

PLATINUM UNDERWRITERS HOLDINGS LTD
Form 10-K
February 15, 2013

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10K

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

- For the fiscal year ended December 31, 2012
- or
- TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE
SECURITIES EXCHANGE ACT OF 1934

For the transition period from _____ to _____

Commission File Number 001-31341
Platinum Underwriters Holdings, Ltd.
(Exact name of registrant as specified in its charter)

Bermuda
(State or other jurisdiction of
incorporation or organization)

98-0416483
(I.R.S. Employer Identification No.)

The Belvedere Building
69 Pitts Bay Road
Pembroke HM 08, Bermuda
(Address of principal executive offices, including postal code)
Registrant's telephone number, including area code: (441) 295-7195

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

Title of each class	Name of each exchange on which registered
Common Shares, par value \$0.01 per share	New York Stock Exchange

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

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

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

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

Indicate by a check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T

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(§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

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

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

Large accelerated filer

Accelerated filer

Non-accelerated filer (Do not check if a smaller reporting company)

Smaller reporting company

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

The aggregate market value of common shares held by non-affiliates of the registrant as of June 29, 2012, the last business day of our most recently completed second fiscal quarter, was \$1,234,849,004 based on the closing sale price of \$38.10 per common share on the New York Stock Exchange on that date. For purposes of this computation only, all executive officers, directors, and 10% beneficial owners of the registrant are deemed to be affiliates.

The registrant had 32,728,513 common shares, par value \$0.01 per share, outstanding as of February 7, 2013.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's definitive proxy statement for the 2013 Annual General Meeting of Shareholders are incorporated by reference into Part III of this report.

PLATINUM UNDERWRITERS HOLDINGS, LTD.

TABLE OF CONTENTS

		Page
PART I		
Item 1.	Business	3
Item 1A.	Risk Factors	18
Item 1B.	Unresolved Staff Comments	26
Item 2.	Properties	26
Item 3.	Legal Proceedings	26
Item 4.	Mine Safety Disclosures	26
PART II		
Item 5.	Market For Registrant’s Common Equity, Related Shareholder Matters and Issuer Purchases of Equity Securities	27
Item 6.	Selected Financial Data	29
Item 7.	Management’s Discussion and Analysis of Financial Condition and Results of Operations	31
Item 7A.	Quantitative and Qualitative Disclosures about Market Risk	56
Item 8.	Financial Statements and Supplementary Data	57
Item 9.	Changes in and Disagreements With Accountants on Accounting and Financial Disclosure	58
Item 9A.	Controls and Procedures	58
Item 9B.	Other Information	60
PART III		
Item 10.	Directors, Executive Officers and Corporate Governance	60
Item 11.	Executive Compensation	60
Item 12.	Security Ownership of Certain Beneficial Owners and Management and Related Shareholder Matters	60
Item 13.	Certain Relationships and Related Transactions, and Director Independence	61
Item 14.	Principal Accountant Fees and Services	61
PART IV		
Item 15.	Exhibits and Financial Statement Schedules	61
Signatures		65
Platinum Underwriters Holdings, Ltd. and Subsidiaries Consolidated Financial Statements		F-1
Index to Schedules to Consolidated Financial Statements		S-1
Exhibits		

Note On Forward-Looking Statements

This Annual Report on Form 10-K for the year ended December 31, 2012 (this “Form 10-K”) contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 (the “Securities Act”) and Section 21E of the Securities Exchange Act of 1934 (the “Exchange Act”). Forward-looking statements are based on our current plans or expectations that are inherently subject to significant business, economic and competitive uncertainties and contingencies. These uncertainties and contingencies can affect actual results and could cause actual results to differ materially from those expressed in any forward-looking statements made by or on behalf of us. In particular, statements using words such as “may”, “should”, “estimate”, “expect”, “anticipate”, “intend”, “believe”, “predict”, “potential”, of similar import generally involve forward-looking statements.

The inclusion of forward-looking statements in this Form 10-K should not be considered as a representation by us or any other person that our current plans or expectations will be achieved. Numerous factors could cause our actual results to differ materially from those in forward-looking statements, including the following:

- the occurrence of severe natural or man-made catastrophic events;
- the effectiveness of our loss limitation methods and pricing models;
- the adequacy of our ceding companies’ ability to assess the risks they underwrite;
- the adequacy of our liability for unpaid losses and loss adjustment expenses;
- the effects of emerging claim and coverage issues on our business;
- our ability to maintain our A.M. Best Company, Inc. (“A.M. Best”) and Standard & Poor’s Ratings Services (“S&P”) financial strength ratings;
 - our ability to raise capital on acceptable terms if necessary;
 - our exposure to credit loss from counterparties in the normal course of business;
 - our ability to provide reinsurance from Bermuda to insurers domiciled in the United States;
 - the effect on our business of the cyclical nature of the property and casualty reinsurance business;
- the effect on our business of the highly competitive nature of the property and casualty reinsurance industry;
 - losses that we could face from terrorism, political unrest and war;
- our dependence on the business provided to us by reinsurance brokers and our exposure to credit risk associated with our brokers during the premium and loss settlement process;
 - the availability of retrocessional reinsurance on acceptable terms;
 - foreign currency exchange rate fluctuation;
- our ability to maintain and enhance effective operating procedures and internal controls over financial reporting;

