Group Affiliation: HCC Insurance Holdings

HOUSTON CASUALTY COMPANY

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Publicly Traded Corporation: HCC Insurance Holdings, Inc.

NYSE: HCC

BEST'S RATING

Based on our opinion of the consolidated Financial Strength of the property/casualty members of HCC Insurance Holdings, which operate under a group structure, each group member is assigned a Best's Rating of A+ (Superior). The company is assigned the Financial Size Category of Class XIII, which is the Financial Size Category of the group.

RATING RATIONALE

The following text is derived from the report of HCC Insurance Holdings.

Rating Rationale: The rating reflects HCC Insurance Holdings' ("the group") sustained profitability and solid level of capitalization, while also recognizing the financial flexibility and support provided by its publicly traded parent, HCC Insurance Holdings, Inc. The rating also considers the group's near-term earnings prospects considering HCC's strong position in the specialty admitted and non-admitted markets segments. Partially offsetting these positive rating factors is HCC's above-average ceded leverage, the additional risk caused by increasing net premium retention levels as premium levels have been growing. The rating outlook reflects A.M. Best's concern related to the continuing informal Securities and Exchange Commission (SEC) inquiry of HCC's stock option granting practices. Furthermore, the rating outlook reflects uncertainty regarding the potential impact of management changes that occurred in conjunction with HCC's November announcement of the completion of the internal investigation into its stock option granting practices. This concern is partially offset by A.M. Best's expectation for underwriting and operating profitability over the near term.

The rating is supported by the group's conservative underwriting, investment and loss reserving strategies that have led to its long-term operating profitability and been the primary driver for its considerable balance sheet strength. The rating is also reflective of the continued parental support. Since the beginning of 2002, underwriting and operating results have been outstanding and more in line with historical profitability following the net underwriting loss in 2001 primarily due to World Trade Center losses. Much of HCC's success stems from the group's well-defined, specialty lines business strategy and its optimum utilization of reinsurance. This strategy, however, has led to above-average levels of ceded leverage. Despite this high ceded leverage position, the group's use of high-quality reinsurers, and its proactive approach to monitoring the quality of its recoverables somewhat tempers A.M. Best's concerns. The rating also recognizes HCC's growth over the past five years, its significant expansion in the diversified financial products segment comprised of professional liability and surety coverage and its resulting impact on net underwriting leverage. The group's overall capitalization, although remaining solid, has weakened somewhat over the last few years due to the level of premium growth and commensurate growth in related liabilities. As expected, underwriting leverage has stabilized during the most recent calendar years as a more than commensurate level of surplus growth has offset net premium growth. The group also remains exposed to large catastrophe losses due to its property and energy lines of business. On a net basis, catastrophe exposure is moderated by the group's purchase of catastrophe reinsurance.

Best's Rating: A+ g **Outlook: Negative**

FIVE YEAR RATING HISTORY

Date	Best's Rating
01/04/07	A+ g
11/22/06	A+ gu
06/09/06	A+ g
06/28/05	A+ g
06/29/04	A+ g
06/24/03	A+ g
07/11/02	A+ g

KEY FINANCIAL INDICATORS

	Statutory Data ($000)		
Period Ending	Direct Premiums Written	Net Premiums Written	Pretax Operating Income
2002	234,306	228,819	32,726
2003	484,283	422,279	24,763
2004	563,332	471,045	33,920
2005	474,513	499,452	7,331
2006	409,185	485,571	175,955
09/2006	325,810	366,993	130,864
09/2007	299,328	328,648	146,288

	Statutory Data ($000)		
Period Ending	Net Income	Total Admitted Assets	Policy-holders' Surplus
2002	30,451	851,590	400,647
2003	16,168	1,261,854	409,466
2004	18,526	1,663,676	604,394
2005	4,655	2,235,101	812,520
2006	160,833	2,520,418	952,083
09/2006	118,515	2,484,851	1,014,067
09/2007	110,324	2,749,911	1,170,286

	Profitability			Leverage			Liquidity	
Period Ending	Comb. Ratio	Inv. Yield (%)	Pretax ROR (%)	NA Inv Lev	NPW to PHS	Net Lev	Overall Liq (%)	Oper. Cash-flow (%)
2002	89.3	5.1	18.1	5.8	0.6	1.5	216.9	144.7
2003	96.5	5.5	7.8	4.1	1.0	2.9	163.8	289.4
2004	96.9	3.1	8.1	-0.3	0.8	2.4	166.1	224.5
2005	105.9	2.5	1.5	14.2	0.6	2.3	164.9	317.3
2006	82.3	4.3	35.4	18.8	0.5	2.1	165.2	206.9
5-Yr Avg	94.6	3.8	14.5	…	…	…	…	…
09/2006	79.2	XX	34.7	XX	0.5	1.9	176.2	132.4
09/2007	76.6	XX	43.0	XX	0.4	1.7	178.1	149.5

(*) Data reflected within all tables of this report has been compiled from the company-filed statutory statement. Within several financial tables of this report, this company is compared against the Professional Surplus Lines Writers.

BUSINESS REVIEW

The following text is derived from the report of HCC Insurance Holdings.

