddie Mac”), each a GSE.

The corporate (non-underwriting) segment results include net investment income, other income (loss), corporate expenses, UGC transaction costs and other, interest expense, items related to the Company’s non-cumulative preferred shares, net realized gains or losses, net impairment losses included in earnings, equity in net income or loss of investment funds accounted for using the equity method, net foreign exchange gains or losses and income taxes. Such amounts exclude the results of the ‘other’ segment.

The ‘other’ segment includes the results of Watford Re (see Note 11). Watford Re has its own management and board of directors that is responsible for the overall profitability of the ‘other’ segment. For the ‘other’ segment, performance is measured based on net income or loss.

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## ARCH CAPITAL GROUP LTD. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

The following tables summarize the Company's underwriting income or loss by segment, together with a reconciliation of underwriting income or loss to net income available to Arch common shareholders:

	Three Months Ended June 30, 2018						
	Insurance	Reinsurance	Mortgage	Sub-Total	Other	Total	
Gross premiums written (1)	\$769,372	\$490,327	\$330,990	\$1,591,202	\$175,175	\$1,696,544	
Premiums ceded	(245,265 )	(136,247 )	(50,867 )	(432,892 )	(34,589 )	(397,648 )	
Net premiums written	524,107	354,080	280,123	1,158,310	140,586	1,298,896	
Change in unearned premiums	22,342	(13,762 )	10,355	18,935	18,932	37,867	
Net premiums earned	546,449	340,318	290,478	1,177,245	159,518	1,336,763	
Other underwriting income (loss)	—	(129 )	3,315	3,186	688	3,874	
Losses and loss adjustment expenses	(357,465 )	(229,956 )	(21,591 )	(609,012 )	(117,141 )	(726,153 )	
Acquisition expenses	(90,670 )	(50,142 )	(27,737 )	(168,549 )	(34,289 )	(202,838 )	
Other operating expenses	(92,680 )	(35,678 )	(38,729 )	(167,087 )	(9,094 )	(176,181 )	
Underwriting income (loss)	\$5,634	\$24,413	\$205,736	235,783	(318 )	235,465	
Net investment income				107,761	27,907	135,668	
Net realized gains (losses)				(59,545 )	(17,066 )	(76,611 )	
Net impairment losses recognized in earnings				(470 )	—	(470 )	
Equity in net income (loss) of investment funds accounted for using the equity method				8,472	—	8,472	
Other income (loss)				3,113	—	3,113	
Corporate expenses (2)				(15,604 )	—	(15,604 )	
UGC transaction costs and other (2)				(6,908 )	—	(6,908 )	
Amortization of intangible assets				(26,472 )	—	(26,472 )	
Interest expense				(26,058 )	(4,286 )	(30,344 )	
Net foreign exchange gains (losses)				46,211	7,495	53,706	
Income before income taxes				266,283	13,732	280,015	
Income tax expense				(23,644 )	(24 )	(23,668 )	
Net income				242,639	13,708	256,347	
Dividends attributable to redeemable noncontrolling interests				—	(4,585 )	(4,585 )	
Amounts attributable to nonredeemable noncontrolling interests				—	(8,116 )	(8,116 )	
Net income available to Arch				242,639	1,007	243,646	
Preferred dividends				(10,403 )	—	(10,403 )	
Net income available to Arch common shareholders				\$232,236	\$1,007	\$233,243	
 Underwriting Ratios							
Loss ratio	65.4	% 67.6	% 7.4	% 51.7	% 73.4	% 54.3	%
Acquisition expense ratio	16.6	% 14.7	% 9.5	% 14.3	% 21.5	% 15.2	%
Other operating expense ratio	17.0	% 10.5	% 13.3	% 14.2	% 5.7	% 13.2	%

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Combined ratio	99.0	% 92.8	% 30.2	% 80.2	% 100.6	% 82.7	%
Goodwill and intangible assets	\$20,724	\$—	\$564,634	\$585,358	\$7,650	\$593,008	

Certain amounts included in the gross premiums written of each segment are related to intersegment transactions.

- (1) Accordingly, the sum of gross premiums written for each segment does not agree to the total gross premiums written as shown in the table above due to the elimination of intersegment transactions in the total.
- (2) Certain expenses have been excluded from 'corporate expenses' and reflected in 'UGC transaction costs and other.'

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## ARCH CAPITAL GROUP LTD. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

	Three Months Ended June 30, 2017						
	Insurance	Reinsurance	Mortgage	Sub-Total	Other	Total	
Gross premiums written (1)	\$743,902	\$453,186	\$336,226	\$1,533,142	\$152,813	\$1,609,659	
Premiums ceded	(247,446 )	(115,262 )	(62,314 )	(424,850 )	(12,410 )	(360,964 )	)
Net premiums written	496,456	337,924	273,912	1,108,292	140,403	1,248,695	
Change in unearned premiums	21,118	(23,222 )	(16,068 )	(18,172 )	10,351	(7,821 )	)
Net premiums earned	517,574	314,702	257,844	1,090,120	150,754	1,240,874	
Other underwriting income (loss)	—	(279 )	4,277	3,998	824	4,822	
Losses and loss adjustment expenses	(350,939 )	(207,606 )	(20,694 )	(579,239 )	(110,621 )	(689,860 )	)
Acquisition expenses	(78,872 )	(51,151 )	(25,666 )	(155,689 )	(34,747 )	(190,436 )	)
Other operating expenses	(92,267 )	(36,711 )	(32,150 )	(161,128 )	(8,853 )	(169,981 )	)
Underwriting income (loss)	\$(4,504 )	\$18,955	\$183,611	198,062	(2,643 )	195,419	
Net investment income				92,520	18,604	111,124	
Net realized gains (losses)				18,046	3,689	21,735	
Net impairment losses recognized in earnings				(1,730 )	—	(1,730 )	)
Equity in net income (loss) of investment funds accounted for using the equity method				32,706	—	32,706	
Other income (loss)				(1,994 )	—	(1,994 )	)
Corporate expenses (2)				(22,201 )	—	(22,201 )	)
UGC transaction costs and other (2)				(2,675 )	—	(2,675 )	)
Amortization of intangible assets				(30,824 )	—	(30,824 )	)
Interest expense				(25,912 )	(2,837 )	(28,749 )	)
Net foreign exchange gains (losses)				(37,821 )	(1,722 )	(39,543 )	)
Income before income taxes				218,177	15,091	233,268	
Income tax expense				(34,169 )	—	(34,169 )	)
Net income				184,008	15,091	199,099	
Dividends attributable to redeemable noncontrolling interests				—	(4,586 )	(4,586 )	)
Amounts attributable to nonredeemable noncontrolling interests				—	(9,346 )	(9,346 )	)
Net income available to Arch				184,008	1,159	185,167	
Preferred dividends				(11,349 )	—	(11,349 )	)
Net income available to Arch common shareholders				\$172,659	\$1,159	\$173,818	
Underwriting Ratios							
Loss ratio	67.8	% 66.0	% 8.0	% 53.1	% 73.4	% 55.6	%
Acquisition expense ratio	15.2	% 16.3	% 10.0	% 14.3	% 23.0	% 15.3	%
Other operating expense ratio	17.8	% 11.7	% 12.5	% 14.8	% 5.9	% 13.7	%
Combined ratio	100.8	% 94.0	% 30.5	% 82.2	% 102.3	% 84.6	%

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Goodwill and intangible assets	\$24,480	\$609	\$680,236	\$705,325	\$7,650	\$712,975
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Certain amounts included in the gross premiums written of each segment are related to intersegment transactions.

- (1) Accordingly, the sum of gross premiums written for each segment does not agree to the total gross premiums written as shown in the table above due to the elimination of intersegment transactions in the total.
- (2) Certain expenses have been excluded from 'corporate expenses' and reflected in 'UGC transaction costs and other.'

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## ARCH CAPITAL GROUP LTD. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

	Six Months Ended					
	June 30, 2018					
	Insurance	Reinsurance	Mortgage	Sub-Total	Other	Total
Gross premiums written (1)	\$ 1,592,750	\$ 1,067,810	\$ 652,168	\$ 3,312,807	\$ 389,045	\$ 3,534,758
Premiums ceded	(492,445 )	(331,977 )	(97,004 )	(921,505 )	(68,907 )	(823,318 )
Net premiums written	1,100,305	735,833	555,164	2,391,302	320,138	2,711,440
Change in unearned premiums	(15,119 )	(116,343 )	15,556	(115,906 )	(23,872 )	(139,778 )
Net premiums earned	1,085,186	619,490	570,720	2,275,396	296,266	2,571,662
Other underwriting income (loss)	—	1,103	6,731	7,834	1,389	9,223
Losses and loss adjustment expenses	(711,195 )	(371,631 )	(65,057 )	(1,147,883 )	(215,130 )	(1,363,013 )
Acquisition expenses	(175,839 )	(98,461 )	(54,304 )	(328,604 )	(65,610 )	(394,214 )
Other operating expenses	(184,654 )	(71,249 )	(77,500 )	(333,403 )	(17,793 )	(351,196 )
Underwriting income (loss)	\$ 13,498	\$ 79,252	\$ 380,590	473,340	(878 )	472,462
Net investment income				208,004	54,388	262,392
Net realized gains (losses)				(171,404 )	(16,205 )	(187,609 )
Net impairment losses recognized in earnings				(632 )	—	(632 )
Equity in net income (loss) of investment funds accounted for using the equity method				36,541	—	36,541
Other income (loss)				3,187	—	3,187
Corporate expenses (2)				(30,086 )	—	(30,086 )
UGC transaction costs and other (2)				(7,738 )	—	(7,738 )
Amortization of intangible assets				(53,208 )	—	(53,208 )
Interest expense				(51,965 )	(9,015 )	(60,980 )
Net foreign exchange gains (losses)				31,172	2,813	33,985
Income before income taxes				437,211	31,103	468,314
Income tax expense				(45,556 )	(27 )	(45,583 )
Net income				391,655	31,076	422,731
Dividends attributable to redeemable noncontrolling interests				—	(9,170 )	(9,170 )
Amounts attributable to nonredeemable noncontrolling interests				—	(19,492 )	(19,492 )
Net income available to Arch				391,655	2,414	394,069
Preferred dividends				(20,840 )	—	(20,840 )
Loss on redemption of preferred shares				(2,710 )	—	(2,710 )
Net income available to Arch common shareholders				\$ 368,105	\$ 2,414	\$ 370,519

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Underwriting Ratios

Loss ratio	65.5	% 60.0	% 11.4	% 50.4	% 72.6	% 53.0	%
Acquisition expense ratio	16.2	% 15.9	% 9.5	% 14.4	% 22.1	% 15.3	%
Other operating expense ratio	17.0	% 11.5	% 13.6	% 14.7	% 6.0	% 13.7	%
Combined ratio	98.7	% 87.4	% 34.5	% 79.5	% 100.7	% 82.0	%

Certain amounts included in the gross premiums written of each segment are related to intersegment transactions.

- (1) Accordingly, the sum of gross premiums written for each segment does not agree to the total gross premiums written as shown in the table above due to the elimination of intersegment transactions in the total.
- (2) Certain expenses have been excluded from 'corporate expenses' and reflected in 'UGC transaction costs and other.'

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## ARCH CAPITAL GROUP LTD. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

	Six Months Ended						Total
	June 30, 2017						
	Insurance	Reinsurance	Mortgage	Sub-Total	Other		
Gross premiums written (1)	\$ 1,526,183	\$ 928,968	\$ 684,849	\$ 3,139,828	\$ 306,933	\$ 3,267,649	
Premiums ceded	(481,541 )	(281,354 )	(136,239 )	(898,962 )	(22,844 )	(742,694 )	
Net premiums written	1,044,642	647,614	548,610	2,240,866	284,089	2,524,955	
Change in unearned premiums	(21,422 )	(88,061 )	(46,243 )	(155,726 )	(11,338 )	(167,064 )	
Net premiums earned	1,023,220	559,553	502,367	2,085,140	272,751	2,357,891	
Other underwriting income (loss)	—	(585 )	8,400	7,815	1,640	9,455	
Losses and loss adjustment expenses	(683,580 )	(313,060 )	(49,759 )	(1,046,399 )	(196,031 )	(1,242,430 )	
Acquisition expenses	(153,740 )	(97,298 )	(54,432 )	(305,470 )	(67,255 )	(372,725 )	
Other operating expenses	(180,393 )	(74,244 )	(74,020 )	(328,657 )	(16,043 )	(344,700 )	
Underwriting income (loss)	\$ 5,507	\$ 74,366	\$ 332,556	412,429	(4,938 )	407,491	
Net investment income				188,332	40,666	228,998	
Net realized gains (losses)				46,558	9,330	55,888	
Net impairment losses recognized in earnings				(3,537 )	—	(3,537 )	
Equity in net income (loss) of investment funds accounted for using the equity method				80,794	—	80,794	
Other income (loss)				(2,776 )	—	(2,776 )	
Corporate expenses (2)				(34,409 )	—	(34,409 )	
UGC transaction costs and other (2)				(18,259 )	—	(18,259 )	
Amortization of intangible assets				(62,118 )	—	(62,118 )	
Interest expense				(51,668 )	(5,757 )	(57,425 )	
Net foreign exchange gains (losses)				(57,666 )	(1,281 )	(58,947 )	
Income before income taxes				497,680	38,020	535,700	
Income tax expense				(62,566 )	—	(62,566 )	
Net income				435,114	38,020	473,134	
Dividends attributable to redeemable noncontrolling interests				—	(9,170 )	(9,170 )	
Amounts attributable to nonredeemable noncontrolling interests				—	(25,670 )	(25,670 )	
Net income available to Arch Preferred dividends				435,114	3,180	438,294	
Net income available to Arch common shareholders				(22,567 )	—	(22,567 )	
				\$ 412,547	\$ 3,180	\$ 415,727	
<b>Underwriting Ratios</b>							
Loss ratio	66.8	% 55.9	% 9.9	% 50.2	% 71.9	% 52.7	%
Acquisition expense ratio	15.0	% 17.4	% 10.8	% 14.6	% 24.7	% 15.8	%

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Other operating expense ratio	17.6	% 13.3	% 14.7	% 15.8	% 5.9	% 14.6	%
Combined ratio	99.4	% 86.6	% 35.4	% 80.6	% 102.5	% 83.1	%

Certain amounts included in the gross premiums written of each segment are related to intersegment transactions.

- (1) Accordingly, the sum of gross premiums written for each segment does not agree to the total gross premiums written as shown in the table above due to the elimination of intersegment transactions in the total.
- (2) Certain expenses have been excluded from 'corporate expenses' and reflected in 'UGC transaction costs and other.'

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## ARCH CAPITAL GROUP LTD. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

## 6. Reserve for Losses and Loss Adjustment Expenses

The following table represents an analysis of losses and loss adjustment expenses and a reconciliation of the beginning and ending reserve for losses and loss adjustment expenses:

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2018	2017	2018	2017
Reserve for losses and loss adjustment expenses at beginning of period	\$ 11,496,205	\$ 10,296,821	\$ 11,383,792	\$ 10,200,960
Unpaid losses and loss adjustment expenses recoverable	2,446,990	2,095,130	2,464,910	2,083,575
Net reserve for losses and loss adjustment expenses at beginning of period	9,049,215	8,201,691	8,918,882	8,117,385
Net incurred losses and loss adjustment expenses relating to losses occurring in:				
Current year	790,742	759,261	1,478,627	1,395,037
Prior years	(64,589 )	(69,401 )	(115,614 )	(152,607 )
Total net incurred losses and loss adjustment expenses	726,153	689,860	1,363,013	1,242,430
Retroactive reinsurance transaction (1)	(420,404 )	—	(420,404 )	—
Net foreign exchange (gains) losses	(118,542 )	75,295	(74,528 )	106,574
Net paid losses and loss adjustment expenses relating to losses occurring in:				
Current year	(59,022 )	(80,499 )	(95,022 )	(115,502 )
Prior years	(404,812 )	(482,046 )	(919,353 )	(946,586 )
Total net paid losses and loss adjustment expenses	(463,834 )	(562,545 )	(1,014,375 )	(1,062,088 )
Net reserve for losses and loss adjustment expenses at end of period	8,772,588	8,404,301	8,772,588	8,404,301
Unpaid losses and loss adjustment expenses recoverable	2,651,749	2,116,210	2,651,749	2,116,210
Reserve for losses and loss adjustment expenses at end of period	\$ 11,424,337	\$ 10,520,511	\$ 11,424,337	\$ 10,520,511

During the 2018 second quarter, a subsidiary of the Company entered into a retroactive reinsurance transaction (1) with a third party reinsurer to reinsure run-off liabilities associated with certain discontinued U.S. specialty casualty and program exposures.

## Development on Prior Year Loss Reserves

## 2018 Second Quarter

During the 2018 second quarter, the Company recorded net favorable development on prior year loss reserves of \$64.6 million, which consisted of \$33.0 million from the reinsurance segment, \$6.1 million from the insurance segment, \$23.3 million from the mortgage segment and \$2.2 million from the 'other' segment.

The reinsurance segment's net favorable development of \$33.0 million, or 9.7 loss ratio points, for the 2018 second quarter consisted of \$22.2 million from short-tailed lines and \$10.8 million from long-tailed and medium-tailed lines.

Favorable development in short-tailed lines included \$19.3 million from property catastrophe and property other than property catastrophe reserves, across most underwriting years (i.e., all premiums and losses attributable to contracts having an inception or renewal date within the given twelve-month period), reflecting lower levels of reported and paid claims activity than previously anticipated which led to decreases in certain loss ratio selections during the period. Favorable development in long-tailed and medium-tailed lines reflected

reductions in marine reserves of \$3.8 million, across most accident years, and in casualty reserves of \$6.9 million based on varying levels of reported and paid claims activity, primarily from the 2003 to 2010 underwriting years. The insurance segment's net favorable development of \$6.1 million, or 1.1 loss ratio points, for the 2018 second quarter consisted of \$13.9 million of net favorable development in short-tailed lines and \$14.3 million of net favorable development in long-tailed lines, partially offset by \$22.1 million of net adverse development in medium-tailed lines. Net favorable development in short-tailed lines primarily resulted from property (including special risk other than marine) reserves from the 2010 to 2017 accident years (i.e., the year in which a loss occurred) while net favorable development in long-tailed lines primarily resulted from reductions in executive assurance reserves of \$6.9 million, primarily from the 2007 to 2011 accident years, and in healthcare reserves of \$4.9 million, primarily from the 2003 accident year. Net adverse development in medium-tailed lines reflected \$11.6 million of adverse development in program business, primarily driven by a few inactive programs that were non-renewed in 2015 and early in 2016 and \$18.0 million of adverse development on

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ARCH CAPITAL GROUP LTD. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

contract binding business, primarily from the 2014 to 2016 accident years. Such amounts were partially offset by \$7.6 million of net favorable development in other medium-tailed lines, including professional liability and surety business, across most accident years.

The mortgage segment's net favorable development was \$23.3 million, or 8.0 loss ratio points, for the 2018 second quarter. The 2018 second quarter development was primarily driven by continued lower than expected claim rates on first lien business and subrogation recoveries on second lien business at Arch MI U.S.

2017 Second Quarter

During the 2017 second quarter, the Company recorded net favorable development on prior year loss reserves of \$69.4 million, which consisted of \$39.5 million from the reinsurance segment, \$2.0 million from the insurance segment, \$29.8 million from the mortgage segment and adverse development of \$1.9 million from the 'other' segment.

The reinsurance segment's net favorable development of \$39.5 million, or 12.6 loss ratio points, for the 2017 second quarter consisted of \$28.1 million from short-tailed lines and \$11.4 million from long-tailed and medium-tailed lines. Favorable development in short-tailed lines included \$16.9 million from property catastrophe and property other than property catastrophe reserves, across most underwriting years, reflecting lower levels of reported and paid claims activity than previously anticipated which led to decreases in certain loss ratio selections during the period. Favorable development in long-tailed and medium-tailed lines reflected reductions in casualty reserves of \$9.0 million based on varying levels of reported and paid claims activity, primarily from the 2002 to 2004 underwriting years, and favorable development in marine reserves of \$2.4 million across most underwriting years.

The insurance segment's net favorable development of \$2.0 million, or 0.4 loss ratio points, for the 2017 second quarter consisted of \$5.3 million of net favorable development in short-tailed lines, partially offset by \$3.3 million of net adverse development in medium-tailed and long-tailed lines. Net favorable development in short-tailed lines primarily resulted from property (including special risk other than marine) reserves from the 2012 to 2016 accident years. Net adverse development in medium-tailed and long-tailed lines reflected \$12.2 million of adverse development on programs, primarily on a small number of programs in the 2014 and 2015 accident years, and \$8.9 million on construction reserves across various accident years. Such amounts were partially offset by net favorable development of \$17.8 million in other medium-tailed lines, primarily in professional liability with \$12.1 million of favorable development across most accident years, and surety with \$3.6 million of favorable development.

The mortgage segment's net favorable development was \$29.8 million, or 11.5 loss ratio points, for the 2017 second quarter. The 2017 second quarter development was primarily driven by continued lower than expected claim rates on first lien business and subrogation recoveries on second lien business at Arch MI U.S.

Six Months Ended June 30, 2018

During the six months ended June 30, 2018, the Company recorded net favorable development on prior year loss reserves of \$115.6 million, which consisted of \$69.6 million from the reinsurance segment, \$8.2 million from the insurance segment, \$36.3 million from the mortgage segment and \$1.6 million from the 'other' segment.

The reinsurance segment's net favorable development of \$69.6 million, or 11.2 loss ratio points, for the 2018 period consisted of \$51.1 million from short-tailed lines and \$18.5 million from long-tailed and medium-tailed lines.

Favorable development in short-tailed lines included \$40.4 million from property catastrophe and property other than property catastrophe reserves, across most underwriting years, reflecting lower levels of reported and paid claims activity than previously anticipated which led to decreases in certain loss ratio selections during the period. Favorable development in long-tailed and medium-tailed lines reflected reductions in casualty reserves of \$8.1 million based on varying levels of reported and paid claims activity, primarily from the 2002 to 2010 underwriting years, and favorable development in marine reserves of \$10.0 million across most underwriting years.

The insurance segment's net favorable development of \$8.2 million, or 0.8 loss ratio points, for the 2018 period consisted of \$22.7 million of net favorable development in short-tailed lines and \$17.2 million of net favorable development in long-tailed lines, partially offset by \$31.7 million of net adverse development in medium-tailed lines. Net favorable development in short-tailed lines primarily resulted from property (including special risk other than

marine) reserves from the 2010 and 2017 accident years. Net favorable development in long-tailed lines reflected net reductions in executive assurance reserves of \$7.5 million, primarily from the 2008 to 2015 accident years, and in healthcare reserves of \$7.0 million, primarily from the 2003 accident year. Net adverse development in medium-tailed lines reflected \$21.9 million of adverse development in program business, primarily driven by a few inactive programs that were non-renewed in 2015 and early in 2016 and \$25.6 million of adverse development on contract binding business, primarily from the 2014 to 2016 accident years. Such amounts were partially offset by \$15.8 million of net favorable development in other medium-tailed lines, including professional liability and surety business, across most accident years.

The mortgage segment's net favorable development was \$36.3 million, or 6.4 loss ratio points, for the 2018 period.  
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ARCH CAPITAL GROUP LTD. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

development was primarily driven by continued lower than expected claim rates on first lien business and subrogation recoveries on second lien business at Arch MI U.S.

Six Months Ended June 30, 2017

During the six months ended June 30, 2017, the Company recorded net favorable development on prior year loss reserves of \$152.6 million, which consisted of \$96.8 million from the reinsurance segment, \$4.1 million from the insurance segment, \$53.4 million from the mortgage segment and adverse development of \$1.7 million from the 'other' segment.

The reinsurance segment's net favorable development of \$96.8 million, or 17.3 loss ratio points, for the 2017 period consisted of \$68.9 million from short-tailed lines and \$27.9 million from long-tailed and medium-tailed lines.

Favorable development in short-tailed lines included \$51.0 million from property catastrophe and property other than property catastrophe reserves, across most underwriting years, reflecting lower levels of reported and paid claims activity than previously anticipated which led to decreases in certain loss ratio selections during the period. Favorable development in long-tailed and medium-tailed lines reflected reductions in casualty reserves of \$15.6 million based on varying levels of reported and paid claims activity, primarily from the 2002 to 2013 underwriting years, and favorable development in marine reserves of \$12.3 million across most underwriting years.

The insurance segment's net favorable development of \$4.1 million, or 0.4 loss ratio points, for the 2017 period consisted of \$7.2 million of net favorable development in short-tailed lines and \$6.6 million of net favorable development in long-tailed lines, partially offset by \$9.7 million of net adverse development in medium-tailed lines. Net favorable development in short-tailed lines primarily resulted from property (including special risk other than marine) reserves from the 2011 to 2016 accident years. Net favorable development in long-tailed lines reflected net reductions in executive assurance reserves from the 2008 to 2014 accident years and reductions in healthcare reserves across various accident years, partially offset by \$13.4 million of net adverse development on construction reserves across various accident years. Net adverse development in medium-tailed lines primarily resulted from an increase in programs of \$26.4 million stemming in part from development on a small number of programs in the 2013 to 2015 accident years, partially offset by net favorable development of \$16.7 million in other medium-tailed lines, primarily in professional liability and surety.

The mortgage segment's net favorable development was \$53.4 million, or 10.6 loss ratio points, for the 2017 period. The 2017 development was primarily driven by continued lower than expected claim rates on first lien business and subrogation recoveries on second lien business at Arch MI U.S.

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## ARCH CAPITAL GROUP LTD. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

## 7. Investment Information

At June 30, 2018, total investable assets of \$21.82 billion included \$19.17 billion held by the Company and \$2.65 billion attributable to Watford Re.

## Available For Sale Investments

The following table summarizes the fair value and cost or amortized cost of the Company's securities classified as available for sale:

	Estimated Fair Value	Gross Unrealized Gains	Gross Unrealized Losses	Cost or Amortized Cost	OTTI Unrealized Losses (2)
June 30, 2018					
Fixed maturities (1):					
Corporate bonds	\$5,535,763	\$7,199	\$(103,978)	\$5,632,542	\$ (69 )
Mortgage backed securities	488,699	1,699	(4,742 )	491,742	(15 )
Municipal bonds	1,431,256	7,371	(22,047 )	1,445,932	—
Commercial mortgage backed securities	590,198	776	(13,222 )	602,644	—
U.S. government and government agencies	2,788,272	6,216	(19,577 )	2,801,633	—
Non-U.S. government securities	1,692,783	17,124	(27,480 )	1,703,139	—
Asset backed securities	1,820,489	3,310	(16,574 )	1,833,753	—
Total	14,347,460	43,695	(207,620 )	14,511,385	(84 )
Equity securities (3)					
Other investments	—	—	—	—	—
Short-term investments	1,096,798	338	(72 )	1,096,532	—
Total	\$15,444,258	\$44,033	\$(207,692)	\$15,607,917	\$ (84 )
December 31, 2017					
Fixed maturities (1):					
Corporate bonds	\$4,434,439	\$30,943	\$(32,340)	\$4,435,836	\$ (73 )
Mortgage backed securities	316,141	1,640	(2,561 )	317,062	(15 )
Municipal bonds	2,158,840	20,285	(12,308 )	2,150,863	—
Commercial mortgage backed securities	545,817	2,131	(4,268 )	547,954	—
U.S. government and government agencies	3,484,257	2,188	(28,769 )	3,510,838	—
Non-U.S. government securities	1,612,754	48,764	(17,321 )	1,581,311	—
Asset backed securities	1,780,143	5,147	(8,614 )	1,783,610	—
Total	14,332,391	111,098	(106,181 )	14,327,474	(88 )
Equity securities					
Other investments	504,333	88,739	(5,583 )	421,177	—
Short-term investments	264,989	66,946	(120 )	198,163	—
Total	1,469,042	650	(563 )	1,468,955	—
Total	\$16,570,755	\$267,433	\$(112,447)	\$16,415,769	\$ (88 )

(1) In securities lending transactions, the Company receives collateral in excess of the fair value of the fixed maturities pledged. For purposes of this table, the Company has excluded the collateral received under securities lending, at fair value and included the securities pledged under securities lending, at fair value. See "—Securities Lending Agreements."