- our need to make many estimates and judgments in the preparation of our financial statements;
- the limitations placed on our financial and operational flexibility by the representations, warranties and covenants in our debt and credit facilities;

- 1 -

- our ability to retain key executives and attract and retain additional qualified personnel in the future;
 - the performance of our investment portfolio;
 - the effects of changes in market interest rates on our investment portfolio;
- the concentration of our investment portfolio in any particular industry, asset class or geographic region;
- the effects that the imposition of U.S. corporate income tax would have on Platinum Underwriters Holdings, Ltd. and its non-U.S. subsidiaries;
 - the risk that U.S. persons who hold our shares will be subject to adverse U.S. federal income tax consequences under certain circumstances;
- the risk that U.S. persons who dispose of our shares may be subject to U.S. federal income taxation at the rates applicable to dividends on all or a portion of their gains, if any;
- the risk that holders of 10% or more of our shares may be subject to U.S. income taxation under the “controlled foreign corporation” rules;
 - the effect of changes in U.S. federal income tax law on an investment in our shares;
 - the possibility that we may become subject to taxes in Bermuda;
 - the effect on our business of potential changes in the regulatory system under which we operate;
- the impact of regulatory regimes and changes to accounting rules on our financial results, irrespective of business operations;
- the uncertain impact on our business of the Dodd–Frank Wall Street Reform and Consumer Protection Act of 2010;
- the dependence of the cash flows of Platinum Underwriters Holdings, Ltd., a holding company, on dividends, interest and other permissible payments from its subsidiaries to meet its obligations;
- the risk that our shareholders may have greater difficulty in protecting their interests than would shareholders of a U.S. corporation; and
 - limitations on the ownership, transfer and voting rights of our common shares.

As a consequence, our future financial condition and results may differ from those expressed in any forward-looking statements made by or on behalf of us. The foregoing factors, which are discussed in more detail in Item 1A, “Risk Factors”, in this Form 10-K, should not be construed as exhaustive. Additionally, forward-looking statements speak only as of the date they are made, and we undertake no obligation to revise or update forward-looking statements to reflect new information or circumstances after the date hereof or to reflect the occurrence of future events.

PART I

Item 1. Business

General Overview

Platinum Underwriters Holdings, Ltd. (“Platinum Holdings”) is a holding company domiciled in Bermuda. Through our reinsurance subsidiaries we provide property and marine, casualty and finite risk reinsurance coverages to a diverse clientele of insurers and select reinsurers on a worldwide basis.

Platinum Holdings and its consolidated subsidiaries (collectively, the “Company”) include Platinum Holdings, Platinum Underwriters Bermuda, Ltd. (“Platinum Bermuda”), Platinum Underwriters Reinsurance, Inc. (“Platinum US”), Platinum Regency Holdings (“Platinum Regency”), Platinum Underwriters Finance, Inc. (“Platinum Finance”) and Platinum Administrative Services, Inc. The terms “we,” “us,” and “our” refer to the Company, unless the context otherwise indicates.

We operate through two licensed reinsurance subsidiaries, Platinum Bermuda, a Bermuda reinsurance company, and Platinum US, a U.S. reinsurance company. Platinum Regency is an intermediate holding company based in Ireland and a wholly owned subsidiary of Platinum Holdings. Platinum Finance is an intermediate holding company based in the U.S. and a wholly owned subsidiary of Platinum Regency. Platinum Bermuda is a wholly owned subsidiary of Platinum Holdings and Platinum US is a wholly owned subsidiary of Platinum Finance. Platinum Administrative Services, Inc. is a subsidiary of Platinum Finance that provides administrative support services to the Company.

At December 31, 2012, our capital resources of \$2.1 billion consisted of \$1.9 billion of common shareholders’ equity and \$250.0 million of debt obligations.

Our net premiums written were \$565.0 million, \$651.5 million and \$760.6 million for the years ended December 31, 2012, 2011 and 2010, respectively. Our Property and Marine, Casualty and Finite Risk operating segments accounted for approximately 45%, 51% and 4% respectively, of our 2012 net written premiums. As of December 31, 2012, we had total investments and cash and cash equivalents of \$3.9 billion.

Our Strategy

We seek to achieve attractive long-term returns for our shareholders, through disciplined risk management and market leadership in selected classes of property and marine, casualty and finite risk reinsurance, through the following strategy:

Operate as a multi-class reinsurer. We seek to offer a broad range of reinsurance coverage to our ceding companies. We believe that this approach enables us to more effectively serve our clients, diversify our risk and leverage our capital.

Focus on profitability, not market share. Our management team pursues a strategy that emphasizes profitability rather than market share. Key elements of this strategy are prudent risk selection, appropriate pricing and adjustment of our business mix to respond to changing market conditions.