The insurance companies comprising the HCC Insurance Holdings group provide group life, accident and health, aviation, property, marine, energy, directors' and officers' liability, professional liability, surety and other specialty lines coverages through the group's lead carrier, Houston Casualty Company and its affiliates. Houston Casualty's operation includes those of a branch office in London, England. In January of 2004, the parent company purchased Surety Associates Holdings Co., Inc., the parent company of American Contractors Indemnity Company. ACIC specializes in court, specialty contract, license and permit, and bail bonds. In February of 2005, HCC Insurance Holdings, Inc., acquired United States Surety Company via the purchase of the insurance holding company USSC Holdings, the privately held parent company of USSC. USSC is a Maryland-domiciled carrier specializing in writing surety bonds for small-to medium-sized contractors. In December of 2005, the parent company purchased MIC Life Insurance Corporation, a Delaware-domiciled company specializing in medical stop-loss business. After acquisition, the company was renamed Perico Life Insurance Company and ownership was transferred to HCC Life.

The group's business is produced directly and through independent agents and brokerage operations on a worldwide basis. HCC's affiliated underwriting agencies act on behalf of unaffiliated and affiliated insurance companies to provide insurance underwriting management and claim administration services while its reinsurance and insurance brokers provide a variety of additional services such as marketing, placing, consulting on and servicing risks for their clients. Aviation coverage is marketed to offshore operations, corporations, cargo operations, commuter airlines, governments and private aircraft owners on both a domestic and international basis. Facilities are currently dedicated to the handling of aircraft hull and liability insurance. In addition to conventional corporate and personal aircraft, the group covers specialty types, such as sport and antique airplanes, amphibians and seaplanes. The group provides accident and health coverages that are marketed through an affiliated underwriting agency and directly through unaffiliated agents, brokers and third-party administrators. Property coverage is provided to large multinational corporations through HC's London branch office. The London branch also underwrites marine hull and liability coverage for ocean-going vessels, as well as onshore and offshore energy coverage for large oil companies and drilling contractors. Many of the policy forms are manuscript and tailored to meet the needs of the insured. Assumed reinsurance consists of accident and health reinsurance coverage, facultative aviation, and property and energy reinsurance issued by local companies in order to satisfy licensing requirements. Directors' and officers' liability and professional liability insurance is written through acquired underwriting agencies. Surety operations are consolidated within HCC Surety Group via ACIC, USSC, HCCE, HCCI and USSIC.

Workers' compensation coverage had been issued through USSIC, but during 2001, management decided to exit this line of business due to loss ratio and expense issues that were adversely impacting profitability. In 2001, the affiliated underwriting agencies writing workers' compensation and aviation business were consolidated with USSIC's operations. In December 1999, HCC completed the acquisition of Centris, a leading provider of medical stop-loss coverage through Centris Life Insurance Company (Centris Life) and U.S. Benefits. Subsequently, HCC contributed Centris Life to Houston Casualty and renamed it

HCC Life Insurance Company (HCC Life). Following the acquisition of the Centris Group, HCC became one of the largest providers of medical stop-loss coverage in the United States. HCC currently markets medical stop-loss coverage through AIC and HCC Life. Since 2003, the company continued transferring medical stop-loss business from AIC to HCC Life. Employers purchase the medical stop-loss coverage to help limit their exposure under self-insured health plans. In 2002, HCC Specialty was also established as an Oklahoma-domiciled subsidiary of AIC. HCC Spl's purpose is to allow HCC to write surplus lines business in Texas that HC cannot write since it is a Texas-domiciled insurer.

HCC supplements the activities of its risk-bearing companies with underwriting agencies and brokers who write on behalf of its insurance carriers and, in certain situations, other non-affiliated companies. These organizations generate fee-service income and profit commissions for the group while bearing no insurance risk. The principal agencies operating within HCC's organization are Covenant Underwriters, HCC Global Financial Products, HCC Indemnity Guaranty Agency, HCC Specialty Underwriters, and Professional Indemnity Agency. The underwriting agencies specialize in the various lines of business written by the group's insurance carriers.

HCC has made numerous strategic transactions in recent years that have furthered its overall business strategy. In June of 2006, the company acquired Novia Underwriters, Inc., an underwriting agency based in Indianapolis, Indiana that specializes in medical stop-loss insurance. Novia's business has since been absorbed into Perico Life Insurance Company. The following month the company acquired G.B. Kenrick & Associates, Inc. a Michigan-based underwriting agency specifically focused on public entity insurance. During the fourth quarter of 2006, HCC acquired the assets of the Health Products division of Allianz life Insurance Company of North America. This entity's business include medical stop-loss and medical excess insurance. Previously, in 2005, the company acquired the remaining 66% of De Montfort Group Limited that it did not own. The key operating subsidiary of De Montfort Group was DMI, a provider of surety and credit insurance in the United Kingdom, allowing the group to further enhance its diversified financial product platform and its geographic base. In 2005, DMI was renamed HCC International Insurance Company PLC. Late in 2005, the company acquired Perico, Ltd., a medical stop-loss insurance underwriting agency domiciled in St. Louis, Missouri, and MIC Life Insurance Corporation, a Delaware-domiciled company. MIC was renamed Perico Life Insurance Company and was re-located to Missouri. In 2002, HCC acquired St. Paul Espana located in Madrid, Spain. This company provides directors' and officers' liability, professional liability and surety coverage utilizing a very experienced management team. St. Paul Espana now operates as HCC Europe. American Contractors Indemnity Company and United States Surety Company were acquired in 2004 and 2005, respectively, to expand HCC's presence in the surety line of business. Management continues to evaluate potential acquisition opportunities to expand and strengthen its existing lines of business or to provide access to additional specialty sectors.