(2) Represents the total other-than-temporary impairments ("OTTI") recognized in accumulated other comprehensive income ("AOCI"). It does not include the change in fair value subsequent to the impairment measurement date. At June 30, 2018, the net unrealized gain related to securities for which a non-credit OTTI was recognized in AOCI

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was \$0.2 million, compared to a net unrealized gain of \$0.3 million at December 31, 2017.

(3) Effective January 1, 2018, the Company adopted new accounting guidance for financial instruments (see Note 2).  
As a result, equity securities are no longer accounted for as available for sale and are excluded from this table.

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## ARCH CAPITAL GROUP LTD. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

The following table summarizes, for all available for sale securities in an unrealized loss position, the fair value and gross unrealized loss by length of time the security has been in a continual unrealized loss position:

	Less than 12 Months		12 Months or More		Total	
	Estimated Fair Value	Gross Unrealized Losses	Estimated Fair Value	Gross Unrealized Losses	Estimated Fair Value	Gross Unrealized Losses
June 30, 2018						
Fixed maturities (1):						
Corporate bonds	\$4,541,077	\$(94,563 )	\$236,332	\$(9,415 )	\$4,777,409	\$(103,978)
Mortgage backed securities	296,876	(4,618 )	708	(124 )	297,584	(4,742 )
Municipal bonds	814,694	(16,888 )	109,913	(5,159 )	924,607	(22,047 )
Commercial mortgage backed securities	351,013	(9,067 )	56,382	(4,155 )	407,395	(13,222 )
U.S. government and government agencies	1,957,338	(18,470 )	41,069	(1,107 )	1,998,407	(19,577 )
Non-U.S. government securities	1,243,055	(24,034 )	160,434	(3,446 )	1,403,489	(27,480 )
Asset backed securities	1,377,269	(14,096 )	110,507	(2,478 )	1,487,776	(16,574 )
Total	10,581,322	(181,736 )	715,345	(25,884 )	11,296,667	(207,620 )
Equity securities (2)						
Other investments	—	—	—	—	—	—
Short-term investments	53,937	(72 )	—	—	53,937	(72 )
Total	\$10,635,259	\$(181,808)	\$715,345	\$(25,884)	\$11,350,604	\$(207,692)
December 31, 2017						
Fixed maturities (1):						
Corporate bonds	\$2,320,716	\$(25,411 )	\$279,082	\$(6,929 )	\$2,599,798	\$(32,340 )
Mortgage backed securities	221,113	(1,715 )	28,380	(846 )	249,493	(2,561 )
Municipal bonds	1,030,389	(8,438 )	132,469	(3,870 )	1,162,858	(12,308 )
Commercial mortgage backed securities	225,164	(1,899 )	57,291	(2,369 )	282,455	(4,268 )
U.S. government and government agencies	2,646,415	(26,501 )	111,879	(2,268 )	2,758,294	(28,769 )
Non-U.S. government securities	1,218,514	(15,546 )	93,530	(1,775 )	1,312,044	(17,321 )
Asset backed securities	1,111,246	(5,915 )	209,207	(2,699 )	1,320,453	(8,614 )
Total	8,773,557	(85,425 )	911,838	(20,756 )	9,685,395	(106,181 )
Equity securities	166,562	(5,583 )	—	—	166,562	(5,583 )
Other investments	15,025	(120 )	—	—	15,025	(120 )
Short-term investments	109,528	(563 )	—	—	109,528	(563 )
Total	\$9,064,672	\$(91,691)	\$911,838	\$(20,756)	\$9,976,510	\$(112,447)

(1) In securities lending transactions, the Company receives collateral in excess of the fair value of the fixed maturities pledged. For purposes of this table, the Company has excluded the collateral received under securities lending, at fair value and included the securities pledged under securities lending, at fair value. See “—Securities Lending Agreements.”

(2) Effective January 1, 2018, the Company adopted new accounting guidance for financial instruments (see Note 2). As a result, equity securities are no longer accounted for as available for sale and are excluded from this table.

At June 30, 2018, on a lot level basis, approximately 5,440 security lots out of a total of approximately 7,450 security lots were in an unrealized loss position and the largest single unrealized loss from a single lot in the Company’s fixed maturity portfolio was \$1.7 million. At December 31, 2017, on a lot level basis, approximately 3,830 security lots out of a total of approximately 7,450 security lots were in an unrealized loss position and the largest single unrealized loss from a single lot in the Company’s fixed maturity portfolio was \$1.3 million.



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## ARCH CAPITAL GROUP LTD. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

The contractual maturities of the Company's fixed maturities are shown in the following table. Expected maturities, which are management's best estimates, will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

Maturity	June 30, 2018		December 31, 2017	
	Estimated Fair Value	Amortized Cost	Estimated Fair Value	Amortized Cost
Due in one year or less	\$344,007	\$343,938	\$550,711	\$548,771
Due after one year through five years	8,154,773	8,235,481	7,436,153	7,434,801
Due after five years through 10 years	2,703,341	2,756,097	3,369,635	3,369,750
Due after 10 years	245,953	247,730	333,791	325,526
	11,448,074	11,583,246	11,690,290	11,678,848
Mortgage backed securities	488,699	491,742	316,141	317,062
Commercial mortgage backed securities	590,198	602,644	545,817	547,954
Asset backed securities	1,820,489	1,833,753	1,780,143	1,783,610
Total (1)	\$14,347,460	\$14,511,385	\$14,332,391	\$14,327,474

In securities lending transactions, the Company receives collateral in excess of the fair value of the securities pledged. For purposes of this table, the Company has excluded the collateral received under securities lending, at (1) fair value and included the securities pledged under securities lending, at fair value. See "—Securities Lending Agreements."

Securities Lending Agreements

The Company enters into securities lending agreements with financial institutions to enhance investment income whereby it loans certain of its securities to third parties, primarily major brokerage firms, for short periods of time through a lending agent. The Company maintains legal control over the securities it lends, retains the earnings and cash flows associated with the loaned securities and receives a fee from the borrower for the temporary use of the securities. An indemnification agreement with the lending agent protects the Company in the event a borrower becomes insolvent or fails to return any of the securities on loan from the Company.

The Company receives collateral in the form of cash or securities. Cash collateral primarily consists of short term investments. At June 30, 2018, the fair value of the cash collateral received on securities lending was \$28.0 million and the fair value of security collateral received was \$209.0 million. At December 31, 2017, the fair value of the cash collateral received on securities lending was \$199.9 million, and the fair value of security collateral received was \$276.7 million.

The Company's securities lending transactions were accounted for as secured borrowings with significant investment categories as follows:

	Remaining Contractual Maturity of the Agreements				
	Overnight and Continuous	Less than 30 Days	30-90 Days	90 Days or More	Total
June 30, 2018					
U.S. government and government agencies	\$147,509	\$—	\$48,268	\$—	—\$195,777
Corporate bonds	29,265	—	—	—	29,265
Equity securities	11,906	—	—	—	11,906
Total	\$188,680	\$—	\$48,268	\$—	—\$236,948



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Gross amount of recognized liabilities for securities lending in offsetting disclosure in Note 9  
 Amounts related to securities lending not included in offsetting disclosure in Note 9 \$236,948

December 31, 2017

U.S. government and government agencies	\$343,425	\$20,309	\$76,086	\$	-\$439,820
Corporate bonds	28,003	—	—	—	28,003
Equity securities	8,782	—	—	—	8,782
Total	\$380,210	\$20,309	\$76,086	\$	-\$476,605

Gross amount of recognized liabilities for securities lending in offsetting disclosure in Note 9 \$—  
 Amounts related to securities lending not included in offsetting disclosure in Note 9 \$476,605

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## ARCH CAPITAL GROUP LTD. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

## Other Investments

The following table summarizes the Company's other investments, including available for sale and fair value option components:

	June 30, 2018	December 31, 2017
Available for sale securities:		
Asian and emerging markets	\$—	\$ 135,140
Investment grade fixed income	—	53,878
Credit related funds	—	18,365
Other	—	57,606
Total available for sale (1)	—	264,989
Fair value option:		
Term loan investments (par value: \$1,321,154 and \$1,223,453)	\$1,286,305	\$ 1,200,882
Mezzanine debt funds	257,750	252,160
Credit related funds	199,437	175,422
Investment grade fixed income	98,240	102,347
Asian and emerging markets	350,308	258,541
Other (2)	136,864	147,029
Total fair value option	2,328,904	2,136,381
Total	\$2,328,904	\$ 2,401,370

(1) The Company reviewed the accounting treatment for three limited partnership investments which were accounted for as available for sale at December 31, 2017 during the 2018 first quarter and determined, based on reconsideration during the period of the Company's percentage ownership, that the equity method of accounting was appropriate for such investments.

(2) Includes fund investments with strategies in mortgage servicing rights, transportation, infrastructure assets and other.

Certain of the Company's other investments are in investment funds for which the Company has the option to redeem at agreed upon values as described in each investment fund's subscription agreement. Depending on the terms of the various subscription agreements, investments in investment funds may be redeemed daily, monthly, quarterly or on other terms. Two common redemption restrictions which may impact the Company's ability to redeem these investment funds are gates and lockups. A gate is a suspension of redemptions which may be implemented by the general partner or investment manager of the fund in order to defer, in whole or in part, the redemption request in the event the aggregate amount of redemption requests exceeds a predetermined percentage of the investment fund's net assets which may otherwise hinder the general partner or investment manager's ability to liquidate holdings in an orderly fashion in order to generate the cash necessary to fund extraordinarily large redemption payouts. A lockup period is the initial amount of time an investor is contractually required to hold the security before having the ability to redeem. If the investment funds are eligible to be redeemed, the time to redeem such fund can take weeks or months following the notification.

## Fair Value Option

The following table summarizes the Company's assets and liabilities which are accounted for using the fair value option:

	June 30, 2018	December 31, 2017
Fixed maturities	\$1,428,503	\$ 1,642,855
Other investments	2,328,904	2,136,381

Short-term investments	217,066	297,426
Equity securities	137,138	139,575
Investments accounted for using the fair value option	\$4,111,611	\$4,216,237

#### Limited Partnership Interests

In the normal course of its activities, the Company invests in limited partnerships as part of its overall investment strategy. Such amounts are included in 'investments accounted for using the equity method' and 'investments accounted for using the fair value option.' The Company has determined that it is not required to consolidate these investments because it is not the primary beneficiary of the funds. The Company's maximum exposure to loss with respect to these investments is limited to the investment carrying amounts reported in the Company's consolidated balance sheet and any unfunded commitment.

The following table summarizes investments in limited partnership interests where the Company has a variable interest by balance sheet line item:

	June 30, 2018	December 31, 2017
Investments accounted for using the equity method (1)	\$1,292,573	\$1,041,321
Investments accounted for using the fair value option (2)	130,471	130,471
Total	\$1,423,044	\$1,171,792

(1) Aggregate unfunded commitments were \$994.7 million at June 30, 2018, compared to \$1.02 billion at December 31, 2017.

(2) Aggregate unfunded commitments were \$91.0 million at June 30, 2018, compared to \$100.4 million at December 31, 2017.

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## ARCH CAPITAL GROUP LTD. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

## Net Investment Income

The components of net investment income were derived from the following sources:

	June 30,	
	2018	2017
Three Months Ended		
Fixed maturities	\$ 115,110	\$ 94,270
Equity securities	4,777	3,654
Short-term investments	4,392	2,016
Other (1)	38,168	34,076
Gross investment income	162,447	134,016
Investment expenses	(26,779 )	(22,892 )
Net investment income	\$ 135,668	\$ 111,124

## Six Months Ended

Fixed maturities	\$ 222,997	\$ 188,663
Equity securities	7,345	6,297
Short-term investments	9,252	3,775
Other (1)	75,542	73,656
Gross investment income	315,136	272,391
Investment expenses	(52,744 )	(43,393 )
Net investment income	\$ 262,392	\$ 228,998

(1) Includes income distributions from investment funds, term loan investments and other items.

## Equity in Net Income (Loss) of Investment Funds Accounted for Using the Equity Method

The Company recorded \$8.5 million of equity in net income related to investment funds accounted for using the equity method in the 2018 second quarter, compared to \$32.7 million for the 2017 second quarter, and \$36.5 million for the six months ended June 30, 2018, compared to \$80.8 million for the 2017 period. In applying the equity method, investments are initially recorded at cost and are subsequently adjusted based on the Company's proportionate share of the net income or loss of the funds (which include changes in the market value of the underlying securities in the funds). Such investments are generally recorded on a one to three month lag based on the availability of reports from the investment funds.

## Net Realized Gains (Losses)

Net realized gains (losses) were as follows, excluding net impairment losses recognized in earnings:

	June 30,	
	2018	2017
Three Months Ended		
Available for sale securities:		
Gross gains on investment sales	\$ 18,777	\$ 76,730
Gross losses on investment sales	(57,711 )	(52,619 )
Change in fair value of assets and liabilities accounted for using the fair value option:		
Fixed maturities	(22,927 )	9,656
Other investments	(254 )	637
Equity securities	1,230	2,829
Short-term investments	(136 )	3,328
Equity securities, at fair value (1):		
Net realized gains (losses) on sales during the period	(5,918 )	—

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Net unrealized gains (losses) on equity securities still held at reporting date	(7,278	)	—
Derivative instruments (2)	(2,146	)	(4,770 )
Other (3)	(248	)	(14,056 )
Net realized gains (losses)	\$(76,611	)	\$21,735

Six Months Ended

Available for sale securities:

Gross gains on investment sales	\$33,742		\$145,905
Gross losses on investment sales	(140,262	)	(113,981 )
Change in fair value of assets and liabilities accounted for using the fair value option:			
Fixed maturities	(40,478	)	30,197
Other investments	(6,628	)	17,885
Equity securities	7,898		6,374
Short-term investments	(287	)	3,332
Equity securities, at fair value (1):			
Net realized gains (losses) on sales during the period	(11,286	)	—
Net unrealized gains (losses) on equity securities still held at reporting date	(14,861	)	—
Derivative instruments (2)	(6,109	)	(13,951 )
Other (3)	(9,338	)	(19,873 )
Net realized gains (losses)	\$(187,609	)	\$55,888

(1) Pursuant to new accounting guidance (see Note 2), changes in fair value on equity securities are recorded through net income effective January 1, 2018.

(2) See Note 9 for information on the Company's derivative instruments.

(3) Includes the re-measurement of contingent consideration liability amounts.

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## ARCH CAPITAL GROUP LTD. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

## Net Impairment Losses Recognized in Earnings

The Company performs quarterly reviews of its available for sale investments in order to determine whether declines in fair value below the amortized cost basis were considered other-than-temporary in accordance with applicable guidance.

The following table details the net impairment losses recognized in earnings by asset class:

	June 30,	
	2018	2017
Three Months Ended		
Fixed maturities:		
Mortgage backed securities	\$(81 )	\$(92 )
Corporate bonds	(241 )	(1,401 )
Asset backed securities	(148 )	—
Municipal bonds	—	(173 )
Total	(470 )	(1,666 )
Other investments	—	(64 )
Net impairment losses recognized in earnings	\$(470)	\$(1,730)

## Six Months Ended

Fixed maturities:		
Mortgage backed securities	\$(123)	\$(1,411)
Corporate bonds	(361 )	(1,402 )
Non-U.S. government securities	—	(198 )
Asset backed securities	(148 )	—
Municipal bonds	—	(173 )
Total	(632 )	(3,184 )
Equity securities	—	(186 )
Other investments	—	(167 )
Net impairment losses recognized in earnings	\$(632)	\$(3,537)

Net impairment losses recognized in earnings in the 2018 periods were primarily related to foreign currency fluctuations on corporate bonds and asset backed securities.

The Company believes that the \$0.1 million of OTTI included in accumulated other comprehensive income at June 30, 2018 on the securities which were considered by the Company to be impaired was due to market and sector-related factors (i.e., not credit losses). At June 30, 2018, the Company did not intend to sell these securities, or any other securities which were in an unrealized loss position, and determined that it is more likely than not that the Company will not be required to sell such securities before recovery of their cost basis.

The following table provides a roll forward of the amount related to credit losses recognized in earnings for which a portion of an OTTI was recognized in accumulated other comprehensive income:

	June 30,	
	2018	2017
Three Months Ended		
Balance at start of period	\$767	\$12,537
Credit loss impairments recognized on securities not previously impaired	—	31
Credit loss impairments recognized on securities previously impaired	—	172
Reductions for increases in cash flows expected to be collected that are recognized over the remaining life of the security	—	—

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Reductions for securities sold during the period	(69 )	(8,303 )
Balance at end of period	\$698	\$4,437

Six Months Ended

Balance at start of year	\$767	\$13,138
Credit loss impairments recognized on securities not previously impaired	—	31
Credit loss impairments recognized on securities previously impaired	—	195
Reductions for increases in cash flows expected to be collected that are recognized over the remaining life of the security	—	—
Reductions for securities sold during the period	(69 )	(8,927 )
Balance at end of period	\$698	\$4,437

Restricted Assets

The Company is required to maintain assets on deposit, which primarily consist of fixed maturities, with various regulatory authorities to support its insurance and reinsurance operations. The Company's insurance and reinsurance subsidiaries maintain assets in trust accounts as collateral for insurance and reinsurance transactions with affiliated companies and also have investments in segregated portfolios primarily to provide collateral or guarantees for letters of credit to third parties. See note 16, "Commitments and Contingencies," of the notes to consolidated financial statements in the Company's 2017 Form 10-K.

The following table details the value of the Company's restricted assets:

	June 30, 2018	December 31, 2017
Assets used for collateral or guarantees:		
Affiliated transactions	\$4,549,122	\$ 4,323,726
Third party agreements	1,537,336	1,674,304
Deposits with U.S. regulatory authorities	701,026	616,987
Deposits with non-U.S. regulatory authorities	58,371	55,895
Total restricted assets	\$6,845,855	\$ 6,670,912

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## ARCH CAPITAL GROUP LTD. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

## 8. Fair Value

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Accounting guidance regarding fair value measurements addresses how companies should measure fair value when they are required to use a fair value measure for recognition or disclosure purposes under GAAP and provides a common definition of fair value to be used throughout GAAP. It defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly fashion between market participants at the measurement date. In addition, it establishes a three-level valuation hierarchy for the disclosure of fair value measurements. The valuation hierarchy is based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date. The level in the hierarchy within which a given fair value measurement falls is determined based on the lowest level input that is significant to the measurement (Level 1 being the highest priority and Level 3 being the lowest priority).

The levels in the hierarchy are defined as follows:

Level 1: Inputs to the valuation methodology are observable inputs that reflect quoted prices (unadjusted) for identical assets or liabilities in active markets

Level 2: Inputs to the valuation methodology include quoted prices for similar assets and liabilities in active markets, and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument

Level 3: Inputs to the valuation methodology are unobservable and significant to the fair value measurement

Following is a description of the valuation methodologies used for securities measured at fair value, as well as the general classification of such securities pursuant to the valuation hierarchy. The Company reviews its securities measured at fair value and discusses the proper classification of such investments with investment advisers and others. The Company determines the existence of an active market based on its judgment as to whether transactions for the financial instrument occur in such market with sufficient frequency and volume to provide reliable pricing information. The independent pricing sources obtain market quotations and actual transaction prices for securities that have quoted prices in active markets. The Company uses quoted values and other data provided by nationally recognized independent pricing sources as inputs into its process for determining fair values of its fixed maturity investments. To validate the techniques or models used by pricing sources, the Company's review process includes, but is not limited to: (i) quantitative analysis (e.g.,

comparing the quarterly return for each managed portfolio to its target benchmark, with significant differences identified and investigated); (ii) a review of the average number of prices obtained in the pricing process and the range of resulting fair values; (iii) initial and ongoing evaluation of methodologies used by outside parties to calculate fair value; (iv) a comparison of the fair value estimates to the Company's knowledge of the current market; (v) a comparison of the pricing services' fair values to other pricing services' fair values for the same investments; and (vi) periodic back-testing, which includes randomly selecting purchased or sold securities and comparing the executed prices to the fair value estimates from the pricing service. A price source hierarchy was maintained in order to determine which price source would be used (i.e., a price obtained from a pricing service with more seniority in the hierarchy will be used over a less senior one in all cases). The hierarchy prioritizes pricing services based on availability and reliability and assigns the highest priority to index providers. Based on the above review, the Company will challenge any prices for a security or portfolio which are considered not to be representative of fair value. The Company did not adjust any of the prices obtained from the independent pricing sources at June 30, 2018. In certain circumstances, when fair values are unavailable from these independent pricing sources, quotes are obtained directly from broker-dealers who are active in the corresponding markets. Such quotes are subject to the validation procedures noted above. Of the \$20.24 billion of financial assets and liabilities measured at fair value at June 30, 2018, approximately \$276.8 million, or 1.4%, were priced using non-binding broker-dealer quotes. Of the \$20.92 billion of financial assets and liabilities measured at fair value at December 31, 2017, approximately \$181.5 million, or 0.9%, were priced using non-binding broker-dealer quotes.



Fixed maturities

The Company uses the market approach valuation technique to estimate the fair value of its fixed maturity securities, when possible. The market approach includes obtaining prices from independent pricing services, such as index providers and pricing vendors, as well as to a lesser extent quotes from broker-dealers. The independent pricing sources obtain market quotations and actual transaction prices for securities that have quoted prices in active markets. Each source has its own proprietary method for determining the fair value of securities that are not actively traded. In general, these methods involve the use of “matrix pricing” in which the independent pricing source uses observable market inputs including, but not limited to, investment yields, credit risks and spreads, benchmarking of like securities, broker-dealer quotes, reported trades and sector groupings to determine a reasonable fair value.

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ARCH CAPITAL GROUP LTD. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

The following describes the significant inputs generally used to determine the fair value of the Company's fixed maturity securities by asset class:

- U.S. government and government agencies — valuations provided by independent pricing services, with all prices provided through index providers and pricing vendors. The Company determined that all U.S. Treasuries would be classified as Level 1 securities due to observed levels of trading activity, the high number of strongly correlated pricing quotes received on U.S. Treasuries and other factors. The fair values of U.S. government agency securities are generally determined using the spread above the risk-free yield curve. As the yields for the risk-free yield curve and the spreads for these securities are observable market inputs, the fair values of U.S. government agency securities are classified within Level 2.
- Corporate bonds — valuations provided by independent pricing services, substantially all through index providers and pricing vendors with a small amount through broker-dealers. The fair values of these securities are generally determined using the spread above the risk-free yield curve. These spreads are generally obtained from the new issue market, secondary trading and from broker-dealers who trade in the relevant security market. As the significant inputs used in the pricing process for corporate bonds are observable market inputs, the fair value of these securities are classified within Level 2. A small number of securities are included in Level 3 due to a low level of transparency on the inputs used in the pricing process.
- Mortgage-backed securities — valuations provided by independent pricing services, substantially all through pricing vendors and index providers with a small amount through broker-dealers. The fair values of these securities are generally determined through the use of pricing models (including Option Adjusted Spread) which use spreads to determine the expected average life of the securities. These spreads are generally obtained from the new issue market, secondary trading and from broker-dealers who trade in the relevant security market. The pricing services also review prepayment speeds and other indicators, when applicable. As the significant inputs used in the pricing process for mortgage-backed securities are observable market inputs, the fair value of these securities are classified within Level 2. A small number of securities are included in Level 3 due to a low level of transparency on the inputs used in the pricing process.
- Municipal bonds — valuations provided by independent pricing services, with all prices provided through index providers and pricing vendors. The fair values of these securities are generally determined using spreads obtained from broker-dealers who trade in the relevant security market, trade prices and the new issue market. As the significant inputs used in the pricing process for municipal bonds are observable market inputs, the fair value of these securities are classified within Level 2.
- Commercial mortgage-backed securities — valuations provided by independent pricing services, substantially all through index providers and pricing vendors with a small amount through broker-dealers. The fair values of these securities are generally determined through the use of pricing models which use spreads to determine the appropriate average life of the securities. These spreads are generally obtained from the new issue market, secondary trading and from broker-dealers who trade in the relevant security market. The pricing services also review prepayment speeds and other indicators, when applicable. As the significant inputs used in the pricing process for commercial mortgage-backed securities are observable market inputs, the fair value of these securities are classified within Level 2. A small number of securities are included in Level 3 due to a low level of transparency on the inputs used in the pricing process.
- Non-U.S. government securities — valuations provided by independent pricing services, with all prices provided through index providers and pricing vendors. The fair values of these securities are generally based on international indices or valuation models which include daily observed yield curves, cross-currency basis index spreads and country credit spreads. As the significant inputs used in the pricing process for non-U.S. government securities are observable market inputs, the fair value of these securities are classified within Level 2.
- Asset-backed securities — valuations provided by independent pricing services, substantially all through index providers and pricing vendors with a small amount through broker-dealers. The fair values of these securities are generally

determined through the use of pricing models (including Option Adjusted Spread) which use spreads to determine the appropriate average life of the securities. These spreads are generally obtained from the new issue market, secondary trading and from broker-dealers who trade in the relevant security market. The pricing services also review prepayment speeds and other indicators, when applicable. As the significant inputs used in the pricing process for asset-backed securities are observable market inputs, the fair value of these securities are classified within Level 2. A small number of securities are included in Level 3 due to a low level of transparency on the inputs used in the pricing process.

Equity securities

The Company determined that exchange-traded equity securities would be included in Level 1 as their fair values are based on quoted market prices in active markets. Other equity securities are included in Level 2 of the valuation hierarchy.

Other investments

The Company determined that exchange-traded investments in mutual funds would be included in Level 1 as their fair values are based on quoted market prices in active markets. Other investments also include term loan investments for which fair values are estimated by using quoted prices of term loan

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ARCH CAPITAL GROUP LTD. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

investments with similar characteristics, pricing models or matrix pricing. Such investments are generally classified within Level 2. The fair values for certain of the Company's other investments are determined using net asset values as advised by external fund managers. The net asset value is based on the fund manager's valuation of the underlying holdings in accordance with the fund's governing documents. In accordance with applicable accounting guidance, certain investments that are measured at fair value using the net asset value per share (or its equivalent) practical expedient have not been classified in the fair value hierarchy. A small number of securities are included in Level 3 due to the lack of an available independent price source for such securities.