Exercise disciplined underwriting and risk management. We exercise underwriting and risk management discipline by: (i) maintaining a diverse spread of risk in our book of business across product lines and geographic zones, (ii) emphasizing excess-of-loss contracts over proportional contracts, (iii) managing our aggregate catastrophe exposure through the application of sophisticated property catastrophe modeling tools and (iv) monitoring our

accumulating exposures on non-property catastrophe exposed coverages.

Operate from a position of financial strength. Our capital is unencumbered by any potential adverse development of unpaid losses for business written prior to January 1, 2002. Our investment strategy focuses on security and stability in our investment portfolio by maintaining a portfolio that consists of diversified, high quality, predominantly investment grade fixed maturity securities.

We believe this strategy allows us to maintain our strong financial position and to be opportunistic when market conditions are most attractive.

Operating Segments

We have organized our worldwide reinsurance business into three operating segments: Property and Marine, Casualty and Finite Risk. We generally write reinsurance in each of our operating segments on either an excess-of-loss basis or a proportional basis (which is also referred to as pro rata or quota share).

In the case of excess-of-loss reinsurance, we assume all or a specified portion of the ceding company's risks in excess of a specified claim amount, referred to as the ceding company's retention or our attachment point. We manage our underwriting risk from excess-of-loss contracts by charging reinsurance premiums at specific retention levels based upon our own underwriting assumptions. Because ceding companies typically retain a larger loss exposure under excess-of-loss contracts, we believe that they typically have a strong incentive to underwrite risks and adjust losses in a prudent manner.

In the case of proportional reinsurance, we assume a predetermined portion of the ceding company's risks under the covered primary insurance contract or contracts. The frequency of claims under a proportional contract is usually greater than under an excess-of-loss contract, since we share proportionally in all losses. Premiums for proportional reinsurance are typically a predetermined portion of the premiums the ceding company receives from its insureds.

Substantially all of the reinsurance that we underwrite is on a treaty basis, which covers a type or category of insurance policies issued by the ceding company. In limited and opportunistic circumstances, we underwrite facultative reinsurance, where we assume all or a part of a specific insurance policy or policies.

The following table sets forth our net premiums written for the years ended December 31, 2012, 2011 and 2010 by operating segment and by type of reinsurance (\$ in thousands):

Net Premiums Written by Operating Segment and Type of Reinsurance

	Years Ended December 31,					
	2012		2011		2010	
	Net Premium Written	Percentage of Net Premiums Written	Net Premium Written	Percentage of Net Premiums Written	Net Premium Written	Percentage of Net Premiums Written
Property and Marine						
Excess-of-Loss	\$209,919	37 %	\$275,879	42 %	\$337,464	44 %
Proportional	46,263	8 %	68,803	11 %	75,211	10 %
Subtotal Property and Marine	256,182	45 %	344,682	53 %	412,675	54 %
Casualty						
Excess-of-Loss	231,379	41 %	242,314	37 %	292,968	39 %
Proportional	55,733	10 %	54,675	9 %	36,429	5 %
Subtotal Casualty	287,112	51 %	296,989	46 %	329,397	44 %
Finite Risk						
Excess-of-Loss	-	0 %	531	0 %	-	0 %
Proportional	21,706	4 %	9,312	1 %	18,517	2 %
Subtotal Finite Risk	21,706	4 %	9,843	1 %	18,517	2 %
Combined Segments						
Excess-of-Loss	441,298	78 %	518,724	79 %	630,432	83 %
Proportional	123,702	22 %	132,790	21 %	130,157	17 %
Total	\$565,000	100 %	\$651,514	100 %	\$760,589	100 %

The following table sets forth our net premiums written for the years ended December 31, 2012, 2011 and 2010 by operating segment and by geographic location of the ceding company (\$ in thousands):

Net Premiums Written by Operating Segment and Geographic Location of the Ceding Company

	Years Ended December 31,					
	2012		2011		2010	
	Net Premium Written	Percentage of Net Premiums Written	Net Premium Written	Percentage of Net Premiums Written	Net Premium Written	Percentage of Net Premiums Written
Property and Marine						
United States	\$161,838	28 %	\$189,442	29 %	\$230,914	30 %
International	94,344	17 %	155,240	24 %	181,761	24 %
Subtotal Property and Marine	256,182	45 %	344,682	53 %	412,675	54 %
Casualty						
United States	258,218	46 %	258,450	40 %	277,666	37 %
International	28,894	5 %	38,539	6 %	51,731	7 %
Subtotal Casualty	287,112	51 %	296,989	46 %	329,397	44 %
Finite Risk						
United States	21,706	4 %	9,843	1 %	18,517	2 %

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International	-	0	%	-	0	%	-	0	%
Subtotal Finite Risk	21,706	4	%	9,843	1	%	18,517	2	%
Combined Segments									
United States	441,762	78	%	457,735	70	%	527,097	69	%
International	123,238	22	%	193,779	30	%	233,492	31	%
Total	\$565,000	100	%	\$651,514	100	%	\$760,589	100	%

Additional financial information about our operating segments is set forth in Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations," in this Form 10-K.