2006 BUSINESS PRODUCTION AND PROFITABILITY ($000)

Product Line	Premiums Written Direct	Premiums Written Net	% of Total NPW	Pure Loss Ratio	Loss & LAE Reserves
Oth Liab Cl-Made	204,433	264,380	54.4	46.9	438,055
Ocean Marine	117,353	68,297	14.1	48.3	108,318
Aircraft	30,255	38,155	7.9	48.9	45,463
Oth Liab Occur	161	33,982	7.0	42.8	37,521
Group A & H	8,750	19,711	4.1	186.4	416,159
Com'l MultiPeril	5,246	14,473	3.0	17.0	7,965
Inland Marine	12,504	1,744	0.4	229.8	2,770
All Other	30,483	44,829	9.2	28.3	101,235
Totals	409,185	485,571	100.0	51.5	1,157,487

Major 2006 Direct Premium Writings By State ($000): California, $64,617 (15.8%); Texas, $37,239 (9.1%); New York, $25,403 (6.2%); Louisiana, $20,736 (5.1%); Florida, $17,763 (4.3%); 48 other jurisdictions, $160,165 (39.1%); Canada, $528 (0.1%); Aggregate Alien, $82,734 (20.2%).

FINANCIAL PERFORMANCE

The following text is derived from the report of HCC Insurance Holdings.

Overall Earnings: On a five-year basis, the group's pre-tax and after-tax returns moderately surpass the average produced by the industry composite. This level of performance is driven by the group's underwriting discipline, expense ratio advantage and the sizeable income garnered from its $2.9 billion investment portfolio. Despite overall market conditions softening over the more recent term, the group sought to take advantage of what management feels are favorable profit margins on specific lines of business, particularly on the group's core aviation and accident and health segments, along with the more newly emphasized surety and professional liability lines of business.

The excellent calendar year results the group has continued to generate have been achieved in spite of losses attributable to catastrophic events in recent years, excluding 2006. While losses associated with these events added points to the group's combined ratio, overall results have remained very profitable. Reserve increases on the accident and health line of business have also had a minor, limiting effect on the group's operating results.

Competitive market pressures over the years have, at times, compressed the group's profit margins. Over the last two calendar years, more aggressive competition led to less emphasis on increasing directors' and officers' liability writings while increased opportunities and better profit margins on surety and professional indemnity business led to increased retentions and more focus on these lines of coverage. Management has historically been able to limit the impact of pricing pressures on its bottom-line during periods of extreme competition through the increased utilization of reinsurance, primarily facultative placements, and the takedown of prior year loss reserves. Substantial growth in the group's net invested asset base has fueled a commensurate increase in net investment income, further augmenting calendar year operating earnings. A.M. Best believes the Group will continue to generate strong earnings despite market softening in some areas because of its diversification and ability to focus on lines of business less impacted by current market pressures. Despite rate softening on directors' and officers' liability business, profit margins for this line have remained ample to generate considerable calendar year earnings. Considering the group's successful history in managing the cycle and its steadfast application of conservative operating fundamentals, A.M. Best believes operating results will remain favorable.

PROFITABILITY ANALYSIS

	Company				Industry Composite			
Period Ending	Pretax ROR (%)	Return on PHS(%)	Comb. Ratio	Oper. Ratio	Pretax ROR (%)	Return on PHS(%)	Comb. Ratio	Oper. Ratio
2002	18.1	14.3	89.3	74.8	8.3	3.5	96.2	81.2
2003	7.8	6.5	96.5	83.4	20.1	19.1	95.2	82.5
2004	8.1	12.0	96.9	88.7	14.7	11.4	95.1	83.3
2005	1.5	9.5	105.9	97.6	18.6	11.8	94.3	80.4
2006	35.4	10.2	82.3	65.2	32.8	18.4	81.3	65.8
5-Yr Avg	14.5	10.3	94.6	82.6	20.1	13.5	91.7	77.9
09/2006	34.7	XX	79.2	66.0	XX	XX	XX	XX
09/2007	43.0	XX	76.6	57.8	XX	XX	XX	XX

Underwriting Income: The group's underwriting performance over the last five years has been very strong as evidenced by a five-year combined ratio that is comfortably better than that of the industry composite. A distinct loss ratio advantage relative to the composite group has led to the above-average historical underwriting performance. Solid results in core lines of business, partially offset by less favorable performance on the discontinued lines of business, drives the long-term favorable underwriting results.

The group produced a net underwriting profit for the fifth consecutive year in 2006, although results would have been moderately better if not for losses related to reinsurance commutations. In 2006, similar to the prior year, the company negotiated reinsurance commutations, leading to the recording of additional losses and loss adjustment expenses for the discontinued, assumed accident and health class of business. Loss reserve increases on the accident & health line, stemming from the effect of the commutations, and to a lesser extent, from the commercial multiple peril line of business also negatively impacted the still strong underwriting results. The group's combined ratio has historically benefited from a large amount of ceding commission, largely offsetting commissions paid on direct and assumed business. Higher net retentions, however, have tempered the positive impact of ceding commissions in recent years. A.M. Best expects HCC's long-held underwriting discipline to allow the group to sustain the favorable underwriting and operating results even as segments of the market face greater price competition.

