



NEWS RELEASE

## Arch Capital Group Ltd. Reports 2015 Third Quarter Results

2015-10-28

HAMILTON, Bermuda--(BUSINESS WIRE)-- Arch Capital Group Ltd. (NASDAQ:ACGL) reports that net income available to Arch common shareholders for the 2015 third quarter was \$74.5 million, or \$0.60 per share, compared to \$223.2 million, or \$1.64 per share, for the 2014 third quarter. The Company also reported after-tax operating income available to Arch common shareholders of \$125.8 million, or \$1.01 per share, for the 2015 third quarter, compared to \$142.1 million, or \$1.05 per share, for the 2014 third quarter. The Company's after-tax operating income available to Arch common shareholders represented an annualized return on average common equity of 8.6% for the 2015 third quarter, compared to 9.7% for the 2014 third quarter. For the trailing twelve months ended September 30, 2015, after-tax operating income available to Arch common shareholders produced a 9.9% return on average common equity while net income available to Arch common shareholders produced an 11.6% return on average common equity. The Company's book value per common share was \$47.68 at September 30, 2015, a 0.4% increase from \$47.49 per share at June 30, 2015 and an 8.3% increase from \$44.04 per share at September 30, 2014.

After-tax operating income or loss available to Arch common shareholders, a non-GAAP measure, 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 and net foreign exchange gains or losses, net of income taxes. See 'Comments on Regulation G' for a further discussion of after-tax operating income or loss available to Arch common shareholders. All earnings per share amounts discussed in this release are on a diluted basis.

The following table summarizes the Company's underwriting results, excluding amounts related to the 'other'

segment (i.e., results of Watford Re). Although the Company owns approximately 11% of Watford Re's common equity, pursuant to generally accepted accounting principles, it consolidates the results of Watford Re in its financial statements. All discussions of line items in this release exclude amounts related to the 'other' segment. For segment results reflecting the contribution of the 'other' segment, see pages 10 to 13 of the Company's Financial Supplement dated September 30, 2015.

(U.S. dollars in thousands)	Three Months Ended September 30,			Nine Months Ended September 30,		
	2015	2014	% Change	2015	2014	% Change
Gross premiums written	\$ 1,158,451	\$ 1,138,392	1.8	\$ 3,625,382	\$ 3,690,462	(1.8)
Net premiums written	846,965	859,724	(1.5)	2,612,774	2,812,646	(7.1)
Net premiums earned	837,523	868,881	(3.6)	2,511,770	2,620,667	(4.2)
Underwriting income	93,470	101,167	(7.6)	316,516	359,878	(12.0)
<b>Underwriting Ratios</b>			<b>% Point Change</b>			<b>% Point Change</b>
Loss ratio	55.5 %	55.0 %	0.5	53.8 %	53.1 %	0.7
Acquisition expense ratio	17.1 %	17.7 %	(0.6)	17.1 %	17.8 %	(0.7)
Other operating expense ratio	17.1 %	15.8 %	1.3	17.4 %	15.6 %	1.8
Combined ratio	89.7 %	88.5 %	1.2	88.3 %	86.5 %	1.8

The following table summarizes, on an after-tax basis, the Company's consolidated financial data, including a reconciliation of after-tax operating income available to Arch common shareholders to net income available to Arch common shareholders and related diluted per share results:

(U.S. dollars in thousands, except share data)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
After-tax operating income available to Arch common shareholders	\$ 125,798	\$ 142,055	\$ 421,600	\$ 467,128
Net realized gains (losses), net of tax	(58,048)	27,476	(24,188)	96,016
Net impairment losses recognized in earnings, net of tax	(5,868)	(8,593)	(12,780)	(26,313)
Equity in net income (loss) of investment funds accounted for using the equity method, net of tax	(2,373)	4,765	19,272	16,983
Net foreign exchange gains (losses), net of tax	15,040	57,488	58,802	48,924
Net income available to Arch common shareholders	\$ 74,549	\$ 223,191	\$ 462,706	\$ 602,738
<b>Diluted per common share results:</b>				
After-tax operating income available to Arch common shareholders	\$ 1.01	\$ 1.05	\$ 3.34	\$ 3.43
Net realized gains (losses), net of tax	(0.46)	0.20	(0.19)	0.70
Net impairment losses recognized in earnings, net of tax	(0.05)	(0.06)	(0.10)	(0.19)
Equity in net income (loss) of investment funds accounted for using the equity method, net of tax	(0.02)	0.03	0.15	0.12
Net foreign exchange gains (losses), net of tax	0.12	0.42	0.46	0.36
Net income available to Arch common shareholders	\$ 0.60	\$ 1.64	\$ 3.66	\$ 4.42
Weighted average common shares and common share equivalents outstanding - diluted	125,011,773	135,876,605	126,354,759	136,354,172