Property and Marine

Property reinsurance protects a ceding company against financial loss arising out of damage to property or loss of its use caused by an insured peril. Property catastrophe reinsurance protects a ceding company against losses arising out of multiple claims for a single event while property per-risk reinsurance protects a ceding company against loss arising out of a single claim for a single event. The Property and Marine segment includes principally property and marine reinsurance coverages that are written in the United States and international markets and includes property reinsurance, crop reinsurance and marine and aviation reinsurance. The Property and Marine segment includes property catastrophe and marine excess-of-loss reinsurance contracts, property and marine per-risk excess-of-loss reinsurance contracts and property proportional reinsurance contracts. Marine reinsurance also includes proportional treaties. We may from time to time write a limited amount of property facultative reinsurance. We employ underwriters and actuaries with expertise in each of the following areas:

Property. We provide reinsurance coverage for damage to property and crops. Our catastrophe excess-of-loss reinsurance contracts provide defined limits of liability, permitting us to quantify our aggregate maximum loss exposure for various catastrophic events. Quantification of loss exposure is fundamental to our ability to manage our loss exposure through geographical zone limits, program limits and peril limits.

Marine. We provide reinsurance coverage for marine, offshore energy and aerospace insurance programs. Coverages reinsured include hull damage, protection and indemnity, cargo damage, satellite damage, aviation hull, aviation liability and general marine liability.

Casualty

Casualty reinsurance protects a ceding company against financial loss arising out of the obligation to others for loss or damage to persons or property. The Casualty segment includes reinsurance contracts that cover general and product liability, professional liability, accident and health, umbrella liability, workers' compensation, casualty clash, automobile liability, surety, trade credit, and political risk. We generally seek to write casualty reinsurance on an excess-of-loss basis.

We seek to write casualty reinsurance contracts covering established books of insurance products where we believe that past experience provides a reasonable basis to price the reinsurance adequately. We underwrite new exposures selectively and perform a comprehensive evaluation of the risk and ceding company being reinsured. We employ underwriters and actuaries that have expertise in one or more of the following areas:

General and Product Liability. We provide reinsurance of various third-party liability coverages to both small and large insureds in both commercial and personal lines predominantly on an excess-of-loss basis. This business includes coverage of commercial, farmowners and homeowners policies as well as third-party liability coverages such as product liability.

Professional Liability. We write reinsurance contracts covering professional liability programs, including directors and officers, employment practices, and errors and omissions for professionals such as accountants, lawyers, medical professionals, architects and engineers. The underlying insurance products for these lines of business are generally written on a claims made basis, which requires notification of claims related to the liabilities insured under the policy to be submitted to the insurer during a specified coverage period.

Accident and Health. We provide accident and health reinsurance, most often covering employer self-insured or fully insured health plans, on a quota share and excess-of-loss basis. We also write reinsurance of student health insurance, sports disability, Medicare and Medicare supplement and other forms of accident and health insurance.

Umbrella Liability. We provide reinsurance of umbrella policies, which are excess insurance policies that provide coverage, typically for general liability or automobile liability, when claims, individually or in the aggregate, exceed the limit of the original policy underlying the excess policy.

Workers' Compensation. We reinsure workers' compensation on a catastrophic basis as well as on a per-claimant basis. We may provide full statutory coverage or coverage that is subject to specific carve-outs. Our exposure to workers' compensation would generally arise from a single occurrence, such as a factory explosion, or earthquake which involves claims from more than one employer.

Casualty Clash. We provide casualty clash reinsurance, which covers losses arising from a single event insured under more than one policy or where there are multiple claimants under one policy. This type of reinsurance is analogous to property catastrophe reinsurance, but written for casualty lines of business.

Automobile Liability. We provide automobile liability reinsurance, which relates to the risks associated with the insured's vehicle and third-party coverage for the insured's liability to other parties for injuries, for damage to the insured's property due to the use of the insured vehicle and coverage for uninsured motorists and medical payments.

Surety. We reinsure risks associated with commercial and contract surety bonds issued to third parties to guarantee the performance of an obligation by the principal under the bond. Commercial bonds guarantee compliance with obligations arising out of regulatory or statutory requirements. Contract bonds guarantee the performance of contractual obligations between two parties and include payment and performance bonds.

Trade Credit. Trade credit insurance is purchased by companies to ensure that invoices for goods and services provided to their customers are paid on time. We provide trade credit reinsurance for financial losses sustained through the failure of an insured's customers to pay for goods or services supplied to them.

Political Risk. Political risk reinsurance covers the impairment of assets as a result of expropriation, political violence, currency inconvertibility, and the failure by sovereign countries to honor their obligations. The locations of risks that we reinsure include Asia, Central and Eastern Europe, Latin America, Africa and the Middle East.

