ARCH CAPITAL GROUP LTD
Form 424B5
March 18, 2002

The information in this prospectus supplement and the accompanying prospectus is not complete and may be changed. This prospectus supplement and the accompanying prospectus are not an offer to sell these securities and are not soliciting an offer to buy these securities in any state where the offer or sale is not premitted.

Filed Pursuant to Rule 424(b)(5)
Subject to Completion   Registration No. 333-82612
Preliminary Prospectus Supplement dated March 18, 2002

PROSPECTUS SUPPLEMENT
(To prospectus dated March 18, 2002)

6,500,000 Common Shares

[LOGO]

Arch Capital Group Ltd. is selling all of the common shares in this offering. The common shares are quoted on the Nasdaq National Market under the symbol "ACGL." On March 15, 2002, the last quoted price of the common shares as reported on the Nasdaq National Market was $27.27 per share.

Investing in our common shares involves risks that are described in the "Risk Factors" section beginning on page S-8 of this prospectus supplement.

	Per Share	Total
Public offering price	$	$
Underwriting discount	$	$
Proceeds, before expenses, to ACGL	$	$

The underwriters may also purchase up to an additional 975,000 common shares from us at the public offering price, less the underwriting discount, within 30 days from the date of this prospectus supplement to cover over-allotments.

Neither the Securities Exchange Commission nor any state securities commission has approved or disapproved of these securities or determined if this prospectus supplement or the accompanying prospectus is truthful or complete. Any representation to the contrary is a criminal offense.

The common shares will be ready for delivery on or about , 2002.

JOINT LEAD MANAGERS AND BOOKRUNNERS

Credit Suisse First Boston   Merrill Lynch & Co.

Goldman, Sachs & Co.   Salomon Smith Barney

The date of this prospectus supplement is , 2002.

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PROSPECTUS

You should rely only on the information contained or incorporated by reference in this prospectus supplement and the accompanying prospectus. We have not, and the underwriters have not, authorized any other person to provide you with different information. If anyone provides you with different or inconsistent information, you should not rely on it. We are not, and the underwriters are not, making an offer to sell these securities in any jurisdiction where the offer or sale is not permitted. You should assume that the information appearing in this prospectus supplement, the accompanying prospectus and

the documents incorporated by reference herein and in the accompanying prospectus is accurate only as of their respective dates. Our business, financial condition, results of operations and prospects may have changed since those dates.

In this prospectus supplement and in the accompanying prospectus, unless the context requires otherwise: (a) "ACGL" refers to Arch Capital Group Ltd., (b) "we," "us" and "our" refer to ACGL and its subsidiaries, (c) "Arch Re (Bermuda)" refers only to our wholly owned Bermuda reinsurance subsidiary, Arch Reinsurance Ltd., and (d) "Arch Re (US)" refers only to our wholly owned U.S. reinsurance subsidiary, Arch Reinsurance Company. The term "Arch US operations" refers to the insurance and reinsurance operations conducted in the United States principally by our subsidiaries First American Insurance Company, Arch Reinsurance Company, Cross River Insurance Company and Rock River Insurance Company. The term "Arch worldwide operations" refers to those operations conducted outside the United States principally by our subsidiaries Arch Re (Bermuda) and Arch Risk Transfer Services Ltd. We sometimes refer to these businesses collectively as our "core businesses." The term "other businesses" refers principally to the insurance advisory and other businesses conducted principally by our subsidiaries Hales & Company, Inc. and American Independent Insurance Holding Company. The terms the "Warburg Pincus funds" and the "Hellman & Friedman funds" refer to the funds affiliated with Warburg Pincus LLC and Hellman & Friedman LLC.

We have obtained consent for the issue and transfer of common shares to and between persons regarded as non-resident in Bermuda for exchange control purposes without specific consent under the Exchange Control Act of 1972 and regulations thereunder. Issues and transfers of shares to any person regarded as resident in Bermuda for exchange control purposes may require specific prior approval under the Exchange Control Act of 1972.

Our Board of Directors will file this prospectus supplement and the accompanying prospectus with the Registrar of Companies in Bermuda under Part III of the Companies Act 1981. However, the Registrar of Companies in Bermuda accepts no responsibility for the financial soundness of any proposal or for the correctness of any of the statements made or the opinions expressed in this prospectus supplement or the accompanying prospectus.

PROSPECTUS SUPPLEMENT SUMMARY

THIS SUMMARY IS NOT COMPLETE AND DOES NOT CONTAIN ALL THE INFORMATION YOU SHOULD CONSIDER. YOU SHOULD READ THIS ENTIRE PROSPECTUS SUPPLEMENT CAREFULLY, INCLUDING "RISK FACTORS" BEGINNING ON PAGE S-8 AND "CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS" ON PAGE S-92.

UNLESS OTHERWISE NOTED, THE INFORMATION CONTAINED IN THIS PROSPECTUS SUPPLEMENT SUMMARY AND THROUGHOUT THIS PROSPECTUS SUPPLEMENT ASSUMES (1) RECEIPT OF THE REGULATORY APPROVALS REQUIRED IN CONNECTION WITH THE CAPITAL

INFUSION LED BY WARBURG PINCUS LLC PRIVATE EQUITY FUNDS AND HELLMAN & FRIEDMAN LLC PRIVATE EQUITY FUNDS, WHICH WAS CONSUMMATED ON NOVEMBER 20, 2001 (SUMMARIZED UNDER THE HEADING "THE CAPITAL INFUSION") AND (2) NO EXERCISE OF THE UNDERWRITERS' OVER-ALLOTMENT OPTION.

OUR COMPANY

We are a Bermuda public limited liability company with $1.0 billion in equity capital and, through operations in Bermuda and the United States, are positioned to write insurance and reinsurance on a worldwide basis. While we are positioned to provide a full range of property and casualty insurance and reinsurance lines, we are focusing on writing specialty lines of insurance and reinsurance profitably and earning a superior return on equity as we establish an enduring underwriting franchise.

Recent events have provided a significant market opportunity for well capitalized insurance companies that are not burdened by the uncertainties resulting from prior years' underwriting losses and material reinsurance recoverable balances. As a result, we recently launched an underwriting initiative that included the recruitment of new insurance and reinsurance management teams and an equity capital infusion of $763.2 million. It is our belief that our existing Bermuda and U.S.-based underwriting platform, our strong management team and our $1.0 billion in capital that is unencumbered by significant exposure to pre-2002 risks have enabled us both to establish an immediate presence in an increasingly attractive insurance marketplace and to actively participate in the January 1, 2002 reinsurance renewal season. Since January 1, 2002, we have entered into approximately 800 reinsurance treaties and other reinsurance arrangements which are expected to provide approximately $500 million of gross written reinsurance premiums during 2002.

MANAGEMENT ADDITIONS AND CAPITAL INFUSION

In October 2001, we launched our underwriting initiative to meet recent demand in the global insurance and reinsurance marketplaces. We recruited a new management team for our Bermuda-based reinsurance subsidiary, Arch Re (Bermuda): Paul Ingrey as Chairman and Chief Executive Officer, formerly Chairman of F&G Re; Dwight Evans as President, formerly Executive Vice President, North American Property for St. Paul Re and F&G Re; and Marc Grandisson as Senior Vice President, formerly Vice President and Actuary of the reinsurance division of Berkshire Hathaway. Together they represent more than 79 years of combined management experience in the insurance industry.

In January 2002, Constantine Iordanou joined us as President and Chief Executive Officer of Arch Capital Group (US) Inc., which is the holding company for all of our U.S. insurance operations. Mr. Iordanou was formerly the Senior Executive Vice President of worldwide insurance operations for Zurich Financial Services, having previously been chief executive officer of Zurich North America and a senior executive of Berkshire Hathaway Group and American International Group. He has 20 years of management experience in the insurance industry. John Vollaro also joined us in 2002 as Chief Financial Officer and Executive Vice President. Mr. Vollaro has over 25 years of experience in the insurance industry, including as President, Chief Operating Officer and Chief Financial Officer of the W.R. Berkley Corporation.

On November 20, 2001, a group of investors led by the Warburg Pincus funds and the Hellman & Friedman funds invested an aggregate of $750.0 million in cash in our equity securities. Certain

members of our management (or entities affiliated with them) also invested an aggregate of $13.2 million in cash in our equity securities. We believe that

Warburg Pincus and Hellman & Friedman provide valuable leadership for our company due to their experience in investing in the insurance industry. Warburg Pincus was the founding investor of RenaissanceRe Holdings Ltd., and Hellman & Friedman was among the original investors in Mid Ocean Limited.

Our Chairman, Robert Clements, former President of Marsh & McLennan Companies, Inc., provides us with important leadership and experience. He was instrumental in the development of the Bermuda insurance and reinsurance markets and, in particular, in the creation and capitalization of, and recruitment of management for, ACE Limited, XL Capital Limited and Mid Ocean Limited. Each of these companies was created in response to significant market capacity needs within the industry.

OUR BUSINESS STRATEGY

Our goal is to produce a superior return on equity and focus on the pursuit of profitability, not premium growth. We target specialty lines of business where we can leverage our underwriting and actuarial expertise, experienced management and financial strength. The principal components of our business strategy are to:

- BUILD AND MAINTAIN A BROAD-BASED INSURANCE PLATFORM FOCUSED ON LINES OF BUSINESS THAT ARE EXPECTED TO PROVIDE ATTRACTIVE RISK/RETURN CHARACTERISTICS. We believe the current market offers a wide array of attractive underwriting opportunities, and we intend to maintain and build our existing platform in order to access these opportunities. We will seek to maintain a diversified book of business in order to mitigate risk and staffing levels that allow us to maintain a high ratio of premium per employee.

- ACTIVELY SELECT AND MANAGE RISKS THROUGH A DISCIPLINED UNDERWRITING PHILOSOPHY. Our underwriting philosophy is to generate an underwriting profit through prudent risk selection and proper pricing across all of our lines of business. We will not write business that does not meet our underwriting profitability criteria and we will emphasize disciplined underwriting over premium growth.

- ENGAGE IN PRUDENT CAPITAL MANAGEMENT. We will frequently assess how our capital is deployed and the returns it is earning. Based on our assessment of the underwriting environment and our views concerning future trends, we may adjust the size or use of our capital base.

- BENEFIT FROM MANAGEMENT'S EXTENSIVE EXPERIENCE AND RELATIONSHIPS WITH BROKERS AND CLIENTS. Our senior management team has an average of 21 years of experience in the insurance industry, and our senior underwriters are all highly trained and experienced professionals with an average of 22 years of experience in the industry. Together, this team has extensive relationships throughout the industry. We have and will continue to aggressively recruit experienced underwriters with specific expertise in the lines of business that we pursue.

- CAPITALIZE ON OUR BALANCE SHEET STRENGTH. As of December 31, 2001, we had total shareholders' equity of more than $1.0 billion, cash and invested assets of $1.0 billion and $113.5 million of gross reserves for loss and loss adjustment expenses ($23.1 million for loss and loss adjustment expenses net of reinsurance recoverables). A.M. Best has assigned its financial strength rating of "A-" (Excellent) to our two principal reinsurance subsidiaries in Bermuda and the U.S. We are seeking a similar rating for our principal U.S. insurance subsidiaries. The size and strength of our balance sheet has been, and will continue to be, important to intermediaries and customers and we intend to capitalize on this strength in sourcing attractive premium.

