ARCH CAPITAL GROUP LTD
Form PRER14A
May 22, 2002

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

SCHEDULE 14A INFORMATION

PROXY STATEMENT PURSUANT TO SECTION 14(a) OF THE
SECURITIES EXCHANGE ACT OF 1934

Filed by the Registrant [X]
Filed by a Party other than the Registrant [ ]
Check the appropriate box:

/X/ Preliminary Proxy Statement
/ / Confidential, for Use of the Commission Only (as permitted by Rule 14a-6(e)(2))
/ / Definitive Proxy Statement
/ / Definitive Additional Materials
/ / Soliciting Material Pursuant to ss.240.14a-12

ARCH CAPITAL GROUP LTD.
(Name of Registrant as Specified in Its Charter)

Not Applicable
(Name of Person(s) Filing Proxy Statement, if other than the Registrant)

Payment of Filing Fee (Check the appropriate box):
/X/ No fee required.
/ / Fee computed on table below per Exchange Act Rules 14(a)-6(i)(1) and 0-11.

1) Title of each class of securities to which transaction applies:
2) Aggregate number of securities to which transaction applies:
3) Per unit price or other underlying value of transaction computed pursuant to Exchange Act Rule 0-11 (set forth the amount on which the filing fee is calculated and state how it was determined):
4) Proposed maximum aggregate value of transaction: $
5) Total fee paid: $

/ / Fee paid previously with preliminary materials.
/ / Check box if any part of the fee is offset as provided by Exchange Act Rule 0-11(a)(2) and identify the filing for which the offsetting fee was paid previously. Identify the previous filing by registration statement number, or the Form or Schedule and the date of its filing.

1) Amount Previously Paid:
2) Form, Schedule or Registration Statement No.:
3) Filing Party:
4) Date Filed:

[Arch Capital Group Ltd. Letterhead]

May [ ], 2002

Dear Shareholder:

I am pleased to invite you to the annual general meeting of the shareholders of Arch Capital Group Ltd. to be held on June 27, 2002, at 9:00 a.m. (local time), at The Fairmont Hamilton Princess, 76 Pitts Bay Road, Pembroke HM 08 Bermuda. The enclosed proxy statement provides you with detailed information regarding the business to be considered at the meeting.

Your vote is very important. Whether or not you plan to attend the meeting, please sign the enclosed proxy card and mail it promptly in the enclosed envelope.

Sincerely,

[signature logo]
Robert Clements
Chairman of the Board

ARCH CAPITAL GROUP LTD.
NOTICE OF ANNUAL GENERAL MEETING OF SHAREHOLDERS

Notice is hereby given that the annual general meeting of the shareholders of Arch Capital Group Ltd. will be held on June 27, 2002, at 9:00 a.m. (local time), at The Fairmont Hamilton Princess, 76 Pitts Bay Road, Pembroke HM 08 Bermuda, for the following purposes:

- PROPOSAL 1: To re-elect four directors to serve for a term of three years or until their respective successors are elected and qualified.

- PROPOSAL 2: To adopt an amendment to our Bye-Law 20 as set forth in Appendix B of, and as more fully described in, this proxy statement, which would provide that a special meeting of the Board of Directors may be called by three directors or a majority of the total number of directors (whichever is fewer), in addition to the chairman of the

Board and the president of the Company.

- PROPOSAL 3: To approve the share-based awards made to the chairman and the vice chairman of our Board of Directors in connection with the capital infusion in November 2001, all as more fully described in this proxy statement.

- PROPOSAL 4: To approve our 2002 Long Term Incentive and Share Award Plan.

- PROPOSAL 5: To elect certain individuals as Designated Company Directors of certain of our non-U.S. subsidiaries.

- PROPOSAL 6: To ratify the selection of PricewaterhouseCoopers as our independent auditors for the year ending December 31, 2002.

- PROPOSAL 7: To conduct other business if properly raised.

Only shareholders of record as of the close of business on May 21, 2002 may vote at the meeting.