UNDERWRITING EXPERIENCE

	Net Undrw	Loss Ratios			Expense Ratios				
Year	Income ($000)	Pure Loss	LAE	Loss & LAE	Net Comm	Other Exp.	Total Exp.	Div. Pol.	Comb Ratio
2002	5,432	58.9	1.6	60.5	21.7	7.2	28.9	…	89.3
2003	-16,314	66.7	3.8	70.4	21.3	4.8	26.1	…	96.5
2004	-833	66.5	2.9	69.4	22.6	4.8	27.5	…	96.9
2005	-33,067	71.4	4.5	75.9	23.3	6.7	30.1	…	105.9
2006	90,950	51.5	4.7	56.2	20.9	5.1	26.1	…	82.3
5-Yr Avg	…	63.1	3.8	66.9	22.0	5.6	27.6	0.0	94.6
09/2006	80,763	49.1	4.1	53.2	XX	XX	26.0	…	79.2
09/2007	82,391	44.7	7.3	52.1	XX	XX	24.5	…	76.6

Investment Income: The group's increased premium level, higher retentions, an increase in the payout period for claims due to the writing of more longer-tail business and the impact of reinsurance commutations have combined to produce improved operating cash flows in recent years that have driven the growth in invested assets and net investment income. Proceeds from public offerings of common stock have also fueled growth in the asset base. The group's invested asset portfolio is predominately concentrated in high-quality fixed-income securities, with an emphasis on asset-backed and mortgage-backed securities, corporate bonds and to a lesser extent, tax-exempt issues. Outside of modest investments in cash and short-term investments, the remainder of the group's assets consisted of balances receivable and reinsurance recoverables. The predominant portion of the group's investment leverage stems from its common stock holdings of affiliated companies and will remain as such given the group's business model and related business strategies. A minimal amount of equity holdings are maintained, particularly relative to the composite. Overall, except for affiliated investment leverage which is slightly above the composite average, HCC maintains relatively conservative investment leverage.

The average maturity of the fixed-income portfolio has consistently been maintained at approximately five to six years. Over the past five years, the group's investment portfolio has generated an investment yield that is slightly below that of the industry composite, as is its average return on invested assets over that same time period.

INVESTMENT INCOME ANALYSIS ($000)

	Company		
Year	Net Inv Income	Realized Capital Gains	Unrealized Capital Gains
2002	26,258	2,775	18,475
2003	41,519	5,618	10,271
2004	34,373	4,254	42,544
2005	40,312	10,453	62,519
2006	85,123	31,236	-71,188
09/2006	49,981	26,553	54,544
09/2007	63,836	4,612	99,289

	Company			Industry Composite	
Year	Inv Inc Growth (%)	Inv Yield (%)	Total Return (%)	Inv Inc Growth (%)	Inv Yield (%)
2002	12.3	5.1	9.5	10.7	4.8
2003	58.1	5.5	7.7	15.5	4.4
2004	-17.2	3.1	7.4	3.8	3.7
2005	17.3	2.5	7.2	18.4	3.8
2006	111.2	4.3	2.2	27.8	4.4
5-Yr Avg	37.2	3.8	5.8	16.0	4.1
09/2006	XX	XX	6.6	XX	XX
09/2007	XX	XX	7.5	XX	XX

INVESTMENT PORTFOLIO ANALYSIS

Asset Class	2006 Inv Assets ($000)	% of Invested Assets 2006	2005	Annual % Chg
Long-Term bonds	1,236,915	57.9	54.9	16.2
Stocks	60,469	2.8	2.8	10.1
Affiliated Investments	504,142	23.6	19.9	31.0
Other Inv Assets	334,151	15.6	22.4	-23.1
Total	2,135,678	100.0	100.0	10.2

2006 BOND PORTFOLIO ANALYSIS

Asset Class	% of Total Bonds	Mkt Val to Stmt Val(%)	Avg. Maturity (Yrs)	Class 1 - 2 (%)	Class 3 - 6 (%)	Struc. Secur. (%)	Struc. Secur. (% of PHS)
Governments	9.8	-1.6	2.0	100.0	…	…	…
States, terr & poss	56.8	0.5	7.0	100.0	…	16.7	13.8
Corporates	33.5	-1.6	3.6	99.3	0.7	22.5	11.0
Total all bonds	100.0	-0.2	5.3	99.8	0.2	17.0	24.9

CAPITALIZATION

The following text is derived from the report of HCC Insurance Holdings.

the considerable appreciation in the group's policyholders' surplus has predominantly been driven by operating earnings, capital contributions from the parent company and both realized and unrealized gains over the last few years. Surplus growth has been generally constrained by dividends paid to the parent, however, those contributions decreased markedly in 2006, down to $6.0 million from $55.0 million in 2005 and $20.0 million the year prior. Excellent operating results in recent years coupled with capital contributions from the parent holding company have enabled capitalization to adequately support the group's growth in premiums written.

In 2004, the $23.6 million in dividends received by Houston Casualty from its life insurance subsidiary, HCC Life, augmented investment income. The group has produced strong earnings through increased earned premium from its higher net retentions of 2005 and 2006. These results are a solid indication that the group has effectively seized opportunities to generate revenue on business where market competition remains reasonable and favorable profit margins still exist.