Derivative instruments

The Company's futures contracts, foreign currency forward contracts, interest rate swaps and other derivatives trade in the over-the-counter derivative market. The Company uses the market approach valuation technique to estimate the fair value for these derivatives based on significant observable market inputs from third party pricing vendors, non-binding broker-dealer quotes and/or recent trading activity. As the significant inputs used in the pricing process for these derivative instruments are observable market inputs, the fair value of these securities are classified within Level 2.

Short-term investments

The Company determined that certain of its short-term investments held in highly liquid money market-type funds, Treasury bills and commercial paper would be included in Level 1 as their fair values are based on quoted market prices in active markets. The fair values of other short-term investments are generally determined using the spread above the risk-free yield curve and are classified within Level 2.

Contingent consideration liabilities

Contingent consideration liabilities (included in 'other liabilities' in the consolidated balance sheets) include amounts related to the acquisition of CMG Mortgage Insurance Company and its affiliated mortgage insurance companies and other acquisitions. Such amounts are remeasured at fair value at each balance sheet date with changes in fair value recognized in 'net realized gains (losses).' To determine the fair value of contingent consideration liabilities, the Company estimates future payments using an income approach based on modeled inputs which include a weighted average cost of capital. The Company determined that contingent consideration liabilities would be included within Level 3.

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## ARCH CAPITAL GROUP LTD. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

The following table presents the Company's financial assets and liabilities measured at fair value by level at June 30, 2018:

	Estimated Fair Value	Estimated Fair Value Measurements Using: Quoted Prices for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets measured at fair value (1):				
Available for sale securities:				
Fixed maturities:				
Corporate bonds	\$5,535,763	\$—	\$5,526,990	\$ 8,773
Mortgage backed securities	488,699	—	488,352	347
Municipal bonds	1,431,256	—	1,431,256	—
Commercial mortgage backed securities	590,198	—	590,169	29
U.S. government and government agencies	2,788,272	2,660,621	127,651	—
Non-U.S. government securities	1,692,783	—	1,692,783	—
Asset backed securities	1,820,489	—	1,820,489	—
Total	14,347,460	2,660,621	11,677,690	9,149
Short-term investments	1,096,798	1,053,661	43,137	—
Equity securities, at fair value	546,075	493,975	52,100	—
Derivative instruments (4)	31,623	—	31,623	—
Fair value option:				
Corporate bonds	936,840	—	925,505	11,335
Non-U.S. government bonds	132,162	—	132,162	—
Mortgage backed securities	16,410	—	16,410	—
Municipal bonds	7,082	—	7,082	—
Commercial mortgage backed securities	1,306	—	1,306	—
Asset backed securities	214,718	—	214,718	—
U.S. government and government agencies	119,985	119,875	110	—
Short-term investments	217,066	19,869	197,197	—
Equity securities	137,138	65,400	71,738	—
Other investments	1,260,645	65,665	1,136,766	58,214
Other investments measured at net asset value (2)	1,068,259	—	—	—
Total	4,111,611	270,809	2,702,994	69,549
Total assets measured at fair value	\$20,133,567	\$4,479,066	\$14,507,544	\$ 78,698
Liabilities measured at fair value:				
Contingent consideration liabilities	\$(63,930)	) \$—	\$—	) \$(63,930)
Securities sold but not yet purchased (3)	(24,529)	) —	(24,529)	) —
Derivative instruments (4)	(22,398)	) —	(22,398)	) —

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Total liabilities measured at fair value                      \$(110,857 ) \$—                      \$(46,927 ) \$ (63,930 )

(1) In securities lending transactions, the Company receives collateral in excess of the fair value of the securities pledged. For purposes of this table, the Company has excluded the collateral received under securities lending, at fair value and included the securities pledged under securities lending, at fair value. See Note 7, “Investment Information—Securities Lending Agreements.”

(2) In accordance with applicable accounting guidance, certain investments that are measured at fair value using the net asset value per share (or its equivalent) practical expedient have not been classified in the fair value hierarchy. The fair value amounts presented in this table are intended to permit reconciliation of the fair value hierarchy to the amounts presented in the consolidated balance sheets.

(3) Represents the Company’s obligations to deliver securities that it did not own at the time of sale. Such amounts are included in “other liabilities” on the Company’s consolidated balance sheets.

(4) See Note 9, “Derivative Instruments.”

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## ARCH CAPITAL GROUP LTD. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

The following table presents the Company's financial assets and liabilities measured at fair value by level at December 31, 2017:

	Estimated Fair Value	Estimated Fair Value Measurements Using: Quoted Prices for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets measured at fair value (1):				
Available for sale securities:				
Fixed maturities:				
Corporate bonds	\$4,434,439	\$—	\$4,424,979	\$ 9,460
Mortgage backed securities	316,141	—	315,754	387
Municipal bonds	2,158,840	—	2,158,840	—
Commercial mortgage backed securities	545,817	—	545,277	540
U.S. government and government agencies	3,484,257	3,408,902	75,355	—
Non-U.S. government securities	1,612,754	—	1,612,754	—
Asset backed securities	1,780,143	—	1,775,143	5,000
Total	14,332,391	3,408,902	10,908,102	15,387
Equity securities	504,333	498,182	6,151	—
Short-term investments	1,469,042	1,420,732	48,310	—
Other investments	76,427	74,611	1,816	—
Other investments measured at net asset value (2)	188,562	—	—	—
Total other investments	264,989	74,611	1,816	—
Derivative instruments (4)	15,747	—	15,747	—
Fair value option:				
Corporate bonds	1,068,725	—	1,056,508	12,217
Non-U.S. government bonds	195,788	—	195,788	—
Mortgage backed securities	20,491	—	20,491	—
Municipal bonds	15,210	—	15,210	—
Commercial mortgage backed securities	11,997	—	11,997	—
Asset backed securities	99,354	—	99,354	—
U.S. government and government agencies	231,290	231,019	271	—
Short-term investments	297,426	40,166	257,260	—
Equity securities	139,575	67,440	72,135	—
Other investments	1,128,094	82,291	986,636	59,167
Other investments measured at net asset value (2)	1,008,287	—	—	—
Total	4,216,237	420,916	2,715,650	71,384
Total assets measured at fair value	\$20,802,739	\$5,823,343	\$13,695,776	\$ 86,771

## Liabilities measured at fair value:

Contingent consideration liabilities	\$ (60,996 )	\$—	\$—	\$ (60,996 )
Securities sold but not yet purchased (3)	(34,375 )	—	(34,375 )	—
Derivative instruments (4)	(20,464 )	—	(20,464 )	—
Total liabilities measured at fair value	\$(115,835 )	\$—	\$(54,839 )	\$ (60,996 )

(1) In securities lending transactions, the Company receives collateral in excess of the fair value of the securities pledged. For purposes of this table, the Company has excluded the collateral received under securities lending, at fair value and included the securities pledged under securities lending, at fair value. See Note 7, “Investment Information—Securities Lending Agreements.”

(2) In accordance with applicable accounting guidance, certain investments that are measured at fair value using the net asset value per share (or its equivalent) practical expedient have not been classified in the fair value hierarchy. The fair value amounts presented in this table are intended to permit reconciliation of the fair value hierarchy to the amounts presented in the consolidated balance sheets.

(3) Represents the Company’s obligations to deliver securities that it did not own at the time of sale. Such amounts are included in “other liabilities” on the Company’s consolidated balance sheets.

(4) See Note 9, “Derivative Instruments.”

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## ARCH CAPITAL GROUP LTD. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

The following table presents a reconciliation of the beginning and ending balances for all financial assets and liabilities measured at fair value on a recurring basis using Level 3 inputs:

s	Assets				Total	Liabilities
	Available For Sale Structured Securities (1)	Corporate Bonds	Corporate Bonds	Fair Value Option Other Investments		Contingent Consideration Liabilities
<b>Three Months Ended June 30, 2018</b>						
Balance at beginning of period	\$5,413	\$9,152	\$11,872	\$ 58,452	\$84,889	\$(62,449 )
Total gains or (losses) (realized/unrealized)						
Included in earnings (2)	3	—	(537 )	336	(198 )	(1,481 )
Included in other comprehensive income	(4 )	(316 )	—	—	(320 )	—
Purchases, issuances, sales and settlements						
Purchases	—	393	—	—	393	—
Issuances	—	—	—	—	—	—
Sales	(5,003 )	—	—	(74 )	(5,077 )	—
Settlements	(33 )	(456 )	—	(500 )	(989 )	—
Transfers in and/or out of Level 3	—	—	—	—	—	—
Balance at end of period	\$376	\$8,773	\$11,335	\$ 58,214	\$78,698	\$(63,930 )
<b>Three Months Ended June 30, 2017</b>						
Balance at beginning of period	\$10,637	\$18,601	\$—	\$ 25,000	\$54,238	\$(125,544 )
Total gains or (losses) (realized/unrealized)						
Included in earnings (2)	3,072	636	—	—	3,708	(3,441 )
Included in other comprehensive income	—	—	—	—	—	—
Purchases, issuances, sales and settlements						
Purchases	—	4,935	—	—	4,935	—
Issuances	—	—	—	—	—	—
Sales	(13,640 )	(12,602 )	—	—	(26,242 )	—
Settlements	(69 )	—	—	—	(69 )	71,739
Transfers in and/or out of Level 3	—	—	—	—	—	—
Balance at end of period	\$—	\$11,570	\$—	\$ 25,000	\$36,570	\$(57,246 )
<b>Six Months Ended June 30, 2018</b>						
Balance at beginning of year	\$5,927	\$9,460	\$12,217	\$ 59,167	\$86,771	\$(60,996 )
Total gains or (losses) (realized/unrealized)						
Included in earnings (2)	4	—	(612 )	(379 )	(987 )	(2,934 )
Included in other comprehensive income	(8 )	(168 )	—	—	(176 )	—
Purchases, issuances, sales and settlements						
Purchases	—	393	—	—	393	—
Issuances	—	—	—	—	—	—
Sales	(5,003 )	—	—	(74 )	(5,077 )	—
Settlements	(544 )	(912 )	(270 )	(500 )	(2,226 )	—
Transfers in and/or out of Level 3	—	—	—	—	—	—
Balance at end of period	\$376	\$8,773	\$11,335	\$ 58,214	\$78,698	\$(63,930 )
<b>Six Months Ended June 30, 2017</b>						

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Balance at beginning of year	\$11,289	\$18,344	\$—	\$25,000	\$54,633	\$(122,350)
Total gains or (losses) (realized/unrealized)						
Included in earnings (2)	3,779	893	—	—	4,672	(7,087)
Included in other comprehensive income	—	—	—	—	—	—
Purchases, issuances, sales and settlements						
Purchases	—	4,935	—	—	4,935	—
Issuances	—	—	—	—	—	—
Sales	(13,640)	(12,602)	—	—	(26,242)	—
Settlements	(1,428)	—	—	—	(1,428)	72,191
Transfers in and/or out of Level 3	—	—	—	—	—	—
Balance at end of period	\$—	\$11,570	\$—	\$25,000	\$36,570	\$(57,246)

(1)Includes asset backed securities, mortgage backed securities and commercial mortgage backed securities.

(2)Gains or losses were included in net realized gains (losses).

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## ARCH CAPITAL GROUP LTD. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

## Financial Instruments Disclosed, But Not Carried, At Fair Value

The Company uses various financial instruments in the normal course of its business. The carrying values of cash, accrued investment income, receivable for securities sold, certain other assets, payable for securities purchased and certain other liabilities approximated their fair values at June 30, 2018, due to their respective short maturities. As these financial instruments are not actively traded, their respective fair values are classified within Level 2.

At June 30, 2018, the Company's senior notes were carried at their cost, net of debt issuance costs, of \$1.73 billion and had a fair value of \$1.89 billion. At December 31, 2017, Company's senior notes were carried at their cost, net of debt issuance costs, of \$1.73 billion and had a fair value of \$2.04 billion. The fair values of the senior notes were obtained from a third party pricing service and are based on observable market inputs. As such, the fair values of the senior notes are classified within Level 2.

## 9. Derivative Instruments

The Company's investment strategy allows for the use of derivative instruments. The Company's derivative instruments are recorded on its consolidated balance sheets at fair value. The Company utilizes exchange traded U.S. Treasury note, Eurodollar and other futures contracts and commodity futures to manage portfolio duration or replicate investment positions in its portfolios and the Company routinely utilizes foreign currency forward contracts, currency options, index futures contracts and other derivatives as part of its total return objective. In addition, certain of the Company's investments are managed in portfolios which incorporate the use of foreign currency forward contracts which are intended to provide an economic hedge against foreign currency movements.

In addition, the Company purchases to-be-announced mortgage backed securities ("TBAs") as part of its investment strategy. TBAs represent commitments to purchase a future issuance of agency mortgage backed securities. For the period between purchase of a TBA and issuance of the underlying security, the Company's position is accounted for as a derivative. The Company purchases TBAs in both long and short positions to enhance investment performance and as part of its overall investment strategy.

The following table summarizes information on the fair values and notional values of the Company's derivative instruments:

	Estimated Fair Value		
	Asset Derivatives	Liability Derivatives	Notional Value (1)
June 30, 2018			
Futures contracts (2)	\$556	\$ (3,425 )	\$ 1,276,189
Foreign currency forward contracts (2)	18,183	(7,732 )	1,072,743
TBAs (3)	14,761	—	14,480
Other (2)	12,884	(11,241 )	1,924,299
Total	\$46,384	\$ (22,398 )	
December 31, 2017			
Futures contracts (2)	\$3,371	\$ (1,542 )	\$ 1,452,497
Foreign currency forward contracts (2)	4,478	(4,381 )	686,941
TBAs (3)	27,184	—	27,066
Other (2)	7,898	(14,541 )	1,457,345
Total	\$42,931	\$ (20,464 )	

(1) Represents the absolute notional value of all outstanding contracts, consisting of long and short positions.

(2) The fair value of asset derivatives are included in 'other assets' and the fair value of liability derivatives are included in 'other liabilities.'

(3)The fair value of TBAs are included in ‘fixed maturities available for sale, at fair value.’

The Company did not hold any derivatives which were designated as hedging instruments at June 30, 2018 or December 31, 2017.

The Company’s derivative instruments can be traded under master netting agreements, which establish terms that apply to all derivative transactions with a counterparty. In the event of a bankruptcy or other stipulated event of default, such agreements provide that the non-defaulting party may elect to terminate all outstanding derivative transactions, in which case all individual derivative positions (loss or gain) with a counterparty are closed out and netted and replaced with a single amount, usually referred to as the termination amount, which is expressed in a single currency. The resulting single net amount, where positive, is payable to the party “in-the-money” regardless of whether or not it is the defaulting party, unless the parties have agreed that only the non-defaulting party is entitled to receive a termination payment where the net amount is positive and is in its favor. Contractual close-out netting reduces derivatives credit exposure from gross to net exposure. The remaining derivatives included in the table above were not subject to a master netting agreement.

At June 30, 2018, asset derivatives and liability derivatives of \$44.0 million and \$20.1 million, respectively, were subject to a master netting agreement, compared to \$40.6 million and \$19.6 million, respectively, at December 31, 2017. The

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## ARCH CAPITAL GROUP LTD. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

remaining derivatives included in the preceding table were not subject to a master netting agreement.

Realized and unrealized contract gains and losses on the Company's derivative instruments are reflected in 'net realized gains (losses)' in the consolidated statements of income, as summarized in the following table:

Derivatives not designated as hedging instruments:	June 30,	
	2018	2017
Three Months Ended		
Net realized gains (losses):		
Futures contracts	\$(240 )	\$(5,310 )
Foreign currency forward contracts	(1,692 )	(272 )
TBAs	—	86
Other	(214 )	726
Total	\$(2,146)	\$(4,770 )

## Six Months Ended

Net realized gains (losses):		
Futures contracts	\$4,790	\$2,410
Foreign currency forward contracts	(7,616 )	(12,038 )
TBAs	(97 )	21
Other	(3,186 )	(4,344 )
Total	\$(6,109)	\$(13,951)

## 10. Commitments and Contingencies

## Investment Commitments

The Company's investment commitments, which are primarily related to agreements entered into by the Company to invest in funds and separately managed accounts when called upon, were approximately \$1.63 billion at June 30, 2018, compared to \$1.70 billion at December 31, 2017.

## Interest Paid

Interest paid on the Company's senior notes and other borrowings were \$60.9 million for the six months ended June 30, 2018, compared to \$58.0 million for the 2017 period.

## 11. Variable Interest Entities and Noncontrolling Interests

A variable interest entity ("VIE") refers to an entity that has characteristics such as (i) insufficient equity at risk to allow the entity to finance its activities without additional financial support or (ii) instances where the equity investors, as a group, do not have characteristics of a controlling financial interest. The primary beneficiary of a VIE is defined as the variable interest holder that is determined to have the controlling financial interest as a result of having both (i) the power to direct the activities of a VIE that most significantly impact the economic performance of the VIE and (ii) the obligation to absorb losses or right to receive benefits from the VIE that could potentially be significant to the VIE. If a company is determined to be the primary beneficiary, it is required to consolidate the VIE in its financial statements. Watford Holdings Ltd.

In March 2014, the Company invested \$100.0 million and acquired approximately 11% of Watford Holdings Ltd.'s common equity and a warrant to purchase additional common equity. Watford Holdings Ltd. is the parent of Watford Re Ltd., a multi-line Bermuda reinsurance company (together with Watford Holdings Ltd., "Watford Re"). Watford Re is considered a VIE and the Company concluded that it is the primary beneficiary of Watford Re. As such, the results

of Watford Re are included in the Company's consolidated financial statements.

The Company does not guarantee or provide credit support for Watford Re, and the Company's financial exposure to Watford Re is limited to its investment in Watford Re's common and preferred shares and counterparty credit risk (mitigated by collateral) arising from reinsurance transactions.

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## ARCH CAPITAL GROUP LTD. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

The following table provides the carrying amount and balance sheet caption in which the assets and liabilities of Watford Re are reported:

	June 30, 2018	December 31, 2017
<b>Assets</b>		
Investments accounted for using the fair value option	\$2,385,316	\$2,426,066
Fixed maturities available for sale, at fair value	279,177	—
Equity securities, at fair value	63,010	—
Cash	45,644	54,503
Accrued investment income	18,108	18,261
Premiums receivable	232,842	177,492
Reinsurance recoverable on unpaid and paid losses and LAE	54,299	42,777
Ceded unearned premiums	55,853	24,762
Deferred acquisition costs	88,752	85,961
Receivable for securities sold	31,387	36,374
Goodwill and intangible assets	7,650	7,650
Other assets	75,478	140,808
Total assets of consolidated VIE	\$3,337,516	\$3,014,654
<b>Liabilities</b>		
Reserves for losses and loss adjustment expenses	\$899,395	\$798,262
Unearned premiums	384,537	330,644
Reinsurance balances payable	41,185	18,424
Revolving credit agreement borrowings	447,289	441,132
Payable for securities purchased	132,164	42,501
Other liabilities	244,320	215,186
Total liabilities of consolidated VIE	\$2,148,890	\$1,846,149

Redeemable noncontrolling interests \$220,805 \$220,622

For the six months ended June 30, 2018, Watford Re generated \$92.4 million of cash provided by operating activities, \$168.0 million of cash used for investing activities and \$2.1 million of cash used for financing activities, compared to \$134.4 million of cash provided by operating activities, \$63.5 million of cash used for investing activities and \$76.4 million of cash used for financing activities for the six months ended June 30, 2017.

Non-redeemable noncontrolling interests

The Company accounts for the portion of Watford Re's common equity attributable to third party investors in the shareholders' equity section of its consolidated balance sheets. The noncontrolling ownership in Watford Re's common shares was approximately 89% at June 30, 2018. The portion of Watford Re's income or loss attributable to third party investors is recorded in the consolidated statements of income in 'net (income) loss attributable to noncontrolling interests.'

The following table sets forth activity in the non-redeemable noncontrolling interests:

	June 30, 2018	2017
<b>Three Months Ended</b>		
Balance, beginning of period	\$854,112	\$868,186
Amounts attributable to noncontrolling interests	8,116	9,346

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Other comprehensive income attributable to noncontrolling interests	(1,075 )	(76 )
Balance, end of period	\$861,153	\$877,456

Six Months Ended

Balance, beginning of year	\$843,411	\$851,854
Amounts attributable to noncontrolling interests	19,492	25,670
Other comprehensive income attributable to noncontrolling interests	(1,750 )	(68 )
Balance, end of period	\$861,153	\$877,456

Redeemable noncontrolling interests

The Company accounts for redeemable noncontrolling interests in the mezzanine section of its consolidated balance sheets in accordance with applicable accounting guidance. Such redeemable noncontrolling interests relate to the 9,065,200 cumulative redeemable preference shares (“Watford Preference Shares”) issued in March 2014 with a par value of \$0.01 per share and a liquidation preference of \$25.00 per share. Preferred dividends, including the accretion of the discount and issuance costs, are included in ‘net (income) loss attributable to noncontrolling interests’ in the Company’s consolidated statements of income.

The following table sets forth activity in the redeemable non-controlling interests:

	June 30,	
	2018	2017
Three Months Ended		
Balance, beginning of period	\$206,013	\$205,644
Accretion of preference share issuance costs	92	92
Balance, end of period	\$206,105	\$205,736
Six Months Ended		
Balance, beginning of year	\$205,922	\$205,553
Accretion of preference share issuance costs	183	183
Balance, end of period	\$206,105	\$205,736

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## ARCH CAPITAL GROUP LTD. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

The portion of Watford Re's income or loss attributable to third party investors, recorded in the Company's consolidated statements of income in 'net (income) loss attributable to noncontrolling interests,' are summarized in the table below:

	June 30,	
	2018	2017
Three Months Ended		
Amounts attributable to non-redeemable noncontrolling interests	\$(8,116 )	\$(9,346 )
Dividends attributable to redeemable noncontrolling interests	(4,585 )	(4,586 )
Net (income) loss attributable to noncontrolling interests	\$(12,701)	\$(13,932)
Six Months Ended		
Amounts attributable to non-redeemable noncontrolling interests	\$(19,492)	\$(25,670)
Dividends attributable to redeemable noncontrolling interests	(9,170 )	(9,170 )
Net (income) loss attributable to noncontrolling interests	\$(28,662)	\$(34,840)

**Bellemeade Re**

The Company has entered into various aggregate excess of loss reinsurance agreements with Bellemeade Re I Ltd. (July 2015), with Bellemeade Re II Ltd. (May 2016), with Bellemeade 2017-1 Ltd. (October 2017) and with Bellemeade 2018-1 Ltd. (April 2018) (the "Bellemeade Agreements"), special purpose reinsurance companies domiciled in Bermuda. At the time the Bellemeade Agreements were entered into, the applicability of the accounting guidance that addresses VIEs was evaluated. As a result of the evaluation of the Bellemeade Agreements, the Company concluded that Bellemeade Re I Ltd., Bellemeade Re II Ltd., Bellemeade 2017-1 Ltd. and Bellemeade 2018-1 Ltd. are VIEs. However, given that the ceding insurers do not have the unilateral power to direct those activities that are significant to the economic performance of Bellemeade Re I Ltd., Bellemeade Re II Ltd., Bellemeade 2017-1 Ltd. and Bellemeade 2018-1 Ltd., the Company does not consolidate such companies in its consolidated financial statements.

The following table presents total assets of the Bellemeade entities, as well as the Company's maximum exposure to loss associated with these VIEs as of June 30, 2018 and December 31, 2017:

	Total VIE Assets	Maximum Exposure to Loss		
		On-Balance Sheet	Off-Balance Sheet	Total
June 30, 2018				
Bellemeade Re I Ltd.	\$69,079	\$263	\$ 469	\$732
Bellemeade Re II Ltd.	55,388	14	110	124
Bellemeade 2017-1 Ltd.	329,030	815	1,759	2,574
Bellemeade 2018-1 Ltd.	374,460	1,242	2,050	3,292
Total	\$827,957	\$2,334	\$ 4,388	\$6,722
December 31, 2017				
Bellemeade Re I Ltd.	\$92,390	\$471	\$ 832	\$1,303
Bellemeade Re II Ltd.	135,201	20	527	547
Bellemeade 2017-1 Ltd.	347,139	391	1,867	2,258
Total	\$574,730	\$882	\$ 3,226	\$4,108

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

## 12. Other Comprehensive Income (Loss)

The following tables present details about amounts reclassified from accumulated other comprehensive income and the tax effects allocated to each component of other comprehensive income (loss):

Details About AOCI Components	Consolidated Statement of Income Line Item That Includes Reclassification	Amounts Reclassified from AOCI				
		Three Months Ended June 30, 2018		Six Months Ended June 30, 2017		
		2018	2017	2018	2017	
Unrealized appreciation on available-for-sale investments						
	Net realized gains (losses)	\$(38,935)	\$24,111	\$(106,521)	\$31,924	
	Other-than-temporary impairment losses	(470 )	(1,730 )	(632 )	(3,537 )	
	Total before tax	(39,405 )	22,381	(107,153 )	28,387	
	Income tax (expense) benefit	2,762	(5,157 )	8,049	(6,119 )	
	Net of tax	\$(36,643)	\$17,224	\$(99,104)	\$22,268	
				Before Tax Amount	Tax Expense (Benefit)	Net of Tax Amount
Three Months Ended June 30, 2018						
	Unrealized appreciation (decline) in value of investments:					
	Unrealized holding gains (losses) arising during period			\$(88,034 )	\$(2,763 )	\$(85,271 )
	Portion of other-than-temporary impairment losses recognized in other comprehensive income (loss)			—	—	—
	Less reclassification of net realized gains (losses) included in net income			(39,405 )	(2,762 )	(36,643 )
	Foreign currency translation adjustments			(12,701 )	(106 )	(12,595 )
	Other comprehensive income (loss)			\$(61,330 )	\$(107 )	\$(61,223 )
Three Months Ended June 30, 2017						
	Unrealized appreciation (decline) in value of investments:					
	Unrealized holding gains (losses) arising during period			\$108,011	\$15,042	\$92,969
	Portion of other-than-temporary impairment losses recognized in other comprehensive income (loss)			—	—	—
	Less reclassification of net realized gains (losses) included in net income			22,381	5,157	17,224
	Foreign currency translation adjustments			18,509	212	18,297
	Other comprehensive income (loss)			\$104,139	\$10,097	\$94,042
Six Months Ended June 30, 2018						
	Unrealized appreciation (decline) in value of investments:					
	Unrealized holding gains (losses) arising during period			\$(277,977)	\$(26,029)	\$(251,948)
	Portion of other-than-temporary impairment losses recognized in other comprehensive income (loss)			—	—	—
	Less reclassification of net realized gains (losses) included in net income			(107,153 )	(8,049 )	(99,104 )
	Foreign currency translation adjustments			(11,269 )	44	(11,313 )
	Other comprehensive income (loss)			\$(182,093)	\$(17,936)	\$(164,157)
Six Months Ended June 30, 2017						
	Unrealized appreciation (decline) in value of investments:					

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Unrealized holding gains (losses) arising during period	\$219,483	\$25,722	\$193,761
Portion of other-than-temporary impairment losses recognized in other comprehensive income (loss)	—	—	—
Less reclassification of net realized gains (losses) included in net income	28,387	6,119	22,268
Foreign currency translation adjustments	21,674	253	21,421
Other comprehensive income (loss)	\$212,770	\$19,856	\$192,914

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## ARCH CAPITAL GROUP LTD. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

## 13. Guarantor Financial Information

The following tables present condensed financial information for Arch Capital, Arch-U.S., a 100% owned subsidiary of Arch Capital, and Arch Capital's other subsidiaries.