Persons holding shares representing an aggregate of 60% of the votes entitled to be cast at the meeting have agreed, in connection with the capital infusion, to vote in favor of Proposal 3. These people are: HFCP IV(Bermuda), L.P., H&F International Partners IV-A (Bermuda), L.P., H&F International Partners IV-B (Bermuda), L.P., H&F Executive Fund IV (Bermuda), L.P., Warburg Pincus Netherlands International Partners I, CV., Warburg Pincus Netherlands International Partners II, CV., Warburg Pincus (Bermuda) International Partners, L.P., Warburg Pincus (Bermuda), Private Equity VIII, L.P., Trident II, L.P., Marsh & McLennan Capital Professionals Fund, L.P., Marsh & McLennan Employees' Securities Company, L.P., Farallon Capital Partners, L.P., Farallon Capital Institutional Partners II, L.P., Farallon Capital Institutional Partners III, L.P., RR Capital Partners, L.P., Insurance Private Equity Investors, L.L.C., Orbital Holdings, Ltd., Sound View Partners, L.P., Otter Capital LLC, Peter A. Appel, Paul B. Ingrey, Dwight R. Evans and Marc Grandisson. Therefore, it is likely that Proposal 3 will receive the requisite vote for approval.

Our audited financial statements for the year ended December 31, 2001, as approved by our Board of Directors, will be presented at this annual general meeting.

Your vote is very important. Please complete, sign, date and return your proxy card in the enclosed envelope promptly.

This proxy statement and accompanying form of proxy are dated May [ ], 2002 and are first being mailed to shareholders on or about May [ ], 2002.

[signature logo]
Dawna Ferguson
Assistant Secretary

Hamilton, Bermuda
May [ ], 2002

TABLE OF CONTENTS

Page

Page

THE ANNUAL GENERAL MEETING

We are furnishing this proxy statement to holders of our common shares in connection with the solicitation of proxies by our Board of Directors at the annual general meeting, and at any adjournments and postponements of the meeting.

Time and Place

The annual general meeting will be held at 9:00 a.m. (local time) on June 27, 2002 at The Fairmont Hamilton Princess, 76 Pitts Bay Road, Pembroke HM 08 Bermuda.

Record Date; Voting at the Annual General Meeting

Our Board of Directors has fixed the close of business on May 21, 2002 as the record date for determination of the shareholders entitled to notice of and to vote at the annual general meeting and any and all postponements or adjournments of the meeting. On the record date, there were 23,667,093 common shares outstanding and entitled to vote, subject to the limitations in our bye-laws described below. At that date, there were an estimated 57 holders of record and 1,663 beneficial holders of the common shares. On the record date, there were 35,687,735 preference shares outstanding and entitled to vote, subject to the limitations in the certificate of designations and our bye-laws described below. There were 23 holders of record and beneficial holders of the preference shares. Each holder of record of shares on the record date is entitled to cast one vote per share, subject to the limitations described below. A shareholder may vote in person or by a properly executed proxy on each proposal put forth at the annual general meeting.

Limitation on Voting Under Our Bye-Laws

Under our bye-laws, if the votes conferred by shares of Arch Capital Group Ltd., directly or indirectly or constructively owned (within the meaning of section 958 of the Internal Revenue Code of 1986, as amended (the "Code")) by any U.S. person (as defined in section 7701(a)(30) of the Code) would otherwise represent more than 9.9% of the voting power of all shares entitled to vote generally at an election of directors, the votes conferred by such shares or such U.S. person will be reduced by whatever amount is necessary so that after any such reduction the votes conferred by the shares of such person will constitute 9.9% of the total voting power of all shares entitled to vote generally at an election of directors.

There may be circumstances in which the votes conferred on a U.S. person are reduced to less than 9.9% as a result of the operation of bye-law 45 because of shares, including shares held by the Warburg Pincus LLC private equity funds ("Warburg Pincus funds") and the Hellman & Friedman LLC private equity funds ("Hellman & Friedman funds"), that may be attributed to that person under the Code.