The Company's investment portfolio continues to be comprised primarily of high quality fixed income securities with an average credit quality of "AA/Aa2." The average effective duration of the Company's investment portfolio was 3.42 years at September 30, 2015, compared to 3.34 years at December 31, 2014. Including the effects of

foreign exchange, total return on the Company's investment portfolio was (0.31)% for the 2015 third quarter, compared to (0.51)% for the 2014 third quarter. Total return in the 2015 third quarter reflected the impact of the strengthening U.S. Dollar against the British Pound Sterling, Canadian Dollar and other major currencies on non-U.S. Dollar denominated investments. Excluding the effects of foreign exchange, total return was 0.04% for the 2015 third quarter, as investment-grade fixed income returns were substantially offset by negative returns on equities, high yield and alternative strategies.

Net investment income for the 2015 third quarter was \$0.54 per share, or \$67.3 million, compared to \$0.53 per share, or \$72.2 million, for the 2014 third quarter, and \$0.53 per share, or \$67.2 million, for the 2015 second quarter. The annualized pre-tax investment income yield was 2.04% for the 2015 third quarter, compared to 2.05% for the 2014 third quarter and 2.05% for the 2015 second quarter. Such yields reflect the effects of low prevailing interest rates available in the market and the Company's investment strategy, which puts an emphasis on total return. Cash flow provided by operating activities was \$359.2 million for the 2015 third quarter, compared to \$319.3 million for the 2014 third quarter, primarily reflecting a higher level of premiums collected.

On a pre-tax basis, net foreign exchange gains for the 2015 third quarter were \$16.1 million, compared to net foreign exchange gains for the 2014 third quarter of \$57.6 million. For both periods, such amounts were primarily unrealized and resulted from the effects of revaluing the Company's net insurance liabilities required to be settled in foreign currencies at each balance sheet date. Changes in the value of available-for-sale investments held in foreign currencies due to foreign currency rate movements are reflected as a direct increase or decrease to shareholders' equity and are not included in the consolidated statements of income. The Company has not matched a portion of its projected liabilities in foreign currencies with investments in the same currencies and may not match such amounts in future periods, which could increase the Company's exposure to foreign currency fluctuations and increase the volatility of the Company's shareholders' equity.

Interest expense for the 2015 third quarter was \$12.0 million, compared to \$4.2 million for the 2014 third quarter. The lower level of interest expense for the 2014 third quarter primarily reflected an \$8.2 million reduction in interest expense on a deposit accounting liability (i.e., a contract that, in accordance with GAAP, does not pass risk transfer). The reduction in the 2014 third quarter resulted from a reassessment of this estimated ultimate liability due to a determination that paid losses were expected to be lower than previously anticipated. The Company reduced the same liability by \$8.4 million in the 2015 second quarter.

The Company's effective tax rate on income before income taxes (based on the Company's estimated annual effective tax rate) was 13.2% for the 2015 third quarter and 5.5% for the nine months ended September 30, 2015, compared to 2.8% for the 2014 third quarter and 2.8% for the nine months ended September 30, 2014. The Company's effective tax rate on pre-tax operating income available to Arch shareholders was 5.7% for the 2015

third quarter and 4.5% for the nine months ended September 30, 2015, compared to 2.5% for the 2014 third quarter and 2.6% for the nine months ended September 30, 2014. The Company's effective tax rate fluctuates from year to year based upon the relative mix of income or loss reported by jurisdiction and the varying tax rates in each jurisdiction. The Company's quarterly tax provision is adjusted to reflect changes in its estimated annual effective tax rate, if any. The adjustment to the estimated annual effective tax rate in the 2015 third quarter reduced the Company's after-tax results by \$1.8 million, or \$.01 per share.