Condensed Consolidating Balance Sheet	June 30, 2018				
	Arch Capital (Parent Guarantor)	Arch-U.S. (Subsidiary Issuer)	Other Arch Capital Subsidiaries	Consolidating Adjustments and Eliminations	Arch Capital Consolidated
<b>Assets</b>					
Total investments	\$ 134	\$ 198,122	\$ 21,353,862	\$(14,700 )	\$ 21,537,418
Cash	7,033	27,513	492,082	—	526,628
Investments in subsidiaries	9,455,746	4,033,568	—	(13,489,314 )	—
Due from subsidiaries and affiliates	—	2	1,849,468	(1,849,470 )	—
Premiums receivable	—	—	1,897,517	(546,207 )	1,351,310
Reinsurance recoverable on unpaid and paid losses and loss adjustment expenses	—	—	8,441,528	(5,714,225 )	2,727,303
Contractholder receivables	—	—	2,044,322	—	2,044,322
Ceded unearned premiums	—	—	1,821,539	(806,876 )	1,014,663
Deferred acquisition costs	—	—	633,454	(63,637 )	569,817
Goodwill and intangible assets	—	—	593,008	—	593,008
Other assets	12,978	56,042	1,555,017	(135,386 )	1,488,651
Total assets	\$9,475,891	\$4,315,247	\$40,681,797	\$(22,619,815)	\$31,853,120
<b>Liabilities</b>					
Reserve for losses and loss adjustment expenses	\$—	\$—	\$16,855,050	\$(5,430,713 )	\$11,424,337
Unearned premiums	—	—	4,640,416	(806,876 )	3,833,540
Reinsurance balances payable	—	—	957,289	(546,207 )	411,082
Contractholder payables	—	—	2,044,322	—	2,044,322
Collateral held for insured obligations	—	—	257,396	—	257,396
Senior notes	297,101	494,672	941,438	—	1,733,211
Revolving credit agreement borrowings	—	—	572,289	—	572,289
Due to subsidiaries and affiliates	1,824	536,747	1,310,899	(1,849,470 )	—
Other liabilities	13,211	29,304	1,785,950	(482,535 )	1,345,930
Total liabilities	312,136	1,060,723	29,365,049	(9,115,801 )	21,622,107
Redeemable noncontrolling interests	—	—	220,805	(14,700 )	206,105
<b>Shareholders' Equity</b>					
Total shareholders' equity available to Arch	9,163,755	3,254,524	10,234,790	(13,489,314 )	9,163,755
Non-redeemable noncontrolling interests	—	—	861,153	—	861,153
Total shareholders' equity	9,163,755	3,254,524	11,095,943	(13,489,314 )	10,024,908
Total liabilities, noncontrolling interests and shareholders' equity	\$9,475,891	\$4,315,247	\$40,681,797	\$(22,619,815)	\$31,853,120

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## ARCH CAPITAL GROUP LTD. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

Condensed Consolidating Balance Sheet	December 31, 2017			Consolidating Adjustments and Eliminations	Arch Capital Consolidated
	Arch Capital (Parent Guarantor)	Arch-U.S. (Subsidiary Issuer)	Other Arch Capital Subsidiaries		
<b>Assets</b>					
Total investments	\$96,540	\$46,281	\$21,711,891	\$(14,700 )	\$21,840,012
Cash	9,997	30,380	565,822	—	606,199
Investments in subsidiaries	9,396,621	4,097,765	—	(13,494,386 )	—
Due from subsidiaries and affiliates	394	—	1,828,864	(1,829,258 )	—
Premiums receivable	—	—	2,967,701	(1,832,452 )	1,135,249
Reinsurance recoverable on unpaid and paid losses and loss adjustment expenses	—	—	8,442,192	(5,902,049 )	2,540,143
Contractholder receivables	—	—	1,978,414	—	1,978,414
Ceded unearned premiums	—	—	2,165,789	(1,239,178 )	926,611
Deferred acquisition costs	—	—	693,053	(157,229 )	535,824
Goodwill and intangible assets	—	—	652,611	—	652,611
Other assets	13,176	49,585	1,860,505	(86,671 )	1,836,595
Total assets	\$9,516,728	\$4,224,011	\$42,866,842	\$(24,555,923)	\$32,051,658
<b>Liabilities</b>					
Reserve for losses and loss adjustment expenses	\$—	\$—	\$17,236,401	\$(5,852,609 )	\$11,383,792
Unearned premiums	—	—	4,861,491	(1,239,177 )	3,622,314
Reinsurance balances payable	—	—	2,155,947	(1,832,451 )	323,496
Contractholder payables	—	—	1,978,414	—	1,978,414
Collateral held for insured obligations	—	—	240,183	—	240,183
Senior notes	297,053	494,621	941,210	—	1,732,884
Revolving credit agreement borrowings	—	—	816,132	—	816,132
Due to subsidiaries and affiliates	235	536,919	1,292,104	(1,829,258 )	—
Other liabilities	22,838	29,317	1,949,696	(293,343 )	1,708,508
Total liabilities	320,126	1,060,857	31,471,578	(11,046,838 )	21,805,723
Redeemable noncontrolling interests	—	—	220,622	(14,700 )	205,922
<b>Shareholders' Equity</b>					
Total shareholders' equity available to Arch	9,196,602	3,163,154	10,331,231	(13,494,385 )	9,196,602
Non-redeemable noncontrolling interests	—	—	843,411	—	843,411
Total shareholders' equity	9,196,602	3,163,154	11,174,642	(13,494,385 )	10,040,013
Total liabilities, noncontrolling interests and shareholders' equity	\$9,516,728	\$4,224,011	\$42,866,842	\$(24,555,923)	\$32,051,658

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## ARCH CAPITAL GROUP LTD. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

Three Months Ended June 30, 2018

Condensed Consolidating Statement of Income and Comprehensive Income	Arch Capital (Parent Guarantor)	Arch-U.S. (Subsidiary Issuer)	Other Arch Capital Subsidiaries	Consolidating Adjustments and Eliminations	Arch Capital Consolidated
Revenues					
Net premiums earned	\$—	\$—	\$ 1,336,763	\$—	\$ 1,336,763
Net investment income	15	560	157,532	(22,439 )	135,668
Net realized gains (losses)	—	—	(76,611 )	—	(76,611 )
Net impairment losses recognized in earnings	—	—	(470 )	—	(470 )
Other underwriting income	—	—	3,874	—	3,874
Equity in net income (loss) of investment funds accounted for using the equity method	—	—	8,472	—	8,472
Other income (loss)	2,339	—	774	—	3,113
Total revenues	2,354	560	1,430,334	(22,439 )	1,410,809
Expenses					
Losses and loss adjustment expenses	—	—	726,153	—	726,153
Acquisition expenses	—	—	202,838	—	202,838
Other operating expenses	—	—	176,181	—	176,181
Corporate expenses	16,642	470	5,400	—	22,512
Amortization of intangible assets	—	—	26,472	—	26,472
Interest expense	5,537	12,013	34,911	(22,117 )	30,344

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Net foreign exchange (gains) losses	—	—	(43,357)	(10,349)	(53,706)
Total expenses	22,179	12,483	1,128,598	(32,466)	1,130,794
Income (loss) before income taxes	(19,825)	(11,923)	301,736	10,027	280,015
Income tax (expense) benefit	—	2,477	(26,145)	—	(23,668)
Income (loss) before equity in net income of subsidiaries	(19,825)	(9,446)	275,591	10,027	256,347
Equity in net income of subsidiaries	263,471	86,727	—	(350,198)	—
Net income	243,646	77,281	275,591	(340,171)	256,347
Net (income) loss attributable to noncontrolling interests	—	—	(13,023)	322	(12,701)
Net income available to Arch	243,646	77,281	262,568	(339,849)	243,646
Preferred dividends	(10,403)	—	—	—	(10,403)
Net income available to Arch common shareholders	\$ 233,243	\$ 77,281	\$ 262,568	\$ (339,849)	\$ 233,243
Comprehensive income available to Arch	\$ 183,500	\$ 70,066	\$ 212,802	\$ (282,868)	\$ 183,500

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## ARCH CAPITAL GROUP LTD. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

Three Months Ended June 30, 2017

Condensed Consolidating Statement of Income and Comprehensive Income	Arch Capital (Parent Guarantor)	Arch-U.S. (Subsidiary Issuer)	Other Arch Capital Subsidiaries	Consolidating Adjustments and Eliminations	Arch Capital Consolidated
Revenues					
Net premiums earned	\$—	\$—	\$ 1,240,874	\$—	\$ 1,240,874
Net investment income	1	184	133,627	(22,688 )	111,124
Net realized gains (losses)	—	—	21,735	—	21,735
Net impairment losses recognized in earnings	—	—	(1,730 )	—	(1,730 )
Other underwriting income	—	—	4,822	—	4,822
Equity in net income (loss) of investment funds accounted for using the equity method	—	—	32,706	—	32,706
Other income (loss)	(437 )	—	(1,557 )	—	(1,994 )
Total revenues	(436 )	184	1,430,477	(22,688 )	1,407,537
Expenses					
Losses and loss adjustment expenses	—	—	689,860	—	689,860
Acquisition expenses	—	—	190,436	—	190,436
Other operating expenses	—	—	169,981	—	169,981
Corporate expenses	21,816	1,309	1,751	—	24,876
Amortization of intangible assets	—	—	30,824	—	30,824
Interest expense	6,075	11,989	33,050	(22,365 )	28,749

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Net foreign exchange (gains) losses	—	—	29,843	9,700	39,543
Total expenses	27,891	13,298	1,145,745	(12,665)	1,174,269
Income (loss) before income taxes	(28,327)	(13,114)	284,732	(10,023)	233,268
Income tax (expense) benefit	—	4,069	(38,238)	—	(34,169)
Income (loss) before equity in net income of subsidiaries	(28,327)	(9,045)	246,494	(10,023)	199,099
Equity in net income of subsidiaries	213,494	86,156	—	(299,650)	—
Net income	185,167	77,111	246,494	(309,673)	199,099
Net (income) loss attributable to noncontrolling interests	—	—	(14,254)	322	(13,932)
Net income available to Arch	185,167	77,111	232,240	(309,351)	185,167
Preferred dividends	(11,349)	—	—	—	(11,349)
Net income available to Arch common shareholders	\$ 173,818	\$ 77,111	\$ 232,240	\$ (309,351)	\$ 173,818
Comprehensive income available to Arch	\$ 279,285	\$ 105,302	\$ 475,747	\$ (581,049)	\$ 279,285

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## ARCH CAPITAL GROUP LTD. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

	Six Months Ended June 30, 2018				
Condensed Consolidating Statement of Income and Comprehensive Income	Arch Capital (Parent Guarantor)	Arch-U.S. (Subsidiary Issuer)	Other Arch Capital Subsidiaries	Consolidating Adjustments and Eliminations	Arch Capital Consolidated
Revenues					
Net premiums earned	\$—	\$—	\$2,571,662	\$—	\$2,571,662
Net investment income	35	818	306,299	(44,760 )	262,392
Net realized gains (losses)	29	(7 )	(187,631 )	—	(187,609 )
Net impairment losses recognized in earnings	—	—	(632 )	—	(632 )
Other underwriting income	—	—	9,223	—	9,223
Equity in net income (loss) of investment funds accounted for using the equity method	—	—	36,541	—	36,541
Other income (loss)	2,261	—	926	—	3,187
Total revenues	2,325	811	2,736,388	(44,760 )	2,694,764
Expenses					
Losses and loss adjustment expenses	—	—	1,363,013	—	1,363,013
Acquisition expenses	—	—	394,214	—	394,214
Other operating expenses	—	—	351,196	—	351,196
Corporate expenses	32,811	759	4,254	—	37,824
Amortization of intangible assets	—	—	53,208	—	53,208
Interest expense	11,073	23,939	70,083	(44,115 )	60,980

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Net foreign exchange (gains) losses	29	—	(26,921)	(7,093)	(33,985)
Total expenses	43,913	24,698	2,209,047	(51,208)	2,226,450
Income (loss) before income taxes	(41,588)	(23,887)	527,341	6,448	468,314
Income tax (expense) benefit	—	5,428	(51,011)	—	(45,583)
Income (loss) before equity in net income of subsidiaries	(41,588)	(18,459)	476,330	6,448	422,731
Equity in net income of subsidiaries	435,657	173,147	—	(608,804)	—
Net income	394,069	154,688	476,330	(602,356)	422,731
Net (income) loss attributable to noncontrolling interests	—	—	(29,307)	645	(28,662)
Net income available to Arch	394,069	154,688	447,023	(601,711)	394,069
Preferred dividends	(20,840)	—	—	—	(20,840)
Loss on redemption of preferred shares	(2,710)	—	—	—	(2,710)
Net income available to Arch common shareholders	\$370,519	\$154,688	\$447,023	\$(601,711)	\$370,519
Comprehensive income available to Arch	\$231,662	\$76,603	\$291,883	\$(368,486)	\$231,662

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## ARCH CAPITAL GROUP LTD. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

	Six Months Ended June 30, 2017				
Condensed Consolidating Statement of Income and Comprehensive Income	Arch Capital (Parent Guarantor)	Arch-U.S. (Subsidiary Issuer)	Other Arch Capital Subsidiaries	Consolidating Adjustments and Eliminations	Arch Capital Consolidated
Revenues					
Net premiums earned	\$—	\$—	\$2,357,891	\$—	\$2,357,891
Net investment income	6	1,000	271,608	(43,616 )	228,998
Net realized gains (losses)	—	—	55,888	—	55,888
Net impairment losses recognized in earnings	—	—	(3,537 )	—	(3,537 )
Other underwriting income	—	—	9,455	—	9,455
Equity in net income (loss) of investment funds accounted for using the equity method	—	—	80,794	—	80,794
Other income (loss)	(266 )	—	(2,510 )	—	(2,776 )
Total revenues	(260 )	1,000	2,769,589	(43,616 )	2,726,713
Expenses					
Losses and loss adjustment expenses	—	—	1,242,430	—	1,242,430
Acquisition expenses	—	—	372,725	—	372,725
Other operating expenses	—	—	344,700	—	344,700
Corporate expenses	39,063	3,317	10,288	—	52,668
Amortization of intangible assets	—	—	62,118	—	62,118
Interest expense	12,090	23,919	64,386	(42,970 )	57,425

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Net foreign exchange (gains) losses	—	—	45,191	13,756	58,947
Total expenses	51,153	27,236	2,141,838	(29,214)	2,191,013
Income (loss) before income taxes	(51,413)	(26,236)	627,751	(14,402)	535,700
Income tax (expense) benefit	—	8,942	(71,508)	—	(62,566)
Income (loss) before equity in net income of subsidiaries	(51,413)	(17,294)	556,243	(14,402)	473,134
Equity in net income of subsidiaries	489,707	163,529	—	(653,236)	—
Net income	438,294	146,235	556,243	(667,638)	473,134
Net (income) loss attributable to noncontrolling interests	—	—	(35,485)	645	(34,840)
Net income available to Arch	438,294	146,235	520,758	(666,993)	438,294
Preferred dividends	(22,567)	—	—	—	(22,567)
Net income available to Arch common shareholders	\$415,727	\$146,235	\$520,758	\$(666,993)	\$415,727
Comprehensive income available to Arch	\$631,276	\$193,083	\$699,920	\$(893,003)	\$631,276

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## ARCH CAPITAL GROUP LTD. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

Six Months Ended June 30, 2018

Condensed Consolidating Statement of Cash Flows	Arch Capital (Parent Guarantor)	Arch-U.S. (Subsidiary Issuer)	Other Arch Capital Subsidiaries	Consolidating Adjustments and Eliminations	Arch Capital Consolidated
Operating Activities Net Cash Provided By (Used For)	\$201,487	\$ 149,576	\$ 1,010,703	\$ (864,880 )	\$ 496,886
Operating Activities					
Investing Activities Purchases of fixed maturity investments	—	(125,440 )	(17,347,846)	605,716	(16,867,570 )
Purchases of equity securities	—	—	(679,663 )	—	(679,663 )
Purchases of other investments	—	—	(1,017,147 )	—	(1,017,147 )
Proceeds from the sales of fixed maturity investments	—	33,793	16,662,466	(605,716 )	16,090,543
Proceeds from the sales of equity securities	—	—	622,068	—	622,068
Proceeds from the sales, redemptions and maturities of other investments	—	—	773,298	—	773,298
Proceeds from	—	—	511,448	—	511,448

redemptions and maturities of fixed maturity investments					
Net settlements of	—	—	4,498	—	4,498
derivative instruments					
Net (purchases) sales of	96,446	(59,798 )	415,253	—	451,901
short-term investments					
Change in cash					
collateral related to securities lending	—	—	176,304	—	176,304
Contributions to subsidiaries	—	(1,000 )	(22,595 )	23,595	—
Purchases of fixed assets	(71 )	—	(13,171 )	—	(13,242 )
Other	(4 )	—	49,965	—	49,961
Net Cash Provided By (Used For)	96,371	(152,445 )	134,878	23,595	102,399
Investing Activities					
Financing Activities					
Redemption of preferred shares	(92,555 )	—	—	—	(92,555 )
Purchases of common shares under share repurchase program	(173,575 )	—	—	—	(173,575 )
Proceeds from common shares	(13,851 )	—	23,595	(23,595 )	(13,851 )



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issued, net					
Proceeds					
from	—	—	130,579	—	130,579
borrowings					
Repayments					
of	—	—	(373,000	) —	(373,000 )
borrowings					
Change in					
cash					
collateral	—	—	(176,304	) —	(176,304 )
related to					
securities					
lending					
Dividends					
paid to					
redeemable—	—	—	(9,632	) 638	(8,994 )
noncontrolling					
interests					
Dividends					
paid to	—	—	(864,242	) 864,242	—
parent (1)					
Other	—	—	(4,489	) —	(4,489 )
Preferred					
dividends	(20,840	) —	—	—	(20,840 )
paid					
Net Cash					
Provided					
By (Used	(300,821	) —	(1,273,493	) 841,285	(733,029 )
For)					
Financing					
Activities					
Effects of					
exchange					
rates					
changes on					
foreign	—	—	(10,431	) —	(10,431 )
currency					
cash and					
restricted					
cash					
Increase					
(decrease)					
in cash and	(2,963	) (2,869	) (138,343	) —	(144,175 )
restricted					
cash					
Cash and					
restricted					
cash,	10,048	30,380	686,856	—	727,284
beginning					
of year					
	\$7,085	\$27,511	\$548,513	\$—	\$583,109

Cash and  
restricted  
cash, end  
of period

(1) Dividends received by parent are included in net cash provided by (used for) operating activities.

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## ARCH CAPITAL GROUP LTD. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

Six Months Ended June 30, 2017					
Condensed Consolidating Statement of Cash Flows	Arch Capital (Parent Guarantor)	Arch-U.S. (Subsidiary Issuer)	Other Arch Capital Subsidiaries	Consolidating Adjustments and Eliminations	Arch Capital Consolidated
Operating Activities Net Cash Provided By (Used For)	\$7,483	\$ 27,853	\$ 956,437	\$ (458,238 )	\$ 533,535
Operating Activities Investing Activities Purchases of fixed maturity investments	—	—	(19,899,326)	—	(19,899,326 )
Purchases of equity securities	—	—	(400,155 )	—	(400,155 )
Purchases of other investments	—	—	(883,704 )	—	(883,704 )
Proceeds from the sales of fixed maturity investments	—	—	19,611,680	—	19,611,680
Proceeds from the sales of equity securities	—	—	473,064	—	473,064
Proceeds from the sales, redemptions and maturities of other investments	—	—	614,494	—	614,494
	—	—	447,941	—	447,941

Proceeds from redemptions and maturities of fixed maturity investments					
Net settlements of derivative instruments	—	—	(5,984	) —	(5,984
Net (purchases) sales of short-term investments	2,354	(27,896	) (419,661	) —	(445,203
Change in cash collateral related to securities lending	—	—	175,693	—	175,693
Contributions to subsidiaries	20,641	(72,900	) (342,950	) 395,209	—
Issuance of intercompany loans	—	—	(47,000	) 47,000	—
Repayment of intercompany loans	—	47,000	—	(47,000	) —
Purchases of fixed assets	(18	) (10	) (11,075	) —	(11,103
Other	—	—	54,129	(20,641	) 33,488
Net Cash Provided By (Used For)	22,977	(53,806	) (632,854	) 374,568	(289,115
Investing Activities					
Financing Activities					
Proceeds from common shares issued, net	(6,838	) —	395,209	(395,209	) (6,838

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Repayments of borrowings	—	—	(72,000	) —	(72,000	)
Change in cash collateral related to securities lending	—	—	(175,693	) —	(175,693	)
Dividends paid to redeemable noncontrolling interests	—	—	(9,632	) 638	(8,994	)
Dividends paid to parent (1)	—	—	(457,600	) 457,600	—	
Other Preferred dividends paid	—	—	(62,339	) 20,641	(41,698	)
Net Cash Provided By (Used For) Financing Activities	(22,567)	—	—	—	(22,567	)
Effects of exchange rates changes on foreign currency cash and restricted cash	(29,405)	—	(382,055	) 83,670	(327,790	)
Increase (decrease) in cash and restricted cash	—	—	9,616	—	9,616	
Cash and restricted cash, beginning of year	1,055	(25,953	) (48,856	) —	(73,754	)
Cash and restricted cash, end of period	1,738	71,955	895,876	—	969,569	
	\$ 2,793	\$ 46,002	\$ 847,020	\$ —	\$ 895,815	

- (1) Dividends received by parent are included in net cash provided by (used for) operating activities.

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ARCH CAPITAL GROUP LTD. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

14. Income Taxes

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The Company's income tax provision on income before income taxes resulted in an expense of 9.7% for the six months ended June 30, 2018, compared to an expense of 11.7% for the 2017 period. The Company's effective tax rate, which is based upon the expected annual effective tax rate, may fluctuate from period to period based on the relative mix of income or loss reported by jurisdiction and the varying tax rates in each jurisdiction. For interim reporting purposes, the Company has calculated its effective tax rate for the full year of 2018 by treating any excess tax benefits that arise from the accounting for stock based compensation as a discrete item. As such, this amount is not included when projecting the Company's full year effective tax rate but rather is accounted for at the U.S. Federal statutory rate of 21% after applying the projected full year effective tax rate to actual results before the discrete item. The impact of the discrete item resulted in a benefit of 0.6% for the six months ended June 30, 2018.

On December 22, 2017, Staff Accounting Bulletin No. 118 ("SAB 118") was issued to address the application of GAAP in situations when a registrant does not have the necessary information available, prepared or analyzed in reasonable detail to complete the accounting for certain income tax effects of the Tax Cuts and Jobs Act of 2017 ("Tax Cuts Act"). Pursuant to the guidance within SAB 118, the Company's remeasurement of its deferred taxes at December 31, 2017 included certain provisional effects associated with enactment of the Tax Cuts Act for which measurement could be reasonably estimated. Provisional amounts may be adjusted in 2018 during the measurement period in accordance with SAB 118 when additional information is obtained. Additional information that may affect the provisional amounts would include, completion of the Company's U.S. subsidiaries' 2017 tax return filings, and potential future guidance from the IRS with respect to the transitional adjustment pertaining to loss reserve discounting as well as the utilization of alternative minimum tax credits. The Company's income tax provision six months ended June 30, 2018 does not include any adjustments to the provisional effects recorded at December 31, 2017.

The Company had a net deferred tax asset of \$9.7 million at June 30, 2018, compared to \$39.6 million at December 31, 2017. In addition, the Company recovered \$46.5 million and paid \$3.9 million of income taxes for the six months ended June 30, 2018 and 2017, respectively.

15. Legal Proceedings

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The Company, in common with the insurance industry in general, is subject to litigation and arbitration in the normal course of its business. As of June 30, 2018, the Company was not a party to any litigation or arbitration which is expected by management to have a material adverse effect on the Company's results of operations and financial condition and liquidity.

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ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

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The following is a discussion and analysis of our financial condition and results of operations. This should be read in conjunction with our consolidated financial statements included in Item 1 of this report and also our Management's Discussion and Analysis of Financial Condition and Results of Operations contained in our Annual Report on Form 10-K for the year ended December 31, 2017 ("2017 Form 10-K"). In addition, readers should review "Risk Factors" set forth in Item 1A of Part I of our 2017 Form 10-K. Tabular amounts are in U.S. Dollars in thousands, except share amounts, unless otherwise noted.

Arch Capital Group Ltd. ("Arch Capital" and, together with its subsidiaries, "we" or "us") is a Bermuda public limited liability company with approximately \$11.02 billion in capital at June 30, 2018 and, through operations in Bermuda, the United States, Europe, Canada and Australia, writes insurance, reinsurance and mortgage insurance on a worldwide basis.

**CURRENT OUTLOOK**

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Our objective is to achieve an average operating return on average equity of 15% or greater over the insurance cycle, which we believe to be an attractive return to our common shareholders given the risks we assume. We continue to look for opportunities to find acceptable books of business to underwrite without sacrificing underwriting discipline and continue to write a portion of our overall book in catastrophe-exposed business which has the potential to increase the volatility of our operating results.

The broad property casualty insurance market environment continues to be competitive, with market conditions improving modestly in the 2018 second quarter. In most of our insurance lines of business, rate increases appear to be in excess of loss cost trends. However, with the continued low interest rate environment, additional price increases are needed in many lines in order for us to achieve our return requirements. Our underwriting teams continue to execute a disciplined strategy by emphasizing small and medium-sized accounts over large accounts, shrinking premiums in more commoditized lines such as general liability and directors and officers, and by utilizing reinsurance purchases to reduce volatility on large account, high capacity business. Writings in property catastrophe exposed business were down in the 2018 second quarter as most rate levels were below our risk-adjusted return requirements.

Our mortgage segment continues to experience generally favorable market conditions, albeit with pressure on pricing,

and our results reflect our success in making superior credit underwriting risk decisions and in expanding our distribution and producer relationships.

Arch remains committed to providing solutions across many offerings as the marketplace evolves, including new mortgage credit risk transfer programs initiated by government sponsored enterprises, or "GSEs," in 2018. Such programs are in their infancy and did not contribute in any significant fashion to our results in the 2018 second quarter. In addition, in April 2018, we announced that we entered into a multi-year agreement with Munich Re to provide mortgage credit assessment and underwriting advisory services related to Munich Re's involvement in credit risk transfer programs offered by Federal National Mortgage Association ("Fannie Mae") and Federal Home Loan Mortgage Corporation ("Freddie Mac"), each a GSE.