Notwithstanding the provisions of our bye-laws described above, after having applied such provisions as best as they consider reasonably practicable, the Board may make such final adjustments to the aggregate number of votes conferred by the shares of any U.S. person that they consider fair and reasonable in all the circumstances to ensure that such votes represent 9.9% of the aggregate voting power of the votes conferred by all shares of Arch Capital Group Ltd. entitled to vote generally at an election of directors.

In order to implement bye-law 45, we will assume that all shareholders (other than the Warburg Pincus funds and the Hellman & Friedman funds) are U.S. persons unless we receive assurance satisfactory to us that they are not U.S. persons.

Quorum; Votes Required for Approval

The presence of two or more persons representing, in person or by properly executed proxy, not less than a majority of the voting power of our shares outstanding and entitled to vote at the annual general meeting is necessary to constitute a quorum. If a quorum is not present, the annual general meeting may be adjourned from time to time until a quorum is obtained.

The affirmative vote of a majority of the voting power of the shares represented at the annual general meeting will be required for approval of each of the proposals, except that Proposal 1 will be determined by a plurality of the votes cast. Persons holding shares representing an aggregate of 60% of the votes entitled to be cast at the meeting have agreed, in connection with the capital infusion, to vote in favor of Proposal 3. These people are: HFCP IV(Bermuda), L.P., H&F International Partners IV-A (Bermuda), L.P., H&F International Partners IV-B (Bermuda), L.P., H&F Executive Fund IV (Bermuda), L.P., Warburg Pincus Netherlands International Partners I, CV., Warburg Pincus Netherlands International Partners II, CV., Warburg Pincus (Bermuda) International Partners, L.P., Warburg Pincus (Bermuda), Private Equity VIII, L.P., Trident II, L.P., Marsh & McLennan Capital Professionals Fund, L.P., Marsh & McLennan Employees' Securities Company, L.P., Farallon Capital Partners, L.P., Farallon Capital Institutional Partners II, L.P., Farallon Capital Institutional Partners III, L.P., RR Capital Partners, L.P., Insurance Private Equity Investors, L.L.C., Orbital Holdings, Ltd., Sound View Partners, L.P., Otter Capital LLC, Peter A. Appel, Paul B. Ingrey, Dwight R. Evans and Marc Grandisson. Therefore, it is likely that Proposal 3 will receive the requisite vote for approval.

Several of our officers and directors will be present at the annual general meeting and available to respond to questions. Our independent auditors are expected to be present at the annual general meeting, will have an opportunity to make a statement if they desire to do so and are expected to be available to respond to appropriate questions.

An automated system administered by our transfer agent will tabulate votes cast by proxy at the annual general meeting, and our transfer agent will tabulate votes cast in person.

Abstentions and broker non-votes (i.e., shares held by a broker which are represented at the meeting but with respect to which such broker does not have discretionary authority to vote on a particular proposal) will be counted for purposes of determining whether or not a quorum exists. Abstentions and broker non-votes will generally not be counted for any other purpose.

Voting and Revocation of Proxies

All shareholders should complete, sign and return the enclosed proxy card. All shares represented at the annual general meeting by properly executed proxies received before or at the annual general meeting, unless those proxies have been revoked, will be voted at the annual general meeting, including any postponement or adjournment of the annual general meeting. If no instructions

are indicated on a properly executed proxy, the proxies will be deemed to be FOR approval of each of the proposals described in this proxy statement.

Any proxy given pursuant to this solicitation may be revoked by the person giving it at any time before it is voted. Proxies may be revoked by either:

- filing, including by facsimile, with the Secretary of the Company, before the vote at the annual general meeting is taken, a written notice of revocation bearing a later date than the date of the proxy or a later-dated proxy relating to the same shares, or

- attending the annual general meeting and voting in person.

In order to vote in person at the annual general meeting, shareholders must attend the annual general meeting and cast their vote in accordance with the voting procedures established for the annual general meeting. Attendance at the annual general meeting will not in and of itself constitute a revocation of a proxy. Any written notice of revocation or subsequent proxy must be sent so as to be delivered at or before the taking of the vote at the annual general meeting to Arch Capital Group Ltd., Wessex House, 3rd Floor, 45 Reid Street, Hamilton HM 12 Bermuda, Facsimile: (441) 278-9255, Attention: Secretary.