During the 2015 third quarter, the Company repurchased a small amount of shares under its share repurchase program. Since the inception of the share repurchase program through September 30, 2015, ACGL has repurchased 124.1 million common shares for an aggregate purchase price of \$3.61 billion. At September 30, 2015, \$521.8 million of repurchases were available under the share repurchase program.

At September 30, 2015, total capital available to Arch of \$7.05 billion consisted of \$791.3 million of senior notes, representing 11.2% of the total, \$100.0 million of revolving credit agreement borrowings, representing 1.4% of the total, \$325.0 million of preferred shares, representing 4.6% of the total, and common shareholders' equity of \$5.84 billion, representing 82.8% of the total. At June 30, 2015, total capital available to Arch of \$7.03 billion consisted of \$791.2 million of senior notes, representing 11.3% of the total, \$100.0 million of revolving credit agreement borrowings, representing 1.4% of the total, \$325.0 million of preferred shares, representing 4.6% of the total, and common shareholders' equity of \$5.81 billion, representing 82.7% of the total.

The Company will hold a conference call for investors and analysts at 11:00 a.m. Eastern Time on October 29, 2015. A live webcast of this call will be available via the Investors section of the Company's website at <http://www.archcapgroup.com>. A telephone replay of the conference call also will be available beginning on October 29, 2015 at 3:00 p.m. Eastern Time until November 5, 2015 at midnight Eastern Time. To access the replay, domestic callers should dial 888-286-8010 (passcode 23491563), and international callers should dial 617-801-6888 (passcode 23491563).

Please refer to the Company's Financial Supplement dated September 30, 2015, which is available via the Investors section of the Company's website at <http://www.archcapgroup.com>. The Financial Supplement provides additional detail regarding the financial performance of the Company. From time to time, the Company posts additional financial information and presentations to its website, including information with respect to its subsidiaries. Investors and other recipients of this information are encouraged to check the Company's website regularly for additional information regarding the Company.

Arch Capital Group Ltd., a Bermuda-based company with approximately \$7.05 billion in capital at September 30, 2015, provides insurance and reinsurance on a worldwide basis through its wholly owned subsidiaries.

## Supplemental Information

### Book Value Per Common Share

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

	September 30, 2015	December 31, 2014
Calculation of book value per common share:		
Total shareholders' equity available to Arch	\$ 6,162,815	\$ 6,130,053
Less preferred shareholders' equity	325,000	325,000
Common shareholders' equity available to Arch	5,837,815	5,805,053
Common shares outstanding, net of treasury shares (1)	122,438,554	127,367,934
Book value per common share	\$ 47.68	\$ 45.58

(1) Excludes the effects of 7,681,882 and 7,804,033 stock options and 415,084 and 447,073 restricted stock units outstanding at September 30, 2015 and December 31, 2014, respectively.

### Investment Information

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
Components of net investment income (1):				
Fixed maturities	\$ 58,888	\$ 64,461	\$ 182,447	\$ 191,409
Term loan investments (2)	4,810	5,717	13,651	16,619
Equity securities (dividends)	3,807	2,779	9,228	8,971
Short-term investments	75	152	453	660
Other (3)	10,253	7,896	33,462	21,681
Gross investment income	77,833	81,005	239,241	239,340
Investment expenses	(10,582)	(8,766)	(34,531)	(27,650)
Net investment income	\$ 67,251	\$ 72,239	\$ 204,710	\$ 211,690
Per share	\$ 0.54	\$ 0.53	\$ 1.62	\$ 1.55
Investment income yield, at amortized cost (1) (4):				
Pre-tax	2.04%	2.05%	2.06%	2.07%
After-tax	1.86%	1.90%	1.89%	1.93%
Total return (1) (5):				
Including effects of foreign exchange	(0.31)%	(0.51)%	0.76%	2.32%
Excluding effects of foreign exchange	0.04%	0.21%	1.73%	2.89%
Cash flow from operations (1)	\$ 359,246	\$ 319,304	\$ 606,607	\$ 770,867

(1) Excludes amounts related to the 'other' segment.

(2) Included in "investments accounted for using the fair value option" on the Company's balance sheet.

(3) Includes income on other investments, funds held balances, cash balances and other.

(4) Presented on an annualized basis and excluding the impact of investments for which returns are not included within investment income, such as investments accounted for using the equity method and certain equities.

(5) Includes net 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 or losses generated by the Company's investment portfolio. Total return is calculated on a pre-tax basis and before investment expenses.