OUR HISTORY

We commenced operations in September 1995 following the completion of the initial public offering of our predecessor, Risk Capital Holdings Inc. From that time until May 2000, we provided reinsurance and other forms of capital to insurance companies. On May 5, 2000, we sold our prior reinsurance book of business to Folksamerica Reinsurance Company in an asset sale, but retained our surplus and our U.S.-licensed reinsurance platform. On November 8, 2000, following shareholder approval, we changed our legal domicile to Bermuda in order to benefit from Bermuda's favorable business, regulatory, tax and financing environment.

During the period from May 2000 through the announcement of our underwriting initiative in October 2001, we built and acquired insurance businesses that enable us to generate both fee-based revenue (e.g., commissions and advisory and management fees) and risk-based revenue (i.e., insurance premium). As part of this strategy, we built an underwriting platform that is intended to enable us to maximize risk-based revenue during periods in the underwriting cycle when we believe it is more favorable to assume underwriting risk. Recent events have led us to conclude that underwriting conditions favor dedicating our attention exclusively to building our insurance and reinsurance business.

PRINCIPAL EXECUTIVE OFFICES

Our registered office is located at Clarendon House, 2 Church Street, Hamilton HM 11 Bermuda (telephone number: (441) 295-1422), and our principal executive offices are located at Wessex House, 45 Reid Street, Hamilton HM 12 Bermuda (telephone number: (441) 296-8240).

THE OFFERING

Common shares offered......................	6,500,000 common shares.
Common shares to be outstanding after this offering(1)..............................	22,265,332 common shares.
Nasdaq National Market symbol...............	ACGL
Use of proceeds............................	We expect to use the net proceeds from the sale of the common shares, estimated to be approximately $166.6 million (after deducting underwriting discounts and estimated expenses of the offering), principally to support the future growth of our insurance and reinsurance operations.
Dividend policy............................	In order to retain earnings to support future growth of our insurance and reinsurance operations, our board of directors currently does not intend to declare dividends or make any other distributions on our common shares.
Voting limitation..........................	Our bye-laws contain a provision limiting the voting rights of any U.S. person, as defined in the Internal Revenue Code, who owns

(directly, indirectly or constructively under the Code) shares with more than 9.9% of the total voting power of all shares entitled to vote generally at an election of directors to 9.9% of such voting power.

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(1) The number of common shares outstanding is calculated as of March 8, 2002. This number differs from the number of common shares outstanding as of December 31, 2001 as a result of the inclusion of 1,689,629 restricted shares issued as part of the capital infusion and the issuance, during the period from January 1, 2002 through March 8, 2002, of 562,165 restricted shares to employees who joined us in 2002.

The number of common shares outstanding after this offering excludes:

The following dilutive shares (the "Dilutive Shares"):	
Common shares issuable upon conversion of outstanding preference shares........................	35,687,735
Common shares issuable upon exercise of outstanding class A warrants.........................	1,206,206(a)
Subtotal...	36,893,941
The following common shares issuable upon conversion or exercise of contingently issuable (the "Contingently Issuable Shares"):	
Preference shares(b)..................................	875,765
Preference shares(c)..................................	2,831,174
Class B warrants(d)..................................	33,495
Subtotal...	3,740,434
Total...	40,634,375

(a) Calculated using the treasury stock method. Class A warrants to purchase an aggregate of 5,401,707 common shares were outstanding as of March 8, 2002. The class A warrants are currently exercisable at $20.00 per share and expire on September 19, 2002.

(b) Represents our current estimate of the number of additional preference shares that will be issued during the first quarter of 2002 pursuant to a post-closing purchase price adjustment under the subscription agreement entered into in connection with the capital infusion. See "The Capital Infusion--Subscription Agreement--Purchase Price Adjustments--Audit Adjustment."

(c) Represents an estimate of the number of additional preference shares that would be issued under the subscription agreement entered into in connection with the capital infusion in the event that, on or prior to September 19, 2005, the closing price of our common shares is at least $30.00 per share for at least 20 out of 30 consecutive trading days or a change of control occurs. See "The Capital Infusion--Subscription Agreement--Purchase Price Adjustments--Adjustment for Trading Price or Change of Control."

(d) Calculated using the treasury stock method. Class B warrants to purchase an aggregate of 150,000 common shares were outstanding as of December 31, 2001 and expire on September 19, 2005. Class B warrants become exercisable at $20.00 per share if the closing price of our common shares is at least $30.00 per share for at least 20 out of 30 consecutive trading days or a change of control occurs.

The above information excludes the effects of our outstanding employee stock options (4,883,811 at March 8, 2002).

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SUMMARY HISTORICAL CONSOLIDATED FINANCIAL AND OPERATING DATA

The following summary historical consolidated financial and operating data for the three-year period ended December 31, 2001 should be read in conjunction with "Management's Discussion and Analysis of Financial Condition and Results of Operations" and our financial statements and the related notes included in our Annual Report on Form 10-K for the year ended December 31, 2001, which is incorporated herein by reference.

Comparisons of our 2001 and 2000 results of operations to each other and to prior year periods are not relevant due to the changes in our business during 2000 and 2001, including (1) the sale of our prior reinsurance operations in May 2000, (2) our change of legal domicile and reorganization completed in November 2000, (3) our recent acquisition activity, (4) our new underwriting initiative and (5) the capital infusion.

	YEAR ENDED DECEMBER 31,		
	2001	2000	1999
	(IN THOUSANDS, EXCEPT SHARE AND PER SHARE DA		
STATEMENT OF OPERATIONS DATA:			
Revenues:			
Net premiums written............................	$ 36,216	$ (10,604)(1)	$ 306
Net premiums earned.............................	30,918	87,530	311,
Net investment income...........................	12,120	15,923	20,
Net realized investment gains (losses)...........	18,382	20,045	17,
Total revenues..............................	76,454	127,634	344,
Income (loss) before income taxes.................	24,144	503	(56,
Net income (loss)................................	22,016	(8,012)	(35,
Average common shares outstanding:			
Basic...	12,855,668	13,198,075	17,086,
Diluted...	17,002,231(2)	13,198,075	17,086,
Net income (loss) per common share:			
Basic...	$ 1.71	$ (0.61)	$ (2
Diluted...	$ 1.29	$ (0.61)	$ (2
Cash dividends per share..........................	--	--	

DECEMBER 31,

	2001	2000	1999
		(IN THOUSANDS)	
BALANCE SHEET DATA:			
Cash and invested assets	$ 1,019,058	$ 276,053	$ 579,874
Unpaid losses and loss adjustment expenses recoverable	90,442	--	55,925
Total assets	1,313,701	295,907	860,175
Reserves for losses and loss adjustment expenses:			
Before reinsurance recoverable	113,507	--	364,554
Net of reinsurance recoverable	23,065	--	308,629
Shareholders' equity	1,020,369	272,299	342,330

	DECEMBER 31,		
	2001	2000	1999
Book value:			
Historical:			
Per common share	$ 20.05(3)	$ 21.43	$ 20.03
Diluted	$ 19.59	$ 21.43	$ 20.03
As adjusted(4):			
Per common share	$ 19.65(3)	--	--
Diluted	$ 20.06	--	--
Common shares outstanding:			
Historical:			
Actual	13,513,538	12,708,818	17,087,970
Diluted	52,097,108(5)	12,708,818	17,087,970
As adjusted(4):			
Actual	22,265,332	--	--
Diluted	59,159,273(5)	--	--

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(1) Net premiums written for 2000 includes the reversal of $92.9 million of premiums recorded in prior periods in connection with the sale of our prior reinsurance operations in May 2000.

(2) For the purposes of calculating "Net income (loss) per common share," "Average common shares outstanding, Diluted" gives effect to the issuance of the Dilutive Shares, on a weighted average basis, calculated using the treasury stock method, where applicable, and does not give effect to the issuance of the Contingently Issuable Shares.

(3) For the purposes of calculating "Book value, Historical, Per common share" and "Book value, As adjusted, Per common share," shareholders' equity at December 31, 2001 excludes the aggregate liquidation preference of $749.4 million for the preference shares issued in the capital infusion.

(4) "As adjusted" adjusts the "Historical, Actual" or "Historical, Diluted" information, as the case may be, by (a) 6,500,000 common shares offered hereby at an estimated price of $27.27 per common share, (b) the issuance of 1,689,629 restricted shares issued as part of the capital infusion and

(c) 562,165 restricted shares issued, during the period from January 1, 2002 through March 8, 2002, to employees who joined us in 2002, but does not include the issuance of any Contingently Issuable Shares.

(5) "Common shares outstanding, Historical, Diluted" and "Common shares outstanding, As adjusted, Diluted" give effect to the Dilutive Shares, but does not include the issuance of any Contingently Issuable Shares.

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RISK FACTORS

AN INVESTMENT IN OUR COMMON SHARES INVOLVES THE FOLLOWING RISKS. YOU SHOULD CONSIDER CAREFULLY THESE RISK FACTORS, AS WELL AS THE INFORMATION UNDER THE HEADING "CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS" AND OTHER INFORMATION IN THIS PROSPECTUS SUPPLEMENT, BEFORE YOU DECIDE TO PURCHASE OUR COMMON SHARES.

RISKS RELATING TO OUR INDUSTRY

WE OPERATE IN A HIGHLY COMPETITIVE ENVIRONMENT, AND SINCE THE SEPTEMBER 11, 2001 EVENTS, NEW CAPITAL HAS ENTERED THE MARKET; THESE FACTORS MAY MITIGATE THE BENEFITS THAT THE FINANCIAL MARKETS MAY PERCEIVE FOR THE PROPERTY AND CASUALTY INSURANCE INDUSTRY, AND WE CANNOT OFFER ANY ASSURANCES THAT WE WILL BE ABLE TO COMPETE SUCCESSFULLY IN OUR INDUSTRY.

The insurance industry is highly competitive. Trends toward consolidation in the insurance industry could also lead to pricing pressure and lower margins for insurers and reinsurers. In addition, since the September 11, 2001 events, several newly formed offshore entities have announced their intention to address the capacity issues in the insurance and reinsurance industry. Several publicly traded insurance and reinsurance companies have also raised additional capital to meet perceived demand in the current environment. Since September 11, 2001, newly formed and existing insurance industry companies have reportedly raised in excess of $10.0 billion in capital, and some industries (in particular, the airline industry) have announced that they may form industry consortia to provide insurance coverage for their members, thereby taking those lines out of the commercial insurance and reinsurance markets in which we operate. In addition, financial institutions and other capital markets participants offer alternative products and services similar to our own or alternative products that compete with insurance and reinsurance products.

We can offer no assurances that we will be successful in competing with others in our industry or that the intensity of competition in our industry will not erode profitability for insurance and reinsurance companies generally, including us. In addition, we can offer no assurances that we will participate at all or to the same extent as more established or other companies in any price increases or increased profitability in our industry. If we do not share in such price increases or increased profitability, our financial condition and results of operations could be materially adversely affected.

THE INSURANCE INDUSTRY IS HIGHLY CYCLICAL AND THE VALUE OF YOUR INVESTMENT MAY BE ADVERSELY AFFECTED BY THIS CYCLICALITY.

Historically, insurers and reinsurers have experienced significant fluctuations in operating results due to competition, frequency of occurrence or severity of catastrophic events, levels of capacity, general economic conditions, changes in legislation, case law and prevailing concepts of liability and other factors. In particular, demand for reinsurance is influenced significantly by the underwriting results of primary insurers and prevailing general economic conditions. The supply of reinsurance is related to prevailing prices and levels of surplus capacity that, in turn, may fluctuate in response to changes in rates of return being realized in the reinsurance industry. We can offer no assurances as to the magnitude or duration of any price increases or increased profitability in our industry or that factors that previously have resulted in excess capacity and pricing pressures in our industry will not recur.