Compared to a few years prior, the group's significant growth during the hard-market period has led to slightly weakened risk-adjusted capitalization. However, the group's capital position is still supportive of its current rating, as measured by Best's Capital Adequacy Ratio (BCAR). This decline in risk-adjusted capitalization is largely attributable to the group's significant growth in net premium volume and commensurate growth in net loss reserves and ceded reinsurance recoverables. Despite these increases, premium and loss reserve leverage measures remain on par with or slightly conservative, relative to the industry composite, primarily due to the impact of the parent company capital contributions.

The strong cash flow of the parent company has been enough to cover the holding company's operating and dividend requirements. A.M. Best does not anticipate the level of dividends paid by the group's insurance companies to the parent to materially weaken the capitalization of these subsidiaries.

CAPITAL GENERATION ANALYSIS ($000)

	Source of Surplus Growth		
Year	Pretax Operating Income	Total Inv. Gains	Net Contrib. Capital
2002	32,726	21,250	69,442
2003	24,763	15,889	765
2004	33,920	46,798	95,791
2005	7,331	72,972	146,900
2006	175,955	-39,952	18,464
5-Yr Total	274,695	116,956	331,362
09/2006	130,864	81,097	18,851
09/2007	146,288	103,901	381

	Source of Surplus Growth		
Year	Other, Net of Tax	Change in PHS	PHS Growth (%)
2002	-8,167	115,250	40.4
2003	-32,598	8,819	2.2
2004	18,419	194,928	47.6
2005	-19,077	208,126	34.4
2006	-14,904	139,563	17.2
5-Yr Total	-56,327	666,686	…
09/2006	-29,266	201,546	24.8
09/2007	-32,366	218,203	22.9

QUALITY OF SURPLUS ($000)

Year	Year-End PHS	% of PHS: Cap Stk/ Contrib. Cap.	% of PHS: Other	% of PHS: Un-assigned Surplus	Dividend Requirements: Stock-holder Divs	Div to POI (%)	Div to Net Inc. (%)
2002	400,647	76.2	…	23.8	…	…	…
2003	409,466	74.8	…	25.2	…	…	…
2004	604,394	66.5	…	33.5	…	…	…
2005	812,520	67.6	…	32.4	…	…	…
2006	952,083	59.6	…	40.4	…	…	…
09/2006	1,014,067	56.0	…	44.0	…	…	…
09/2007	1,170,286	48.5	…	51.5	…	…	…

LEVERAGE ANALYSIS

Year	Company: NPW to PHS	Reserves to PHS	Net Lev	Gross Lev	Industry Composite: NPW to PHS	Reserves to PHS	Net Lev	Gross Lev
2002	0.6	0.5	1.5	3.8	0.8	0.8	2.6	4.6
2003	1.0	0.9	2.9	6.2	0.8	1.0	2.6	4.4
2004	0.8	1.0	2.4	4.9	0.7	1.1	2.5	4.1
2005	0.6	1.2	2.3	4.2	0.6	1.1	2.4	4.0
2006	0.5	1.2	2.1	3.4	0.7	1.1	2.4	3.6
09/2006	0.5	1.0	1.9	XX	XX	XX	XX	XX
09/2007	0.4	1.0	1.7	XX	XX	XX	XX	XX

Current BCAR: 187.1

PREMIUM COMPOSITION & GROWTH ANALYSIS

Period Ending	DPW ($000)	DPW (% Chg)	GPW ($000)	GPW (% Chg)
2002	234,306	224.8	490,159	65.8
2003	484,283	106.7	909,775	85.6
2004	563,332	16.3	927,909	2.0
2005	474,513	-15.8	833,566	-10.2
2006	409,185	-13.8	738,596	-11.4
5-Yr CAGR	…	41.5	…	20.1
5-Yr Change	…	467.2	…	149.9
09/2006	325,810	-11.7	567,692	-12.4
09/2007	299,328	-8.1	511,930	-9.8

Period Ending	NPW ($000)	NPW (% Chg)	NPE ($000)	NPE (% Chg)
2002	228,819	78.2	180,862	66.0
2003	422,279	84.5	317,033	75.3
2004	471,045	11.5	420,427	32.6
2005	499,452	6.0	485,539	15.5
2006	485,571	-2.8	496,968	2.4
5-Yr CAGR	…	30.5	…	35.5
5-Yr Change	…	278.1	…	356.1
09/2006	366,993	-1.7	376,696	8.1
09/2007	328,648	-10.4	340,108	-9.7

Reserve Quality: From a calendar year perspective, the group has reported unfavorable loss reserve development in recent years, primarily impacting accident years 1998-2002 and largely driven by the commutation of reinsurance recoverables in 2003, 2005 and 2006 related to the discontinued accident and health line of business. The group attributes the increased loss totals to late reporting of claims by cedants and state guaranty associations, in addition to changes in actuarial assumptions related specifically to this business. As a result of these developments, overall loss reserve development has trended adversely, particularly for the aforementioned accident years. Excluding the impact of the commutations, prior year reserve development would have been relatively flat if not favorable, as has historically been the case. The group's lead company, HC, has borne the brunt of the adverse reserve development, specifically related to its run-off accident and health reinsurance business. The exit from the workers' compensation line of business in 2001, except for the minimum premium workers' compensation business, has also led to recorded deficiencies. The largest portion of the group's favorable loss reserve development has been attributable to its property, aviation and marine lines of business. Absent the negative impact of additional reinsurance commutations, A.M. Best expects the group's reserve development pattern to return to historical norms in 2007.