## Investment Information (continued)

(U.S. dollars in thousands)

	September 30, 2015		December 31, 2014	
	Amount	% of Total	Amount	% of Total
<b>Investable assets (1) (2):</b>				
Fixed maturities available for sale, at fair value	\$ 10,560,635	71.7	\$ 10,750,770	73.6
Fixed maturities, at fair value (3)	341,131	2.3	377,053	2.6
Fixed maturities pledged under securities lending agreements, at fair value	285,632	1.9	50,802	0.3
Total fixed maturities	11,187,398	75.9	11,178,625	76.6
Short-term investments available for sale, at fair value	708,428	4.8	797,226	5.5
Cash	521,137	3.5	474,247	3.2
Equity securities available for sale, at fair value	606,259	4.1	658,182	4.5
Equity securities, at fair value (3)	78	—	—	—
Other investments available for sale, at fair value	281,014	1.9	296,224	2.0
Other investments, at fair value (3)	891,484	6.1	878,774	6.0
Investments accounted for using the equity method (4)	589,277	4.0	349,014	2.4
Securities transactions entered into but not settled at the balance sheet date	(51,343)	(0.3)	(32,802)	(0.2)
Total investable assets managed by the Company	\$ 14,733,732	100.0	\$ 14,599,490	100.0
<b>Investment portfolio statistics (1):</b>				
Average effective duration (in years)		3.42		3.34
Average credit quality (Standard & Poor's/Moody's Investors Service)		AA/Aa2		AA/Aa2
Embedded book yield (before investment expenses)		2.10 %		2.18 %

(1) Excludes amounts related to the 'other' segment.

(2) This table excludes the collateral received and reinvested and includes the fixed maturities and short-term investments pledged under securities lending agreements, at fair value.

(3) Represents investments which are carried at fair value under the fair value option and reflected as "investments accounted for using the fair value option" on the Company's balance sheet. Changes in the carrying value of such investments are recorded in net realized gains or losses.

(4) Changes in the carrying value of investment funds accounted for using the equity method are recorded as "equity in net income (loss) of investment funds accounted for using the equity method" rather than as an unrealized gain or loss component of accumulated other comprehensive income.

## Selected Information on Losses and Loss Adjustment Expenses (1)

(U.S. dollars in thousands)

	Three Months Ended		Nine Months Ended	
	September 30, 2015	2014	September 30, 2015	2014
<b>Components of losses and loss adjustment expenses incurred</b>				
Paid losses and loss adjustment expenses	\$ 467,855	\$ 467,102	\$ 1,365,542	\$ 1,328,386
Change in unpaid losses and loss adjustment expenses	(2,654)	10,988	(14,356)	61,912
Total losses and loss adjustment expenses	\$ 465,201	\$ 478,090	\$ 1,351,186	\$ 1,390,298
<b>Estimated net (favorable) adverse development in prior year loss reserves, net of related adjustments</b>				
Net impact on underwriting results:				
Insurance	\$ (7,572)	\$ (8,096)	\$ (29,694)	\$ (34,650)
Reinsurance	(48,075)	(60,525)	(164,156)	(198,327)
Mortgage	(3,965)	(751)	(7,885)	(1,863)
Total	\$ (59,612)	\$ (69,372)	\$ (201,735)	\$ (234,840)