Finite Risk

Finite risk reinsurance includes principally structured reinsurance contracts with ceding companies whose needs may not be met efficiently through traditional reinsurance products. Reinsurance contracts classified as finite risk are typically structured to include loss limitation or loss mitigation features. In exchange for contractual features that limit our risk, reinsurance contracts that we include in our Finite Risk segment typically provide the potential for significant profit commission to the ceding company. The classes of risks underwritten through our finite risk contracts are generally consistent with the classes covered by our traditional products. The finite risk reinsurance contracts that we underwrite generally provide prospective protection, meaning coverage is provided for losses that are incurred after inception of the contract, as contrasted with retrospective coverage, which covers losses that are incurred prior to inception of the contract. The three main categories of finite risk contracts are quota share, multi-year excess-of-loss and whole account aggregate stop loss:

Finite quota share. Under finite quota share reinsurance contracts, the reinsurer agrees to indemnify a ceding company for a percentage of its losses up to an aggregate maximum or cap in return for a percentage of the ceding company's premium, less a ceding commission. The expected benefit to the ceding company provided by finite quota share reinsurance is increased underwriting capacity of the ceding company and a sharing of premiums and losses with the reinsurer. These reinsurance contracts often provide broad protection and may cover multiple classes of a ceding company's business. Unlike traditional quota share reinsurance agreements, these contracts often provide for profit commissions which take into account investment income for purposes of calculating the reinsurer's profit on business ceded. Additionally, finite quota share reinsurance contracts are often written on a funds withheld basis, meaning the parties agree that funds that would normally be remitted to a reinsurer are withheld by the ceding company. The funds withheld are generally credited with interest at a negotiated rate and the net balances are settled generally after expiration at a date established in the contract.

Multi-year excess-of-loss. These reinsurance contracts often complement ceding companies' traditional excess-of-loss reinsurance programs. This type of contract often carries an up-front premium plus additional premiums which are dependent on the magnitude of losses claimed by the ceding company under the contract. The expected benefit to the ceding company of multi-year excess-of-loss reinsurance is that the ceding company has the ability to negotiate specific terms and conditions that remain applicable over multiple years of coverage. These reinsurance contracts may cover multiple classes of a ceding company's business and typically provide the benefit of reducing the impact of large or catastrophic losses on a ceding company's underwriting results. In general, these reinsurance contracts are designed so that the ceding company funds the expected level of loss activity over the multi-year period. The reinsurer incorporates a profit margin to cover its costs and a charge for the risk that actual losses assumed may be worse than expected. The payment of premiums based on the magnitude of losses claimed is intended to benefit the ceding company by linking its own loss experience to the actual cost of reinsurance over time. The multiple year term and premium structure of multi-year excess-of-loss reinsurance contracts are not typically found in traditional reinsurance contracts.

Whole account aggregate stop loss. Aggregate stop loss reinsurance contracts provide broad protection against a wide range of contingencies that are difficult to address with traditional reinsurance, including inadequate pricing by a ceding company or higher frequency of claims than the ceding company expected. The reinsurer on a whole account aggregate stop loss contract agrees to indemnify a ceding company for aggregate losses in excess of a deductible specified in the contract. These contracts can be offered on a single or multi-year basis, and may provide catastrophic and attritional loss protection. The benefit of whole account aggregate stop loss contracts to ceding

companies is that such contracts provide the broadest possible protection of a ceding company's underwriting results which is not generally available in the traditional reinsurance market. Unlike traditional reinsurance contracts, these contracts often contain sub-limits of coverage for losses on certain classes of business or exposures and often include provisions for profit commissions which take into account investment income for purposes of calculating the reinsurer's profit on business ceded. Additionally, these reinsurance contracts may be written on a funds withheld basis.

Marketing

We market our reinsurance products worldwide primarily through non-exclusive relationships with leading reinsurance brokers, as we believe that the use of reinsurance brokers enables us to operate on a more cost-effective basis and to maintain the flexibility to enter and exit reinsurance lines in a quick and efficient manner. We also believe that brokers are particularly useful in assisting with placements of excess-of-loss reinsurance programs. In addition to their role as intermediaries in placing risk, brokers perform data collection, contract preparation and other administrative tasks. We believe that by doing business largely through reinsurance brokers we are able to avoid the expense and regulatory complications of a worldwide network of offices and thereby minimize fixed costs associated with marketing activities.

Based on in-force premiums written by us as of December 31, 2012, the brokers from which we derived the largest portions of our business (with the approximate percentage of business derived from each of such brokers and its affiliates) were: Aon Benfield (34%), Marsh & McLennan Companies (31%), and Willis Group Holdings (15%). The loss of business relationships with any of these brokers could have a material adverse effect on our business.

Underwriting and Risk Management

Overview

Our approach to underwriting and risk management emphasizes discipline and profitability rather than premium volume or market share. We seek to limit our overall exposure to risk by limiting the amount of reinsurance we write by geographic zone, peril and type of program or contract. Our risk management practices include evaluating the quality of the ceding company in connection with our review of a program proposal and using contract terms, diversification criteria, probability analysis and analysis of comparable historical loss experience. We estimate the impact of catastrophic events using information from ceding companies, reinsurance contract information, expected loss ratios, our historical loss ratios, industry loss data and catastrophe modeling software to evaluate our exposure to losses from individual contracts and in the aggregate.