Solicitation of Proxies

Proxies are being solicited by and on behalf of the Board of Directors. In addition to the use of the mails, proxies may be solicited by personal interview, telephone, telegram, facsimile and advertisement in periodicals and postings, in each case by our directors, officers and employees.

We have retained MacKenzie Partners, Inc. to aid in the solicitation of proxies and to verify records related to the solicitation. We will pay MacKenzie Partners, Inc. fees of not more than $4,500 plus expense reimbursement for its services. Brokerage houses, nominees, fiduciaries and other custodians will be requested to forward solicitation materials to beneficial owners and will be reimbursed for their reasonable expenses incurred in so doing. We may request by telephone, facsimile, mail, electronic mail or other means of communication the return of the proxy cards.

Other Matters

Our audited financial statements for the year ended December 31, 2001, as approved by our Board of Directors, will be presented at this annual general meeting.

As of the date of this proxy statement, our Board of Directors knows of no matters that will be presented for consideration at the annual general meeting, other than as described in this proxy statement. If any other matters shall properly come before the annual general meeting or any adjournments or postponements of the annual general meeting and shall be voted on, the enclosed proxies will be deemed to confer discretionary authority on the individuals named as proxies therein to vote the shares represented by such proxies as to any of those matters. The persons named as proxies intend to vote or not vote in accordance with the recommendation of our Board of Directors and management.

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, 3rd Floor, 45 Reid Street, Hamilton HM 12 Bermuda (telephone number: (441) 278-9250).

THE CAPITAL INFUSION

On November 20, 2001, investors led by the Warburg Pincus funds and the Hellman & Friedman funds purchased from us, for $750.0 million in cash, 35,072,795 series A convertible preference shares and 3,710,959 class A warrants. At the same time, we also entered into a management subscription agreement whereby certain members of our management (or entities affiliated with them) agreed to purchase, for an aggregate of $13.2 million, 614,940 preference shares and 65,066 class A warrants. The purpose of this capital infusion was to provide a significant infusion of capital to launch our new underwriting initiative to meet current and future demand in the global insurance and reinsurance markets. On March 7, 2002, certain matters relating to the capital infusion required to be approved by our shareholders were approved.

Prior to the closing on November 20, 2001, the Warburg Pincus funds and the Hellman & Friedman funds assigned portions of their commitments to third parties. At closing, we issued the following numbers of preference shares and class A warrants for the aggregate dollar amounts specified:

	Preference Shares	Class A Warrants
Warburg Pincus funds	18,939,311	2,003,918
Hellman & Friedman funds	10,521,839	1,113,289
Trident II, L.P. and co-investment funds(1)	1,636,729	173,178
Farallon Capital investors	1,169,093	123,698
Insurance Private Equity Investors, L.L.C. (affiliated with GE Asset Management)	2,338,186	247,397
Orbital Holdings, Ltd. (affiliated with GE Capital)	467,637	49,479
Management investors	614,940	65,066
Total	35,687,735	3,776,025

(1) In a related transaction, upon closing of the capital infusion, 905,397 previously existing class A warrants held by Marsh & McLennan Risk Capital Holdings, Ltd. were canceled in exchange for 140,380 newly issued common shares, and 1,770,601 class B warrants held by Marsh & McLennan Risk Capital Holdings were canceled in exchange for a cash payment by us of $7.50 per class B warrant (approximately $13.3 million in the aggregate). See note (2) under "Security Ownership of Certain Beneficial Owners and Management" for a description of the terms of the class B warrants. Marsh & McLennan Risk Capital Holdings' pre-existing right to have an observer attend meetings of our board of directors was terminated, and The Trident Partnership, L.P's pre-existing right to designate a director for election to our board of directors was terminated. We were released from our remaining $11.0 million capital commitment to Trident II, L.P. for new

investments.