**FINANCIAL MEASURES**

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Management uses the following three key financial indicators in evaluating our performance and measuring the overall growth in value generated for Arch Capital's common shareholders:

**Book Value per Share**

Book value per share represents total common shareholders' equity available to Arch divided by the number of common shares outstanding. Management uses growth in book value per share as a key measure of the value generated for our common shareholders each period and believes that book value per share is the key driver of Arch



Capital's share price over time. Book value per share is impacted by, among other factors, our underwriting results, investment returns and share repurchase activity, which has an accretive or dilutive impact on book value per share depending on the purchase price.

Book value per share was \$20.68 at June 30, 2018, compared to \$20.41 at March 31, 2018 and \$19.87 at June 30, 2017. The 1.3% increase for the 2018 second quarter reflected strong underwriting results, partially offset by the impact of an increase in interest rates on our fixed income securities in the period, while the 4.1% increase over the trailing twelve months reflected strong investment and underwriting results.

Operating Return on Average Common Equity

Operating return on average common equity ("Operating ROAE") represents annualized after-tax operating income available to Arch common shareholders divided by the average

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of beginning and ending common shareholders' equity available to Arch during the period. After-tax operating income available to Arch common shareholders, a non-GAAP financial measure as defined in Regulation G, represents net income available to Arch common shareholders, excluding net realized gains or losses, net impairment losses recognized in earnings, equity in net income or loss of investment funds accounted for using the equity method, net foreign exchange gains or losses, UGC transaction costs and other, loss on redemption of preferred shares and income taxes. Management uses Operating ROAE as a key measure of the return generated to common shareholders. See "Comment on Non-GAAP Financial Measures."

Our Operating ROAE was 11.6% for the 2018 second quarter, compared to 8.5% for the 2017 second quarter, and 11.4% for the six months ended June 30, 2018, compared to 9.4% for the 2017 period. The 2018 returns reflected strong mortgage insurance underwriting performance and a low level of catastrophic activity.

**Total Return on Investments**

Total return on investments includes investment income, equity in net income or loss of investment funds accounted for using the equity method, net realized gains and losses and the change in unrealized gains and losses generated by Arch's investment portfolio. Total return is calculated on a pre-tax basis and before investment expenses, excludes amounts reflected in the 'other' segment, and reflects the effect of financial market conditions along with foreign currency fluctuations. In addition, total return incorporates the timing of investment returns during the periods. The following table summarizes our total return compared to the benchmark return against which we measured our portfolio during the periods. See "Comment on Non-GAAP Financial Measures."

	Arch Portfolio	Benchmark Return
2018 Second Quarter	(0.19 )%	(0.21 )%
2017 Second Quarter	1.63 %	1.53 %

Six Months Ended June 30, 2018 (0.51 )% (0.89 )%

Six Months Ended June 30, 2017 3.37 % 3.05 %

Excluding the effects of foreign exchange, total return was 0.33% for the 2018 second quarter and (0.08)% for the six months ended June 30, 2018, reflecting an increase in interest rates in the 2018 periods. Total return for the 2018 periods reflected the strengthening of the U.S. Dollar against the Euro and British Pound Sterling on non-U.S. Dollar denominated investments.

The benchmark return index is a customized combination of indices intended to approximate a target portfolio by asset mix and average credit quality while also matching the approximate estimated duration and currency mix of our insurance and

reinsurance liabilities. Although the estimated duration and average credit quality of this index will move as the duration and rating of its constituent securities change, generally we do not adjust the composition of the benchmark return index except to incorporate changes to the mix of liability currencies and durations noted above. The benchmark return index should not be interpreted as expressing a preference for or aversion to any particular sector or sector weight. The index is intended solely to provide, unlike many master indices that change based on the size of their constituent indices, a relatively stable basket of investable indices. At June 30, 2018, the benchmark return index had an average credit quality of "Aa2" by Moody's Investors Service ("Moody's"), and an estimated duration of 3.25 years. The benchmark return index included weightings to the following indices, which are primarily from The Bank of America Merrill Lynch ("BoAML"):

	%
BoAML 1-10 Year U.S. Corporate & All Yankees, A - AAA Rated Index	20.00 %
BoAML 1-5 Year U.S. Treasury Index	15.00
BoAML 1-10 Year U.S. Municipal Securities Index	14.50
BoAML 3-5 Year Fixed Rate Asset Backed Securities Index	7.00
Barclays CMBS Inv. Grade, AAA Rated Index	5.00
MSCI All Country World Gross Total Return Index	5.00

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BoAML German Government 1-10 Year Index	5.00
BoAML U.S. Mortgage Backed Securities Index	4.00
Hedge Fund Research HFRX Fixed Income Credit Index	3.50
Hedge Fund Research HFRX Equal Weighted Strategies	3.50
BoAML 5-10 Year U.S. Treasury Index	3.00
BoAML 1-5 Year U.K. Gilt Index	3.00
BoAML U.S. High Yield Constrained Index	2.50
BoAML 1-5 Year Australian Governments Index	2.50
S&P Leveraged Loan Index	2.50
BoAML 0-3 Month U.S. Treasury Bill Index	2.00
BoAML 1-5 Year Canada Government Index	1.50
BoAML 20+ Year Canada Government Index	0.50
Total	100.00%

COMMENT ON NON-GAAP FINANCIAL MEASURES

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Throughout this filing, we present our operations in the way we believe will be the most meaningful and useful to investors, analysts, rating agencies and others who use our financial information in evaluating the performance of our company. This presentation includes the use of after-tax operating income available to Arch common shareholders, which is defined as net income available to Arch common shareholders, excluding net realized gains or losses, net impairment losses recognized in earnings, equity in net income or loss of investment funds accounted for using the equity method, net foreign exchange gains or losses, UGC transaction costs and other, loss on redemption of preferred shares and income taxes, and the use of annualized operating return on average common equity. The

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presentation of after-tax operating income available to Arch common shareholders and annualized operating return on average common equity are non-GAAP financial measures as defined in Regulation G. The reconciliation of such measures to net income available to Arch common shareholders and annualized return on average common equity (the most directly comparable GAAP financial measures) in accordance with Regulation G is included under “Results of Operations” below.

We believe that net realized gains or losses, net impairment losses recognized in earnings, equity in net income or loss of investment funds accounted for using the equity method, net foreign exchange gains or losses, UGC transaction costs and other and loss on redemption of preferred shares in any particular period are not indicative of the performance of, or trends in, our business. Although net realized gains or losses, net impairment losses recognized in earnings, equity in net income or loss of investment funds accounted for using the equity method and net foreign exchange gains or losses are an integral part of our operations, the decision to realize investment gains or losses, the recognition of the change in the carrying value of investments accounted for using the fair value option in net realized gains or losses, the recognition of net impairment losses, the recognition of equity in net income or loss of investment funds accounted for using the equity method and the recognition of foreign exchange gains or losses are independent of the insurance underwriting process and result, in large part, from general economic and financial market conditions. Furthermore, certain users of our financial information believe that, for many companies, the timing of the realization of investment gains or losses is largely opportunistic. In addition, net impairment losses recognized in earnings on our investments represent other-than-temporary declines in expected recovery values on securities without actual realization. The use of the equity method on certain of our investments in certain funds that invest in fixed maturity securities is driven by the ownership structure of such funds (either limited partnerships or limited liability companies). In applying the equity method, these investments are initially recorded at cost and are subsequently adjusted based on our proportionate share of the net income or loss of the funds (which include changes in the market value of the underlying securities in the funds). This method of accounting is different from the way we account for our other fixed maturity securities and the timing of the recognition of equity in net income or loss of investment funds accounted for using the equity method may differ from gains or losses in the future upon sale or maturity of such investments. UGC transaction costs and other include advisory, financing, legal, severance, incentive compensation and other transaction costs related to the acquisition of United Guaranty Corporation, a North Carolina corporation (“UGC”) which closed at the end of 2016. We believe that UGC transaction costs and other, due to their non-recurring nature, are not indicative of the performance of, or trends in, our business performance. The loss on redemption of preferred shares related to the redemption of our Series C preferred shares

in January 2018 and had no impact on shareholders' equity or cash flows. Due to these reasons, we exclude net realized gains or losses, net impairment losses recognized in earnings, equity in net income or loss of investment funds accounted for using the equity method, net foreign exchange gains or losses, UGC transaction costs and other and loss on redemption of preferred shares from the calculation of after-tax operating income available to Arch common shareholders.

We believe that showing net income available to Arch common shareholders exclusive of the items referred to above reflects the underlying fundamentals of our business since we evaluate the performance of and manage our business to produce an underwriting profit. In addition to presenting net income available to Arch common shareholders, we believe that this presentation enables investors and other users of our financial information to analyze our performance in a manner similar to how management analyzes performance. We also believe that this measure follows industry practice and, therefore, allows the users of financial information to compare our performance with our industry peer group. We believe that the equity analysts and certain rating agencies which follow us and the insurance industry as a whole generally exclude these items from their analyses for the same reasons.

Our segment information includes the presentation of consolidated underwriting income or loss and a subtotal of underwriting income or loss before the contribution from the ‘other’ segment. Such measures represent the pre-tax profitability of our underwriting operations and include net premiums earned plus other underwriting income, less losses and loss adjustment expenses, acquisition expenses and other operating expenses. Other operating expenses include those operating expenses that are incremental and/or directly attributable to our individual underwriting

operations. Underwriting income or loss does not incorporate items included in our corporate (non-underwriting) segment. While these measures are presented in Note 5, “Segment Information,” of the notes accompanying our consolidated financial statements, they are considered non-GAAP financial measures when presented elsewhere on a consolidated basis. The reconciliations of underwriting income or loss to income before income taxes (the most directly comparable GAAP financial measure) on a consolidated basis and a subtotal before the contribution from the ‘other’ segment, in accordance with Regulation G, is shown in Note 5, “Segment Information” to our consolidated financial statements.

We measure segment performance for our three underwriting segments based on underwriting income or loss. We do not manage our assets by underwriting segment, with the exception of goodwill and intangibles and, accordingly, investment income and other non-underwriting related items are not allocated to each underwriting segment. For the ‘other’ segment, performance is measured based on net income or loss.

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Along with consolidated underwriting income, we provide a subtotal of underwriting income or loss before the contribution from the ‘other’ segment. Pursuant to generally accepted accounting principles, Watford Re is considered a variable interest entity and we concluded that we are the primary beneficiary of Watford Re. As such, we consolidate the results of Watford Re in our consolidated financial statements, although we only own approximately 11% of Watford Re’s common equity. Watford Re has its own management and board of directors that is responsible for its overall profitability. In addition, we do not guarantee or provide credit support for Watford Re. Since Watford Re is an independent company, the assets of Watford Re can be used only to settle obligations of Watford Re and Watford Re is solely responsible for its own liabilities and commitments. Our financial exposure to Watford Re is limited to our investment in Watford Re’s common and preferred shares and counterparty credit risk (mitigated by collateral) arising from the reinsurance transactions. We believe that presenting certain information excluding the ‘other’ segment enables investors and other users of our financial information to analyze our performance in a manner similar to how our management analyzes performance.

Our presentation of segment information includes the use of a current year loss ratio which excludes favorable or adverse development in prior year loss reserves. This ratio is a non-GAAP financial measure as defined in Regulation G. The reconciliation of such measure to the loss ratio (the most directly comparable GAAP financial measure) in accordance with Regulation G is shown on the individual segment pages. Management utilizes the current year loss ratio in its analysis of the underwriting performance of each of our underwriting segments.

Total return on investments includes investment income, equity in net income or loss of investment funds accounted for using the equity method, net realized gains and losses and the change in unrealized gains and losses generated by Arch’s investment portfolio. Total return is calculated on a pre-tax basis and before investment expenses, excludes amounts reflected in the ‘other’ segment, and reflects the effect of financial market conditions along with foreign currency fluctuations. In addition, total return incorporates the timing of investment returns during the periods. There is no directly comparable GAAP financial measure for total return. Management uses total return on investments as a key measure of the return generated to Arch common shareholders on the capital held in the business, and compares the return generated by our investment portfolio against benchmark returns which we measured our portfolio against during the periods.

**RESULTS OF OPERATIONS**

The following table summarizes our consolidated financial data, including a reconciliation of net income available to Arch common shareholders to after-tax operating income available to Arch common shareholders. Each line item reflects the impact of our approximate 11% ownership of Watford Re’s common equity.

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2018	2017	2018	2017
Net income available to Arch common shareholders	\$233,243	\$173,818	\$370,519	\$415,727
Net realized (gains) losses	61,426	(18,452)	173,190	(47,586)
Net impairment losses recognized in earnings	470	1,730	632	3,537
Equity in net (income) loss of investment funds accounted for using the equity method	(8,472)	(32,706)	(36,541)	(80,794)
Net foreign exchange (gains) losses	(47,038)	38,012	(31,482)	57,808
UGC transaction costs and other	6,908	2,675	7,738	18,259
Loss on redemption of preferred shares	—	—	2,710	—
Income tax expense (benefit) (1)	(3,941)	3,842	(9,027)	(67)
After-tax operating income available to Arch common shareholders	\$242,596	\$168,919	\$477,739	\$366,884
Beginning common shareholders’ equity	\$8,370,372	\$7,833,289	\$8,324,047	\$7,481,163

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Ending common shareholders' equity	8,383,755	8,126,332	8,383,755	8,126,332
Average common shareholders' equity	\$8,377,064	\$7,979,811	\$8,353,901	\$7,803,748
Annualized return on average common equity %	11.1	8.7	8.9	10.7
Annualized operating return on average common equity %	11.6	8.5	11.4	9.4

(1) Income tax on net realized gains or losses, net impairment losses recognized in earnings, equity in net income or loss of investment funds accounted for using the equity method, net foreign exchange gains or losses, UGC transaction costs and other and loss on redemption of preferred shares reflects the relative mix reported by jurisdiction and the varying tax rates in each jurisdiction.

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## Segment Information

We classify our businesses into three underwriting segments — insurance, reinsurance and mortgage — and two other operating segments — corporate (non-underwriting) and ‘other.’ Our insurance, reinsurance and mortgage segments each have managers who are responsible for the overall profitability of their respective segments and who are directly accountable to our chief operating decision makers, the President and Chief Executive Officer of Arch Capital and the Chief Financial Officer of Arch Capital. The chief operating decision makers do not assess performance, measure return on equity or make resource allocation decisions on a line of business basis. Management measures segment performance for our three underwriting segments based on underwriting income or loss. We do not manage our assets by underwriting segment, with the exception of goodwill and intangible assets, and, accordingly, investment income is not allocated to each underwriting segment.

We determined our reportable segments using the management approach described in accounting guidance regarding disclosures about segments of an enterprise and related information. The accounting policies of the segments are the same as those used for the preparation of our consolidated financial statements. Intersegment business is allocated to the segment accountable for the underwriting results.

## Insurance Segment

The following tables set forth our insurance segment’s underwriting results:

	Three Months Ended June 30,		
	2018	2017	% Change
Gross premiums written	\$769,372	\$743,902	3.4
Premiums ceded	(245,265 )	(247,446 )	
Net premiums written	524,107	496,456	5.6
Change in unearned premiums	22,342	21,118	
Net premiums earned	546,449	517,574	5.6
Losses and loss adjustment expenses	(357,465 )	(350,939 )	
Acquisition expenses	(90,670 )	(78,872 )	
Other operating expenses	(92,680 )	(92,267 )	
Underwriting income (loss)	\$5,634	\$(4,504 )	n/m

  

Underwriting Ratios	% Point Change		
	2018	2017	% Change
Loss ratio	65.4	% 67.8	% (2.4 )
Acquisition expense ratio	16.6	% 15.2	% 1.4
Other operating expense ratio	17.0	% 17.8	% (0.8 )
Combined ratio	99.0	% 100.8	% (1.8 )

	Six Months Ended June 30,		
	2018	2017	% Change
Gross premiums written	\$1,592,750	\$1,526,183	4.4
Premiums ceded	(492,445 )	(481,541 )	
Net premiums written	1,100,305	1,044,642	5.3
Change in unearned premiums	(15,119 )	(21,422 )	
Net premiums earned	1,085,186	1,023,220	6.1
Losses and loss adjustment expenses	(711,195 )	(683,580 )	
Acquisition expenses	(175,839 )	(153,740 )	
Other operating expenses	(184,654 )	(180,393 )	
Underwriting income	\$13,498	\$5,507	145.1

Underwriting Ratios	% Point Change		
	2018	2017	% Change
Loss ratio	65.4	% 67.8	% (2.4 )
Acquisition expense ratio	16.6	% 15.2	% 1.4
Other operating expense ratio	17.0	% 17.8	% (0.8 )
Combined ratio	99.0	% 100.8	% (1.8 )



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Loss ratio	65.5	% 66.8	% (1.3 )
Acquisition expense ratio	16.2	% 15.0	% 1.2
Other operating expense ratio	17.0	% 17.6	% (0.6 )
Combined ratio	98.7	% 99.4	% (0.7 )

The insurance segment consists of our insurance underwriting units which offer specialty product lines on a worldwide basis. Product lines include:

- Construction and national accounts: primary and excess casualty coverages to middle and large accounts in the construction industry and a wide range of products for middle and large national accounts, specializing in loss sensitive primary casualty insurance programs (including large deductible, self-insured retention and retrospectively rated programs).
- Excess and surplus casualty: primary and excess casualty insurance coverages, including middle market energy business, and contract binding, which primarily provides casualty coverage through a network of appointed agents to small and medium risks.
- Lenders products: collateral protection, debt cancellation and service contract reimbursement products to banks, credit unions, automotive dealerships and original equipment manufacturers and other specialty programs that pertain to automotive lending and leasing.
- Professional lines: directors' and officers' liability, errors and omissions liability, employment practices liability, fiduciary liability, crime, professional indemnity and other financial related coverages for corporate, private equity, venture capital, real estate investment trust, limited partnership, financial institution and not-for-profit clients of all sizes and medical professional and general liability insurance coverages for the healthcare industry. The business is predominately written on a claims-made basis.
- Programs: primarily package policies, underwriting workers' compensation and umbrella liability business in support of desirable package programs, targeting program managers with unique expertise and niche products offering

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general liability, commercial automobile, inland marine and property business with minimal catastrophe exposure.

- Property, energy, marine and aviation: primary and excess general property insurance coverages, including catastrophe-exposed property coverage, for commercial clients. Coverages for marine include hull, war, specie and liability. Aviation and stand alone terrorism are also offered.
- Travel, accident and health: specialty travel and accident and related insurance products for individual, group travelers, travel agents and suppliers, as well as accident and health, which provides accident, disability and medical plan insurance coverages for employer groups, medical plan members, students and other participant groups.
- Other: includes alternative market risks (including captive insurance programs), excess workers' compensation and employer's liability insurance coverages for qualified self-insured groups, associations and trusts, and contract and commercial surety coverages, including contract bonds (payment and performance bonds) primarily for medium and large contractors and commercial surety bonds for Fortune 1,000 companies and smaller transaction business programs.

Premiums Written.

The following tables set forth our insurance segment's net premiums written by major line of business:

	Three Months Ended June 30,			
	2018		2017	
	Amount	%	Amount	%
Professional lines	\$108,298	20.7	\$110,784	22.3
Programs	100,178	19.1	93,428	18.8
Construction and national accounts	66,384	12.7	73,474	14.8
Travel, accident and health	63,222	12.1	52,690	10.6
Property, energy, marine and aviation	62,121	11.9	46,031	9.3
Excess and surplus casualty	40,042	7.6	45,222	9.1
Lenders products	22,290	4.3	21,459	4.3
Other	61,572	11.7	53,368	10.7
Total	\$524,107	100.0	\$496,456	100.0

2018 Second Quarter versus 2017 Second Quarter. Gross premiums written by the insurance segment in the 2018 second quarter were 3.4% higher than in the 2017 second quarter, while net premiums written were 5.6% higher than in the 2017 second quarter. Changes in foreign currency rates resulted in an increase in net premiums written in the 2018 second quarter of \$2.0 million, or 0.4%, compared to the 2017 second quarter. The increase in net premiums written reflected growth in property, primarily due to new business and rate increases, in travel, due to both new business and growth in existing

accounts, and in programs, reflecting rate increases and growth in recently added programs.

	Six Months Ended June 30,			
	2018		2017	
	Amount	%	Amount	%
Professional lines	\$228,087	20.7	\$219,252	21.0
Programs	196,734	17.9	193,385	18.5
Construction and national accounts	164,812	15.0	173,451	16.6
Travel, accident and health	143,746	13.1	118,218	11.3
Property, energy, marine and aviation	114,248	10.4	86,135	8.2
Excess and surplus casualty	81,964	7.4	91,054	8.7
Lenders products	44,274	4.0	46,164	4.4
Other	126,440	11.5	116,983	11.2
Total	\$1,100,305	100.0	\$1,044,642	100.0

Six Months Ended June 30, 2018 versus 2017 period. Gross premiums written by the insurance segment for the six months ended June 30, 2018 were 4.4% higher than in the 2017 period, while net premiums written were 5.3% higher than in the 2017 period. The increase in net premiums written reflected growth in travel, due to both new business and

growth in existing accounts, in property, primarily due to new business and rate increases, and in professional lines, reflecting increases in small and medium sized accounts.

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## Net Premiums Earned.

The following tables set forth our insurance segment's net premiums earned by major line of business:

	Three Months Ended June 30,			
	2018		2017	
	Amount	%	Amount	%
Professional lines	\$112,226	20.5	\$108,375	20.9
Programs	97,333	17.8	87,582	16.9
Construction and national accounts	81,784	15.0	80,848	15.6
Travel, accident and health	74,754	13.7	63,436	12.3
Property, energy, marine and aviation	50,840	9.3	41,423	8.0
Excess and surplus casualty	40,049	7.3	48,850	9.4
Lenders products	23,161	4.2	24,562	4.7
Other	66,302	12.1	62,498	12.1
Total	\$546,449	100.0	\$517,574	100.0
	Six Months Ended June 30,			
	2018		2017	
	Amount	%	Amount	%
Professional lines	\$228,244	21.0	\$217,013	21.2
Programs	192,344	17.7	172,762	16.9
Construction and national accounts	158,996	14.7	158,271	15.5
Travel, accident and health	141,589	13.0	121,917	11.9
Property, energy, marine and aviation	99,443	9.2	79,501	7.8
Excess and surplus casualty	86,593	8.0	99,857	9.8
Lenders products	45,977	4.2	48,661	4.8
Other	132,000	12.2	125,238	12.2
Total	\$1,085,186	100.0	\$1,023,220	100.0

Net premiums written are primarily earned on a pro rata basis over the terms of the policies for all products, usually 12 months. Net premiums earned reflect changes in net premiums written over the previous five quarters. Net premiums earned in the 2018 second quarter were 5.6% higher than in the 2017 second quarter. Net premiums earned for the six months ended June 30, 2018 were 6.1% higher than in the 2017 period.

## Losses and Loss Adjustment Expenses.

The table below shows the components of the insurance segment's loss ratio:

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2018	2017	2018	2017
Current year	66.5 %	68.2 %	66.3 %	67.2 %
Prior period reserve development	(1.1 )%	(0.4 )%	(0.8 )%	(0.4 )%
Loss ratio	65.4 %	67.8 %	65.5 %	66.8 %

## Current Year Loss Ratio.

The insurance segment's current year loss ratio in the 2018 second quarter was 1.7 points lower than in the 2017 second quarter and reflected 1.4 points of current year catastrophic activity, compared to 1.6 points in the 2017 second quarter. The insurance segment's current year loss ratio for the six months ended June 30, 2018 was 0.9 points lower than in the 2017 period and reflected 0.8 points of current year catastrophic activity, compared to 1.1 points in the 2017 period. The balance of the change in the 2018 loss ratios resulted, in part, from changes in mix of business.

## Prior Period Reserve Development.

The insurance segment's net favorable development was \$6.1 million, or 1.1 points, for the 2018 second quarter, compared to \$2.0 million, or 0.4 points, for the 2017 second quarter, and \$8.2 million, or 0.8 points, for the six months

ended June 30, 2018, compared to \$4.1 million, or 0.4 points, for the 2017 period. See note 6, "Reserve for Losses and Loss Adjustment Expenses," to our consolidated financial statements for information about the insurance segment's prior year reserve development.

Underwriting Expenses.

2018 Second Quarter versus 2017 Second Quarter. The insurance segment's underwriting expense ratio was 33.6% in the 2018 second quarter, compared to 33.0% in the 2017 second quarter. The comparison of the underwriting expense ratios reflects changes in the level of reinsurance ceded on a quota share basis and changes in the mix of business.

Six Months Ended June 30, 2018 versus 2017 period. The insurance segment's underwriting expense ratio was 33.2% for the six months ended June 30, 2018, compared to 32.6% for the 2017 period. The comparison of the underwriting expense ratios reflects changes in the level of reinsurance ceded on a quota share basis and changes in the mix of business.

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## Reinsurance Segment

The following tables set forth our reinsurance segment's underwriting results:

	Three Months Ended June 30,		
	2018	2017	% Change
Gross premiums written	\$490,327	\$453,186	8.2
Premiums ceded	(136,247 )	(115,262 )	
Net premiums written	354,080	337,924	4.8
Change in unearned premiums	(13,762 )	(23,222 )	
Net premiums earned	340,318	314,702	8.1
Other underwriting income	(129 )	(279 )	
Losses and loss adjustment expenses	(229,956 )	(207,606 )	
Acquisition expenses	(50,142 )	(51,151 )	
Other operating expenses	(35,678 )	(36,711 )	
Underwriting income	\$24,413	\$18,955	28.8

Underwriting Ratios	% Point Change		
Loss ratio	67.6	% 66.0	% 1.6
Acquisition expense ratio	14.7	% 16.3	% (1.6 )
Other operating expense ratio	10.5	% 11.7	% (1.2 )
Combined ratio	92.8	% 94.0	% (1.2 )

	Six Months Ended June 30,		
	2018	2017	% Change
Gross premiums written	\$1,067,810	\$928,968	14.9
Premiums ceded	(331,977 )	(281,354 )	
Net premiums written	735,833	647,614	13.6
Change in unearned premiums	(116,343 )	(88,061 )	
Net premiums earned	619,490	559,553	10.7
Other underwriting income	1,103	(585 )	
Losses and loss adjustment expenses	(371,631 )	(313,060 )	
Acquisition expenses	(98,461 )	(97,298 )	
Other operating expenses	(71,249 )	(74,244 )	
Underwriting income	\$79,252	\$74,366	6.6

Underwriting Ratios	% Point Change		
Loss ratio	60.0	% 55.9	% 4.1
Acquisition expense ratio	15.9	% 17.4	% (1.5 )
Other operating expense ratio	11.5	% 13.3	% (1.8 )
Combined ratio	87.4	% 86.6	% 0.8

The reinsurance segment consists of our reinsurance underwriting units which offer specialty product lines on a worldwide basis. Product lines include:

- Casualty: provides coverage to ceding company clients on third party liability and workers' compensation exposures from ceding company clients, primarily on a treaty basis. Exposures include, among others, executive assurance, professional liability, workers' compensation, excess and umbrella liability, excess motor and healthcare business.

- Marine and aviation: provides coverage for energy, hull, cargo, specie, liability and transit, and aviation business, including airline and general aviation risks. Business written may also include space business, which includes coverages for satellite assembly, launch and operation for commercial space programs.