Ceding Company Selection and Underwriting Evaluation

Before entering into a reinsurance contract, we consider the quality of the ceding company, including the experience and reputation of its management, its capital, its risk management and underwriting strategy and practices and its claims settlement practices and procedures. In addition, we seek to obtain information on the nature of the perils to be covered and, in the case of natural or man-made catastrophe exposures, aggregate information as to the location or locations of the risks covered under the reinsurance contract. We request information on the ceding company's loss history for the perils proposed to be covered, together with relevant underwriting considerations, which would impact our exposures. If the program meets all these initial underwriting criteria, we then evaluate the proposal's risk/reward profile to assess the adequacy of the proposed pricing and its potential impact on our overall return on capital.

Loss Limits

Reinsurance contracts generally contain limits that restrict the amount that we may be required to pay in the event of a loss. These limits may apply on a per risk, per occurrence, or aggregate basis. Contracts with per risk limits include a limit on our liability for each underlying insured, for each occurrence. If multiple underlying insureds are affected by a single event, our total limit of liability, without any other mitigating contractual terms, would be the sum of the per risk limits for all the underlying insureds affected by the event up to the occurrence or aggregate limits. Per occurrence limits restrict our liability to a certain amount for each event, regardless of the number of underlying insureds involved. If multiple events occur in a single reinsurance policy period, our total limit of liability, without any other mitigating contractual terms, would be the sum of the occurrence limits for all events within the policy term. Aggregate limits provide us with a maximum amount for which we are liable, in total, for all underlying risks and all occurrences combined within the coverage period.

Our contracts typically contain a per risk limit or an occurrence limit and may contain both. Some of our contracts contain an aggregate limit. Property and marine reinsurance contracts with natural catastrophe exposure generally contain occurrence limits. In addition, our high layer property and marine reinsurance contracts generally contain aggregate limits. Casualty reinsurance contracts generally contain either a per risk or an occurrence limit. Casualty clash contracts generally contain an aggregate limit. Few of our other casualty contracts contain an aggregate limit.

Loss Modeling and Monitoring

For catastrophe coverages exposed to natural perils, we measure our exposure to aggregate catastrophic claims using catastrophe models that analyze the effect of wind speed and earthquakes on the exposed property values within our portfolio. We seek to limit the amount of capital that we expect to lose from a severe catastrophic event; however, there can be no assurance that we will successfully limit actual losses from such a catastrophic event.

We use sophisticated modeling techniques to measure and estimate loss exposure under both simulated and actual loss scenarios. We also use these models to assess the impact of both single and multiple events. We evaluate the commercial catastrophe exposure models that form the basis for our own proprietary pricing models. These computer-based loss modeling systems primarily utilize direct exposure information obtained from our clients and data compiled by A.M. Best to assess each client's potential for catastrophe losses. We believe that loss modeling is an important part of the underwriting process for catastrophe exposure pricing.

We maintain a database of our exposure in each geographic zone and estimate our probable maximum loss for each zone and for each peril (e.g. earthquakes and hurricanes) to which that zone is subject based on catastrophe models and underwriting assessments. We also use catastrophe loss modeling to review exposures from events that cross country borders, such as wind events that may affect the Caribbean and Florida or the United Kingdom and continental Europe. Our largest exposures are in the United States for hurricane and earthquake, in Japan for

earthquake, and in Europe for flood and wind.

In respect of our property catastrophe exposure, we seek to limit our estimated probable maximum loss to a specific level for severe catastrophic events. We currently expect to limit the probable maximum pre-tax loss for 2013 to no more than 22.5% of total capital for a severe catastrophic event in any geographic zone that could be expected to occur once in every 250 years, although we may change this threshold at any time. The estimated probable maximum loss for a catastrophic event in any geographic zone arising from a 1-in-250 year event was approximately \$229.0 million, or 10.7% of total capital, and \$219.0 million, or 11.3% of total capital, as of January 1, 2013 and January 1, 2012, respectively.

We also monitor our exposures to accumulating risks for man-made perils impacting coverage such as surety, umbrella liability, directors' and officers' liability, trade credit and terrorism.

Diversification

We seek to diversify our property catastrophe exposure across geographic zones and type of peril around the world in order to manage the concentration of risk. We attempt to limit our coverage for risks located in a particular zone to a predetermined level. Currently, our largest property exposures in the United States are in Florida and along the Atlantic coast for hurricane and in California and along the New Madrid fault zone for earthquake. Internationally our largest property exposures are in Japan for earthquake and in Europe for windstorm.

We seek to diversify our casualty exposure by writing casualty business throughout the United States and internationally. In addition, we seek to diversify our casualty exposure by writing casualty reinsurance across a broad range of product lines.