Subscription Agreement

Set forth below is a summary of the material terms of the subscription agreement entered into with the investors (other than the management investors) in connection with the capital infusion. All material agreements relating to the capital infusion were filed as exhibits to our Annual Report on Form 10K for the year ended December 31, 2001.

Purchase Price. The purchase price for the preference shares and class A warrants paid at closing was based on the book value of our common shares as of June 30, 2001. The number of preference shares issued to each investor was equal to the total dollar amount of that investor's investment divided by the estimated per share price as determined under the subscription agreement (approximately $21.384), which was based on an estimate of the book value of our assets at June 30, 2001. The number of warrants issued to each investor was equal to the Adjusted Warrant Amount times the number of common shares issuable upon exercise of all outstanding class A warrants (2,531,079) divided by the number of common shares outstanding as of June 30, 2001 (12,863,079). The `Adjusted Warrant Amount" was equal to one-half of the quotient of the total dollar amount of that investor's investment divided by the difference of the estimated per share price minus $1.50. There would have been an adjustment to the purchase price if any of the transactions contemplated by the subscription agreement or the options granted to management concurrently therewith had triggered an anti-dilution adjustment under our existing class A warrants or class B warrants, but all holders of those warrants waived any rights to any anti-dilution adjustment with respect to the issuance under the subscription agreements or the grants to management contemplated thereby. 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.

Purchase Price Adjustments. The subscription agreement provides that the estimated per share price may be adjusted as described below. All determinations to be made by the investors in connection with the purchase price adjustments will be made by the Warburg Pincus funds and the Hellman & Friedman funds. These adjustments are the sole remedy for any breach of representations and warranties of the company under the subscription agreement.

Audit Adjustment. We agreed to engage PricewaterhouseCoopers as independent accountants to audit our consolidated balance sheet as of June 30, 2001, an independent actuary (to be selected by us and the Warburg Pincus funds and the Hellman & Friedman funds) to review the reserves for claims and claims expenses on our balance sheet, and an independent pricing service selected by us and the Warburg Pincus funds and the Hellman & Friedman funds to determine the estimated fair value of our investments in marketable securities as of the third business day prior to closing. The independent pricing service, the public accountants and the independent actuary are referred to below as the independent advisors.

If the audited per share price is greater than the estimated per share price at closing, each investor will either pay the difference to us in cash or return the equivalent amount in preference shares. If the estimated per share price at closing is greater than the audited per share price, we will issue an amount of preference shares to the investors representing the difference. We

currently estimate that we will issue an additional 875,765 preference shares during the second quarter of 2002 in connection with the audit of the book value of our assets at June 30, 2001 discussed above.

Adjustment for Trading Price or Change of Control. In the event that on or prior to September 19, 2005, (1) 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 (2) a change of control occurs (either case, a "Triggering Event"), we agreed to issue and deliver to each investor additional preference shares such that the audited per share price is adjusted downward by $1.50 per preference share. For this purpose "change of control" means the acquisition by any person or group (within the meaning of section 13(d)(3) of the Exchange Act) of beneficial ownership of 40% or more of either the voting power of our then outstanding common shares or the combined voting power of our then outstanding voting securities entitled to vote generally in the election of directors; provided that if such acquisition results in whole or in part from a transfer of common shares or other voting securities by Marsh & McLennan Companies, Inc. or any of its subsidiaries, such acquisition will not constitute a change of control unless such transfer is effected pursuant to an offer by such acquiror to purchase all of our outstanding common shares.

Final Adjustments. We agreed to make another adjustment at the second anniversary of closing (or such earlier date as the Warburg Pincus funds and the Hellman & Friedman funds request and the Transaction Committee (described below under "--Transaction Committee") agrees) based on an adjustment basket described below.