LOSS & ALAE RESERVE DEVELOPMENT: CALENDAR YEAR ($000)

Calendar Year	Original Loss Reserves	Developed Reserves Thru 2006	Develop. to Orig.(%)	Develop. to PHS (%)	Develop. to NPE (%)	Unpaid Reserves @ 12/2006	Unpaid Resrv. to Dev.(%)
2001	152,293	309,621	103.3	55.1	284.2	368,178	118.9
2002	183,460	341,739	86.3	39.5	189.0	410,965	120.3
2003	364,934	468,651	28.4	25.3	147.8	508,529	108.5
2004	586,434	616,212	5.1	4.9	146.6	640,995	104.0
2005	943,965	939,522	-0.5	-0.5	193.5	899,221	95.7
2006	1,151,441	1,151,441	…	…	231.7	1,151,441	100.0

LOSS & ALAE RESERVE DEVELOPMENT: ACCIDENT YEAR ($000)

Accident Year	Original Loss Reserves	Developed Reserves Thru 2006	Develop. to Orig.(%)	Unpaid Reserves @12/2006	Acc Yr. Loss Ratio	Acc Yr. Comb Ratio
2001	65,092	63,973	-1.7	204,567	85.8	116.4
2002	76,026	79,755	4.9	42,787	61.2	90.1
2003	158,816	144,643	-8.9	97,564	53.9	79.9
2004	214,291	177,169	-17.3	132,466	52.6	80.1
2005	309,469	299,471	-3.2	258,226	68.4	98.5
2006	252,220	252,220	…	252,220	56.3	82.4

Reinsurance Utilization: Maintaining sufficient reinsurance to support the catastrophe portion of its exposure, as well as limiting its exposure in any one class of business, is an integral part of the group's business strategy. Various foreign and domestic reinsurers are utilized in order to limit the group's credit risk to any particular reinsurer. In addition, management has positioned the group to be able to increase the utilization of reinsurance as market conditions warrant, while maintaining a solid balance sheet to support increased retention of premium when reinsurance capacity lessens. A specific reinsurance program is structured for each line of business. Since the beginning of 2002, the group has significantly reduced its ceded business, going from ceding almost two-thirds of its gross book of business to only, approximately 30%, in accordance with its strategy to increase retentions, capitalize on the rising rates and improved market conditions, and manage reinsurance costs.

Despite the reduction, the utilization of reinsurance to mitigate the group's exposure to any one event leaves it exposed to the impact of changes in the reinsurance sector, including but not limited to pricing behavior, credit risk and dispute risk. As such, management remains highly attuned to activity in the reinsurance market sector seeking to ensure that the group remains aligned with financially strong reinsurance partners. The focus on maintaining solid partnerships has led to the commutation of recoverables when circumstances determined it to be the best strategic option.

The group's total reinsurance recoverables, specifically those related to unpaid and incurred but not reported (IBNR) losses, have increased because of the growth in gross writings. A.M. Best anticipates that the level of reinsurance recoverables will likely decrease again in 2007 although not likely to the same extent that occurred in 2006.

CEDED REINSURANCE ANALYSIS ($000)

	Company				Industry Composite		
Year	Ceded Reins Total	Business Retention (%)	Rein Rec to PHS (%)	Ceded Reins to PHS (%)	Business Retention (%)	Rein Rec to PHS (%)	Ceded Reins to PHS(%)
2002	922,527	47.0	166.1	230.3	40.7	143.5	198.6
2003	1,356,461	46.4	212.2	331.3	39.5	123.2	180.0
2004	1,515,672	50.8	175.2	250.8	42.9	116.7	159.2
2005	1,546,438	61.0	149.2	190.3	42.5	121.8	159.2
2006	1,198,756	66.2	99.3	125.9	46.3	96.1	128.8

2006 REINSURANCE RECOVERABLES ($000)

	Paid & Unpaid Losses	IBNR	Unearned Premiums	Other Recov*	Total Reins Recov
US Affiliates	634	…	…	-146	488
Foreign Affiliates	1,114	…	15,173	-4,285	12,002
US Insurers	155,375	130,779	51,815	-2,748	335,221
Pools/Associations	47	…	…	-4	43
Other Non-US	340,407	190,912	64,098	3,046	598,463
Total (ex US Affils)	496,943	321,691	131,086	-3,991	945,729
Grand Total	497,577	321,691	131,086	-4,137	946,217

* Includes Commissions less Funds Withheld

INVESTMENT LEVERAGE ANALYSIS (% OF PHS)

	Company						Industry Composite	
Year	Class 3-6 Bonds	Real Estate/ Mtg.	Other Invested Assets	Common Stocks	Non-Affl Inv. Lev.	Affil Inv.	Class 3-6 Bonds	Common Stocks
2002	0.7	…	2.6	2.6	5.8	57.3	1.9	16.6
2003	…	…	3.1	1.0	4.1	61.3	1.3	17.8
2004	…	…	4.3	-4.6	-0.3	49.0	1.6	17.9
2005	…	…	9.7	4.5	14.2	47.4	1.8	16.7
2006	0.3	…	12.3	6.1	18.8	53.0	1.0	17.8

LIQUIDITY

The following text is derived from the report of HCC Insurance Holdings.