Impact on losses and loss adjustment expenses:				
Insurance	\$ (9,867)	\$ (11,395)	\$ (37,216)	\$ (46,355)
Reinsurance	(49,941)	(61,015)	(165,750)	(200,529)
Mortgage	(3,975)	(723)	(7,715)	(1,769)
Total	<u>\$ (63,783)</u>	<u>\$ (73,133)</u>	<u>\$ (210,681)</u>	<u>\$ (248,653)</u>
Impact on acquisition expenses:				
Insurance	\$ 2,295	\$ 3,299	\$ 7,522	\$ 11,705
Reinsurance	1,866	490	1,594	2,202
Mortgage	10	(28)	(170)	(94)
Total	<u>\$ 4,171</u>	<u>\$ 3,761</u>	<u>\$ 8,946</u>	<u>\$ 13,813</u>
Impact on combined ratio:				
Insurance	(1.4)%	(1.6)%	(1.9)%	(2.3)%
Reinsurance	(18.5)%	(20.4)%	(20.2)%	(20.4)%
Mortgage	(7.3)%	(1.4)%	(5.0)%	(1.3)%
Total	<u>(7.1)%</u>	<u>(8.0)%</u>	<u>(8.0)%</u>	<u>(9.0)%</u>
Impact on loss ratio:				
Insurance	(1.9)%	(2.2)%	(2.4)%	(3.1)%
Reinsurance	(19.2)%	(20.6)%	(20.4)%	(20.6)%
Mortgage	(7.3)%	(1.4)%	(4.9)%	(1.2)%
Total	<u>(7.6)%</u>	<u>(8.4)%</u>	<u>(8.4)%</u>	<u>(9.5)%</u>
Impact on acquisition expense ratio:				
Insurance	0.5%	0.6%	0.5%	0.8%
Reinsurance	0.7%	0.2%	0.2%	0.2%
Mortgage	—%	—%	(0.1)%	(0.1)%
Total	<u>0.5%</u>	<u>0.4%</u>	<u>0.4%</u>	<u>0.5%</u>
Estimated net losses incurred from current accident year catastrophic events (2)				
Insurance	\$ 8,545	\$ 1,958	\$ 17,745	\$ 8,311
Reinsurance	10,302	12,226	21,574	27,908
Total	<u>\$ 18,847</u>	<u>\$ 14,184</u>	<u>\$ 39,319</u>	<u>\$ 36,219</u>
Impact on combined ratio:				
Insurance	1.6%	0.4%	1.2%	0.6%
Reinsurance	4.0%	4.1%	2.7%	2.9%
Total	<u>2.3%</u>	<u>1.6%</u>	<u>1.6%</u>	<u>1.4%</u>

(1) Excludes amounts related to the 'other' segment.

(2) Equals estimated losses from catastrophic events occurring in the current accident year, net of reinsurance and reinstatement premiums. Amounts shown for the insurance segment are for named catastrophic events only. Amounts shown for the reinsurance segment include (i) named events with over \$5 million of losses incurred by its Bermuda and Europe operations and (ii) all catastrophe losses incurred by its U.S. operations. Amounts not applicable for the mortgage segment.

## Segment Information

The following section provides analysis on the Company's 2015 third quarter performance by operating segment. For additional details regarding the Company's operating segments, please refer to the Company's Financial Supplement dated September 30, 2015. The Company's segment information includes the use of a combined ratio excluding catastrophic activity and prior year development for the insurance segment and reinsurance segment and a combined ratio excluding prior year development for the mortgage segment. These ratios are "non-GAAP financial measures" as defined in Regulation G. See 'Comments on Regulation G' for further details.

### Insurance Segment

Three Months Ended September 30,

(U.S. dollars in thousands)

	2015	2014	% Change
Gross premiums written	\$ 752,438	\$ 726,683	3.5
Net premiums written	542,995	538,994	0.7
Net premiums earned	522,544	519,387	0.6
Underwriting income	21,508	16,654	29.1
			<u>% Point</u>
			<u>Change</u>
Underwriting Ratios			
Loss ratio	65.0%	65.1%	(0.1)
Acquisition expense ratio	14.8%	15.7%	(0.9)
Other operating expense ratio	16.2%	16.0%	0.2
Combined ratio	96.0%	96.8%	(0.8)
Catastrophic activity and prior year development:			
Current accident year catastrophic events, net of reinsurance and reinstatement premiums	1.6%	0.4%	1.2
Net (favorable) adverse development in prior year loss reserves, net of related adjustments	(1.4)%	(1.6)%	0.2
Combined ratio excluding catastrophic activity and prior year development	95.8%	98.0%	(2.2)

Gross premiums written by the insurance segment in the 2015 third quarter were 3.5% higher than in the 2014 third quarter while net premiums written were 0.7% higher than in the 2014 third quarter. Changes in foreign currency rates resulted in a decrease in net premiums written in the 2015 third quarter of approximately \$11 million, or 2.1%, compared to the 2014 third quarter. The higher level of net premiums written reflected growth in construction, alternative markets and travel, accident and health business, partially offset by a reduction in program business. The growth in construction business primarily reflected an increase in new projects and audit premiums, while the increase in alternative markets primarily resulted from changes in renewal dates on business acquired as part of the renewal rights agreement entered into in the 2014 second quarter. The higher level of travel, accident and health business reflected growth in U.S. travel along with international medical small and medium accounts, while the reduction in program business reflected underwriting decisions. Net premiums earned by the insurance segment in the 2015 third quarter were 0.6% higher than in the 2014 third quarter, and reflect changes in net premiums written over the previous five quarters.