The adjustment basket will be equal to:

- the difference between value realized upon sale and the book value at closing (as adjusted based on a pre-determined growth rate) of the agreed upon non-core businesses as described below; plus

- the difference between the GAAP net book value of all of our insurance balances with respect to any policy or contract written or having an effective date prior to November 20, 2001 (ie., premiums receivable, unpaid claims and claims expenses recoverable, prepaid reinsurance premiums,

reinsurance balances receivable, deferred policy acquisition costs, claims and claims expenses, unearned premiums, reinsurance balances payable, and any other insurance balance attributable to our "core insurance operations," as defined below) at the time of determination of the final adjustment and those balances at the closing; minus

- reductions in book value arising from (without duplication of any expenses included in the calculation of value realized upon sale of the non-core businesses or any expense otherwise reflected in the determination of the per share price) costs and expenses relating to the investments and transactions provided for under the subscription agreement, actual losses arising out of breach of representations under the subscription agreement and certain other costs and expenses.

Our "core insurance operations" include:

- Arch Re (Bermuda);

- Arch Capital Group (U.S.) Inc.;
- Arch Re (US);
- Cross River (including funding for Rock River);
- ART Services (including First American Financial Corporation);
- capital held at ACGL, gross of capital to be invested in unfunded private equity commitments; and
- $2.5 million in segregated assets and liabilities in "cell" accounts formed by Alternative Insurance Company Limited and Alternative Re, Ltd.

Non-core businesses are currently defined as American Independent Insurance Holding Company, Hales & Company Inc., all nonpublic securities held by ACGL and Arch Re (US), and all commitments to Distribution Partners, as and when funded.

The adjustment basket will be calculated by our independent auditors as soon as practicable after the second anniversary of the closing or such earlier date as the Warburg Pincus funds and the Hellman & Friedman funds request and ACGL agrees. ACGL and the Warburg Pincus funds and the Hellman & Friedman funds have the right to make a full review of the adjustment basket determination. We agreed to cause our subsidiaries to maintain the components necessary to calculate the adjustment basket under separate ledgers.

If the adjustment basket is less than zero, we agreed to issue additional preference shares to the investors based on the decrease in the value of the components of the adjustment basket. If the adjustment basket is greater than zero, the subscription agreement allows us to use cash in an amount based on the increase in value of the components of the adjustment basket to repurchase common shares (other than any common shares issued upon conversion of the preference shares or exercise of the class A warrants).

In addition, if the adjustment basket is less than zero and in the event that a Triggering Event occurs, we agreed to issue additional preference shares to the investors as a further adjustment.

Finally, on the fourth anniversary of the closing, there will be a calculation of a further adjustment basket based on (1) liabilities in excess of the Folksamerica escrow assets owed to Folksamerica under the Asset Purchase Agreement, dated as of January 10, 2000, between ACGL, Arch Re (US), Folksamerica Holding Com-

pany, Inc. and Folksamerica Reinsurance Company and (2) specified tax and ERISA matters under the subscription agreement. In February 2002, we reached a definitive settlement agreement with Folksamerica pursuant to which we satisfied all of our obligations under the escrow agreement for an amount equal to approximately $17.0 million of the escrowed assets, plus accrued interest on such amount.

Restrictions on Transfer of Securities. The investors agreed not to transfer, in one transaction, or a series of transactions, to a single person or group, common shares or securities convertible into common shares representing in excess of either 51% of the votes then entitled to be cast in the election of directors, or 51% of the then outstanding common shares (taking into account

common shares issuable upon conversion of the preference shares) without giving all shareholders the right to participate in such transaction on the same or substantially the same terms as the investors.

The shareholders agreement between us and the holders of preference shares also contains restrictions on the transfer of preference shares, which terminates upon consummation of any registered public offering of our common shares generating net proceeds to us in excess of $25.0 million.

Dispositions; PendingAcquisition. We agreed to sell, prior to the time of the audit adjustment described above, the portion of our investment portfolio specified in a schedule to the agreement, consisting of specified publicly traded noninvestment grade debt securities and certain equity securities.

Information. The investors agreed to give us information regarding their ownership of our company, ownership information concerning each of them and other related information in connection with preparing disclosure in filings under the United States Securities Act of 1933 (the "Securities Act") or the Exchange Act on issues arising under the Internal Revenue Code, including the rules applicable to "controlled foreign corporations."