WE COULD FACE UNANTICIPATED LOSSES FROM WAR, TERRORISM AND POLITICAL UNREST, AND THESE OR OTHER UNANTICIPATED LOSSES COULD HAVE A MATERIAL ADVERSE EFFECT ON OUR FINANCIAL CONDITION AND RESULTS OF OPERATIONS.

We may have substantial exposure to unexpected, large losses resulting from future man-made catastrophic events, such as acts of war, acts of terrorism and political instability. Although we may attempt to exclude losses from terrorism and certain other similar risks from some coverages written by

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us, we may not be successful in doing so. These risks are inherently unpredictable, although recent events may lead to increased frequency and severity of losses. It is difficult to predict the timing of such events with statistical certainty or estimate the amount of loss any given occurrence will generate. Accordingly, we can offer no assurance that our reserves will be adequate to cover losses when they materialize. It is not possible to eliminate completely our exposure to unforecasted or unpredictable events, and to the extent that losses from such risks occur, our financial condition and results of operations could be materially adversely affected.

CLAIMS FOR CATASTROPHIC EVENTS COULD CAUSE LARGE LOSSES AND SUBSTANTIAL VOLATILITY IN OUR RESULTS OF OPERATIONS, AND, AS A RESULT, THE VALUE OF YOUR INVESTMENT MAY FLUCTUATE WIDELY.

We intend to underwrite property catastrophe reinsurance and will have large aggregate exposure to disasters. Catastrophes can be caused by various events, including hurricanes, floods, windstorms, earthquakes, hailstorms, explosions, severe winter weather and fires, and we may have exposures to losses resulting from acts of war or acts of terrorism (to the extent not excluded from policy coverage) and political instability. Catastrophes can also cause losses in non-property lines of business such as workers' compensation or general liability. In addition to the nature of the property catastrophe 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. Therefore, claims for catastrophic events could expose us to large losses and cause substantial volatility in our results of operations, which could cause the value of your investment to fluctuate widely.

UNDERWRITING CLAIMS AND RESERVING FOR LOSSES ARE BASED ON PROBABILITIES AND RELATED MODELING, WHICH ARE SUBJECT TO INHERENT UNCERTAINTIES.

Our success is dependent upon our ability to assess accurately the risks associated with the businesses that we insure and reinsure. Claim reserves represent estimates involving actuarial and statistical projections, at a given point in time, of our expectations of the ultimate settlement and administration costs of claims incurred. We utilize actuarial models as well as historical insurance industry loss development patterns to assist in the establishment of appropriate claim reserves. Actual claims and claim expenses paid may deviate, perhaps substantially, from the reserve estimates reflected in our financial statements.

Like other reinsurers, we do not separately evaluate each of the individual risks assumed under reinsurance treaties. Therefore, we will be largely dependent on the original underwriting decisions made by ceding companies. We are subject to the risk that the ceding companies may not have adequately evaluated the risks to be reinsured and that the premiums ceded may not adequately compensate us for the risks we assume.

If our claim reserves are determined to be inadequate, we will be required to increase claim reserves at the time of such determination with a corresponding reduction in our net income in the period in which the deficiency is rectified. It is possible that claims in respect of events that have occurred could exceed our claim reserves and have a material adverse effect on our results of operations, in a particular period, or our financial condition in general. As a compounding factor, although most insurance contracts have policy limits, the nature of property and casualty insurance and reinsurance is that losses can exceed policy limits for a variety of reasons and could significantly exceed the premiums received on the underlying policies, thereby further adversely affecting our financial condition.

WHILE REINSURANCE AND RETROCESSIONAL COVERAGE WILL BE USED TO LIMIT OUR EXPOSURE TO RISKS, THE AVAILABILITY OF SUCH ARRANGEMENTS MAY BE LIMITED, AND COUNTERPARTY CREDIT AND OTHER RISKS ASSOCIATED WITH OUR REINSURANCE ARRANGEMENTS MAY RESULT IN LOSSES WHICH COULD ADVERSELY AFFECT OUR FINANCIAL CONDITION AND RESULTS OF OPERATIONS.

For the purposes of limiting our risk of loss, we will use reinsurance and also may use retrocessional arrangements. The availability and cost of reinsurance and retrocessional protection is subject to market conditions, which are beyond our control. Currently, the market for these arrangements is experiencing high demand for various products and it is not certain that we will be able to obtain adequate protection at cost effective levels.

As a result of such market conditions and other factors, we may not be able successfully to alleviate risk through reinsurance and retrocessional arrangements. Further, we are subject to credit risk with respect to our reinsurance and retrocessions because the ceding of risk to reinsurers and retrocessionaires does not relieve us of our liability to the clients or companies we insure or reinsure. Our failure to establish adequate reinsurance or retrocessional arrangements or the failure of our existing reinsurance or retrocessional arrangements to protect us from overly concentrated risk exposure could adversely affect our financial condition and results of operations.

AS A RESULT OF RECENT EVENTS AND INSTABILITY IN THE MARKETPLACE FOR INSURANCE PRODUCTS, THERE IS THE POTENTIAL FOR GOVERNMENT INTERVENTION IN OUR INDUSTRY WHICH COULD HINDER OUR FLEXIBILITY AND NEGATIVELY AFFECT THE BUSINESS OPPORTUNITIES WE PERCEIVE ARE AVAILABLE TO US IN THE MARKET.

In response to the current tightening of supply in certain insurance markets, as well as the impact of the September 11, 2001 events, it is possible that the United States and other governments worldwide may intervene in the insurance and reinsurance markets. Government regulators are generally concerned with the protection of policyholders to the exclusion of other constituencies, including shareholders. While we cannot predict the type of government intervention that may occur or its timing, such intervention could materially adversely affect us by:

- disproportionately benefiting one country's companies over companies in other countries;

- providing insurance and reinsurance capacity in the markets and to the customers that we target;

- regulating the terms of insurance and reinsurance policies; or

- mandating participation in guaranty associations or other industry pools.

The insurance industry is also affected by political, judicial and legal developments which have in the past resulted in new or expanded theories of liability. These or other changes could impose new financial obligations on us, require us to make unplanned modifications to the products and services that we provide, or cause the delay or cancellation of products and services that we provide. Substantial government intervention could adversely impact our ability to achieve our goals.

In addition, we engage in intercompany reinsurance arrangements between our U.S. operations and our Bermuda reinsurance operations. Some U.S. insurance companies have been lobbying Congress to pass legislation intended to eliminate certain perceived tax advantages of U.S. insurance companies with Bermuda affiliates, which result principally from reinsurance arrangements between or among U.S. insurance companies and their Bermuda affiliates.

RISKS RELATING TO OUR COMPANY

THE WARBURG PINCUS FUNDS AND THE HELLMAN & FRIEDMAN FUNDS TOGETHER CONTROL A MAJORITY OF OUR VOTING POWER ON A FULLY DILUTED BASIS AND THESE SHAREHOLDERS HAVE THE RIGHT TO HAVE DIRECTORS ON OUR BOARD AND THE RIGHT TO APPROVE MOST TRANSACTIONS OUTSIDE OF THE ORDINARY COURSE OF OUR BUSINESS; THEIR INTERESTS MAY MATERIALLY DIFFER FROM YOURS.

On a fully diluted basis and after giving effect to the exercise of all outstanding options and warrants and the conversion of all preference issues, the Warburg Pincus funds and the Hellman & Friedman funds own 33.8% and 18.8% of our common shares, respectively. These shareholders are non-U.S. persons (as defined in the Internal Revenue Code) and, as such, they are not subject to the voting limitation contained in our bye-laws. In addition, our shareholders agreement prevents us from taking many actions outside the ordinary course of our business without the approval of a director designated by the Warburg Pincus funds and a director designated by the Hellman & Friedman funds. We have agreed not to declare any dividend or make any other distribution on our common shares, and not to repurchase any common shares, until we have repurchased from the Warburg Pincus funds, the Hellman & Friedman funds and the other holders of preference shares, pro rata, on the basis of the amount of these shareholders' investment in us at the time of such repurchase, preference shares having an aggregate value of $250.0 million, at a per share price acceptable to these shareholders. By reason of their ownership and the shareholders agreement between us and the holders of preference shares, the Warburg Pincus funds and the Hellman & Friedman funds are able to strongly influence or effectively control actions to be taken by us, or our shareholders.

In addition, the Warburg Pincus funds and the Hellman & Friedman funds are entitled to nominate a prescribed number of directors based on the respective retained percentages of their equity securities purchased in November 2001. Currently, our board consists of nine members, which includes one director nominated by the Warburg Pincus funds and one director nominated by the Hellman & Friedman funds. Once we have received the regulatory approvals required in connection with the capital infusion, the size of our board will be increased to up to 17 members. As long as the Warburg Pincus funds retain at least 75% of their original investment and the Hellman & Friedman funds retain at least 60% of their original investment, these shareholders will be entitled to nominate six and three directors, respectively. Together they will nominate a majority of directors to our board. The interests of these shareholders may differ materially from your interests, and these shareholders could take actions or make decisions that are not in your best interest.

WE MAY BE REQUIRED TO ISSUE ADDITIONAL PREFERENCE SHARES TO THE INVESTORS IN THE CAPITAL INFUSION AS A RESULT OF VARIOUS PURCHASE PRICE ADJUSTMENTS AGREED TO IN CONNECTION WITH IT, AND YOUR INVESTMENT IN OUR COMMON SHARES MAY, THEREFORE, BE FURTHER DILUTED.

The purchase price paid for the securities purchased in the capital infusion was based on the estimated, unaudited U.S. GAAP book value of our common shares as of June 30, 2001 (before giving effect to certain agreed transaction costs incurred in connection with the capital infusion that had not yet been determined), subject to certain adjustments. We are required to re-calculate, on designated dates in the future, our June 30, 2001 book value on such dates (after giving effect to the agreed transaction costs) and if that re-calculated amount is less than the amount used to calculate the purchase price for the preference shares and warrants, we will be required to issue additional securities, convertible into our common shares, to those investors.

In particular, we agreed to adjust the purchase price paid for the preference shares:

- based upon an audit of the book value of our assets at June 30, 2001 (after giving effect to the agreed transaction costs);

- if, on or prior to September 19, 2005, the closing price of our common shares is at least $30.00 per share for at least 20 out of 30 consecutive trading days or a change of control occurs (in

which event, the purchase price paid per preference share by the Warburg Pincus funds, the Hellman & Friedman funds and the other holders of our preference shares would be adjusted downward by $1.50);

- on the second anniversary of the closing date based upon the adjustment basket described under the heading "The Capital Infusion--Subscription Agreement--Purchase Price Adjustments--Final Adjustments" related to the valuation of our core and non-core businesses; and

- on the fourth anniversary of the closing date based upon an adjustment basket related to specified liabilities connected to our asset sale to Folksamerica and specified tax and ERISA matters. See "The Capital Infusion--Subscription Agreement--Purchase Price Adjustments--Final Adjustments."

We currently estimate that, principally because of the deduction of the agreed transaction costs, we will issue an additional 875,765 preference shares during the first quarter of 2002 in connection with the adjustments discussed in the first bullet point above, and we currently estimate that we may be required to issue an additional 2,831,174 preference shares in connection with the trading price adjustment described in the second bullet point above.