Overall Liquidity: The group maintains a sound liquidity position as evidenced by current and overall liquidity ratios that are on par with industry composite averages. Increased emphasis on shorter-term bonds over the past two years has helped maintain the sound liquidity as has the positive impact of reinsurance commutations on cash holdings. The level of invested assets has increased more than threefold since year-end 2001, thereby offsetting similar growth in total liabilities stemming from higher loss reserves and unearned premium. Operating cash flow, driven by increased premiums collected, has risen dramatically over the past four calendar years. Historically, the group's adequate liquidity position has been derived from consistent operating cash flow and contributed capital from the parent holding company with solid investment income also contributing.

Early in 2007, HCC Insurance Holdings, Inc., replaced its existing $300 million bank credit facility with a similar facility that expires in December 2011. There were borrowings outstanding on this facility as of March 31, 2007. In late May of 2006, the parent company filed for a new $1 billion universal shelf registration, to replace the $750 million shelf previously in place. This shelf allows HCC to issue debt, stock, or any other subordinated debt type of security. In November of 2004, HCC exchanged substantially all of its 2.00% Convertible Notes for 2.00% Convertible Exchange Notes, due in 2021, that have terms similar to the original notes but provide that the company settle any conversion by paying cash for the principal amount of the notes.

LIQUIDITY ANALYSIS

	Company				Industry Composite			
Year	Quick Liq (%)	Current Liq (%)	Overall Liq (%)	Gross Agents Bal to PHS(%)	Quick Liq (%)	Current Liq (%)	Overall Liq (%)	Gross Agents Bal to PHS(%)
2002	28.6	99.4	216.9	22.3	33.0	122.5	154.4	15.9
2003	29.2	88.7	163.8	38.6	34.2	119.1	154.2	14.8
2004	34.9	104.3	166.1	26.9	35.4	129.0	154.8	13.3
2005	36.7	114.9	164.9	18.9	31.0	130.5	154.6	13.7
2006	23.1	107.4	165.2	12.6	35.2	139.8	157.8	12.6
09/2006	XX	118.9	176.2	10.8	XX	XX	XX	XX
09/2007	XX	122.5	178.1	9.4	XX	XX	XX	XX

CASH FLOW ANALYSIS ($000)

Year	Underw Cash Flow	Company Oper Cash Flow	Company Net Cash Flow	Company Underw Cash Flow (%)	Company Oper Cash Flow (%)	Industry Composite Underw Cash Flow (%)	Industry Composite Oper Cash Flow (%)
2002	74,237	77,938	5,792	148.6	144.7	136.5	151.7
2003	262,627	290,565	86,909	292.1	289.4	212.7	200.2
2004	248,162	275,093	153,745	217.8	224.5	195.0	193.9
2005	355,168	373,978	46,536	341.9	317.3	147.5	156.0
2006	271,444	273,644	-161,832	230.5	206.9	151.8	155.2
09/2006	86,473	106,341	-221,394	129.5	132.4	XX	XX
09/2007	93,814	142,214	-28,262	137.8	149.5	XX	XX

HISTORY

The company was incorporated under the laws of Texas on December 9, 1980, as International Indemnity Company of Texas and began business on June 18, 1981. The name was changed to Houston Casualty Company on May 26, 1983.

Capital paid-up at year-end was $5,000,000 consisting of 5,000,000 shares of common stock at a par value of $1 per share. Authorized capital stock at year end was 10,000,000 shares.

MANAGEMENT

The company is ultimately wholly owned by HCC Insurance Holdings, Inc., a publicly held insurance and insurance-related services holding company traded on the NYSE under the symbol HCC. Administration of the company's affairs is under the direction of Michael J. Schell, chief executive officer and president and executive vice president of HCC Insurance Holdings, Inc.

Officers: Chief Executive Officer, Charles Manchester (London Branch); President and Chief Executive Officer, Michael J. Schell; Chief Underwriting Officer, Michael Onslow (London Branch); Executive Vice Presidents, Edward H. Ellis, Jr., John N. Molbeck, Jr.; Senior Vice President and Actuary, Annette J. Goodreau; Senior Vice Presidents, Mark A. Buechler, Michael J. Donovan, Brian Duffy, Duane R. Dyckman, Carl Nederman, Mark P. Reynolds, Mark Rickert, Randy D. Rinicella, Robert F. Thomas; Vice President and Chief Financial Officer, Stephen MacDonough; Vice President and Treasurer, Hamendra P. Ojha; Vice Presidents, Christopher D. Bonnett, Sharon Brock, Jackie S. Kellems, Christopher M. Lewis, Joycelyn Ray, Deborah L. Riffe, Chris Tlucek; Secretary, James L. Simmons.

Directors: Edward H. Ellis, Jr., Stephen Macdonough, John N. Molbeck, Jr., Hamendra P. Ojha, Pamela J. Penny, Randy D. Rinicella, Michael J. Schell.

REGULATORY

An examination of the financial condition was made as of December 31, 2003 by the Insurance Departments of Delaware and Texas. The 2006 annual independent audit of the company was conducted by PricewaterhouseCoopers, LLP. The annual statement of actuarial opinion is provided by John F. Gibson, PricewaterhouseCoopers, LLP.

TERRITORY

The company is licensed in Texas. It also operates on a surplus lines or non-admitted basis in the District of Columbia, American Samoa, Guam, Puerto Rico, U.S. Virgin Islands, AL, AK, AZ, AR, CA, CO, CT, DE, FL, GA, HI, ID, IL, IN, IA, KS, KY, LA, ME, MD, MA, MI, MN, MS, MO, MT, NE, NV, NJ, NM, NY, NC, ND, OH, OK, OR, PA, RI, SC, SD, TN, UT, VT, VA, WA, WV, WI and WY.