- Other specialty: provides coverage to ceding company clients for proportional motor and other lines, including surety, accident and health, workers' compensation catastrophe, agriculture, trade credit and political risk.
- Property catastrophe: provides protection for most catastrophic losses that are covered in the underlying policies written by reinsureds, including hurricane, earthquake, flood, tornado, hail and fire, and coverage for other perils on a case-by-case basis. Property catastrophe reinsurance provides coverage on an excess of loss basis when aggregate losses and loss adjustment expense from a single occurrence or aggregation of losses from a covered peril exceed the retention specified in the contract.
- Property excluding property catastrophe: provides coverage for both personal lines and commercial property exposures and principally covers buildings, structures, equipment and contents. The primary perils in this business include fire, explosion, collapse, riot, vandalism, wind, tornado, flood and earthquake. Business is assumed on both a proportional and excess of loss basis. In addition, facultative business is written which focuses on individual commercial property risks on an excess of loss basis.
- Other: includes life reinsurance business on both a proportional and non-proportional basis, casualty clash business and, in limited instances, non-traditional business which is intended to provide insurers with risk management solutions that complement traditional reinsurance.

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## Premiums Written.

The following tables set forth our reinsurance segment's net premiums written by major line of business:

	Three Months Ended June 30,			
	2018		2017	
	Amount	%	Amount	%
Other specialty	\$155,081	43.8	\$155,328	46.0
Casualty	68,113	19.2	63,054	18.7
Property excluding property catastrophe	77,876	22.0	69,115	20.5
Property catastrophe	35,045	9.9	37,127	11.0
Marine and aviation	10,061	2.8	8,932	2.6
Other	7,904	2.2	4,368	1.3
Total	\$354,080	100.0	\$337,924	100.0
Pro rata	\$212,858	60.1	\$200,893	59.4
Excess of loss	141,222	39.9	137,031	40.6
Total	\$354,080	100.0	\$337,924	100.0

2018 Second Quarter versus 2017 Second Quarter. Gross premiums written by the reinsurance segment in the 2018 second quarter were 8.2% higher than in the 2017 second quarter, while net premiums written were 4.8% higher than in the 2017 second quarter. Changes in foreign currency rates resulted in an increase in net premiums written in the 2018 second quarter of \$6.9 million, or 2.0%, compared to the 2017 second quarter. The increase in net premiums written reflected growth in property excluding property catastrophe business, primarily due to new accounts and rate increases.

	Six Months Ended June 30,			
	2018		2017	
	Amount	%	Amount	%
Other specialty	\$294,073	40.0	\$269,746	41.7
Casualty	198,289	26.9	173,674	26.8
Property excluding property catastrophe	163,046	22.2	144,502	22.3
Property catastrophe	42,677	5.8	29,650	4.6
Marine and aviation	20,073	2.7	18,473	2.9
Other	17,675	2.4	11,569	1.8
Total	\$735,833	100.0	\$647,614	100.0
Pro rata	\$365,023	49.6	\$329,909	50.9
Excess of loss	370,810	50.4	317,705	49.1
Total	\$735,833	100.0	\$647,614	100.0

Six Months Ended June 30, 2018 versus 2017 period. Gross premiums written by the reinsurance segment for the six months ended June 30, 2018 were 14.9% higher than in the 2017 period, while net premiums written were 13.6% higher than in the 2017 period. The increase in net premiums written reflected growth in property lines, primarily due to new business and rate increases, and in other specialty, primarily due to new international motor contracts.

## Net Premiums Earned.

The following tables set forth our reinsurance segment's net premiums earned by major line of business:

	Three Months Ended June 30,			
	2018		2017	
	Amount	%	Amount	%
Other specialty	\$149,648	44.0	\$141,565	45.0
Casualty	85,009	25.0	79,903	25.4
Property excluding property catastrophe	70,849	20.8	62,884	20.0



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Marine and aviation	10,089	3.0	9,986	3.2
Property catastrophe	15,716	4.6	15,759	5.0
Other	9,007	2.6	4,605	1.5
Total	\$340,318	100.0	\$314,702	100.0

Pro rata	\$203,632	59.8	\$181,988	57.8
Excess of loss	136,686	40.2	132,714	42.2
Total	\$340,318	100.0	\$314,702	100.0

Six Months Ended June 30,  
2018                      2017

	Amount	%	Amount	%
Other specialty	\$253,365	40.9	\$211,530	37.8
Casualty	154,381	24.9	152,871	27.3
Property excluding property catastrophe	139,603	22.5	132,736	23.7
Marine and aviation	19,478	3.1	19,476	3.5
Property catastrophe	34,103	5.5	31,936	5.7
Other	18,560	3.0	11,004	2.0
Total	\$619,490	100.0	\$559,553	100.0

Pro rata	\$367,628	59.3	\$315,080	56.3
Excess of loss	251,862	40.7	244,473	43.7
Total	\$619,490	100.0	\$559,553	100.0

Net premiums written, irrespective of the class of business, are generally earned on a pro rata basis over the terms of the underlying policies or reinsurance contracts. For the 2018 second quarter, net premiums earned were 8.1% higher than in the 2017 second quarter, and reflect changes in net premiums written over the previous five quarters. For the six months ended June 30, 2018, net premiums earned were 10.7% higher than in the 2017 period.

Other Underwriting Income (Loss).

Other underwriting income (loss) for the 2018 second quarter was \$(0.1) million, compared to \$(0.3) million for the 2017 second quarter, and \$1.1 million for the six months ended June 30, 2018, compared to \$(0.6) million for the 2017 period.

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## Losses and Loss Adjustment Expenses.

The table below shows the components of the reinsurance segment's loss ratio:

	Three Months Ended		Six Months Ended	
	June 30, 2018	2017	June 30, 2018	2017
Current year	77.3 %	78.6 %	71.2 %	73.2 %
Prior period reserve development	(9.7 )%	(12.6 )%	(11.2)%	(17.3)%
Loss ratio	67.6 %	66.0 %	60.0 %	55.9 %

## Current Year Loss Ratio.

The reinsurance segment's current year loss ratio in the 2018 second quarter was 1.3 points lower than in the 2017 second quarter and reflected 2.2 points of current year catastrophic activity, compared to 5.4 points in the 2017 second quarter. The 2018 second quarter loss ratio contained 9.9 points, or \$33.7 million, of property facultative loss activity, compared to 11.1 points, or \$34.8 million, in the 2017 second quarter. The balance of the change in the 2018 second quarter current year loss ratio resulted, in part, from a higher level of large attritional loss activity than in the 2017 second quarter.

The reinsurance segment's current year loss ratio for the six months ended June 30, 2018 was 2.0 points lower than in the 2017 period and reflected 1.4 points of current year catastrophic activity, compared to 4.8 points in the 2017 period. The loss ratio for the six months ended June 30, 2018 contained 7.0 points, or \$43.4 million, of property facultative loss activity, compared to 5.9 points, or \$33.1 million, in the 2017 period.

## Prior Period Reserve Development.

The reinsurance segment's net favorable development was \$33.0 million, or 9.7 points, for the 2018 second quarter, compared to \$39.5 million, or 12.6 points, for the 2017 second quarter, and \$69.6 million, or 11.2 points, for the six months ended June 30, 2018, compared to \$96.8 million, or 17.3 points, for the 2017 period. See [note 6, "Reserve for Losses and Loss Adjustment Expenses,"](#) to our consolidated financial statements for information about the reinsurance segment's prior year reserve development.

## Underwriting Expenses.

2018 Second Quarter versus 2017 Second Quarter. The underwriting expense ratio for the reinsurance segment was 25.2% in the 2018 second quarter, compared to 28.0% in the 2017 second quarter. The comparison of the underwriting expense ratios also reflected changes in the mix and type of business and a higher level of net premiums earned in the 2018 second quarter. The underwriting expense ratio benefited from a reduction in federal excise taxes incurred of \$2.6 million, or 0.8 points, as the reinsurance agreements between the Company's U.S.-based property casualty insurance and

reinsurance subsidiaries and Arch Reinsurance Ltd. ("Arch Re Bermuda") were canceled on a cutoff basis as of January 1, 2018.

Six Months Ended June 30, 2018 versus 2017 period. The underwriting expense ratio for the reinsurance segment was 27.4% for the six months ended June 30, 2018, compared to 30.7% for the 2017 period. The comparison of the underwriting expense ratios also reflected changes in the mix and type of business and a higher level of net premiums earned for the 2018 period. The underwriting expense ratio benefited from a reduction in federal excise taxes incurred of \$5.1 million, or 0.8 points, as discussed above.

## Mortgage Segment

Our mortgage operations include U.S. and international mortgage insurance and reinsurance operations as well as GSE credit risk sharing transactions. Our mortgage group includes direct mortgage insurance in the U.S. primarily provided by Arch Mortgage Insurance Company and United Guaranty Residential Insurance Company (together, "Arch MI U.S."), as well as through Arch Mortgage Guaranty Company; mortgage reinsurance by Arch Re Bermuda to mortgage insurers on both a proportional and non-proportional basis globally; direct mortgage insurance in Europe provided by Arch MI Europe and in Hong Kong by Arch MI Asia; and various GSE credit risk sharing products provided primarily by Arch Re Bermuda.

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The following tables set forth our mortgage segment's underwriting results.

	Three Months Ended June 30,		
	2018	2017	% Change
Gross premiums written	\$330,990	\$336,226	(1.6 )
Premiums ceded	(50,867 )	(62,314 )	
Net premiums written	280,123	273,912	2.3
Change in unearned premiums	10,355	(16,068 )	
Net premiums earned	290,478	257,844	12.7
Other underwriting income	3,315	4,277	
Losses and loss adjustment expenses	(21,591 )	(20,694 )	
Acquisition expenses	(27,737 )	(25,666 )	
Other operating expenses	(38,729 )	(32,150 )	
Underwriting income	\$205,736	\$183,611	12.0

Underwriting Ratios			% Point Change
Loss ratio	7.4	% 8.0	% (0.6 )
Acquisition expense ratio	9.5	% 10.0	% (0.5 )
Other operating expense ratio	13.3	% 12.5	% 0.8
Combined ratio	30.2	% 30.5	% (0.3 )

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	Six Months Ended June 30,		
	2018	2017	% Change
Gross premiums written	\$652,168	\$684,849	(4.8 )
Premiums ceded	(97,004 )	(136,239 )	
Net premiums written	555,164	548,610	1.2
Change in unearned premiums	15,556	(46,243 )	
Net premiums earned	570,720	502,367	13.6
Other underwriting income	6,731	8,400	
Losses and loss adjustment expenses	(65,057 )	(49,759 )	
Acquisition expenses	(54,304 )	(54,432 )	
Other operating expenses	(77,500 )	(74,020 )	
Underwriting income	\$380,590	\$332,556	14.4

Underwriting Ratios			% Point Change
Loss ratio	11.4	% 9.9	% 1.5
Acquisition expense ratio	9.5	% 10.8	% (1.3 )
Other operating expense ratio	13.6	% 14.7	% (1.1 )
Combined ratio	34.5	% 35.4	% (0.9 )

## Premiums Written.

The following tables set forth our mortgage segment's net premiums written by client location and underwriting location (i.e., where the business is underwritten):

	Three Months Ended June 30,			
	2018		2017	
	Amount	%	Amount	%
Client location:				
United States	\$254,966	91.0	\$253,456	92.5
Other	25,157	9.0	20,456	7.5
Total	\$280,123	100.0	\$273,912	100.0

## Underwriting location:

United States	\$229,715	82.0	\$227,266	83.0
Other	50,408	18.0	46,646	17.0
Total	\$280,123	100.0	\$273,912	100.0

2018 Second Quarter versus 2017 Second Quarter. Gross premiums written by the mortgage segment in the 2018 second quarter were 1.6% lower than in the 2017 second quarter. The reduction in gross premiums written primarily reflected a lower level of Australian mortgage reinsurance business and a lower level of U.S. single premium business. Net premiums written for the 2018 second quarter were 2.3% higher than in the 2017 second quarter and reflected a declining cession to AIG on the 50% quota share reinsurance agreement covering 2014 to 2016 policy years of UGC business on a run-off basis, while the 2017 second quarter also reflected higher retrocessions of Australian mortgage reinsurance business.

	Six Months Ended June 30,			
	2018		2017	
	Amount	%	Amount	%
Client location:				
United States	\$501,514	90.3	\$494,592	90.2
Other	53,650	9.7	54,018	9.8
Total	\$555,164	100.0	\$548,610	100.0

## Underwriting location:

United States	\$450,892	81.2	\$443,995	80.9
Other	104,272	18.8	104,615	19.1
Total	\$555,164	100.0	\$548,610	100.0

Six Months Ended June 30, 2018 versus 2017 period. Gross premiums written by the mortgage segment for the six months ended June 30, 2018 were 4.8% lower than in the 2017 period. The reduction in gross premiums written primarily reflected a lower level of Australian mortgage reinsurance business and a lower level of U.S. single premium business. Net premiums written for the six months ended June 30, 2018 were 1.2% higher than in the 2017 period and reflected a declining cession to AIG on the 50% quota share reinsurance agreement covering 2014 to 2016 policy years of UGC business on a run-off basis, while the 2017 period also reflected higher retrocessions of Australian mortgage reinsurance business.

The persistency rate, which represents the percentage of mortgage insurance in force at the beginning of a 12-month period that remains in force at the end of such period, of the Arch MI U.S. portfolio of mortgage loans was 81.7% at June 30, 2018, compared to 81.8% at December 31, 2017.

Arch MI U.S. generated \$19.9 billion of new insurance written (“NIW”) in the 2018 second quarter, compared to \$17.3 billion in the 2017 second quarter, with a decrease in the origination market and a decline in single premium and other business with high risk attributes. NIW represents the original principal balance of all loans that received coverage during the period. Monthly premium policies contributed 94.3% of NIW in the 2018 second quarter, compared to 85.7% for the 2017 second quarter.

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The following tables provide details on the NIW generated by Arch MI U.S.:

(U.S. Dollars in millions)	Three Months Ended June 30,			
	2018		2017	
	Amount	%	Amount	%
Total new insurance written (NIW) (1)	\$19,944		\$17,303	

## Credit quality (FICO):

>=740	\$11,308	56.7	\$9,814	56.7
680-739	7,182	36.0	6,274	36.3
620-679	1,454	7.3	1,215	7.0
Total	\$19,944	100.0	\$17,303	100.0

## Loan-to-value (LTV):

95.01% and above	\$2,835	14.2	\$1,700	9.8
90.01% to 95.00%	9,205	46.2	8,372	48.4
85.01% to 90.00%	5,910	29.6	5,462	31.6
85.01% and below	1,994	10.0	1,769	10.2
Total	\$19,944	100.0	\$17,303	100.0

## Monthly vs. single:

Monthly	\$18,814	94.3	\$14,832	85.7
Single	1,130	5.7	2,471	14.3
Total	\$19,944	100.0	\$17,303	100.0

## Purchase vs. refinance:

Purchase	\$18,871	94.6	\$16,063	92.8
Refinance	1,073	5.4	1,240	7.2
Total	\$19,944	100.0	\$17,303	100.0

(1) Represents the original principal balance of all loans that received coverage during the period.

(U.S. Dollars in millions)	Six Months Ended June 30,			
	2018		2017	
	Amount	%	Amount	%

Total new insurance written (NIW) (1)	\$31,317		\$29,963	
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## Credit quality (FICO):

>=740	\$17,920	57.2	\$16,998	56.7
680-739	11,224	35.8	10,889	36.3
620-679	2,173	6.9	2,076	6.9
Total	\$31,317	100.0	\$29,963	100.0

## Loan-to-value (LTV):

95.01% and above	\$4,097	13.1	\$2,672	8.9
90.01% to 95.00%	14,341	45.8	14,357	47.9
85.01% to 90.00%	9,553	30.5	9,523	31.8
85.01% and below	3,326	10.6	3,411	11.4
Total	\$31,317	100.0	\$29,963	100.0

## Monthly vs. single:

Monthly	\$29,204	93.3	\$25,200	84.1
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Single	2,113	6.7	4,763	15.9
Total	\$31,317	100.0	\$29,963	100.0

Purchase vs. refinance:

Purchase	\$29,159	93.1	\$26,783	89.4
Refinance	2,158	6.9	3,180	10.6
Total	\$31,317	100.0	\$29,963	100.0

(1) Represents the original principal balance of all loans that received coverage during the period.

Net Premiums Earned.

The following tables set forth our mortgage segment's net premiums earned by client location and underwriting location (i.e., where the business is underwritten):

	Three Months Ended June 30,			
	2018		2017	
	Amount	%	Amount	%
Client Location:				
United States	\$274,921	94.6	\$246,656	95.7
Other	15,557	5.4	11,188	4.3
Total	\$290,478	100.0	\$257,844	100.0

Underwriting location:

United States	\$247,897	85.3	\$219,084	85.0
Other	42,581	14.7	38,760	15.0
Total	\$290,478	100.0	\$257,844	100.0
	Six Months Ended June 30,			
	2018		2017	
	Amount	%	Amount	%
Client Location:				
United States	\$540,606	94.7	\$482,687	96.1
Other	30,114	5.3	19,680	3.9
Total	\$570,720	100.0	\$502,367	100.0

Underwriting location:

United States	\$486,038	85.2	\$427,783	85.2
Other	84,682	14.8	74,584	14.8
Total	\$570,720	100.0	\$502,367	100.0

Net premiums earned for the 2018 second quarter were 12.7% higher than in the 2017 second quarter. For the six months ended June 30, 2018, net premiums earned were 13.6% higher than in the 2017 period. The increases were primarily due to growth in insurance in force for Arch MI U.S.

Other Underwriting Income.

Other underwriting income, which is primarily related to older GSE credit risk-sharing transactions receiving derivative accounting treatment, was \$3.3 million for the 2018 second quarter, compared to \$4.3 million for the 2017 second quarter, and \$6.7 million for the six months ended June 30, 2018, compared to \$8.4 million for the 2017 period.

Losses and Loss Adjustment Expenses.

The table below shows the components of the mortgage segment's loss ratio:

	Three Months		Six Months	
	Ended		Ended	
	June 30,		June 30,	
	2018	2017	2018	2017
Current year	15.4 %	19.5 %	17.8 %	20.5 %

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Prior period reserve development	(8.0 )%	(11.5)%	(6.4 )%	(10.6)%
Loss ratio	7.4 %	8.0 %	11.4 %	9.9 %

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## Current Year Loss Ratio.

The mortgage segment's current year loss ratio was 4.1 points lower in the 2018 second quarter than in the 2017 second quarter. The mortgage segment's current year loss ratio was 2.7 points lower for the six months ended June 30, 2018 than for the 2017 period. The lower current year loss ratio for the 2018 periods reflect the current favorable macroeconomic environment.

## Prior Period Reserve Development.

The mortgage segment's net favorable development was \$23.3 million, or 8.0 points, for the 2018 second quarter, compared to \$29.8 million, or 11.5 points, for the 2017 second quarter, and \$36.3 million, or 6.4 points, for the six months ended June 30, 2018, compared to \$53.4 million, or 10.6 points, for the 2017 period. See note 6, "Reserve for Losses and Loss Adjustment Expenses," to our consolidated financial statements for information about the mortgage segment's prior year reserve development.

## Underwriting Expenses.

2018 Second Quarter versus 2017 Second Quarter. The underwriting expense ratio for the mortgage segment was 22.8% in the 2018 second quarter, compared to 22.5% in the 2017 second quarter. The higher underwriting expense ratio in the 2018 second quarter reflected a higher level of incentive compensation costs.

Six Months Ended June 30, 2018 versus 2017 period. The underwriting expense ratio for the mortgage segment was 23.1% for the six months ended June 30, 2018, compared to 25.5% for the 2017 period. The lower underwriting expense ratio in the 2018 period reflected a higher level of net premiums earned and expense savings from integration efforts following the acquisition of UGC.

## Corporate (Non-Underwriting) Segment

The corporate (non-underwriting) segment results include net investment income, other income (loss), corporate expenses, UGC transaction costs and other, amortization of intangible assets, interest expense, items related to our non-cumulative preferred shares, net realized gains or losses, net impairment losses included in earnings, equity in net income or loss of investment funds accounted for using the equity method, net foreign exchange gains or losses and income taxes. Such amounts exclude the results of the 'other' segment.

## Net Investment Income.

The components of net investment income were derived from the following sources:

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2018	2017	2018	2017
Fixed maturities	\$98,968	\$83,656	\$191,406	\$166,437
Equity securities	4,232	3,976	6,982	6,942
Short-term investments	4,225	1,669	8,174	3,110
Other (1)	19,242	18,298	38,471	39,532
Gross investment income	126,667	107,599	245,033	216,021
Investment expenses (2)	(18,906 )	(15,079 )	(37,029 )	(27,689 )
Net investment income	\$107,761	\$92,520	\$208,004	188,332

(1) Amounts include dividends and other distributions on investment funds, term loan investments, funds held balances, cash balances and other items.

(2) Investment expenses were approximately 0.40% of average invested assets for the 2018 second quarter, compared to 0.33% for the 2017 second quarter, and 0.37% for the six months ended June 30, 2018, compared to 0.29% for the 2017 period.

The higher level of net investment income for the 2018 second quarter reflected an increase in the embedded book yield on fixed income securities, partially offset by a higher level of expenses. The pre-tax investment income yield, calculated based on amortized cost and on an annualized basis, was 2.32% for the 2018 second quarter, compare to 2.04% for the 2017 second quarter, and 2.23% for the six months ended June 30, 2018, compared to 2.10% for the 2017 period.

## Corporate Expenses.

Corporate expenses were \$15.6 million for the 2018 second quarter, compared to \$22.2 million for the 2017 second quarter, and \$30.1 million for the six months ended June 30, 2018, compared to \$34.4 million for the 2017 period. The lower level of corporate expenses in the 2018 periods was primarily due to lower incentive compensation costs.

UGC Transaction Costs and Other.

UGC transaction costs and other were \$6.9 million for the 2018 second quarter, compared to \$2.7 million for the 2017 second quarter, and \$7.7 million for the six months ended June 30, 2018, compared to \$18.3 million for the 2017 period. Amounts for the 2018 second quarter were primarily attributable to the write off of intangible assets related to insurance licenses for a subsidiary of UGC which is being merged with another subsidiary. Amounts for the 2017 periods primarily related to severance and related costs along with incentive compensation paid in conjunction with the UGC acquisition.

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### Amortization of Intangible Assets.

Amortization of intangible assets for the 2018 second quarter was \$26.5 million, compared to \$30.8 million for the 2017 second quarter, and \$53.2 million for the six months ended June 30, 2018, compared to \$62.1 million for the 2017 period, with amounts in all periods primarily related to intangible assets related to the UGC acquisition.

### Interest Expense.

Interest expense was \$26.1 million for the 2018 second quarter, compared to the \$25.9 million for the 2017 second quarter, and \$52.0 million for the six months ended June 30, 2018, compared to \$51.7 million for the 2017 period.

### Loss on Redemption of Preferred Shares.

In January 2018, we redeemed all remaining 6.75% Series C preferred shares and, in accordance with GAAP, recorded a loss of \$2.7 million to remove original issuance costs related to the redeemed shares from additional paid-in capital. Such adjustment had no impact on total shareholders' equity or cash flows.

### Net Realized Gains or Losses.

We recorded net realized losses of \$59.5 million for the 2018 second quarter, compared to net realized gains of \$18.0 million for the 2017 second quarter, and net realized losses of \$171.4 million for the six months ended June 30, 2018, compared to net realized gains of \$46.6 million for the 2017 period. Currently, our portfolio is actively managed to maximize total return within certain guidelines. The effect of financial market movements on the investment portfolio will directly impact net realized gains and losses as the portfolio is adjusted and rebalanced. Net realized gains or losses from the sale of fixed maturities primarily results from our decisions to reduce credit exposure, to change duration targets, to rebalance our portfolios or due to relative value determinations. Net realized gains or losses also include realized and unrealized contract gains and losses on our derivative instruments, changes in the fair value of assets and liabilities accounted for using the fair value option and in the fair value of equities pursuant to new accounting guidance effective in the 2018 first quarter, along with re-measurement of contingent consideration liability amounts. See note 7, "Investment Information—Net Realized Gains (Losses)," to our consolidated financial statements for additional information.

### Net Impairment Losses Recognized in Earnings.

We recorded \$0.5 million of impairment losses for the 2018 second quarter, compared to \$1.7 million for the 2017 second quarter, and \$0.6 million for the six months ended June 30, 2018, compared to \$3.5 million for the 2017 period. See note 7, "Investment Information—Other-Than-Temporary

Impairments," to our consolidated financial statements for additional information.

### Equity in Net Income (Loss) of Investment Funds Accounted for Using the Equity Method.

We recorded \$8.5 million of equity in net income related to investment funds accounted for using the equity method in the 2018 second quarter, compared to \$32.7 million of income for the 2017 second quarter, and \$36.5 million of income for the six months ended June 30, 2018, compared to \$80.8 million for the 2017 period. Investment funds accounted for using the equity method totaled \$1.43 billion at June 30, 2018, compared to \$1.04 billion at December 31, 2017.

### Net Foreign Exchange Gains or Losses.

Net foreign exchange gains for the 2018 second quarter were \$46.2 million, compared to net foreign exchange losses for the 2017 second quarter of \$37.8 million. Net foreign exchange gains for the six months ended June 30, 2018 were \$31.2 million, compared to net foreign exchange losses for the 2017 period of \$57.7 million. Amounts in such periods were primarily unrealized and resulted from the effects of revaluing our net insurance liabilities required to be settled in foreign currencies at each balance sheet date.

### Income Tax Expense.

Our income tax provision on income (loss) before income taxes resulted in an expense of 8.9% for the 2018 second quarter, compared to an expense of 15.7% for the 2017 second quarter, and 10.4% for the six months ended June 30, 2018, compared to 12.6% for the 2017 period. The effective tax rates for the 2018 second quarter and six months ended June 30, 2018 included a discrete income tax benefit of \$1.6 million and \$3.0 million, respectively, related to share-based compensation. Our effective tax rate, which is based upon the expected annual effective tax rate, may fluctuate from period to period based on the relative mix of income or loss reported by jurisdiction and the varying tax

rates in each jurisdiction. The change in the U.S. federal corporate tax rate from 35% to 21% commencing on January 1, 2018 contributed to a lower effective tax rate for the 2018 periods as compared to the 2017 periods.

Other Segment

The 'other' segment includes the results of Watford Re. Pursuant to generally accepted accounting principles, Watford Re is considered a variable interest entity and we concluded that we are the primary beneficiary of Watford Re. As such, we consolidate the results of Watford Re in our consolidated financial statements, although we only own approximately 11% of Watford Re's common equity. See note 11, "Variable Interest Entities and Noncontrolling Interests" and note 5, "Segment Information," to our consolidated financial statements for additional information on Watford Re.

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CRITICAL ACCOUNTING POLICIES,  
ESTIMATES AND RECENT ACCOUNTING PRONOUNCEMENTS

Critical accounting policies, estimates and recent accounting pronouncements are discussed in Management's Discussion and Analysis of Financial Condition and Results of Operations contained in our 2017 Form 10-K, updated where applicable in the notes accompanying our consolidated financial statements, including note 2. "Recent Accounting Pronouncements."