OUR FAILURE TO OBTAIN REGULATORY APPROVAL FOR THE CAPITAL INFUSION WOULD HAVE A MATERIAL ADVERSE IMPACT ON THE VALUE OF YOUR INVESTMENT IN OUR COMMON SHARES.

In the event that:

- we fail to obtain the approval of the Florida insurance department with respect to the capital infusion before May 20, 2002; or

- the purchase price adjustment to be made on the second and fourth anniversaries of the closing results in a downward adjustment to the purchase price of the preference shares aggregating more than

$250.0 million,

the Warburg Pincus funds, the Hellman & Friedman funds and the other holders of our preference shares will have the right to exchange their equity securities for equity securities of a corporate entity which would hold our insurance and reinsurance operating subsidiaries, other than Arch Re (US). See "The Capital Infusion--Subscription Agreement--Right to Exchange into Subsidiary Shares." In this event, we would own less than a majority of those subsidiaries. This situation would have a material adverse impact on the value of our common shares.

OUR MANAGEMENT TEAM HAS ONLY RECENTLY BEEN ASSEMBLED AND OUR BUSINESS STRATEGY IS NEWLY FORMULATED; THEREFORE, THERE CAN BE NO ASSURANCE THAT WE WILL BE SUCCESSFUL IN ACCOMPLISHING OUR GOALS.

We have recently assembled a new management team and other personnel in connection with our new underwriting initiative to meet current and future demand in the global insurance and reinsurance marketplaces. Our future success depends on the successful integration of our new management team and other personnel. The success of our management team in their past endeavors is not necessarily predictive of future results. In addition, we cannot assure you that we will be successful in integrating such executives and personnel into our existing operations or that this new management team will have success with our new underwriting initiative. In addition, the pool of talent from which we actively recruit is limited. The inability to attract and retain qualified personnel when available and the loss of services of key personnel could have a material adverse effect on our financial condition and results of operations.

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FUTURE SALES OF OUR COMMON SHARES AFTER THIS OFFERING, WHETHER BY US OR OUR SHAREHOLDERS, COULD ADVERSELY AFFECT THEIR MARKET PRICE.

Generally, our board of directors has the power to issue new equity (to the extent of authorized shares) without shareholder approval, except that shareholder approval may be required under applicable law or Nasdaq National Market rules for certain transactions. We may issue new equity to raise additional capital to support our insurance and reinsurance operations or for other purposes. Any additional issuance by us would have the effect of diluting the percentage ownership of our shareholders and could have the effect of diluting our earnings and our book value per share.

In addition, the market price of our common shares could fall substantially if our shareholders sell large amounts of common shares in the public market following this offering. The availability of a large number of shares for sale could result in the need for sellers to accept a lower price in order to complete a sale. After this offering, there will be 22,265,332 common shares outstanding, assuming no exercise of the underwriters' over-allotment option. There are up to 45,973,253 common shares issuable upon exercise of options, conversion of convertible securities or exercise of outstanding class A warrants.

We have granted the Warburg Pincus funds and Hellman & Friedman funds demand registration rights and all of the investors in the capital infusion certain "piggy-back" registration rights with respect to the common shares issuable to them upon conversion of the preference shares or exercise of the class A warrants. Certain other investors who purchased or acquired shares in unregistered transactions also have demand and piggy-back registration rights. They can exercise these rights at any time.

OUR BUSINESS WILL BE DEPENDENT UPON INSURANCE AND REINSURANCE BROKERS, AND THE FAILURE TO DEVELOP OR THE LOSS OF IMPORTANT BROKER RELATIONSHIPS COULD

MATERIALLY ADVERSELY AFFECT OUR ABILITY TO MARKET OUR PRODUCTS AND SERVICES.

We intend to market our insurance and reinsurance products primarily through brokers. We expect that we will derive a significant portion of our business from a limited number of brokers. Some of our competitors have had longer term relationships with the brokers which we use than we have. Loss of all or a substantial portion of the business provided by these brokers could have a material adverse effect on us.

A DOWNGRADE IN OUR RATINGS OR OUR INABILITY TO OBTAIN A RATING FOR OUR OPERATING INSURANCE SUBSIDIARIES MAY ADVERSELY AFFECT OUR RELATIONSHIPS WITH CLIENTS AND BROKERS AND NEGATIVELY IMPACT SALES OF OUR PRODUCTS.

Financial strength and claims paying ratings from third party rating agencies are instrumental in establishing the competitive positions of companies in our industry. Periodically, rating agencies evaluate us to confirm that we continue to meet their criteria for the ratings assigned to us by them. Recently, rating agencies have been coming under increasing pressure as a result of high-profile corporate bankruptcies and may, as a result, increase their scrutiny of rated companies, revise their rating policies or take other action. We can offer no assurances that our ratings will remain at their current levels. A ratings downgrade, or the potential for such a downgrade, could adversely affect both our relationships with agents, brokers, wholesalers and other distributors of our existing products and services and new sales of our products and services.

In addition, we are seeking ratings for our principal U.S. insurance subsidiaries. Due to the perceived importance of financial strength ratings in our industry, our failure to obtain adequate ratings for our unrated insurance subsidiaries could cause our operations to be removed from the approved lists of some brokers or clients. Any ratings downgrade or failure to obtain a necessary rating could adversely affect our ability to compete in our markets and have a material adverse impact on our financial condition and results of operations. See "Business--Ratings."

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WE SOLD OUR PRIOR REINSURANCE OPERATIONS IN MAY 2000 AND MAY HAVE LIABILITY TO THE PURCHASER AND CONTINUING LIABILITY FROM THOSE REINSURANCE OPERATIONS IF THE PURCHASER SHOULD FAIL TO MAKE PAYMENTS ON THE REINSURANCE LIABILITIES IT ASSUMED.

On May 5, 2000, we sold our prior reinsurance operations to Folksamerica Reinsurance Company. The Folksamerica transaction was structured as a transfer and assumption agreement (and not reinsurance), and, accordingly, the loss reserves (and any related reinsurance recoverables) relating to the transferred business are not included as assets or liabilities on our balance sheet. In addition, in connection with that sale, we made extensive representations and warranties about us and our reinsurance operations, some of which survived the closing of the asset sale. Breach of these representations and warranties could result in liability to us. We also retained our tax and employee benefit liabilities and other liabilities not assumed by Folksamerica, including all liabilities not arising under our reinsurance subsidiary's reinsurance agreements transferred to Folksamerica. In the event that Folksamerica is unable to make payment for reserved losses transferred to it by us in the May 2000 sale, we would be liable for such claims. In addition, if amounts related to the transferred liabilities turn out to be more than forecasted, we may be required to issue additional preference shares to the holders of our preference shares.

SOME OF THE PROVISIONS OF OUR BYE-LAWS AND OUR SHAREHOLDERS AGREEMENT MAY HAVE THE EFFECT OF HINDERING, DELAYING OR PREVENTING THIRD PARTY TAKEOVERS, WHICH MAY PREVENT YOU FROM RECEIVING PREMIUM PRICES FOR YOUR SHARES IN AN UNSOLICITED

TAKEOVER.

Some provisions of our bye-laws could have the effect of discouraging unsolicited takeover bids from third parties or the removal of incumbent management. These provisions may encourage companies interested in acquiring the company to negotiate in advance with our board of directors, since the board has the authority to overrule the operation of several of the limitations. See "Description of Share Capital--Description of Common Shares--Anti-Takeover Effects."

In addition, pursuant to the shareholders agreement which we entered into in connection with the capital infusion, we cannot engage in transactions outside the ordinary course of our business, including mergers and acquisitions, without the consent of a director designated by the Warburg Pincus funds and a director designated by the Hellman & Friedman funds. To the extent these provisions discourage takeover attempts, they could deprive our shareholders of opportunities to realize takeover premiums for their shares or could depress the market price of our common shares.

OUR OPERATING INSURANCE AND REINSURANCE SUBSIDIARIES ARE SUBJECT TO REGULATION IN VARIOUS JURISDICTIONS, AND MATERIAL CHANGES IN THE REGULATION OF THEIR OPERATIONS COULD ADVERSELY AFFECT OUR RESULTS OF OPERATIONS.

Our Bermuda reinsurance subsidiary, Arch Re (Bermuda), conducts its business from its executive offices in Bermuda and is not licensed or admitted to do business in any jurisdiction except Bermuda. We do not believe that Arch Re (Bermuda) is subject to the insurance laws of any state in the United States; however, recent scrutiny of the insurance and reinsurance industry in the U.S. and other countries could subject Arch Re (Bermuda) to additional regulation.

In addition, our U.S. reinsurance subsidiary, Arch Re (US), and our U.S. insurance subsidiaries, First American Insurance Company, Rock River Insurance Company, Cross River Insurance Company and American Independent Insurance Company, write reinsurance and insurance in the United States. These subsidiaries are subject to extensive regulation under state statutes which delegate regulatory, supervisory and administrative powers to state insurance commissioners. Such regulation generally is designed to protect policyholders rather than investors.

We periodically review our corporate structure in the United States so that we can optimally deploy our capital. Changes in that structure require regulatory approval, and we are in the process of

seeking regulatory approval to maximize our U.S. regulatory capital that will support our U.S. insurance operations. Delays or failure in obtaining these approvals could limit the amount of insurance that we can write in the United States.

If ACGL or any of our subsidiaries were to become subject to the laws of a new jurisdiction where that subsidiary is not presently admitted, it may not be in compliance with the laws of the new jurisdiction. Any failure to comply with applicable laws could result in the imposition of significant restrictions on our ability to do business, and could also result in fines and other sanctions, any or all of which could adversely affect our financial condition and results of operations.

IF OUR BERMUDA REINSURANCE SUBSIDIARY IS UNABLE TO PROVIDE COLLATERAL TO CEDING COMPANIES, ITS ABILITY TO CONDUCT BUSINESS COULD BE SIGNIFICANTLY AND NEGATIVELY AFFECTED.

Arch Re (Bermuda) is a registered Bermuda insurance company and is not licensed or admitted as an insurer in any jurisdiction in the United States. Because insurance regulations in the United States do not permit insurance companies to take credit for reinsurance obtained from unlicensed or non-admitted insurers on their statutory financial statements unless security is posted, Arch Re (Bermuda)'s contracts generally require it to post a letter of credit or provide other security after a reinsured reports a claim. If we are unable to post security in the form of letters of credit or trust funds when required, the operations of Arch Re (Bermuda) could be significantly and negatively affected.

WE ARE SUBJECT TO CHANGES IN BERMUDA LAW OR POLITICAL CIRCUMSTANCES.

Under current Bermuda law, we are not subject to tax on income or capital gains. Furthermore, we have obtained from the Minister of Finance of Bermuda under the Exempted Undertakings Tax Protection Act, 1966, an undertaking that, in the event that Bermuda enacts legislation imposing tax computed on profits, income, any capital asset, gain or appreciation, or any tax in the nature of estate duty or inheritance tax, then the imposition of the tax will not be applicable to us or our operations until March 28, 2016. We could be subject to taxes in Bermuda after that date. This undertaking does not, however, prevent the imposition of taxes on any person ordinarily resident in Bermuda or any company in respect of its ownership of real property or leasehold interests in Bermuda.

Bermuda's political structure is based upon a parliamentary system with two major parties, the United Bermuda Party and the Progressive Labour Party. In the most recent election, the Progressive Labour Party gained control of the legislative branch for the first time over the incumbent United Bermuda Party. To date, the government's financial and regulatory policies have not been changed in ways that we believe would materially affect us or our shareholders.