REINSURANCE PROGRAMS

The following text is derived from the report of HCC Insurance Holdings.

Reinsurance is maintained on a quota share and excess of loss basis with a separate program maintained for each line of business. Catastrophe coverage is purchased for property, marine, and energy business that is exposed to natural disasters and aviation for ground accumulation. Facultative reinsurance is also purchased when deemed appropriate.

BALANCE SHEET ($000)

ADMITTED ASSETS	12/31/2006	12/31/2005	2006 %	2005 %
Bonds	1,236,915	1,064,397	49.1	47.6
Preferred stock	2,016	18,312	0.1	0.8
Common stock	58,453	36,591	2.3	1.6
Cash & short-term invest	179,430	341,262	7.1	15.3
Other non-affil inv asset	117,367	78,960	4.7	3.5
Investments in affiliates	494,553	374,797	19.6	16.8
Real estate, offices	9,589	10,185	0.4	0.5
Total invested assets	2,098,324	1,924,503	83.3	86.1
Premium balances	174,985	207,689	6.9	9.3
Accrued interest	37,354	14,221	1.5	0.6
All other assets	209,755	88,688	8.3	4.0
Total assets	2,520,418	2,235,101	100.0	100.0

LIABILITIES & SURPLUS	12/31/2006	12/31/2005	2006 %	2005 %
Loss & LAE reserves	1,157,487	946,374	45.9	42.3
Unearned premiums	253,798	265,195	10.1	11.9
Conditional reserve funds	42,665	67,230	1.7	3.0
All other liabilities	114,385	143,781	4.5	6.4
Total liabilities	1,568,335	1,422,581	62.2	63.6
Capital & assigned surplus	567,352	548,887	22.5	24.6
Unassigned surplus	384,731	263,633	15.3	11.8
Total policyholders' surplus	952,083	812,520	37.8	36.4
Total liabilities & surplus	2,520,418	2,235,101	100.0	100.0

SUMMARY OF 2006 OPERATIONS ($000)

STATEMENT OF INCOME	12/31/2006	FUNDS PROVIDED FROM OPERATIONS	12/31/2006
Premiums earned	496,968	Premiums collected	479,516
Losses incurred	256,132	Benefit & loss related pmts	62,253
LAE incurred	23,340		
Undrw expenses incurred	126,547	LAE & undrw expenses paid	145,818
Net underwriting income	90,950	Undrw cash flow	271,444
Net investment income	85,123	Investment income	50,123
Other income/expense	-119	Other income/expense	-119
Pre-tax oper income	175,955	Pre-tax cash operations	321,449
Realized capital gains	31,236		
Income taxes incurred	46,358	Income taxes pd (recov)	47,805
Net income	160,833	Net oper cash flow	273,644

INTERIM BALANCE SHEET

ADMITTED ASSETS	03/31/2007	06/30/2007	09/30/2007
Cash & short term invest	131,097	136,936	151,167
Bonds	1,484,029	1,505,537	1,548,098
Preferred stock	565	…	…
Common stock	579,432	622,530	647,444
Other investments	132,803	137,270	139,286
Total investments	2,327,926	2,402,273	2,485,996
Premium balances	140,962	159,480	147,649
Reinsurance funds	61,722	76,651	59,944
Accrued interest	16,187	16,181	18,744
All other assets	46,189	36,623	37,579
Total assets	2,592,986	2,691,208	2,749,911

LIABILITIES & SURPLUS	03/31/2007	06/30/2007	09/30/2007
Loss & LAE reserves	1,161,008	1,179,393	1,164,504
Unearned premiums	237,100	251,328	237,978
Conditional reserve funds	43,078	31,387	35,571
All other liabilities	130,219	121,876	141,572
Total liabilities	1,571,405	1,583,983	1,579,625
Capital & assigned surp	567,417	567,647	567,732
Unassigned surplus	454,165	539,579	602,554
Policyholders' surplus	1,021,581	1,107,225	1,170,286
Total liabilities & surplus	2,592,986	2,691,208	2,749,911

INTERIM INCOME STATEMENT

	Period Ended 09/30/2007	Period Ended 09/30/2006	Increase/ Decrease
Premiums earned	340,108	376,696	-36,588
Losses incurred	152,135	185,117	-32,982
LAE incurred	24,947	15,401	9,546
Underwriters expenses incurred	80,635	95,415	-14,780
Net underwriting income	82,391	80,763	1,628
Net investment income	63,836	49,981	13,855
Other income/expenses	62	121	-59
Pre-tax operating income	146,288	130,864	15,424
Realized capital gains	4,612	26,553	-21,941
Income taxes incurred	40,576	38,901	1,675
Net income	110,324	118,515	-8,192

INTERIM CASH FLOW

	Period Ended 09/30/2007	Period Ended 09/30/2006	Increase/ Decrease
Premiums collected	341,872	379,775	-37,903
Benefit & loss related pmts	146,724	187,988	-41,264
Undrw expenses paid	101,334	105,314	-3,980
Underwriting cash flow	93,814	86,473	7,341
Investment income	87,754	54,283	33,471
Other income/expense	62	121	-59
Pre-tax cash operations	181,630	140,876	40,753
Income taxes pd (recov)	39,416	34,535	4,880
Net oper cash flow	142,214	106,341	35,873