FINANCIAL CONDITION

Investable Assets

At June 30, 2018, total investable assets held by Arch were \$19.17 billion, excluding the \$2.65 billion included in the 'other' segment (i.e., attributable to Watford Re).

Investable Assets Held by Arch

The following table summarizes the fair value of the investable assets held by Arch:

Investable assets (1):	Estimated Fair Value	% of Total
June 30, 2018		
Fixed maturities (2)	\$14,442,991	75.3
Short-term investments (2)	1,119,977	5.8
Cash	480,984	2.5
Equity securities (2)	545,146	2.8
Other investments (2)	1,266,327	6.6
Investments accounted for using the equity method	1,428,582	7.5
Securities transactions entered into but not settled at the balance sheet date	(111,997 )	(0.6 )
Total investable assets held by Arch	\$19,172,010	100.0
December 31, 2017		
Fixed maturities (2)	\$14,798,213	75.1
Short-term investments (2)	1,509,713	7.7
Cash	551,696	2.8
Equity securities (2)	576,040	2.9
Other investments (2)	1,476,960	7.5
Investments accounted for using the equity method	1,041,322	5.3
Securities transactions entered into but not settled at the balance sheet date	(237,523 )	(1.2 )
Total investable assets held by Arch	\$19,716,421	100.0

In securities lending transactions, we receive collateral in excess of the fair value of the securities pledged. For (1) purposes of this table, we have excluded the collateral received under securities lending, at fair value and included the securities pledged under securities lending, at fair value.

(2) Includes investments carried at fair value under the fair value option.

At June 30, 2018, our fixed income portfolio, which includes fixed maturity securities and short-term investments, had average credit quality ratings from Standard & Poor's Rating

Services ("S&P")/Moody's of "AA/Aa2" and an average yield to maturity (embedded book yield), before investment expenses, of 2.64%. At December 31, 2017, our fixed income portfolio had average credit quality ratings from S&P/Moody's of "AA-/Aa2" and an average yield to maturity of 2.32%. Our investment portfolio had an average effective duration of 2.89 years at June 30, 2018, compared to 2.83 years at December 31, 2017. At June 30, 2018, approximately \$13.54 billion, or 71%, of total investable assets held by Arch were internally managed, compared to \$13.73 billion, or 70%, at December 31, 2017.

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The following table summarizes our fixed maturities and fixed maturities pledged under securities lending agreements (“Fixed Maturities”) by type:

	Estimated Fair Value	% of Total
June 30, 2018		
Corporate bonds	\$5,847,160	39.7
Mortgage backed securities	498,759	3.4
Municipal bonds	1,431,256	9.7
Commercial mortgage backed securities	590,198	4.0
U.S. government and government agencies	2,788,272	18.9
Non-U.S. government securities	1,735,495	11.8
Asset backed securities	1,831,028	12.4
Total	\$14,722,168	100.0
December 31, 2017		
Corporate bonds	\$4,787,272	32.4
Mortgage backed securities	328,924	2.2
Municipal bonds	2,158,840	14.6
Commercial mortgage backed securities	545,817	3.7
U.S. government and government agencies	3,484,257	23.5
Non-U.S. government securities	1,704,337	11.5
Asset backed securities	1,788,766	12.1
Total	\$14,798,213	100.0

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The following table provides the credit quality distribution of our Fixed Maturities. For individual fixed maturities, S&P ratings are used. In the absence of an S&P ratings, ratings from Moody's are used, followed by ratings from Fitch Ratings.

	Estimated Fair Value	% of Total
June 30, 2018		
U.S. government and gov't agencies (1)	\$3,196,856	22.1
AAA	3,897,441	27.0
AA	2,139,794	14.8
A	3,114,115	21.6
BBB	1,373,644	9.5
BB	240,114	1.7
B	185,066	1.3
Lower than B	64,858	0.4
Not rated	231,103	1.6
Total	\$14,442,991	100.0

December 31, 2017		
U.S. government and gov't agencies (1)	\$3,771,835	25.5
AAA	4,080,808	27.6
AA	2,440,864	16.5
A	2,470,936	16.7
BBB	1,157,136	7.8
BB	313,286	2.1
B	254,011	1.7
Lower than B	77,543	0.5
Not rated	231,794	1.6
Total	\$14,798,213	100.0

(1) Includes U.S. government-sponsored agency residential mortgage-backed securities and agency commercial mortgage-backed securities.

The following table provides information on the severity of the unrealized loss position as a percentage of amortized cost for all Fixed Maturities which were in an unrealized loss position:

Severity of gross unrealized losses:	Estimated Fair Value	Gross Unrealized Losses	% of Total Gross Unrealized Losses
June 30, 2018			
0-10%	\$11,248,303	\$(200,606)	96.6
10-20%	45,886	(6,215)	3.0
20-30%	2,105	(591)	0.3
Greater than 30%	373	(208)	0.1
Total	\$11,296,667	\$(207,620)	100.0
December 31, 2017			
0-10%	\$9,598,768	\$(93,057)	87.6
10-20%	82,638	(11,269)	10.6
20-30%	2,108	(671)	0.6
Greater than 30%	1,881	(1,184)	1.1
Total	\$9,685,395	\$(106,181)	100.0

The following table summarizes our top ten exposures to fixed income corporate issuers by fair value at June 30, 2018, excluding guaranteed amounts and covered bonds:

	Estimated Fair Value	Credit Rating (1)
Citigroup Inc.	\$190,925	A/A2
JPMorgan Chase & Co.	180,960	A-/A2
Bank of America Corporation	178,797	A-/A3
Apple Inc.	170,852	AA+/Aa1
Wells Fargo & Company	136,738	A/A1
Daimler AG	100,541	A/A2
Philip Morris International Inc.	99,728	A/A2
The Bank of New York Mellon Corporation	96,728	A/A1
Toyota Motor Corporation	96,200	AA-/Aa3
U.S. Bancorp	90,850	AA-/A1
Total	\$1,342,319	

(1) Average credit ratings as assigned by S&P and Moody's, respectively.

The following table provides information on our structured securities, which includes residential mortgage-backed securities ("RMBS"), commercial mortgage-backed securities ("CMBS") and asset-backed securities ("ABS"):

	Agencies	Investment Grade	Below Investment Grade	Total
June 30, 2018				
RMBS	\$460,617	\$14,362	\$23,780	\$498,759
CMBS	46,205	523,535	20,458	590,198
ABS	—	1,747,850	73,898	1,821,748
Total	\$506,822	\$2,285,747	\$118,136	\$2,910,705
December 31, 2017				
RMBS	\$284,466	\$14,581	\$29,877	\$328,924
CMBS	3,112	465,980	76,725	545,817
ABS	—	1,691,232	97,534	1,788,766
Total	\$287,578	\$2,171,793	\$204,136	\$2,663,507

At June 30, 2018, our structured securities included \$40.3 million par value in sub-prime securities with a fair value of \$32.7 million and average credit quality ratings from S&P/Moody's of "CCC-/Caa3," compared to \$42.3 million par value with a fair value of \$35.4 million and average credit quality ratings of "CCC-/Caa3" at December 31, 2017.



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The following table provides information on the fair value of our Eurozone investments at June 30, 2018:

Country (1)	Sovereign (2)	Corporate Bonds	Other (3)	Total
Germany	\$ 256,053	\$ 3,404	\$ 45,854	\$ 305,311
Netherlands	110,568	117,589	18,360	246,517
France	20,275	45,582	34,912	100,769
Luxembourg	—	11,338	8,952	20,290
Ireland	—	7,811	5,302	13,113
Spain	—	2,415	9,157	11,572
Greece	1,968	—	3,091	5,059
Austria	3,976	—	—	3,976
Italy	—	685	2,309	2,994
Belgium	—	181	1,166	1,347
Portugal	—	—	1,236	1,236
Total	\$ 392,840	\$ 189,005	\$ 130,339	\$ 712,184

The country allocations set forth in the table are based on various assumptions made by us in assessing the country in which the underlying credit risk resides, including a review of the jurisdiction of organization, business operations and other factors. Based on such analysis, we do not believe that we have any other Eurozone investments at June 30, 2018.

(1) Includes securities issued and/or guaranteed by Eurozone governments.

(2) Includes bank loans, equities and other.

At June 30, 2018, our investment portfolio included \$545.1 million of equity securities, compared to \$576.0 million at December 31, 2017. Our equity portfolio includes publicly traded common stocks in the natural resources, energy, consumer staples and other sectors.

The following table summarizes our other investments:

	June 30, 2018	December 31, 2017
Asian and emerging markets	\$ 300,050	\$ 344,068
Term loan investments	273,986	326,085
Mezzanine debt funds	257,750	252,160
Credit related funds	199,437	193,787
Investment grade fixed income	98,240	156,225
Other (1)	136,864	204,635
Total	\$ 1,266,327	\$ 1,476,960

(1) Includes fund investments with strategies in mortgage servicing rights, transportation and infrastructure assets and other.

Our investment strategy allows for the use of derivative instruments. We utilize various derivative instruments such as futures contracts to enhance investment performance, replicate investment positions or manage market exposures and duration risk that would be allowed under our investment guidelines if implemented in other ways. See [note 9, “Derivative Instruments,”](#) to our consolidated financial statements for additional disclosures related to derivatives. Accounting guidance regarding fair value measurements addresses how companies should measure fair value when they

are required to use a fair value measure for recognition or disclosure purposes under GAAP and provides a common definition of fair value to be used throughout GAAP. See [note 8, “Fair Value,”](#) to our consolidated financial statements for a summary of our financial assets and liabilities measured at fair value, segregated by level in the fair value hierarchy.

Investable Assets in the ‘Other’ Segment

Investable assets in the ‘other’ segment are managed by Watford Re. The board of directors of Watford Re establishes their investment policies and guidelines. Watford Re’s investments are accounted for using the fair value option with changes in the carrying value of such investments recorded in net realized gains or losses.

The following table summarizes investable assets in the ‘other’ segment:

	June 30, 2018	December 31, 2017
Investments accounted for using the fair value option:		
Other investments	\$1,062,577	\$924,410
Fixed maturities	1,053,795	1,177,033
Short-term investments	193,887	256,755
Equity securities	75,058	67,868
Total	2,385,317	2,426,066
Fixed maturities available for sale, at fair value	279,177	—
Equity securities, at fair value	63,009	—
Cash	45,644	54,503
Securities sold but not yet purchased	(24,529 )	(34,375 )
Securities transactions entered into but not settled at the balance sheet date	(100,777 )	(6,127 )
Total investable assets included in ‘other’ segment	\$2,647,841	\$2,440,067

#### Premiums Receivable and Reinsurance Recoverables

At June 30, 2018, 79.7% of premiums receivable of \$1.35 billion represented amounts not yet due, while amounts in excess of 90 days overdue were 3.7% of the total. At December 31, 2017, 78.2% of premiums receivable of \$1.14 billion represented amounts not yet due, while amounts in excess of 90 days overdue were 4.0% of the total. Our reserves for doubtful accounts were approximately \$26.6 million at June 30, 2018, compared to \$25.3 million at December 31, 2017.

At June 30, 2018 and December 31, 2017, approximately 63.5% and 69.9% of reinsurance recoverables on paid and unpaid losses (not including ceded unearned premiums) of \$2.73 billion and \$2.54 billion, respectively, were due from carriers which had an A.M. Best rating of “A-” or better while 36.5% and 30.1%, respectively, were from companies not rated. For items not rated, over 90% of such amount was collateralized through reinsurance trusts or letters of credit at June 30, 2018 and December 31, 2017. The largest reinsurance recoverables from any one carrier was approximately 3.1% and 2.2%,

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respectively, of total shareholders' equity available to Arch at June 30, 2018 and December 31, 2017. Growth in items not rated is due to recoverables from a third party reinsurer related to a retroactive reinsurance transaction to reinsure run-off liabilities associated with certain discontinued U.S. specialty casualty and program exposures. Such amounts are fully collateralized. See note 6, "Reserve for Losses and Loss Adjustment Expenses," to our consolidated financial statements for additional information.

Approximately 5.1% of the \$67.7 million of paid losses and loss adjustment expenses recoverable at June 30, 2018 were more than 90 days overdue, compared to 3.0% of the \$75.2 million of paid losses and loss adjustment expenses recoverable at December 31, 2017. No collection issues were indicated on the amount in excess of 90 days overdue at June 30, 2018.

The effects of reinsurance on written and earned premiums and losses and loss adjustment expenses ("LAE") with unaffiliated reinsurers were as follows:

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2018	2017	2018	2017
Premiums written:				
Direct	\$1,158,772	\$1,093,558	\$2,359,134	\$2,190,313
Assumed	537,772	516,101	1,175,624	1,077,336
Ceded	(397,648 )	(360,964 )	(823,318 )	(742,694 )
Net	\$1,298,896	\$1,248,695	\$2,711,440	\$2,524,955

## Premiums earned:

Direct	\$1,174,372	\$1,071,648	\$2,322,048	\$2,095,100
Assumed	534,485	513,814	980,454	930,159
Ceded	(372,094 )	(344,588 )	(730,840 )	(667,368 )
Net	\$1,336,763	\$1,240,874	\$2,571,662	\$2,357,891

## Losses and LAE:

Direct	\$520,473	\$544,061	\$1,088,939	\$1,051,179
Assumed	340,969	303,582	561,279	490,538
Ceded	(135,289 )	(157,783 )	(287,205 )	(299,287 )
Net	\$726,153	\$689,860	\$1,363,013	\$1,242,430

## Reserves for Losses and Loss Adjustment Expenses

We establish reserves for losses and loss adjustment expenses ("Loss Reserves") which represent estimates involving actuarial and statistical projections, at a given point in time, of our expectations of the ultimate settlement and administration costs of losses incurred. Estimating Loss Reserves is inherently difficult, which is exacerbated by the fact that we have relatively limited historical experience upon which to base such estimates. We utilize actuarial models as well as available historical insurance industry loss ratio experience and loss development patterns to assist in the establishment of Loss Reserves. Actual losses and loss adjustment expenses paid will deviate, perhaps substantially, from the reserve estimates reflected in our financial statements.

At June 30, 2018 and December 31, 2017, our Loss Reserves, net of unpaid losses and loss adjustment expenses recoverable, by type and by operating segment were as follows:

	June 30,	December 31,
	2018	2017
Insurance segment:		
Case reserves	\$1,449,505	\$1,648,910
IBNR reserves	3,190,253	3,272,351
Total net reserves	4,639,758	4,921,261
Reinsurance segment:		

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Case reserves	1,111,716	1,033,413
Additional case reserves	128,272	158,377
IBNR reserves	1,509,580	1,499,962
Total net reserves	2,749,568	2,691,752
Mortgage segment:		
Case reserves	403,464	443,069
IBNR reserves	129,848	104,169
Total net reserves (1)	533,312	547,238
Other segment:		
Case reserves	327,170	260,876
Additional case reserves	18,200	32,587
IBNR reserves	504,580	465,168
Total net reserves	849,950	758,631
Total:		
Case reserves	3,291,855	3,386,268
Additional case reserves	146,472	190,964
IBNR reserves	5,334,261	5,341,650
Total net reserves	\$8,772,588	\$ 8,918,882

At June 30, 2018, total net reserves include \$451.2 million from U.S. primary mortgage insurance business, of which 76.7% represents policy years 2008 and prior and the remainder from later policy years. At December 31, (1) 2017, total net reserves include \$477.1 million from U.S. primary mortgage insurance business, of which 79.8% represents policy years 2008 and prior and the remainder from later policy years.

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At June 30, 2018 and December 31, 2017, the insurance segment's Loss Reserves by major line of business, net of unpaid losses and loss adjustment expenses recoverable, were as follows:

	June 30, 2018	December 31, 2017
Insurance segment:		
Professional lines (1)	\$1,275,011	\$ 1,308,261
Construction and national accounts	1,133,342	1,094,300
Excess and surplus casualty (2)	605,675	672,903
Programs	444,959	644,340
Property, energy, marine and aviation	380,149	437,518
Travel, accident and health	83,251	86,122
Lenders products	47,387	53,912
Other (3)	669,984	623,905
Total net reserves	\$4,639,758	\$ 4,921,261

(1) Includes professional liability, executive assurance and healthcare business.

(2) Includes casualty and contract binding business.

(3) Includes alternative markets, excess workers' compensation and surety business.

At June 30, 2018 and December 31, 2017, the reinsurance segment's Loss Reserves by major line of business, net of unpaid losses and loss adjustment expenses recoverable, were as follows:

	June 30, 2018	December 31, 2017
Reinsurance segment:		
Casualty (1)	\$1,492,791	\$ 1,489,933
Other specialty (2)	589,117	523,321
Property excluding property catastrophe (3)	385,442	376,020
Marine and aviation	130,262	135,484
Property catastrophe	83,712	98,622
Other (4)	68,244	68,372
Total net reserves	\$2,749,568	\$ 2,691,752

(1) Includes executive assurance, professional liability, workers' compensation, excess motor, healthcare and other.

(2) Includes non-excess motor, surety, accident and health, workers' compensation catastrophe, agriculture, trade credit and other.

(3) Includes facultative business.

(4) Includes life, casualty clash and other.

#### Mortgage Operations Supplemental Information

The mortgage segment's insurance in force ("IIF") and risk in force ("RIF") were as follows at June 30, 2018 and December 31, 2017:

(U.S. Dollars in millions)	June 30, 2018		December 31, 2017	
	Amount	%	Amount	%
Insurance In Force (IIF) (1):				
U.S. primary mortgage insurance	\$262,889	73.1	\$253,914	72.2
Mortgage reinsurance	26,302	7.3	28,017	8.0
Other (2)	70,677	19.6	69,905	19.9
Total	\$359,868	100.0	\$351,836	100.0

#### Risk In Force (RIF) (3):

U.S. primary mortgage insurance	\$67,271	92.4	\$64,904	92.3
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Mortgage reinsurance	2,282	3.1	2,473	3.5
Other (2)	3,237	4.4	2,921	4.2
Total	\$72,790	100.0	\$70,298	100.0

(1) Represents the aggregate dollar amount of each insured mortgage loan's current principal balance.

(2) Includes GSE credit risk-sharing transactions and international insurance business.

Represents the aggregate dollar amount of each insured mortgage loan's current principal balance multiplied by the (3) insurance coverage percentage specified in the policy for insurance policies issued and after contract limits and/or loss ratio caps for credit risk-sharing or reinsurance transactions.

The insurance in force and risk in force for our U.S. primary mortgage insurance business by policy year were as follows at June 30, 2018:

(U.S. Dollars in millions)	IIF		RIF		Delinquency	
	Amount	%	Amount	%	Rate (1)	
Policy year:						
2008 and prior	\$23,538	9.0	\$5,335	7.9	8.76	%
2009	889	0.3	207	0.3	2.73	%
2010	806	0.3	220	0.3	2.22	%
2011	3,201	1.2	879	1.3	1.29	%
2012	11,398	4.3	3,135	4.7	0.71	%
2013	19,175	7.3	5,300	7.9	0.83	%
2014	20,352	7.7	5,473	8.1	0.92	%
2015	37,664	14.3	9,792	14.6	0.60	%
2016	57,643	21.9	14,645	21.8	0.65	%
2017	57,325	21.8	14,502	21.6	0.34	%
2018	30,898	11.8	7,783	11.6	0.03	%
Total	\$262,889	100.0	\$67,271	100.0	1.70	%

(1) Represents the ending percentage of loans in default.

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The insurance in force and risk in force for our U.S. primary mortgage insurance business by policy year were as follows at December 31, 2017:

(U.S. Dollars in millions)	IIF		RIF		Delinquency	
	Amount	%	Amount	%	Rate (1)	
Policy year:						
2008 and prior	\$26,140	10.3	\$6,003	9.2	10.24	%
2009	1,072	0.4	253	0.4	2.94	%
2010	1,089	0.4	295	0.5	2.31	%
2011	3,828	1.5	1,046	1.6	1.37	%
2012	13,247	5.2	3,629	5.6	0.75	%
2013	21,840	8.6	5,996	9.2	0.95	%
2014	22,884	9.0	6,112	9.4	1.10	%
2015	41,991	16.5	10,828	16.7	0.77	%
2016	62,020	24.4	15,643	24.1	0.80	%
2017	59,803	23.6	15,099	23.3	0.35	%
Total	\$253,914	100.0	\$64,904	100.0	2.23	%

(1) Represents the ending percentage of loans in default.

The following tables provide supplemental disclosures on risk in force for our U.S. primary mortgage insurance business at June 30, 2018 and December 31, 2017:

(U.S. Dollars in millions)	June 30, 2018		December 31, 2017	
	Amount	%	Amount	%
Credit quality (FICO):				
>=740	\$39,038	58.0	\$37,794	58.2
680-739	22,325	33.2	21,213	32.7
620-679	5,235	7.8	5,159	7.9
<620	673	1.0	738	1.1
Total	\$67,271	100.0	\$64,904	100.0
Weighted average FICO score	743		743	

Loan-to-value (LTV):

95.01% and above	\$6,915	10.3	\$6,337	9.8
90.01% to 95.00%	37,488	55.7	36,174	55.7
85.01% to 90.00%	19,904	29.6	19,482	30.0
85.00% and below	2,964	4.4	2,911	4.5
Total	\$67,271	100.0	\$64,904	100.0
Weighted average LTV	92.9	%	92.9	%

Total RIF, net of external reinsurance \$52,167 \$49,100

(U.S. Dollars in millions)	June 30, 2018		December 31, 2017	
	Amount	%	Amount	%
Total RIF by State:				
Texas	\$5,260	7.8	\$5,151	7.9
California	4,066	6.0	3,803	5.9
Florida	3,186	4.7	2,881	4.4
Virginia	2,844	4.2	2,773	4.3
North Carolina	2,456	3.7	2,410	3.7

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Georgia	2,453	3.6	2,331	3.6
Illinois	2,351	3.5	2,229	3.4
Maryland	2,298	3.4	2,234	3.4
Washington	2,297	3.4	2,294	3.5
Minnesota	2,268	3.4	2,165	3.3
Others	37,792	56.2	36,633	56.4
Total	\$67,271	100.0	\$64,904	100.0

The following table provides supplemental disclosures for our U.S. primary mortgage insurance business related to insured loans and loss metrics:

(U.S. Dollars in thousands, except policy, loan and claim count)	Six Months Ended	
	June 30, 2018	2017
Roll-forward of insured loans in default:		
Beginning delinquent number of loans	27,068	29,691
New notices (1)	17,792	18,721
Cures	(21,865 )	(20,785 )
Paid claims	(1,958 )	(3,724 )
Ending delinquent number of loans (1)(2)	21,037	23,903
Ending number of policies in force (2)	1,239,565	1,183,659
Delinquency rate (1)(2)	1.70 %	2.02 %
Losses:		
Number of claims paid	1,958	3,724
Total paid claims	\$83,534	\$156,323
Average per claim	\$42.7	\$42.0
Severity (3)	101.6 %	103.1 %
Average reserve per default (in thousands)	\$19.3	\$20.4

(1) There were no incremental new notices for the six months ended June 30, 2018 and 1,300 ending delinquent loans at June 30, 2018 from areas attributable to the 2017 third quarter hurricanes.

(2) Includes first lien primary and pool policies.

(3) Represents total paid claims divided by RIF of loans for which claims were paid.

The risk-to-capital ratio, which represents total current (non-delinquent) risk in force, net of reinsurance, divided by total statutory capital, for Arch MI U.S. was approximately 11.6 to 1 at June 30, 2018, compared to 10.8 to 1 at December 31, 2017.

Shareholders' Equity and Book Value per Share

Total shareholders' equity available to Arch was \$9.16 billion at June 30, 2018, compared to \$9.20 billion at December 31, 2017. The decrease reflected share buybacks and negative investment returns resulting from the increase in interest rates during the period, partially offset by strong underwriting results.

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The following table presents the calculation of book value per share:

(U.S. dollars in thousands, except share data)	June 30, 2018	December 31, 2017
Total shareholders' equity available to Arch	\$9,163,755	\$9,196,602
Less preferred shareholders' equity	780,000	872,555
Common shareholders' equity available to Arch	\$8,383,755	\$8,324,047
Common shares and common share equivalents outstanding, net of treasury shares (1)	405,436,637	409,956,417
Book value per share	\$20.68	\$20.30

(1) Excludes the effects of 20,843,879 and 19,770,174 stock options and 1,400,051 and 913,488 restricted stock units outstanding at June 30, 2018 and December 31, 2017, respectively.

**LIQUIDITY**

This section does not include information specific to Watford Re. We do not guarantee or provide credit support for Watford Re, and our financial exposure to Watford Re is limited to our investment in Watford Re's common and preferred shares and counterparty credit risk (mitigated by collateral) arising from reinsurance transactions with Watford Re.

Liquidity is a measure of our ability to access sufficient cash flows to meet the short-term and long-term cash requirements of our business operations.

Arch Capital is a holding company whose assets primarily consist of the shares in its subsidiaries. Generally, Arch Capital depends on its available cash resources, liquid investments and dividends or other distributions from its subsidiaries to make payments, including the payment of debt service obligations and operating expenses it may incur and any dividends or liquidation amounts with respect to our preferred and common shares.

For the six months ended June 30, 2018, Arch Capital received dividends of \$239.6 million from Arch Re Bermuda, our Bermuda-based reinsurer and insurer, which can pay approximately \$1.93 billion to Arch Capital during the remainder of 2018 without providing an affidavit to the Bermuda Monetary Authority ("BMA").

For the six months ended June 30, 2018, Arch Capital Group (U.S.) Inc. ("Arch-U.S.") received \$25.0 million of dividends from Arch Reinsurance Company ("Arch Re U.S."), our U.S.-licensed reinsurer. Arch Re U.S. can pay approximately \$103.8 million to Arch-U.S. during the remainder of 2018, subject to the approval of the Commissioner of the Delaware Department of Insurance.

For the six months ended June 30, 2018, Arch-U.S. received

\$150.0 million of dividends from Arch U.S. MI Holdings Inc., a subsidiary of Arch-U.S., which received \$400.0 million of dividends from United Guaranty Residential Insurance Company ("UGRIC") and other UGC companies. Arch U.S. MI Holdings Inc. used \$250.0 million of such proceeds to pay down its revolving credit agreement borrowings. UGRIC has no remaining ordinary dividend capacity for the remainder of 2018.

We expect that our liquidity needs, including our anticipated (re)insurance obligations and operating and capital expenditure needs, for the next twelve months, at a minimum, will be met by funds generated from underwriting activities and investment income, as well as by our balance of cash, short-term investments, proceeds on the sale or maturity of our investments, and our credit facilities.

**Cash Flows**

The following table summarizes our cash flows from operating, investing and financing activities, excluding amounts related to the 'other' segment (i.e., Watford Re). See note 11, "Variable Interest Entities and Noncontrolling Interests," for cash flows related to Watford Re.

	Six Months Ended	
	June 30, 2018	2017
Total cash provided by (used for):		
Operating activities	\$404,451	\$399,755

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Investing activities	270,381	(225,626 )
Financing activities	(731,613 )	(252,009 )
Effects of exchange rate changes on foreign currency cash	(9,024 )	8,457
Increase (decrease) in cash and restricted cash	\$(65,805 )	\$(69,423 )

- Cash provided by operating activities for the six months ended June 30, 2018 reflected a higher level of premiums collected than in the 2017 period and an income tax refund, partially offset by a retroactive reinsurance transaction with a third party reinsurer, while the 2017 period reflected higher purchases of tax and loss bonds and outflows related to the UGC acquisition.