The 2015 third quarter loss ratio reflected 1.6 points of current year catastrophic activity, compared to 0.4 points in the 2014 third quarter. Estimated net favorable development in prior year loss reserves, before related adjustments, reduced the loss ratio by 1.9 points in the 2015 third quarter, compared to 2.2 points in the 2014 third quarter. The estimated net favorable development in the 2015 third quarter primarily resulted from better than expected claims emergence in medium-tail and longer-tailed lines from older accident years. The balance of the change in the 2015 third quarter loss ratio primarily resulted from a lower level of attritional large loss activity relative to the 2014 third quarter and changes in the mix of business.

The underwriting expense ratio was 31.0% in the 2015 third quarter, compared to 31.7% in the 2014 third quarter. The acquisition expense ratio was 14.8% in the 2015 third quarter, compared to 15.7% in the 2014 third quarter. The lower 2015 third quarter ratio primarily resulted from changes in the mix of business. The operating expense ratio was 16.2% in the 2015 third quarter, compared to 16.0% in the 2014 third quarter.

## Reinsurance Segment

(U.S. dollars in thousands)

	Three Months Ended September 30,		
	2015	2014	% Change
Gross premiums written	\$ 329,327	\$ 345,747	(4.7)
Net premiums written	237,145	262,245	(9.6)
Net premiums earned	260,431	296,548	(12.2)
Other underwriting income	2,783	215	1,194.4
Underwriting income	54,887	76,437	(28.2)
			% Point Change
Loss ratio	44.5%	41.7%	2.8
Acquisition expense ratio	21.3%	20.3%	1.0
Other operating expense ratio	14.3%	12.3%	2.0
Combined ratio	80.1%	74.3%	5.8
Catastrophic activity and prior year development:			
Current accident year catastrophic events, net of reinsurance and reinstatement premiums	4.0%	4.1%	(0.1)
Net (favorable) adverse development in prior year loss reserves, net of related adjustments	(18.5)%	(20.4)%	1.9
Combined ratio excluding catastrophic activity and prior year development	94.6%	90.6%	4.0

Gross premiums written by the reinsurance segment in the 2015 third quarter were 4.7% lower than in the 2014 third quarter, while net premiums written were 9.6% lower than in the 2014 third quarter. Changes in foreign currency rates resulted in a decrease in net premiums written in the 2015 third quarter of approximately \$9 million, or 3.4%, compared to the 2014 third quarter. The difference in gross versus net premiums written primarily reflects an increase in cessions to Watford Re in the 2015 third quarter compared to the 2014 third quarter. The lower level of net premiums written reflected decreases in other specialty and property lines. The decrease in other specialty reflected non-renewals and share decreases in response to current market conditions, primarily in proportional motor contracts. The lower level of property business reflected share decreases and timing of renewals. Net premiums earned in the 2015 third quarter were 12.2% lower than in the 2014 third quarter, and primarily reflect changes in net premiums written over the previous five quarters, including the mix and type of business written.

The 2015 third quarter loss ratio reflected 4.2 points of current year catastrophic activity, compared to 4.6 points of catastrophic activity in the 2014 third quarter. Estimated net favorable development in prior year loss reserves, before related adjustments, reduced the loss ratio by 19.2 points in the 2015 third quarter, compared to 20.6 points in the 2014 third quarter. The estimated net favorable development in the 2015 third quarter primarily resulted from better than expected claims emergence in short-tail business from more recent underwriting years and in longer-tail business across earlier underwriting years. The balance of the change in the 2015 third quarter loss ratio primarily resulted from a higher level of attritional large loss activity and changes in mix of business.

The underwriting expense ratio was 35.6% in the 2015 third quarter, compared to 32.6% in the 2014 third quarter. The acquisition expense ratio for the 2015 third quarter was 21.3%, compared to 20.3% for the 2014 third quarter. The comparison of the acquisition expense ratios in each period is influenced by, among other things, the mix and

type of business written and earned, and an increase in the level of ceding commissions incurred. The operating expense ratio for the 2015 third quarter was 14.3%, compared to 12.3% in the 2014 third quarter, primarily reflecting the lower level of net premiums earned.