Retrocessional Reinsurance and Derivative Instruments

We buy retrocessional reinsurance, which is insurance for our own account, to reduce liability on individual risks, protect against catastrophic losses and obtain additional underwriting capacity. Our decisions with respect to purchasing retrocessional coverage take into account both the potential coverage and market conditions such as pricing, terms, conditions and availability of such coverage, with the aim of securing cost-effective protection. We may purchase industry loss warranty reinsurance, which provides retrocessional coverage when insurance industry losses for a defined event exceed a certain level. We expect that the type and level of retrocessional coverage we purchase will vary over time, reflecting our view of the changing dynamics of both the underlying exposure and the reinsurance markets. There can be no assurance that retrocessional coverage will be available on terms we find acceptable.

Retrocessional agreements do not relieve us from our obligations to the insurers and reinsurers from whom we assume business. The failure of retrocessionaires to honor their obligations would result in losses to us. Consequently, we consider the financial strength of retrocessionaires when determining whether to purchase retrocessional coverage from them. We generally obtain retrocessional coverage from companies rated “A-” or better by A.M. Best unless the retrocessionaire’s obligations are collateralized. We routinely monitor the financial performance and rating status of all material retrocessionaires.

We may also use derivative instruments to reduce our exposure to catastrophe losses as an alternative to traditional retrocession. We either trade derivatives on recognized exchanges or require collateral to enhance the financial security of the derivative counterparty. We may also use derivative instruments to reduce our exposure to other types of underwriting exposures, such as on our crop portfolio.

Claims Administration

Our claims personnel administer claims arising from our reinsurance contracts, including validating and monitoring claims, posting case reserves and approving payments. Authority for establishing reserves and payment of claims is based upon the level and experience of claims personnel.

Our claims personnel, or consultants engaged by us, conduct periodic audits of specific claims and the overall claims procedures of our ceding companies at their offices. We rely on our ability to effectively monitor the claims handling and claims reserving practices of ceding companies in order to help establish the reinsurance premium for reinsurance contracts and to estimate our liability for unpaid losses and loss adjustment expenses. Moreover, prior to accepting or renewing certain risks, our underwriters may request that our claims personnel conduct pre-underwriting claims audits of ceding companies.

Unpaid Losses and Loss Adjustment Expenses

Unpaid losses and loss adjustment expenses on our consolidated balance sheets represent our best estimates, at a given point in time, of our liability to pay losses and loss adjustment expenses (“LAE”) for events that have occurred on or before the balance sheet date. We do not establish liabilities for unpaid losses and LAE until the occurrence of an event that may give rise to a loss.

Estimates of losses and LAE are established after extensive consultation with individual underwriters, actuarial review of loss development patterns and comparison with industry and our own loss information. These estimates are based on predictions of future developments and trends, including predictions of claim severity and frequency. Consequently, estimates of ultimate losses and LAE, and our unpaid liability for losses and LAE, may differ materially from our initial estimates.

Reconciliation of Claims Reserves

The following table sets forth the changes in our liability for unpaid losses and LAE for the years ended December 31, 2012, 2011 and 2010 (\$ in thousands):

	2012	2011	2010
Net unpaid losses and LAE as of January 1,	\$2,385,659	\$2,208,466	\$2,335,008
Net incurred losses and LAE related to:			
Current year	395,661	905,595	625,250
Prior years	(212,001)	(100,158)	(157,830)
Net incurred losses and LAE	183,660	805,437	467,420

Net paid losses and LAE related to:			
Current year	95,808	155,534	96,245
Prior years	524,423	477,755	497,968
Net paid losses and LAE	620,231	633,289	594,213
Net effects of foreign currency exchange rate changes	8,597	5,045	251
Net unpaid losses and LAE as of December 31,	1,957,685	2,385,659	2,208,466
Reinsurance recoverable on unpaid losses and LAE	3,597	3,955	8,912
Gross unpaid losses and LAE as of December 31,	\$ 1,961,282	\$ 2,389,614	\$ 2,217,378

We report changes in estimates of prior years' unpaid losses and LAE, referred to as net favorable or unfavorable loss development, in our consolidated statements of operations in the period in which we make the change.

The following table sets forth the components of net incurred losses and LAE related to prior years for the years ended December 31, 2012, 2011 and 2010 (\$ in thousands):

	2012	2011	2010
Net favorable loss development	\$(235,543)	\$(112,984)	\$(158,939)
Increase in losses attributable to changes in premium estimates	23,542	10,857	14,331
Change in unallocated loss adjustment expense reserves	-	1,969	(13,222)
Net incurred losses and LAE - prior years	\$(212,001)	\$(100,158)	\$(157,830)

Net favorable loss development was primarily the result of favorable adjustments in ultimate loss ratios. Prior years' incurred losses and LAE included losses associated with changes in premium estimates and the patterns of their earnings. The effect on net income from the increase in losses attributable to changes in premium estimates, after considering corresponding changes in premium estimates and acquisition expenses, was not significant. During the year ended December 31, 2010, a review of our administrative expenses of managing claims resulted in a \$13.2 million reduction of unallocated loss adjustment expense ("ULAE") reserves.