- Cash provided by investing activities for the six months ended June 30, 2018 was higher than the cash used in the 2017 period, primarily reflecting the sale of short term investments to fund the financing activities noted below. In addition, activity for the 2018 period reflected higher net purchases of fixed maturity investments than in the 2017 period.

- Cash used for financing activities for the six months ended June 30, 2018 was higher than in the 2017 period, and reflected \$250.0 million of paydowns on our revolving credit agreement borrowings, \$173.6 million of repurchases under our share repurchase program and \$92.6 million related to redemption of our Series C preferred shares in January 2018.

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## CAPITAL RESOURCES

This section does not include information specific to Watford Re. We do not guarantee or provide credit support for Watford Re, and our financial exposure to Watford Re is limited to our investment in Watford Re's common and preferred shares and counterparty credit risk (mitigated by collateral) arising from reinsurance transactions with Watford Re.

The following table provides an analysis of our capital structure:

(U.S. dollars in thousands, except share data)	Jun 30, 2018	Dec 31, 2017
Debt:		
Senior notes, due May 2034	\$297,101	\$297,053
Arch-U.S. senior notes, due Nov 2043 (1)	494,671	494,621
Arch Finance senior notes, due Dec 2026 (1)	496,229	496,043
Arch Finance senior notes, due Dec 2046 (1)	445,210	445,167
Revolving credit agreement borrowings due Oct 2021 (2)	125,000	375,000
Total	\$1,858,211	\$2,107,884
Shareholders' equity available to Arch:		
Series C non-cumulative preferred shares (3)	\$—	\$92,555
Series E non-cumulative preferred shares	450,000	450,000
Series F non-cumulative preferred shares	330,000	330,000
Common shareholders' equity	8,383,755	8,324,047
Total	\$9,163,755	\$9,196,602
Total capital available to Arch	\$11,021,966	\$11,304,486
Senior notes to total capital (%)	15.7	15.3
Revolving credit agreement borrowings to total capital (%)	1.1	3.3
Debt to total capital (%)	16.9	18.6
Preferred to total capital (%)	7.1	7.7
Debt and preferred to total capital (%)	23.9	26.4

(1) Fully and unconditionally guaranteed by Arch Capital.

(2) \$500 million unsecured facility for revolving loans and letters of credit.

(3) Redeemed on January 2, 2018.

Arch Capital and Arch-U.S. are each holding companies and, accordingly, they conduct substantially all of their operations through their operating subsidiaries. Arch Capital Finance LLC ("Arch Finance") is a wholly owned subsidiary of Arch U.S. MI Holdings Inc. As a result, Arch Capital, Arch-U.S. and Arch Finance's cash flows and their ability to service their debt depends upon the earnings of their operating subsidiaries, or affiliates in the case of Arch Finance, and on their ability to distribute the earnings, loans or other payments from such subsidiaries or affiliates to Arch Capital, Arch-U.S. and Arch Finance, respectively.

In addition, Arch MI U.S. is required to maintain compliance with the GSEs requirements, known as the Private Mortgage Insurer Eligibility Requirements or "PMIERS." The financial requirements require an eligible mortgage insurer's available assets, which generally include only the most liquid assets of

an insurer, to meet or exceed "minimum required assets" as of each quarter end. Minimum required assets are calculated from PMIERS tables with several risk dimensions (including origination year, original loan-to-value and original credit score of performing loans, and the delinquency status of non-performing loans) and are subject to a minimum amount. Arch MI U.S. satisfied the PMIERS' financial requirements as of June 30, 2018 with an estimated PMIER sufficiency ratio of 134%, compared to 129% at December 31, 2017.

Arch Capital, through its subsidiaries, provides financial support to certain of its insurance subsidiaries and affiliates, through certain reinsurance arrangements beneficial to the ratings of such subsidiaries. Historically, our insurance, reinsurance and mortgage insurance subsidiaries have entered into separate reinsurance arrangements with Arch Re Bermuda covering individual lines of business. The reinsurance agreements between our U.S.-based property casualty insurance and reinsurance subsidiaries and Arch Re Bermuda were canceled on a cutoff basis as of January 1, 2018. As a result, the level of subject business ceded to Arch Re Bermuda was substantially lower for the six months ended June 30, 2018 than in prior periods.

#### SHARE REPURCHASE PROGRAM

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The board of directors of Arch Capital has authorized the investment in Arch Capital's common shares through a share repurchase program. For the six months ended June 30, 2018, Arch Capital repurchased 6,522,645 shares under the share repurchase program with an aggregate purchase price of \$173.6 million. Since the inception of the share repurchase program through June 30, 2018, Arch Capital has repurchased 382.2 million common shares for an aggregate purchase price of \$3.86 billion. At June 30, 2018, approximately \$272.9 million of share repurchases were available under the program, which may be effected from time to time in open market or privately negotiated transactions through December 31, 2019.

The timing and amount of the repurchase transactions under this program will depend on a variety of factors, including market conditions and corporate and regulatory considerations. We will continue to monitor our share price and, depending upon results of operations, market conditions and the development of the economy, as well as other factors, we will consider share repurchases on an opportunistic basis.

#### CATASTROPHIC EVENTS AND SEVERE ECONOMIC EVENTS

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We have large aggregate exposures to natural and man-made catastrophic events and severe economic events. Catastrophes can be caused by various events, including hurricanes, floods, windstorms, earthquakes, hailstorms, tornadoes, explosions, severe winter weather, fires, droughts and other natural disasters. Catastrophes can also cause losses in non-property

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business such as mortgage insurance, workers' compensation or general liability. In addition to the nature of property business, we believe that economic and geographic trends affecting insured property, including inflation, property value appreciation and geographic concentration, tend to generally increase the size of losses from catastrophic events over time.

Our models employ both proprietary and vendor-based systems and include cross-line correlations for property, marine, offshore energy, aviation, workers compensation and personal accident. We seek to limit the probable maximum pre-tax loss to a specific level for severe catastrophic events. Currently, we seek to limit our 1-in-250 year return period net probable maximum loss from a severe catastrophic event in any geographic zone to approximately 25% of total shareholders' equity available to Arch. We reserve the right to change this threshold at any time.

Based on in-force exposure estimated as of July 1, 2018, our modeled peak zone catastrophe exposure was a windstorm affecting the Northeastern U.S., with a net probable maximum pre-tax loss of \$404 million, followed by windstorms affecting the Gulf of Mexico and Florida Tri-County regions with net probable maximum pre-tax losses of \$390 million and \$346 million, respectively. Our exposures to other perils, such as U.S. earthquake and international events, were less than the exposures arising from U.S. windstorms and hurricanes. As of July 1, 2018, our modeled peak zone earthquake exposure (Los Angeles earthquake) represented approximately 57% of our peak zone catastrophe exposure, and our modeled peak zone international exposure (Japan earthquake) was substantially less than both our peak zone windstorm and earthquake exposures.

Effective July 1, 2018, our insurance operations had in effect a reinsurance program which provided coverage for certain property-catastrophe related losses equal to \$275 million in excess of a \$75 million retention per occurrence. Such amounts compare to \$200 million in excess of a \$150 million retention per occurrence prior to July 1, 2018. We also have significant exposure to losses due to mortgage defaults resulting from severe economic events in the future. For our U.S. mortgage insurance business, we have developed a proprietary risk model ("Realistic Disaster Scenario" or "RDS") that simulates the maximum loss resulting from a severe economic downturn impacting the housing market. The RDS models the collective impact of adverse conditions for key economic indicators, the most significant of which is a decline in home prices. The RDS model projects paths of future home prices, unemployment rates, income levels and interest rates and assumes correlation across states and geographic regions. The resulting future performance of our in-force portfolio is then estimated under the economic stress scenario, reflecting

loan and borrower information.

Currently, we seek to limit our modeled RDS loss from a severe economic event to approximately 25% of total tangible shareholders' equity available to Arch (total shareholders' equity available to Arch less goodwill and intangible assets). We reserve the right to change this threshold at any time. Based on in-force exposure estimated as of July 1, 2018, our modeled RDS loss was less than 15% of tangible shareholders' equity available to Arch.

Net probable maximum loss estimates are net of expected reinsurance recoveries, before income tax and before excess reinsurance reinstatement premiums. RDS loss estimates are net of expected reinsurance recoveries and after income tax. Catastrophe loss estimates are reflective of the zone indicated and not the entire portfolio. Since hurricanes and windstorms can affect more than one zone and make multiple landfalls, our catastrophe loss estimates include clash estimates from other zones. Our catastrophe loss estimates and RDS loss estimates do not represent our maximum exposures and it is highly likely that our actual incurred losses would vary materially from the modeled estimates. There can be no assurances that we will not suffer pre-tax losses greater than 25% of our total shareholders' equity or tangible shareholders' equity from one or more catastrophic events or severe economic events due to several factors, including the inherent uncertainties in estimating the frequency and severity of such events and the margin of error in making such determinations resulting from potential inaccuracies and inadequacies in the data provided by clients and brokers, the modeling techniques and the application of such techniques or as a result of a decision to change the percentage of shareholders' equity exposed to a single catastrophic event or severe economic event. In addition, actual losses may increase if our reinsurers fail to meet their obligations to us or the reinsurance protections purchased by us are exhausted or are otherwise unavailable. See "Risk Factors—Risks Relating to Our Industry" and "Management's Discussion and Analysis of Financial Condition and Results of Operations—Catastrophic Events and Severe Economic Events" in our 2017 Form 10-K.

OFF-BALANCE SHEET ARRANGEMENTS

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Off-balance sheet arrangements are discussed in Management's Discussion and Analysis of Financial Condition and Results of Operations contained in our 2017 Form 10-K.

MARKET SENSITIVE INSTRUMENTS AND RISK MANAGEMENT

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In accordance with the SEC's Financial Reporting Release No. 48, we performed a sensitivity analysis to determine the effects that market risk exposures could have on the future earnings, fair values or cash flows of our financial instruments as of June 30, 2018. Market risk represents the risk of changes in the fair value of a financial instrument and is comprised of

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several components, including liquidity, basis and price risks. We have not included Watford Re in the following analyses as we do not guarantee or provide credit support for Watford Re, and our financial exposure to Watford Re is limited to our investment in Watford Re's common and preferred shares and counterparty credit risk (mitigated by collateral) arising from reinsurance transactions.

An analysis of material changes in market risk exposures at June 30, 2018 that affect the quantitative and qualitative disclosures presented in our 2017 Form 10-K (see section captioned "Management's Discussion and Analysis of Financial Condition and Results of Operations—Market Sensitive Instruments and Risk Management") were as follows:

**Investment Market Risk**

**Fixed Income Securities.** We invest in interest rate sensitive securities, primarily debt securities. We consider the effect of interest rate movements on the fair value of our fixed maturities, fixed maturities pledged under securities lending agreements, short-term investments and certain of our other investments which invest in fixed income securities and the corresponding change in unrealized appreciation. As interest rates rise, the fair value of our interest rate sensitive securities falls, and the converse is also true. Based on historical observations, there is a low probability that all interest rate yield curves would shift in the same direction at the same time. Furthermore, at times interest rate movements in certain credit sectors exhibit a much lower correlation to changes in U.S. Treasury yields. Accordingly, the actual effect of interest rate movements may differ materially from the amounts set forth in the following tables.

The following table summarizes the effect that an immediate, parallel shift in the interest rate yield curve would have had on our fixed income securities:

(U.S. dollars in billions)	Interest Rate Shift in Basis Points				
	-100	-50	—	+50	+100
Jun 30, 2018					
Total fair value	\$18.67	\$18.40	\$18.15	\$17.89	\$17.64
Change from base	2.9	% 1.4	%	(1.4 )%	(2.8 )%
Change in unrealized value	\$0.53	\$0.25		\$(0.25 )	\$(0.51 )

## Dec 31, 2017

Total fair value	\$19.11	\$18.85	\$18.59	\$18.33	\$18.09
Change from base	2.8	% 1.4	%	(1.4 )%	(2.7 )%
Change in unrealized value	\$0.52	\$0.26		\$(0.26 )	\$(0.50 )

In addition, we consider the effect of credit spread movements on the market value of our fixed maturities, fixed maturities pledged under securities lending agreements, short-term investments and certain of our other investments and

investment funds accounted for using the equity method which invest in fixed income securities and the corresponding change in unrealized appreciation. As credit spreads widen, the fair value of our fixed income securities falls, and the converse is also true.

The following table summarizes the effect that an immediate, parallel shift in credit spreads in a static interest rate environment would have had on our fixed income securities:

(U.S. dollars in billions)	Credit Spread Shift in Percentage Points				
	-100	-50	—	+50	+100
Jun 30, 2018					
Total fair value	\$18.51	\$18.33	\$18.15	\$17.96	\$17.78
Change from base	2.0	% 1.0	%	(1.0 )%	(2.0 )%
Change in unrealized value	\$0.36	\$0.18		\$(0.18 )	\$(0.36 )

## Dec 31, 2017

Total fair value	\$18.96	\$18.77	\$18.59	\$18.40	\$18.22
Change from base	2.0	% 1.0	%	(1.0 )%	(2.0 )%
Change in unrealized value	\$0.37	\$0.19		\$(0.19 )	\$(0.37 )

Another method that attempts to measure portfolio risk is Value-at-Risk (“VaR”). VaR attempts to take into account a broad cross-section of risks facing a portfolio by utilizing relevant securities volatility data skewed towards the most recent months and quarters. VaR measures the amount of a portfolio at risk for outcomes 1.65 standard deviations from the mean based on normal market conditions over a one year time horizon and is expressed as a percentage of the portfolio’s initial value. In other words, 95% of the time, should the risks taken into account in the VaR model perform per their historical tendencies, the portfolio’s loss in any one year period is expected to be less than or equal to the calculated VaR, stated as a percentage of the measured portfolio’s initial value. As of June 30, 2018, our portfolio’s VaR was estimated to be 3.15% compared to an estimated 3.10% at December 31, 2017.

Equity Securities. At June 30, 2018 and December 31, 2017, the fair value of our investments in equity securities totaled \$545.1 million and \$576.0 million, respectively. These investments are exposed to price risk, which is the potential loss arising from decreases in fair value. An immediate hypothetical 10% decline in the value of each position would reduce the fair value of such investments by approximately \$54.5 million and \$57.6 million at June 30, 2018 and December 31, 2017, respectively, and would have decreased book value per share by approximately \$0.13 and \$0.14, respectively. An immediate hypothetical 10% increase in the value of each position would increase the fair value of such investments by approximately \$54.5 million and \$57.6 million at June 30, 2018 and December 31, 2017, respectively, and would have increased book value per share by approximately \$0.13 and \$0.14, respectively. Investment-Related Derivatives. At June 30, 2018, the notional value of all derivative instruments (excluding to-be-announced

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mortgage backed securities which are included in the fixed income securities analysis above and foreign currency forward contracts which are included in the foreign currency exchange risk analysis below) was \$3.20 billion, compared to \$2.44 billion at December 31, 2017. If the underlying exposure of each investment-related derivative held at June 30, 2018 depreciated by 100 basis points, it would have resulted in a reduction in net income of approximately \$32.0 million, and a decrease in book value per share of approximately \$0.08 per share, compared to \$24.4 million and \$0.06 per share, respectively, on investment-related derivatives held at December 31, 2017. If the underlying exposure of each investment-related derivative held at June 30, 2018 appreciated by 100 basis points, it would have resulted in an increase in net income of approximately \$32.0 million, and an increase in book value per share of approximately \$0.08 per share, compared to \$24.4 million and \$0.06 per share, respectively, on investment-related derivatives held at December 31, 2017. See note 9, “Derivative Instruments,” to our consolidated financial statements for additional disclosures concerning derivatives.

For further discussion on investment activity, please refer to “Financial Condition—Investable Assets.”

Foreign Currency Exchange Risk

Foreign currency rate risk is the potential change in value, income and cash flow arising from adverse changes in foreign currency exchange rates. Through our subsidiaries and branches located in various foreign countries, we conduct our insurance and reinsurance operations in a variety of local currencies other than the U.S. Dollar. We generally hold investments in foreign currencies which are intended to mitigate our exposure to foreign currency fluctuations in our net insurance liabilities. We may also utilize foreign currency forward contracts and currency options as part of our investment strategy. See note 9, “Derivative Instruments,” to our

consolidated financial statements for additional information.

The following table provides a summary of our net foreign currency exchange exposures, as well as foreign currency derivatives in place to manage these exposures:

(U.S. dollars in thousands, except per share data)	June 30, 2018	December 31, 2017
Net assets (liabilities), denominated in foreign currencies, excluding shareholders’ equity and derivatives	\$(67,954 )	\$ 401,966
Shareholders’ equity denominated in foreign currencies (1)	336,778	345,743
Net foreign currency forward contracts outstanding (2)	138,494	(123,732 )
Net exposures denominated in foreign currencies	\$407,318	\$ 623,977

Pre-tax impact of a hypothetical 10% appreciation of the U.S. Dollar against foreign currencies:

Shareholders’ equity	\$(40,732 )	\$ (62,398 )
Book value per share	\$(0.10 )	\$ (0.15 )

Pre-tax impact of a hypothetical 10% decline of the U.S. Dollar against foreign currencies:

Shareholders’ equity	\$40,732	\$ 62,398
Book value per share	\$0.10	\$ 0.15

(1) Represents capital contributions held in the foreign currencies of our operating units.

(2) Represents the net notional value of outstanding foreign currency forward contracts.

Although the Company generally attempts to match the currency of its projected liabilities with investments in the same currencies, from time to time the Company may elect to over or underweight one or more currencies, which could increase the Company’s exposure to foreign currency fluctuations and increase the volatility of the Company’s shareholders’ equity. Historical observations indicate a low probability that all foreign currency exchange rates would shift against the U.S. Dollar in the same direction and at the same time and, accordingly, the actual effect of foreign currency rate movements may differ materially from the amounts set forth above. For further discussion on foreign exchange activity, please refer to “—Results of Operations.”

Effects of Inflation

We do not believe that inflation has had a material effect on our consolidated results of operations, except insofar as inflation may affect our reserves for losses and loss adjustment expenses and interest rates. The potential exists, after a catastrophe loss, for the development of inflationary pressures in a local economy. The anticipated effects of inflation on us are considered in our catastrophe loss models. The actual effects of inflation on our results cannot be accurately known until claims are ultimately settled.

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OTHER FINANCIAL INFORMATION

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The consolidated financial statements as of June 30, 2018 and for the three month and six month periods ended June 30, 2018 and 2017 have been reviewed by PricewaterhouseCoopers LLP, the registrant's independent public accountants, whose report is included as an exhibit to this filing. The report of PricewaterhouseCoopers LLP states that they did not audit and they do not express an opinion on that unaudited financial information. Accordingly, the degree of reliance on their report on such information should be restricted in light of the limited nature of the review procedures applied. PricewaterhouseCoopers LLP is not subject to the liability provisions of Section 11 of the Securities Act of 1933 for their report on the unaudited financial information because that report is not a "report" or a "part" of the registration statement prepared or certified by PricewaterhouseCoopers LLP within the meaning of Sections 7 and 11 of the Securities Act of 1933.

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ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

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Reference is made to the information appearing above under the subheading "Market Sensitive Instruments and Risk Management" under the caption "Management's Discussion and Analysis of Financial Condition and Results of Operations," which information is hereby incorporated by reference.

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ITEM 4. CONTROLS AND PROCEDURES

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Evaluation of Disclosure Controls and Procedures

In connection with the filing of this Form 10-Q, our management, including the Chief Executive Officer and Chief Financial Officer, conducted an evaluation of the effectiveness of disclosure controls and procedures pursuant to applicable Exchange Act Rules as of the end of the period covered by this report. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the disclosure controls and procedures were effective as of the end of and during the period covered by this report with respect to information being recorded, processed, summarized and reported within time periods specified in the SEC's rules and forms and with respect to timely communication to them and other members of management responsible for preparing periodic reports of all material information required to be disclosed in this report as it relates to Arch Capital and its consolidated subsidiaries. We continue to enhance our operating procedures and internal controls to effectively support our business and our regulatory

and reporting requirements. Our management does not expect that our disclosure controls or our internal controls will prevent all errors and all fraud. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. As a result of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the company have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons or by collusion of two or more people. The design of any system of controls also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions; over time, controls may become inadequate because of changes in conditions, or the degree of compliance with the policies or procedures may deteriorate. As a result of the inherent limitations in a cost-effective control system, misstatement due to error or fraud may occur and not be detected. Accordingly, our disclosure controls and procedures are designed to provide reasonable, not absolute, assurance that the disclosure controls and procedures are met.

Changes in Internal Controls Over Financial Reporting

There have been no changes in internal control over financial reporting that occurred during the quarter ended June 30, 2018 that have materially affected, or are reasonably likely to materially affect, internal control over financial reporting.

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## PART II. OTHER INFORMATION

## ITEM 1. LEGAL PROCEEDINGS

We, in common with the insurance industry in general, are subject to litigation and arbitration in the normal course of our business. As of June 30, 2018, we were not a party to any litigation or arbitration which is expected by management to have a material adverse effect on our results of operations and financial condition and liquidity.

## ITEM 1A. RISK FACTORS

There were no material changes from the risk factors previously disclosed in our Annual Report on Form 10-K for the year ended December 31, 2017.

## ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

The following table summarizes our purchases of common shares for the 2018 second quarter:

Period	Issuer Purchases of Equity Securities		Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Approximate Dollar Value of Shares that May Yet be Purchased Under the Plan or Programs (2)
	Total Number of Shares Purchased (1)	Average Price Paid per Share		
4/1/2018 - 4/30/2018	2,754,393	\$ 26.90	2,727,816	\$ 369,861
5/1/2018 - 5/31/2018	3,215,118	26.38	2,872,941	\$ 294,159
6/1/2018 - 6/30/2018	888,757	26.43	803,673	\$ 272,926
Total	6,858,268	\$ 26.60	6,404,430	

Represents repurchases by Arch Capital of shares, from time to time, from employees in order to facilitate the payment of withholding taxes on restricted shares granted and the exercise of stock appreciation rights. We (1) purchased these shares at their fair value, as determined by reference to the closing price of our common shares on the day the restricted shares vested or the stock appreciation rights were exercised.

Remaining amount available at June 30, 2018 under Arch Capital's share repurchase authorization, under which (2) repurchases may be effected from time to time in open market or privately negotiated transactions through December 31, 2019.

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ITEM 5. OTHER INFORMATION

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In accordance with Section 10a(i)(2) of the Securities Exchange Act of 1934, as amended, we are responsible for disclosing non-audit services to be provided by our independent auditor, PricewaterhouseCoopers LLP, which are approved by the Audit Committee of our board of directors. During the 2018 second quarter, the Audit Committee approved engagements of PricewaterhouseCoopers LLP for permitted non-audit services, which consisted of tax consulting services, tax compliance services and other accounting consulting services.

Disclosure of Certain Activities Under Section 13(r) of the Securities Exchange Act of 1934

Section 13(r) of the Securities Exchange Act of 1934, as amended, requires an issuer to disclose in its annual or quarterly reports whether it or an affiliate knowingly engaged in certain activities described in that section, including certain activities related to Iran during the period covered by the report.

On January 16, 2016, the Office of Foreign Assets Control of the U.S. Department of the Treasury (“OFAC”) adopted General License H which authorized non-U.S. entities that are owned or controlled by a U.S. person to engage in certain activities with Iran so long as they complied with certain specific requirements set forth therein.

Certain of our non-U.S. subsidiaries provide global marine policies that provide coverage for vessels navigating into and out of ports worldwide. In light of European Union and U.S. modifications to Iran sanctions in 2016, including the issuance of General License H, and consistent with General License H, we have been notified that certain of our policyholders shipped cargo to and from Iran, and that such cargo may include transporting crude oil from Iran to another country. Since these policies insure multiple voyages and fleets containing multiple ships, we are unable to attribute gross revenues and net profits from such marine policies to these activities involving Iran. On May 8, 2018, the President announced that the U.S. will cease participation in the Joint Comprehensive Plan of Action and will begin reimposing the U.S. nuclear-related sanctions. On June 27, 2018, OFAC revoked General License H and added Section 560.537 to the Iranian Transactions and Sanctions Regulations, which authorizes all transactions and activities that are ordinarily incident and necessary to the winding down of activities previously approved under General License H through November 4, 2018. Our non-U.S. affiliates expect to wind down activities in Iran by November 4, 2018 in accordance with all applicable laws and regulations. Since May 8, 2018, our non-U.S. subsidiaries have not entered into any new transactions that had previously been permitted under General License H.

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**ITEM 6. EXHIBITS**

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Exhibit No.	Description
10.1	<u>ACGL 2018 Long Term Incentive and Share Award Plan</u> †
10.2	<u>Employment Agreement, dated as of February 1, 2018, between ACGL and W. Preston Hutchings</u> †
10.3	<u>Form of Restricted Share Award Agreement for Named Executive Officers and certain Executive Officers of ACGL and subsidiaries</u> †
10.4	<u>Form of Non-Qualified Stock Option Agreement for Named Executive Officers and certain Executive Officers of ACGL and subsidiaries</u> †
10.5	<u>Form of Performance Restricted Share Agreement for Named Executive Officers and certain Executive Officers of ACGL and subsidiaries</u> †
10.6	<u>Form of Non-Employee Director Restricted Share Agreement</u> †
10.7	<u>Restricted Share Agreement, dated May 9, 2018, between ACGL and Constantine Iordanou</u> †
10.8	<u>Non-Qualified Stock Option Agreement, dated May 9, 2018, between ACGL and Constantine Iordanou</u> †
15	<u>Accountants' Awareness Letter (regarding unaudited interim financial information)</u>
31.1	<u>Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002</u>
31.2	<u>Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002</u>
32.1	<u>Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002</u>
32.2	<u>Certification of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002</u>
101	The following financial information from Arch Capital Group Ltd.'s Quarterly Report for the quarter ended June 30, 2018 formatted in XBRL: (i) Consolidated Balance Sheets at June 30, 2018 and December 31, 2017; (ii) Consolidated Statements of Income for the three and six month periods ended June 30, 2018 and 2017; (iii) Consolidated Statements of Comprehensive Income for the three and six month periods ended June 30, 2018 and 2017; (iv) Consolidated Statements of Changes in Shareholders' Equity for the six month periods ended June 30, 2018 and 2017; (v) Consolidated Statements of Cash Flows for the six month periods ended June 30, 2018 and 2017; and (vi) Notes to Consolidated Financial Statements.
†	Management contract or compensatory plan or arrangement

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SIGNATURES

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

ARCH CAPITAL GROUP LTD.  
(REGISTRANT)

/s/ Marc Grandisson

Date: August 8,  
2018

Marc Grandisson

President and Chief Executive Officer (Principal Executive Officer)

/s/ François Morin

Date: August 8,  
2018

François Morin

Executive Vice President, Chief Financial Officer and Treasurer (Principal Financial and Accounting Officer)

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