## Mortgage Segment

(U.S. dollars in thousands)	Three Months Ended September 30,		
	2015	2014	% Change
Gross premiums written	\$ 74,657	\$ 66,389	12.5
Net premiums written	66,825	58,485	14.3
Net premiums earned	54,548	52,946	3.0
Other underwriting income	3,565	988	260.8
Underwriting income	17,075	8,076	111.4
			<b>% Point Change</b>
Loss ratio	17.5%	30.2%	(12.7)
Acquisition expense ratio	19.1%	22.6%	(3.5)
Other operating expense ratio	38.6%	33.8%	4.8
Combined ratio	75.2%	86.6%	(11.4)
Net (favorable) adverse development in prior year loss reserves, net of related adjustments	(7.3)%	(1.4)%	(5.9)
Combined ratio excluding prior year development	82.5%	88.0%	(5.5)

The mortgage segment includes the results of Arch Mortgage Insurance Company ("Arch MI U.S.") and Arch Mortgage Insurance Limited, leading providers of mortgage insurance products and services to the U.S. and European markets, respectively. Arch MI U.S. is approved as an eligible mortgage insurer by Fannie Mae and Freddie Mac (each a government sponsored enterprise, or "GSE"). The mortgage segment also includes GSE credit risk-sharing transactions and mortgage reinsurance for the U.S. and Australian markets.

Gross premiums written by the mortgage segment in the 2015 third quarter were 12.5% higher than in the 2014 third quarter, while net premiums written were 14.3% higher than in the 2014 third quarter. Net premiums written in the 2015 third quarter included \$31.2 million of business underwritten by Arch MI U.S., compared to \$32.2 million in the 2014 third quarter. The 2015 third quarter amount reflected \$23.7 million from credit union clients and \$7.5 million from banks and other mortgage originators, compared to \$24.6 million from credit union clients and \$7.6 million from banks and other mortgage originators in the 2014 third quarter. Premiums written on reinsurance treaties were higher by \$9.4 million compared to the 2014 third quarter, primarily reflecting growth in single premium Australian business. Net premiums earned for the 2015 third quarter were 3.0% higher than in the 2014 third quarter.

Other underwriting income, which is primarily related to GSE risk-sharing transactions, was \$3.6 million for the 2015 third quarter, compared to \$1.0 million for the 2014 third quarter, and comparable with the \$3.7 million

recorded in the 2015 second quarter.

The loss ratio for the 2015 third quarter continues to reflect relatively low levels of reported delinquencies. As noted previously, the mortgage segment's underwriting expense ratio is expected to stay at an elevated level until Arch MI U.S. reaches scale. At September 30, 2015, the mortgage segment's risk-in-force consisted of \$6.47 billion from Arch MI U.S. and an additional \$3.80 billion through the mortgage segment's reinsurance and risk-sharing operations. Arch MI U.S. generated \$3.18 billion of new insurance written ("NIW") during the 2015 third quarter, of which approximately 57% was from banks and other mortgage originators. For additional information on the mortgage segment, please refer to the Company's Financial Supplement.

## Cautionary Note Regarding Forward-Looking Statements

The Private Securities Litigation Reform Act of 1995 ("PSLRA") provides a "safe harbor" for forward-looking statements. This release or any other written or oral statements made by or on behalf of the Company may include forward-looking statements, which reflect the Company's 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 release 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" and similar statements of a future or forward-looking nature or their negative or variations or similar terminology.

Forward-looking statements involve the Company's 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 release and in the Company's periodic reports filed with the Securities and Exchange Commission (the "SEC"), and include:

- the Company's ability to successfully implement its business strategy during "soft" as well as "hard" markets;
- acceptance of the Company's business strategy, security and financial condition by rating agencies and regulators, as well as by brokers and its insureds and reinsureds;
- the Company's ability to maintain or improve its ratings, which may be affected by its 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, 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 the Company operates;