FOREIGN CURRENCY EXCHANGE RATE FLUCTUATION MAY ADVERSELY AFFECT OUR FINANCIAL RESULTS.

We will write business on a worldwide basis and our results of operations may be affected by fluctuations in the value of currencies other than the U.S. dollar. Changes in foreign currency exchange rates can reduce our revenues and increase our liabilities and costs, as measured in the dollar as our functional currency. We have not attempted and currently do not expect to attempt to reduce our exposure to these exchange rate risks by using hedging transactions. We may therefore suffer losses solely as a result of exchange rate fluctuations.

EMPLOYEES OF OUR BERMUDA OPERATIONS ARE REQUIRED TO OBTAIN WORK PERMITS BEFORE ENGAGING IN A GAINFUL OCCUPATION IN BERMUDA, AND WE CAN OFFER NO ASSURANCE THAT REQUIRED WORK PERMITS WILL BE GRANTED OR REMAIN IN EFFECT.

Under Bermuda law, non-Bermudians (other than spouses of Bermudians) may not engage in any gainful occupation in Bermuda without an appropriate governmental work permit. Our success may

depend in part on the continued services of key employees in Bermuda. A work permit may be granted or renewed upon showing that, after proper public advertisement, no Bermudian (or spouse of a Bermudian) is available who meets the minimum standards reasonably required by the employer. The Bermuda government recently announced a new policy that places a six year term limit on individuals with work permits, subject to certain exemptions for key employees. A work permit is issued with an expiry date (up to five years) and no assurances can be given that any work permit will be issued or, if issued, renewed upon the expiration of the relevant term.

THE ENFORCEMENT OF CIVIL LIABILITIES AGAINST US MAY BE DIFFICULT.

We are a Bermuda company and in the future some of our officers and directors may be residents of various jurisdictions outside the United States. All or a substantial portion of our assets and of those persons may be located outside the United States. As a result, it may be difficult for you to effect service of process within the United States upon those persons or to enforce in United States courts judgments obtained against those persons.

We have appointed National Registered Agents, Inc., New York, New York, as our agent for service of process with respect to actions based on offers and sales of securities made in the United States. We have been advised by our Bermuda counsel, Conyers Dill & Pearman, that the United States and Bermuda do not currently have a treaty providing for reciprocal recognition and enforcement of judgments of U.S. courts in civil and commercial matters and that a final judgment for the payment of money rendered by a court in the United States based on civil liability, whether or not predicated solely upon the U.S. federal securities laws, would, therefore, not be automatically enforceable in Bermuda. We also have been advised by Conyers Dill & Pearman that a final and conclusive judgment obtained in a court in the United States under which a sum of money is payable as compensatory damages (i.e., not being a sum claimed by a revenue authority for taxes or other charges of a similar nature by a governmental authority, or in respect of a fine or penalty or multiple or punitive damages) may be the subject of an action on a debt in the Supreme Court of Bermuda under the common law doctrine of obligation. Such an action should be successful upon proof that the sum of money is due and payable, and without having to prove the facts supporting the underlying judgment, as long as:

- the court which gave the judgment had proper jurisdiction over the parties to such judgment;

- such court did not contravene the rules of natural justice of Bermuda;

- such judgment was not obtained by fraud;

- the enforcement of the judgment would not be contrary to the public policy of Bermuda;

- no new admissible evidence relevant to the action is submitted prior to the rendering of the judgment by the courts of Bermuda; and

- there is due compliance with the correct procedures under Bermuda law.

A Bermuda court may impose civil liability on us or our directors or officers in a suit brought in the Supreme Court of Bermuda against us or such persons with respect to a violation of U.S. federal securities laws, provided that the facts surrounding such violation would constitute or give rise to a cause of action under Bermuda law.

RISKS RELATING TO TAXATION

WE AND OUR NON-U.S. SUBSIDIARIES MAY BECOME SUBJECT TO U.S. FEDERAL INCOME TAXATION.

ACGL and its non-U.S. subsidiaries intend to operate their business in a manner that will not cause them to be treated as engaged in a trade or business in the United States and, thus, will not be required to pay U.S. federal income taxes (other than withholding taxes on certain U.S. source investment income) on their income. However, because there is uncertainty as to the activities which constitute being engaged in a trade or business in the United States, there can be no assurances that the U.S. Internal Revenue Service will not contend successfully that ACGL or its non-U.S. subsidiaries are engaged in a trade or business in the United States. If ACGL or any of its non-U.S. subsidiaries were subject to U.S. income tax, our shareholders' equity and earnings could be adversely affected. We may be a personal holding company in 2002, but do not currently expect to have "undistributed personal holding company income." See "Material U.S. Federal Income Tax Considerations--Taxation of ACGL--United States--Personal Holding Company Rules."

We changed our legal domicile from the United States to Bermuda in November 2000. Legislation has recently been introduced which (if enacted) could eliminate the tax benefits available to companies, like us, that changed their legal domiciles to Bermuda. In addition, some U.S. insurance companies have been lobbying Congress to pass legislation intended to eliminate certain perceived tax advantages of U.S. insurance companies with Bermuda affiliates resulting principally from reinsurance between or among U.S. insurance companies and their Bermuda affiliates. Legislation, if passed, and other changes in U.S. tax laws, regulations and interpretations thereof to address these issues could adversely affect us.

U.S. PERSONS WHO HOLD OUR COMMON SHARES MAY BE SUBJECT TO U.S. INCOME TAXATION AT ORDINARY INCOME RATES ON OUR UNDISTRIBUTED EARNINGS AND PROFITS. IN ADDITION, THE HEIRS OR ESTATE OF ANY INDIVIDUAL HOLDER MAY NOT BE ENTITLED TO A "STEP-UP" IN BASIS OF OUR COMMON SHARES WHICH MIGHT OTHERWISE BE AVAILABLE UPON SUCH HOLDER'S DEATH.

We believe that we and our foreign subsidiaries currently are controlled foreign corporations ("CFCs"), although our bye-laws are designed to preclude any U.S. person from adverse tax consequences as a result of our CFC status. We also believe that we are likely to be a foreign personal holding company in 2002, but do not currently expect to have undistributed foreign personal holding company income. We do not believe that we are a passive foreign investment company. Since these determinations and beliefs are based upon legal and factual conclusions, some of which are described under "Material U.S. Federal Income Tax Considerations," no assurances can be given that the IRS or a court would concur with our conclusions. If they were not to so concur, U.S. persons who hold our common shares may suffer adverse tax consequences. See "Material U.S. Federal Income Tax Considerations."

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USE OF PROCEEDS

We expect to use the net proceeds from the sale of the common shares, estimated to be approximately $166.6 million (after deducting underwriting discounts and estimated expenses of the offering), principally to support the future growth of our insurance and reinsurance operations.

This use of proceeds does not reflect the underwriters' exercise of their over-allotment option. If the underwriters exercise their over-allotment option in full, we will receive additional net proceeds of approximately $25.1 million.

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PRICE RANGE OF COMMON SHARES

Our common shares are traded on the Nasdaq National Market under the symbol ACGL. For the periods presented below, the high and low sales prices and closing prices for our common shares as reported on the Nasdaq National Market were as follows:

	THREE MONTHS ENDED			
	MARCH 31, 2001	JUNE 30, 2001	SEPTEMBER 30, 2001	DECEMBER
High............................	$18.06	$17.06	$19.20	$
Low.............................	14.38	14.81	15.45	
Close...........................	15.88	15.75	16.75	

	THREE MONTHS ENDED			
	MARCH 31, 2000	JUNE 30, 2000	SEPTEMBER 30, 2000	DECEMBER
High............................	$16.75	$16.63	$15.88	$15
Low.............................	11.38	14.56	14.63	13
Close...........................	16.38	14.94	15.75	15

	THREE MONTHS ENDED			
	MARCH 31, 1999	JUNE 30, 1999	SEPTEMBER 30, 1999	DECEMBER
High............................	$22.63	$17.38	$16.00	$15
Low.............................	12.00	13.50	13.00	11
Close...........................	15.13	13.50	15.63	12

During the period from January 1, 2002 through March 15, 2002, the high and low sales prices and the closing price for our common shares as reported on the Nasdaq National Market were $27.94, $25.91 and $27.27, respectively. For the ten trading day period preceding the date of this prospectus supplement, our average daily trading volume on the Nasdaq National Market was 19,680 common shares.

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(1) For the ten trading days ended October 23, 2001, the last trading day prior to the announcement of the signing of the subscription agreements for the capital infusion and our new underwriting initiative, the average closing price of our common shares on the Nasdaq National Market was $16.86 per share.

DIVIDEND POLICY

Any determination to pay dividends will be at the discretion of our board of directors and will be dependent upon our results of operations, financial condition and other factors deemed relevant by our board of directors. As a holding company, we will depend on future dividends and other permitted payments from our subsidiaries to pay dividends to our shareholders. Our subsidiaries' ability to pay dividends, as well as our ability to pay dividends, is, and is expected to be, subject to regulatory, contractual, rating agency and other constraints. Our board of directors currently does not intend to declare dividends or make any other distributions.

In addition, pursuant to our shareholders agreement, we have agreed not to declare any dividend or make any other distribution on our common shares, and not to repurchase any common shares, until we have repurchased from the Warburg Pincus funds, the Hellman & Friedman funds and the other holders of our preference shares, pro rata, on the basis of the amount of those shareholders' investment in us at the time of such repurchase, preference shares having an aggregate value of $250.0 million, at a per share price acceptable to those shareholders.

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CAPITALIZATION

The following table sets forth our capitalization at December 31, 2001 on:

- an historical basis; and

- an as adjusted basis to give effect to this offering, receipt of all regulatory approvals with respect to the capital infusion and the issuances of restricted shares described in note (2) below.

The following should be read in conjunction with our financial statements and the notes related thereto which are included in our Annual Report on Form 10-K for the year ended December 31, 2001, which is incorporated by reference in this prospectus supplement.

	DECEMBER 31, 2001	
	HISTORICAL	AS ADJUSTED
	(IN THOUSANDS)	
Debt(1)	$ --	$ --
Shareholders' equity:		
Series A convertible preference shares, $0.01 par value, 50,000,000 shares authorized, 35,687,735 shares issued and outstanding	357	357
Common shares, $0.01 par value, 200,000,000 shares authorized, 13,513,538 shares issued and outstanding actual, 22,265,332 shares issued and outstanding as adjusted(2)	135	223
Additional paid-in capital	1,039,887	1,206,405
Deferred compensation under share award plan	(8,230)	(8,230)
Retained earnings (deficit)	(11,610)	(11,610)
Accumulated other comprehensive income consisting of appreciation (decline) in value of investments, net of income tax	(170)	(170)
Total shareholders' equity	1,020,369	1,186,975
Total capitalization	$1,020,369	$1,186,975

DECEMBER 31, 2001

	HISTORICAL	AS ADJUSTED(3)
Book value:		
Per common share	$20.05(4)	$19.65(4)
Diluted	$19.59	$20.06
Common shares outstanding:		
Actual	13,513,538	22,265,332
Diluted	52,097,108(5)	59,159,273(5)

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(1) Does not include reserves or other balance sheet or non-balance-sheet liabilities, including contingent liabilities. See "Selected Historical Consolidated Financial and Operating Data" and "Management's Discussion and Analysis of Financial Condition and Results of Operations."