Indemnification; Insurance. We and the investors agreed to maintain all rights to indemnification in favor of our directors, officers, employees and agents or any of our subsidiaries with respect to their activities prior to the closing (except that with respect to the Transaction Committee this covenant will cover activities after the closing) (as provided for in our organizational documents in effect on October 24, 2001) in full force and effect for a period of not less than six years from the closing. The investors agreed not to cause us to take any action inconsistent with this agreement.

We and the investors also agreed that we will indemnify each of our present and former directors or officers against liabilities arising before the closing (including the transactions contemplated by the subscription agreement) and, with respect to the Transaction Committee, also after the closing. We and the investors agreed that we will maintain our current level of directors' and officers' liability insurance coverage for a period of at least six years after the closing.

Certain Tax Matters. With respect to each taxable year during which any of the Warburg Pincus funds or the Hellman & Friedman funds owns our shares, we agreed to use reasonable best efforts to cause us and each of our subsidiaries:

- not to constitute a "passive foreign investment company" within the meaning of Section 1297 of the Code;
- not to satisfy the gross income requirement set forth in Section 542(a) of the Code;
- not to satisfy the gross income requirement set forth in Section 552(a) of the Code; and

- not to have any related person insurance income within the meaning of Section 953(c)(2) of the Code.

In the event that we or any of our subsidiaries constitute a personal holding company, a foreign personal holding company, a controlled foreign corporation, a foreign investment company or a passive foreign investment company for U.S.

federal income tax purposes with respect to any taxable year, we agreed to provide each of the Warburg Pincus funds or the Hellman & Friedman funds with any information it requests to satisfy its legitimate tax, accounting or other reporting requirements.

Right to Exchange into Subsidiary Shares. We agreed to form a new, wholly owned subsidiary to hold Arch Re (Bermuda) as well as all of the "core insurance operations" other than Arch Re (US).

In the event that the adjustments described above under "-Purchase Price Adjustments-Final Adjustment" are less than zero and their absolute value exceeds $250.0 million, the Warburg Pincus funds, the Hellman & Friedman funds and the other holders of our preference shares will have the option to exchange their preference shares and class A warrants, in whole or in part (but not for less than $150.0 million liquidation preference of preference shares), for preference shares and warrants of our newly formed subsidiary bearing identical rights and privileges, including the right to convert into, or be exercised for, common shares of our newly formed subsidiary.

Investors' Costs and Expenses. We reimbursed the Warburg Pincus funds and the Hellman & Friedman funds for their costs and expenses, and the GE investors for up to $50,000 of their costs and expenses, in connection with the investment and the related transactions.

Transaction Committee. Until the date of the final determination of the adjustment basket at the fourth anniversary of closing, approval of the following actions by the Transaction Committee (as defined below) is deemed to be approval by the entire board of directors:

- an amendment, modification or waiver of rights by ACGL under the subscription agreement, the certificate of designation for the preference shares, the class A warrants or the shareholders agreement;
- the enforcement of obligations of the investors under the above agreements; or
- approval of actions relating to the disposition of non-core assets.

"Transaction Committee" means a committee of the board of directors consisting of persons who either (a) were members of our board of directors on October 22, 2001 and/or (b) were designated as members of the Transaction Committee by a person who was a member of our board of directors on October 22, 2001. The Transaction Committee currently consists of Robert Clements, Peter A. Appel, James J. Meenaghan and Robert F Works.

Shareholders Agreement

On November 20, 2001 upon consummation of the capital infusion, we entered into a shareholders agreement with the investors. Set forth below is a summary of the material terms of the shareholders agreement.

Board Representation. Following the closing, the Warburg Pincus funds exercised their right to designate one director to our board and the Hellman & Friedman funds exercised their right to designate one director

to our board. Continued representation on our board of directors by these shareholders is based on the respective retained percentages of their equity

securities in according to the following schedules:

Warburg Pincus funds		Hellman & Fried	
Percentage of Original Investment Held	Minimum Number of Directors To Be Nominated	Percentage of Original Investment Held	Min Di
=> 75% 60% => x	6	=>60%	