- competition, including increased competition, on the basis of pricing, capacity, coverage terms or other factors;
- developments in the world’s financial and capital markets and the Company’s access to such markets;
- the Company’s ability to successfully enhance, integrate and maintain operating procedures (including information technology) to effectively support its current and new business;
- the loss of key personnel;
- the integration of businesses the Company has acquired or may acquire into its existing operations;
- accuracy of those estimates and judgments utilized in the preparation of the Company’s 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 the Company, are even more difficult to make than those made in a mature company since relatively limited historical information has been reported to the Company through September 30, 2015;
- greater than expected loss ratios on business written by the Company and adverse development on claim and/or claim expense liabilities related to business written by its insurance and reinsurance subsidiaries;
- severity and/or frequency of losses;
- claims for natural or man-made catastrophic events in the Company’s insurance or reinsurance business could cause large losses and substantial volatility in its results of operations;
- acts of terrorism, political unrest and other hostilities or other unforecasted and unpredictable events;
- availability to the Company of reinsurance to manage its 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 the Company;
- the timing of loss payments being faster or the receipt of reinsurance recoverables being slower than anticipated by the Company;
- the Company’s investment performance, including legislative or regulatory developments that may adversely affect the fair value of the Company’s investments;

- the impact of the continued weakness of the U.S., European countries and other key economies, projected budget deficits for the U.S., European countries and other governments and the consequences associated with possible additional downgrades of securities of the U.S., European countries and other governments by credit rating agencies, and the resulting effect on the value of securities in the Company's investment portfolio as well as the uncertainty in the market generally;
- losses relating to aviation business and business produced by a certain managing underwriting agency for which the Company may be liable to the purchaser of its prior reinsurance business or to others in connection with the May 5, 2000 asset sale described in the Company's periodic reports filed with the SEC;
- changes in accounting principles or policies or in the Company's application of such accounting principles or policies;
- changes in the political environment of certain countries in which the Company operates, underwrites business or invests;
- statutory or regulatory developments, including as to tax policy 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 the Company, its subsidiaries, brokers or customers; 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 the Company's Annual Report on Form 10-K, as well as the other factors set forth in the Company's 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 the Company or persons acting on its 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. The Company undertakes no obligation to publicly update or revise any forward-looking statement, whether as a result of new information, future events or otherwise.

## Comments on Regulation G

Throughout this release, the Company presents its operations in the way it believes will be the most meaningful and useful to investors, analysts, rating agencies and others who use the Company's financial information in evaluating the performance of the Company. This presentation includes the use of after-tax operating income or loss 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 and net foreign exchange gains or

losses, net of income taxes. The presentation of after-tax operating income or loss available to Arch common shareholders is a “non-GAAP financial measure” as defined in Regulation G. The reconciliation of such measure to net income available to Arch common shareholders (the most directly comparable GAAP financial measure) in accordance with Regulation G is included on page 2 of this release.

The Company believes 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 and net foreign exchange gains or losses in any particular period are not indicative of the performance of, or trends in, the Company's business performance. 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 the Company's 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 the Company's 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 the Company's investments represent other-than-temporary declines in expected recovery values on securities without actual realization. The use of the equity method on certain of the Company's 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 the Company's proportionate share of the net income or loss of the funds (which include changes in the fair value of the underlying securities in the funds). This method of accounting is different from the way the Company accounts for its 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. Due to these reasons, the Company excludes 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 from the calculation of after-tax operating income or loss available to Arch common shareholders.

The Company believes that showing net income available to Arch common shareholders exclusive of the items referred to above reflects the underlying fundamentals of the Company's business since the Company evaluates the performance of and manages its business to produce an underwriting profit. In addition to presenting net income available to Arch common shareholders, the Company believes that this presentation enables investors and other users of the Company's financial information to analyze the Company's performance in a manner similar to how the Company's management analyzes performance. The Company also believes that this measure follows

industry practice and, therefore, allows the users of the Company's financial information to compare the Company's performance with its industry peer group. The Company believes that the equity analysts and certain rating agencies which follow the Company and the insurance industry as a whole generally exclude these items from their analyses for the same reasons.

In addition, the Company's segment information includes the use of a combined ratio excluding catastrophic activity and prior year development for the insurance segment and reinsurance segment and a combined ratio excluding prior year development for the mortgage segment. These ratios are "non-GAAP financial measures" as defined in Regulation G. The reconciliation of such measures to the combined ratio (the most directly comparable GAAP financial measure) in accordance with Regulation G are shown on the individual segment pages. The Company's management utilizes the adjusted combined ratio excluding current accident year catastrophic events and favorable or adverse development in prior year loss reserves in its analysis of the core underwriting performance of each of its underwriting segments.

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Source: Arch Capital Group Ltd.