(2) The number of common shares outstanding is calculated as of March 8, 2002. This number differs from the number of common shares outstanding as of December 31, 2001 as a result of the inclusion of 1,689,629 restricted shares issued as part of the capital infusion and the issuance, during the period from January 1, 2002 through March 8, 2002, of 562,165 restricted shares to employees who joined us in 2002.

The number of common shares outstanding after this offering excludes:

The following dilutive shares (the "Dilutive Shares"):	
Common shares issuable upon conversion of outstanding preference shares	35,687,735
Common shares issuable upon exercise of outstanding class A warrants	1,206,206(a)
Subtotal	36,893,941
The following common shares issuable upon conversion or exercise of contingently issuable (the "Contingently Issuable Shares"):	
Preference shares(b)	875,765
Preference shares(c)	2,831,174
Class B warrants(d)	33,495
Subtotal	3,740,434
Total	40,634,375

(a) Calculated using the treasury stock method. Class A warrants to purchase an aggregate of 5,401,707 common shares were outstanding as of March 8, 2002. The class A warrants are currently exercisable at $20.00 per share and expire on September 19, 2002.

(b) Represents our current estimate of the number of additional preference shares that will be issued during the first quarter of 2002 pursuant to a post-closing purchase price adjustment under the subscription agreement entered into in connection with the capital infusion. See "The Capital

Infusion--Subscription Agreement--Purchase Price Adjustments--Audit Adjustment."

(c) Represents an estimate of the number of additional preference shares that would be issued under the subscription agreement entered into in connection with the capital infusion in the event that, on or prior to September 19, 2005, the closing price of our common shares is at least $30.00 per share for at least 20 out of 30 consecutive trading days or a change of control occurs. See "The Capital Infusion--Subscription Agreement--Purchase Price Adjustments--Adjustment for Trading Price or Change of Control."

(d) Calculated using the treasury stock method. Class B warrants to purchase an aggregate of 150,000 common shares were outstanding as of December 31, 2001 and expire on September 19, 2005. Class B warrants become exercisable at $20.00 per share if the closing price of our common shares is at least $30.00 per share for at least 20 out of 30 consecutive trading days or a change of control occurs.

The above information excludes the effects of our outstanding employee stock options (4,883,811 at March 8, 2002).

(3) "As adjusted" adjusts the "Historical, Actual" or "Historical, Diluted" information, as the case may be, by (a) 6,500,000 common shares offered hereby at an estimated price of $27.27 per common share, (b) the issuance of 1,689,629 restricted shares issued as part of the capital infusion and (c) 562,165 restricted shares issued, during the period from January 1, 2002 through March 8, 2002, to employees who joined us in 2002, but does not include the issuance of any Contingently Issuable Shares.

(4) For the purposes of calculating "Book value, Historical, Per common share" and "Book value, As adjusted, Per common share," Shareholders' equity at December 31, 2001 excludes the aggregate liquidation preference of $749.4 million for the preference shares issued in the capital infusion.

(5) "Common shares outstanding, Historical, Diluted" and "Common shares outstanding, As adjusted, Diluted" give effect to the Dilutive Shares, but does not include the issuance of any Contingently Issuable Shares.

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SELECTED HISTORICAL CONSOLIDATED FINANCIAL AND OPERATING DATA

The following selected historical consolidated financial and operating data for the three-year period ended December 31, 2001 should be read in conjunction with "Management's Discussion and Analysis of Financial Condition and Results of Operations" and our financial statements and the related notes included in our Annual Report on Form 10-K for the year ended December 31, 2001 which is incorporated herein by reference.

Comparisons of our 2001 and 2000 results of operations to each other and to prior year periods are not relevant due to the changes in our business during 2000 and 2001, including (1) the sale of our prior reinsurance operations in May 2000, (2) our change of legal domicile and reorganization completed in November 2000, (3) our recent acquisition activity, (4) our new underwriting initiative and (5) the capital infusion.

	YEAR ENDED DECEMBER 31,		
	2001	2000	1999

	(IN THOUSANDS, EXCEPT SHARE AND PER SHARE DATA)		
STATEMENT OF OPERATIONS DATA:			
Revenues:			
Net premiums written	$ 36,216	$ (10,604)(1)	$ 306,726
Net premiums earned	30,918	87,530	311,368
Net investment income	12,120	15,923	20,173
Net realized investment gains (losses)	18,382	20,045	17,227
Total revenues	76,454	127,634	344,800
Income (loss) before income taxes	24,144	503	(56,199
Net income (loss)	22,016	(8,012)	(35,636
Average common shares outstanding:			
Basic	12,855,668	13,198,075	17,086,732
Diluted	17,002,231(2)	13,198,075	17,086,732
Net income (loss) per common share:			
Basic	$ 1.71	$ (0.61)	$ (2.09
Diluted	$ 1.29	$ (0.61)	$ (2.09
Cash dividends per share	--	--	--

	DECEMBER 31,		
	2001	2000	1999
		(IN THOUSANDS)	
BALANCE SHEET DATA:			
Cash and invested assets	$ 1,019,058	$ 276,053	$ 579,874
Unpaid losses and loss adjustment expenses recoverable	90,442	--	55,925
Total assets	1,313,701	295,907	860,175
Reserves for losses and loss adjustment expenses:			
Before reinsurance recoverable	113,507	--	364,554
Net of reinsurance recoverable	23,065	--	308,629
Shareholders' equity	1,020,369	272,299	342,330

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(1) Net premiums written for 2000 includes the reversal of $92.9 million of premiums recorded in prior periods in connection with the sale of our prior reinsurance operations in May 2000.

(2) For the purposes of calculating "Net income (loss) per common share," "Average common shares outstanding, Diluted" gives effect to the issuance of the Dilutive Shares, on a weighted average basis, calculated on the treasury stock method, where applicable, and does not give effect to the issuance of the Contingently Issuable Shares.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

GENERAL

NEW UNDERWRITING INITIATIVE AND NOVEMBER 20, 2001 CAPITAL INFUSION

On October 24, 2001, we announced the launch of a new underwriting initiative to meet current and future demand in the global insurance and reinsurance markets. Simultaneously with the launch of this new underwriting initiative, we entered into agreements with the Warburg Pincus funds and the Hellman & Friedman funds and certain members of management to purchase from us in a private placement, for $763.2 million in cash, 35,687,735 series A convertible preference shares and 3,776,025 class A warrants. This capital infusion was consummated on November 20, 2001. The proceeds of the capital infusion were primarily contributed to our Bermuda and U.S. subsidiaries to support the new underwriting initiative.

EVENTS PRIOR TO THE NEW UNDERWRITING INITIATIVE

2001 ACQUISITIONS. On February 28, 2001, we acquired one of our investee companies, American Independent Insurance Company ("American Independent"). American Independent underwrites private passenger automobile liability and physical damage insurance primarily in the Commonwealth of Pennsylvania. During 2001, 70% of American Independent's written premiums were ceded to third-party reinsurers. During 2002, we expect that approximately 20% of American Independent's written premiums will be ceded to third-party reinsurers.

On June 22, 2001, we acquired all of the remaining ownership interests in Arch Risk Transfer Services Ltd. ("ART Services"), which provides insurance and alternative risk transfer services through rent-a-captive and other facilities. First American Insurance Company, a subsidiary of ART Services, is an admitted insurer in 49 states with an A.M. Best rating of "A-" (Excellent). During 2001, approximately 71% of ART Services' written premiums were ceded to third-party reinsurers. During 2002, we expect that less than half of ART Services' written premiums will be ceded to third-party reinsurers.

The results of operations of American Independent and ART Services are included in our financial statements from the respective dates of acquisition. Prior to the date of acquisition of ART Services, we accounted for our 27% initial ownership interest in ART Services under the equity method.

We entered into a definitive agreement on September 24, 2001 to acquire Rock River Insurance Company, an approved excess and surplus lines insurer in 45 states and the District of Columbia and an admitted insurer in two other states, for $19.3 million. We consummated this acquisition on February 1, 2002. Under the terms of the acquisition agreement, the existing policies and other liabilities of Rock River reinsured or otherwise assumed by the seller, Sentry Insurance, a mutual company, which has an A.M. Best rating of "A+" (Superior). At February 1, 2002, Rock River had net assets of approximately $17.0 million.

FORMATION OF BERMUDA-BASED REINSURANCE SUBSIDIARY. On May 21, 2001, we formed our wholly owned Bermuda-based reinsurance subsidiary, Arch Re (Bermuda). Under the Insurance Act of 1978, Arch Re (Bermuda) is registered as a Class 4 and long-term insurer and reinsurer and, in December 2001, Arch Re (Bermuda) and Arch Re (US), our wholly owned U.S.-based reinsurance subsidiary, were assigned ratings of "A-" (Excellent) by A.M. Best.

CHANGE OF LEGAL DOMICILE TO BERMUDA. On November 8, 2000, we completed an internal reorganization that resulted in our changing our legal domicile to Bermuda. In that transaction, the shareholders of Arch Capital (US) (formerly Risk Capital Holdings Inc.) became the shareholders of

ACGL. Prior to the reorganization, ACGL had no significant assets or capitalization and had not engaged in any business or prior activities other than in connection with the reorganization.

MAY 2000 SALE OF OUR PRIOR REINSURANCE OPERATIONS. On May 5, 2000, we sold our prior reinsurance operations to Folksamerica Reinsurance Company. The Folksamerica transaction was structured as a transfer and assumption agreement (and not reinsurance), and, accordingly, the loss reserves (and any related reinsurance recoverables) relating to the transferred business are not included as assets or liabilities on our balance sheet. However, in the event that Folksamerica is unable to make payment of claims on the reinsurance business assumed by it in the May 2000 sale, we would be liable for such claims. Folksamerica has an A.M. Best rating of "A-" (Excellent). (See Note 3, "Acquisition of Subsidiaries and Disposition of Prior Reinsurance Operations," of the notes accompanying our financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2001, which is incorporated herein by reference.) See "Risk Factors--Risks Relating to Our Company--We sold our prior reinsurance operations in May 2000 and may have liability to the purchaser and continuing liability from those reinsurance operations if the purchaser should fail to make payments on the reinsurance liabilities it assumed."

In connection with that sale we placed $20.0 million of the purchase price in escrow. The agreement required that these funds would be held for a period of five years to reimburse Folksamerica if certain loss reserves transferred to it in the asset sale became deficient as measured at the end of such five-year period or to satisfy certain indemnity claims Folksamerica may have had during such period. In February 2002, we reached a definitive settlement agreement with Folksamerica pursuant to which we will satisfy all of our obligations under the escrow agreement for an amount equal to approximately $17.0 million, plus accrued interest income of $1.8 million, in cash.

LIQUIDITY AND CAPITAL RESOURCES

ACGL is a holding company whose assets primarily consist of the shares in its subsidiaries. Generally, we depend on our available cash resources, liquid investments and dividends or other distributions from our subsidiaries to make payments, including the payment of operating expenses we may incur and for any dividends our board of directors may determine, and we may need to utilize funds from such sources in connection with acquisitions. ACGL does not currently intend to declare any dividends or make any other distributions.

The ability of our regulated insurance subsidiaries to pay dividends or make distributions is dependent on their ability to meet applicable regulatory standards. Prior approval of the Bermuda Supervisor of Insurance is required if any dividend payments or other distributions of Arch Re (Bermuda) would reduce its total statutory capital by 15% or more. At December 31, 2001, Arch Re (Bermuda) had statutory capital of $508 million. As of December 31, 2001, our U.S. insurance and reinsurance subsidiaries may not pay any significant dividends or distributions during 2002 without prior regulatory approval. In addition, the ability of our insurance subsidiaries to pay dividends could be constrained by our dependence on financial strength ratings from independent rating agencies. Our ratings from these rating agencies depend to a large extent on the capitalization levels of our insurance subsidiaries.