The following table sets forth the net favorable loss development by operating segment for the years ended December 31, 2012, 2011 and 2010 (\$ in thousands):

	2012	2011	2010
Property and Marine	\$(45,664)	\$(41,435)	\$(36,853)
Casualty	(182,014)	(59,420)	(113,281)
Finite Risk	(7,865)	(12,129)	(8,805)
Net favorable loss development	\$(235,543)	\$(112,984)	\$(158,939)

The Property and Marine segment net favorable loss development included net favorable loss development related to major catastrophe events of \$12.7 million primarily from 2011 events and \$19.4 million primarily from 2010 events for the years ended December 31, 2012 and 2011, respectively. There was net unfavorable loss development related to major catastrophes of \$16.2 million primarily from Hurricane Ike for the year ended December 31, 2010. The net favorable loss development, excluding major catastrophes, for the year ended December 31, 2012 was primarily attributable to the catastrophe excess-of-loss (non-major events) and property per risk classes. The net favorable loss development, excluding major catastrophes, for the year ended December 31, 2011 was primarily attributable to the property per risk excess-of-loss and proportional classes, partially offset by net unfavorable loss development in the catastrophe excess-of-loss (non-major events) class. The net favorable loss development, excluding major catastrophes, for the year ended December 31, 2010 was primarily attributable to the property per risk excess-of-loss, crop and catastrophe excess-of-loss (non-major events) classes.

The Casualty segment net favorable loss development included \$165.8 million, \$52.7 million and \$96.4 million attributable to the long-tailed casualty classes for years ended December 31, 2012, 2011 and 2010, respectively. The majority of the long-tailed casualty net favorable loss development for the year ended December 31, 2012 was attributable to the 2009 and prior underwriting years of the claims made, umbrella, casualty occurrence and international casualty classes. The majority of the long-tailed casualty net favorable loss development for the year ended December 31, 2011 was attributable to the 2007 and prior underwriting years of the claims made, umbrella and casualty occurrence excess-of-loss classes, partially offset by net unfavorable loss development in the international casualty class in the 2010 and 2008 underwriting years. The majority of the long-tailed casualty net favorable loss development for the year ended December 31, 2010 was attributable to the 2006 and prior underwriting years of the claims made, casualty occurrence excess-of-loss and umbrella classes, partially offset by net unfavorable loss development in the international casualty class in the 2008 underwriting year.

The Finite Risk segment net favorable loss development was offset by additional profit commissions of \$8.1 million, \$8.2 million and \$11.3 million for the years ended December 31, 2012, 2011 and 2010, respectively.

The net favorable loss development for the years ended December 31, 2012, 2011 and 2010 was primarily attributable to a level of cumulative losses reported by our ceding companies that was lower than expected, and that, in our judgment, resulted in sufficient credibility in the loss experience to change our previously selected loss ratios and reduce estimated ultimate losses.

Loss Reserve Development

The table below shows the loss reserve development from December 31, 2002, the end of the first period of our operations, through December 31, 2012.

The top line of the table shows the liability for unpaid losses and LAE, net of unpaid retrocessional reinsurance recoverable, at the balance sheet date for each of the indicated years. This represents our estimate of our gross and net liability for losses and LAE arising in all prior years that are unpaid at the balance sheet date, including our estimate of the cost of claims incurred but not yet reported, generally referred to as "IBNR."

We re-estimate the liability to reflect additional information regarding claims incurred prior to the end of each year. Changes in our estimate of our liability for unpaid losses and LAE recorded at the end of the prior year are reflected in the consolidated statement of operations of the year during which the liabilities are re-estimated and result in a redundancy or deficiency of our unpaid losses and LAE. A cumulative redundancy or deficiency reflects the cumulative difference between the original estimate of our liability for unpaid losses and LAE and the current re-estimated liability.

The table also shows the cumulative amounts paid as of successive years with respect to that liability. Unpaid losses and LAE denominated in foreign currencies are restated at the foreign exchange rates in effect as of December 31, 2012 and the resulting cumulative foreign exchange effect is shown as an adjustment to the cumulative redundancy. Each amount in the table includes the effects of all changes in amounts for the prior years.

The table does not present accident year or underwriting year development data nor does it include any corresponding adjustments that may accompany loss redundancies or deficiencies such as premium or commission adjustments. Conditions and trends that have affected the development of liabilities in the past may not necessarily exist in the future. Therefore, it would not be appropriate to extrapolate future deficiencies or redundancies based on the following table.

Development of Loss and LAE Reserves
(\$ in thousands)

	2002	2003	2004	2005	2006	2007	2008	2009	2010
Net unpaid losses and LAE as of December 31,	\$281,659	\$731,918	\$1,379,227	\$2,268,655	\$2,326,227	\$2,342,185	\$2,452,045	\$2,335,008	\$2,208,400
Net unpaid losses and LAE re-estimated as of:									
One year later	224,693	649,902	1,306,708	2,215,635	2,235,849	2,182,249	2,351,083	2,177,178	2,108,300
Two years later	194,422	604,891	1,277,627	2,149,153	2,129,932	2,076,330	2,217,451	2,075,876	1,915,000