Pursuant to a shareholders agreement that we entered into in connection with the capital infusion, we have agreed not to declare any dividend or make any other distribution on our common shares, and not to repurchase any common shares, until we have repurchased from the Warburg Pincus funds, the Hellman & Friedman funds and the other holders of our preference shares, pro rata, on the basis of the amount of each of these shareholders' investment in us at the time of such repurchase, preference shares having an aggregate value of $250.0 million, at a per share price acceptable to these shareholders.

Our new underwriting initiative and related capital infusion are designed to position us to address current and anticipated future needs for capacity in the global insurance marketplace. During the fourth quarter of 2001, we expanded our underwriting activities, initially with a primary focus on reinsurance, and we intend to continue to expand significantly our insurance and reinsurance underwriting activities in the future.

Our aggregate invested assets, including cash and short-term investments, totaled $1.0 billion at December 31, 2001, compared to $276.1 million at December 31, 2000. The increase in cash and invested assets from 2000 to 2001 resulted primarily from the receipt of the proceeds from the capital infusion in November 2001.

As of December 31, 2001, our readily available cash, short-term investments and marketable securities, excluding amounts held by our regulated insurance subsidiaries, totaled $108.5 million. Such amount consisted of $26.4 million of cash and short-term investments and $82.1 million of fixed maturity investments. As of that date, investments that are restricted or generally unavailable for liquidity purposes (other than our ownership interests in our subsidiaries and the invested assets of our regulated insurance subsidiaries) included $35.4 million of privately held securities and $22.2 million of fixed maturity investments held in escrow in connection with the sale of our prior reinsurance operations to Folksamerica in May 2000. In addition, at December 31, 2001, we had investment commitments relating to our privately held investment, Distribution Investors, LLC, of approximately $0.6 million. In connection with the capital infusion on November 20, 2001, we were released from our obligations to make any further capital contributions to Trident II, other than with respect to outstanding capital calls of approximately $6.5 million, which we funded in November 2001.

Cash flows are provided by premiums collected, fee income, investment income (excluding net realized investment gains) and collected reinsurance receivable balances, offset by reinsurance premiums payable, loss and loss expense payments and operating costs. Consolidated cash flows provided by (used for) operating activities for the years ended December 31, 2001, 2000 and 1999 were approximately ($5.6) million, $2.6 million and $7.5 million, respectively. The decline in cash flow in 2001 was primarily due to an increase in reinsurance recoverables at American Independent, and start-up costs related to the new underwriting initiative.

Our expanded underwriting activities will initially be supported by our capital, and we expect that our other operational needs for the foreseeable future will be met by our balance of cash and short-term investments, as well as by funds generated from premiums and investment income and proceeds on the sale or maturity of our investments.

We filed a Form S-3 shelf registration statement with the Securities and Exchange Commission on February 12, 2002. The shelf registration statement permits us to issue various types of securities, including unsecured debt securities, preference shares and common shares, from time to time, up to an aggregate of $500 million. This offering is being made pursuant to the shelf registration statement.

CONTRACTUAL OBLIGATIONS AND COMMERCIAL COMMITMENTS

Set forth below, in tabular form, is information as of December 31, 2001 for the periods indicated below concerning our obligations and commitments to make future payments under long-term obligations:

CONTRACTUAL OBLIGATIONS

LESS THAN MOR

	TOTAL	1 YEAR	1-3 YEARS	4-5 YEARS	5
			(IN THOUSANDS)		
Operating Leases..........................	$5,081	$1,213	$2,751	$1,117	

We are in the process of putting in place a letter of credit facility for up to $200 million. We expect that this facility will have a one-year term. The purpose of this facility is to issue standby letters of credit in favor of primary insurance or reinsurance counterparties with which we have entered into reinsurance arrangements. Such letters of credit when issued will be secured by a first priority, perfected security interest in investment securities. Any issued letters of credit will expire 364 days from the date of issuance.

We have agreed to make a non-recourse loan of up to $13.5 million to our Chairman, which will be used to pay income and self-employment taxes, payable in April 2002, on restricted shares granted to him on October 23, 2001. (See Note 9, "Commitments," of the notes accompanying our financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2001, which is incorporated herein by reference.)

INVESTMENTS

At December 31, 2001, consolidated cash and invested assets totaled approximately $1.0 billion, consisting of $486.8 million of cash and short-term investments, $468.3 million of publicly traded fixed maturity investments, $22.2 million of short-term investments held in escrow, $41.6 million of privately held securities and $0.2 million of publicly traded equity securities. See "Business--Investments."

Investments included in our private portfolio include securities issued by privately held companies that are generally restricted as to resale or are otherwise illiquid and do not have readily ascertainable market values. The risk of investing in such securities is generally greater than the risk of investing in securities of widely held, publicly traded companies. Lack of a secondary market and resale restrictions may result in an inability by us to sell a security at a price that would otherwise be obtainable if such restrictions did not exist and may substantially delay the sale of a security we seek to sell. At December 31, 2001, our private equity portfolio consisted of eight investments, with additional investment portfolio commitments in an aggregate amount of approximately $3.7 million. See Note 4, "Investment Information," of the notes accompanying our consolidated financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2001, which is incorporated herein by reference.

At December 31, 2001, almost all of our fixed maturity and short-term investments were rated investment grade by Moody's or Standard & Poor's and had an average Standard & Poor's quality rating of "AA-" and an average duration of approximately 1.9 years.

We have not invested in derivative financial instruments such as futures, forward contracts, swaps or options or other financial instruments with similar characteristics such as interest rate caps or floors and fixed-rate loan commitments. Our portfolio includes market sensitive instruments, such as mortgage-backed securities, which are subject to prepayment risk and changes in market value in connection with changes in interest rates. Our investments in mortgage-backed securities, which amounted to approximately $91.1 million at December 31, 2001, or 8.9% of cash and invested assets, are classified as available for sale and are not held for trading purposes.

RESULTS OF OPERATIONS

Comparisons of our 2001 and 2000 results of operations to each other and to prior year periods are not relevant due to the changes in our business during 2000 and 2001, including (1) the sale of our prior reinsurance operations in May 2000, (2) our change of legal domicile and reorganization completed in November 2000, (3) our recent acquisition activity, (4) our new underwriting initiative and (5) the capital infusion. In addition, because of these factors, as well as the other factors noted in "Cautionary Note Regarding Forward-Looking Statements," our historical financial results do not provide you with a meaningful measure of our future results. We have attempted to describe certain of these potential changes below.

Statement of Financial Accounting Standards No. 131 requires certain disclosures about operating segments in a manner that is consistent with how management evaluates the performance of the segment. At December 31, 2001, our primary operating segment was insurance. In 2002, we expect to operate in two different business segments, insurance and reinsurance.

We had consolidated net income (loss) of $22.0 million, ($8.0) million and ($35.6) million for the years ended December 31, 2001, 2000 and 1999, respectively. The increase in net income is primarily a result of the effects of the sale of our prior reinsurance operations in May 2000, the realignment of our investment portfolio in connection with the sale of our prior reinsurance operations (and the realization of gains thereon in connection therewith), and the reversal of a portion of the deferred tax valuation allowance, which was originally established as a result of that sale. Such reversal resulted primarily from the expected tax effects of the new underwriting initiative at our U.S.-based underwriting operations.

Based on all information available to us to date, we believe that our insurance and reinsurance subsidiaries do not have any material exposures to the events of September 11, 2001.

UNDERWRITING ACTIVITIES

For the year ended December 31, 2001, premiums written, losses incurred and commissions and brokerage resulted primarily from the acquisitions of American Independent and ART Services. The corresponding amounts for the years ended December 31, 2000 and December 31, 1999 reflect the results of our prior reinsurance operations which were sold in May 2000. Approximately 55% of the 2001 net premiums written were attributable to American Independent, and approximately 40% were attributable to ART Services. The remaining 5% was attributable to new business written by Arch Re (Bermuda) effective December 31, 2001. We expect that our new underwriting initiative and improving market conditions will produce very substantial growth in our direct, assumed and net premiums written in 2002.

A summary of premiums written is as follows:

	YEAR ENDED DECEMBER 31,		
	2001	2000	1999
	(IN MILLIONS)		

Direct premiums written	$117.4	$ --	$ --
Assumed premiums written	1.8	102.0	386.8
Gross premiums written	119.2	102.0	386.8
Ceded premiums written	(83.0)	(19.7)	(80.1)
Subtotal	36.2	82.3	306.7
Unearned premium portfolio transfer and assumption	--	(92.9)	--
Net premiums written	$ 36.2	$(10.6)	$306.7

REINSURANCE CEDED

We follow the customary industry practice of reinsuring a portion of our exposures, paying to reinsurers and retrocessionaires a part of the premiums received on the policies we write. We monitor the financial condition of our reinsurers and retrocessionaires and attempt to place coverages only with substantial, financially sound carriers. During 2001, we ceded approximately two-thirds of our business written on a proportional basis in accordance with our then current business plan. Comparisons of premiums written between 2001 and 2000 are not meaningful because of the changes in our business discussed above. At December 31, 2001, substantially all of our reinsurance recoverables were due from carriers which had an A.M. Best rating of "A-" or better and we had no amounts recoverable from a single entity or group of entities that exceeded 5% of shareholders' equity. As a result of the new underwriting initiative and our enhanced financial position, we expect to retain a significant amount of business written by American Independent and ART Services as well as premiums written by Arch Re (Bermuda) and Arch Re (US). In 2002, reinsurance may be purchased on both a facultative and treaty basis primarily to reduce net liability on individual risks and, if deemed necessary, to reduce our exposure to catastrophic losses.

NET INVESTMENT INCOME

At December 31, 2001, approximately 94% of our invested assets consisted of fixed maturity and short-term investments, exclusive of securities held in escrow, compared to 53% at December 31, 2000. Net investment income was approximately $12.1 million in 2001, compared to $15.9 million in 2000 and $20.2 million in 1999. Such amounts for 2001, 2000 and 1999 are net of investment expenses of $0.1 million, $0.9 million and $5.5 million, respectively. The investment expense amounts include investment advisory fees of $0.7 million, $0.8 million and $2.0 million, respectively. The 2001 and 2000 net investment expenses are offset by advisory fee income that we received from MMC Capital, Inc. in the amount of $1.25 million.

The decrease in net investment income in 2001 compared with 2000 reflected primarily the decline in our average invested asset base resulting from the sale of our prior reinsurance operations. The impact was partially offset by investment income earned on the proceeds received from the capital infusion in November 2001 as well as the inclusion of the results of American Independent and ART Services. The decrease in net investment income in 2000 compared with 1999 primarily reflected the decline in our average invested asset base resulting from the sale of our prior reinsurance operations, partially offset by the decrease in investment expenses described above and a higher interest rate environment.

Our investment yields at amortized cost were as follows for the periods set forth below:

	YEAR ENDED DECEMBER 31, 2001	2000	1999
Investment yields:			
Pre-tax	5.2%	4.3%	3.6%
Net of tax	4.6%	3.1%	2.7%

Proceeds from the capital infusion were initially invested in short duration, high quality fixed maturities and short-term investments. Yields on future investment income may vary based on investment allocation decisions, economic conditions and other factors. Investment yields in 2000 and 1999 reflect a significant allocation of the total investment portfolio in equity securities, which yield less current income than fixed maturity investments. At December 31, 2000 and 1999, public and private equity securities approximated 40% and 41%, respectively, of total cash and invested assets. Additionally such investment yields exclude the equity in net income or loss of private equity investments accounted for under the equity method of accounting.

RESERVE FOR LOSS OF ESCROWED ASSETS

In connection with the definitive settlement agreement reached with Folksamerica in February 2002 (as described above under "--General--May 2000 Sale of Our Prior Reinsurance Operations"), for 2001, we recorded an after-tax benefit of $0.4 million to reflect the net effects of this agreement. During 2000, our net loss included an after-tax charge of $9.8 million related to the escrowed assets. (See Note 3, "Acquisition of Subsidiaries and Disposition of Prior Reinsurance Operations," of the notes accompanying our consolidated financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2001, which is incorporated herein by reference.)

OTHER OPERATING EXPENSES

Other operating expenses were $27.7 million in 2001, compared to $6.9 million and $14.2 million for the years ended December 31, 2000 and 1999, respectively. The increase in operating expenses is primarily due to the 2001 acquisitions. In addition, during the fourth quarter of 2001, we incurred approximately $4.0 million of costs from the formation of our new reinsurance operations. We expect that we will incur a significant amount of additional costs in 2002 in connection with the expected increase in our insurance and reinsurance operations.

PROVISION FOR NON-CASH COMPENSATION

During 2001, we made certain grants to new and existing employees under our stock incentive plans and other arrangements, resulting in pre-tax charges of $2.8 million. These grants were made primarily in connection with our new underwriting initiative, which resulted in the increase in non-cash compensation in 2001. As a result of the new initiative, we expect to reflect a significant increase in non-cash compensation in 2002. In 2000 and 1999, we made grants under our stock incentive plans and other arrangements that resulted in pre-tax charges of $1.1 million and $0.6 million, respectively.

NET REALIZED GAINS (LOSSES) ON INVESTMENTS

Our sources of net realized investment gains (losses) were as follows:

	YEARS ENDED DECEMBER 31,		
	2001	2000	1999
	(IN THOUSANDS)		
Fixed maturities	$(2,116)	$(15,550)	$(1,776)
Publicly traded equity securities	22,896	30,088	16,798
Privately held securities	(2,398)	177	2,205
Subtotal	18,382	14,715	17,227
Loss on fixed maturities included in gain on sale of prior reinsurance operations	--	5,330	--
Net realized investment gains	18,382	20,045	17,227
Income tax expense	7,242	7,408	6,029
Net realized investment gains, net of tax	$11,140	$ 12,637	$11,198

INCOME TAXES

Under current Bermuda law, we are not obligated to pay any taxes in Bermuda based upon income or capital gains. We have received a written undertaking from the Minister of Finance in Bermuda under the Exempted Undertakings Tax Protection Act 1966 that, in the event that any legislation is enacted in Bermuda imposing any tax computed on profits, income, gain or appreciation

on any capital asset, or any tax in the nature of estate duty or inheritance tax, such tax will not be applicable to us or our operations until March 28, 2016. This undertaking does not, however, prevent the imposition of taxes on any person ordinarily resident in Bermuda or any company in respect of its ownership of real property or leasehold interests in Bermuda.

ACGL and our Bermuda and other non-U.S. subsidiaries will be subject to U.S. federal income tax to the extent that they derive U.S. source income that is subject to U.S. withholding tax or income that is effectively connected with the conduct of a trade or business within the United States and is not exempt from U.S. tax under an applicable income tax treaty with the United States. They will be subject to a withholding tax on dividends from U.S. investments and interest from certain U.S. payors. In addition, Arch Re (Bermuda) will be subject to excise taxes on United States insurance and reinsurance premiums received by it.

We do not consider ACGL or our Bermuda or other non-U.S. subsidiaries to be engaged in a trade or business within the United States and, consequently, do not expect them to be subject to direct U.S. income taxation. See "Risk Factors--Risks Relating to Taxation" and "Material U.S. Federal Income Tax Considerations." Our U.S. subsidiaries will continue to be subject to U.S. income taxes on their worldwide income.

Our 2001 income tax expense was $2.1 million, resulting in an effective tax rate of 9%. The effective tax rate was lower than the U.S. federal income tax rate of 35% primarily as a result of a reduction in the valuation allowance on certain deferred tax assets, which was slightly offset by foreign losses not subject to U.S. tax. This reduction resulted primarily from the expected tax effects of the new underwriting initiative at our U.S.-based underwriting operations, which included an increase in our on-shore investment portfolio.

Our 2000 income tax expense was $8.5 million, compared with an income tax benefit of $20.9 million in 1999. In 2000, income tax expense on our pre-tax net loss included a charge to establish a valuation allowance of $5.7 million that adjusted our deferred income tax asset to its estimated realizable value. Income tax expense for 2000 also included the write-off of certain deferred tax assets in the amount of $3.0 million in connection with our change of legal domicile to Bermuda. In 1999, Arch Re (US)'s underwriting results had significantly deteriorated, resulting in a pre-tax net loss that generated an income tax benefit for the year.

At December 31, 2001, the net deferred income tax asset was $13.7 million after reflecting a valuation allowance of $9.6 million recorded to reduce the net deferred income tax asset to the amount that management expects to more likely than not be realized. This valuation allowance primarily relates to certain deferred income tax assets of ART Services, which was acquired during 2001, and also reflects the reduction in the valuation allowance recorded at December 31, 2000 due to the expected tax effects of the new underwriting initiative, as discussed above. At December 31, 2000, we had a valuation allowance of $5.7 million that adjusted the net deferred income tax asset to its estimated realizable value of $8.2 million. At December 31, 1999, we did not have a valuation allowance because we believed at that time the entire deferred tax asset was realizable due to our ability to generate future taxable income. See "--Critical Accounting Policies, Estimates and Recent Accounting Pronouncements--Valuation Allowance."

We have net operating loss carryforwards totaling $43.3 million at December 31, 2001. Such net operating losses are currently available to offset our future taxable income and expire between 2011 and 2021. We also have an alternative minimum tax credit carryforward in the amount of $1.0 million which can be carried forward without expiration.

On November 20, 2001, we underwent an ownership change for U.S. federal income tax purposes as a result of the capital infusion. As a result of this ownership change, limitations are imposed upon the utilization of our existing net operating losses.

Upon our change of legal domicile to Bermuda in November 2000, Arch Capital (US) distributed substantially all of its public equity portfolio to its Bermuda parent, ACGL, at the then current market values and realized gains for tax purposes of $21.0 million. The associated U.S. federal income tax expense of $7.4 million reduced our net operating loss carryforwards by a corresponding amount. However, for financial reporting purposes, since the securities had not been sold to an unrelated third party, the realized gain had been deferred and was reported as unrealized appreciation in our consolidated financial statements. Accordingly, the income tax expense was also deferred and reduced unrealized appreciation in the consolidated financial statements. In 2001, we divested of this public equity portfolio in its entirety and, accordingly, have recognized the U.S. federal income tax expense of $7.4 million in our consolidated financial statements for the year ended December 31, 2001. See Note 7, "Income Taxes," of the notes accompanying our consolidated financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2001, which is incorporated herein by reference.

MARKET SENSITIVE INSTRUMENTS AND RISK MANAGEMENT

The following analysis presents hypothetical losses in cash flows, earnings and fair values of market sensitive instruments which are held by us as of

December 31, 2001 and are sensitive to changes in interest rates and equity security prices. This risk management discussion and the estimated amounts generated from the following sensitivity analysis represent forward-looking statements of market risk assuming certain adverse market conditions occur. Actual results in the future may differ materially from these projected results due to actual developments in the global financial markets. The methods used by us to assess and mitigate risk should not be considered projections of future events or losses.

Market risk represents the risk of changes in the fair value of a financial instrument and is comprised of several components, including liquidity, basis and price risks. The focus of the SEC's market risk rules is on price risk. For purposes of specific risk analysis, we employ 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.

The financial instruments included in the following sensitivity analysis consist of all of our cash and invested assets, excluding investments carried under the equity method of accounting.

EQUITY PRICE RISK

We are exposed to equity price risks on the private equity securities included in our investment portfolio. All of our privately held securities were issued by insurance and reinsurance companies or companies providing services to the insurance and reinsurance industry. We typically do not attempt to reduce or eliminate our market exposure on these securities. Investments included in our private portfolio include securities issued by privately held companies that are generally restricted as to resale or are otherwise illiquid and do not have readily ascertainable market values. Investments in privately held securities issued by privately held companies may include both equity securities and securities convertible into, or exercisable for, equity securities (some of which may have fixed maturities).

Our privately held equity securities, which at December 31, 2001 were carried at a fair value of $41.6 million, have exposure to price risk. The estimated potential losses in fair value for our privately held equity portfolios resulting from a hypothetical 10% decrease in quoted market prices, dealer quotes or fair value is $4.2 million.

INTEREST RATE RISK

The aggregate hypothetical loss generated from an immediate adverse shift in the treasury yield curve of 100 basis points would result in a decrease in total return of 1.9%, which would produce a decrease in market value of $8.6 million on our fixed maturity investment portfolio, valued at $468.3 million at December 31, 2001. There would be no material impact on our short-term investments.

CRITICAL ACCOUNTING POLICIES, ESTIMATES AND RECENT ACCOUNTING PRONOUNCEMENTS

The preparation of consolidated financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities (including reserves), revenues and expenses, and related disclosures of contingent liabilities. On an ongoing basis, we evaluate our estimates, including those related to insurance and other reserves, intangible assets, bad debts, income taxes, pensions, contingencies and litigation. We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions. We believe that the following critical accounting policies affect our more significant judgments and estimates used in the preparation of our consolidated financial statements.

PREMIUM REVENUES AND RELATED EXPENSES

Insurance premiums written are recorded in accordance with the terms of the underlying policies. Reinsurance premiums assumed are recognized as income on a straight line basis over the terms of the related reinsurance contracts. These amounts are based on reports received from ceding companies, supplemented by our own estimates of premiums for which ceding company reports have not been received. Subsequent differences arising on such estimates are recorded in the period they are determined. Unearned premium reserves represent the portion of premiums written that relates to the unexpired terms of contracts in force. Certain of our contracts included provisions that adjusted premiums or acquisition costs based upon the experience under the contracts. Premiums written and earned as well as related acquisition expenses under those contracts are recorded based upon the expected ultimate experience under these contracts.

Acquisition costs, which vary with and are primarily related to the acquisition of policies, consisting principally of commissions and brokerage expenses incurred at the time a contract is issued, are deferred and amortized over the period in which the related premiums are earned. Deferred acquisition costs are carried at their estimated realizable value based on the related unearned premiums and take into account anticipated losses and loss adjustment expenses, based on historical and current experience and anticipated investment income.

LOSSES AND LOSS ADJUSTMENT EXPENSES

Insurance reserves are inherently subject to uncertainty. Loss and loss adjustment expense reserves represent estimates involving actuarial and statistical projections at a given point in time of our expectations of the ultimate settlement and administration costs of claims incurred. We utilize actuarial models as well as historical insurance and reinsurance industry loss development patterns to assist in the establishment of appropriate claim reserves. In contrast to casualty claims, which frequently can be determined only through lengthy and unpredictable litigation, non-casualty property clai